

# Adapting the Price Cap Methodology for Resilience in Volatile Markets

**EUK Response - 13 January 2022**

## Introduction

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering over 80% of both the UK's power generation and energy supply for the 28 million UK homes as well as businesses. The energy industry invests £13bn annually, delivers £31bn in gross value added on top of the £95bn in economic activity through its supply chain and interaction with other sectors, and supports 738,000 jobs in every corner of the country.

This is a high-level industry view in response to Ofgem's Call for Input: Adapting the Price Cap Methodology for Resilience in Volatile Markets. Energy UK's members may hold different views on particular aspects of the call for input. We would be happy to discuss any of the points made in further detail with BEIS or any other interested party if this is considered to be beneficial.

## Executive Summary

Given the tight timescales involved in responding, Energy UK is not putting forward detailed views on the specific policy proposals raised in the Call for Input at this time. However, we raise in this response a number of high-level issues which we believe should be addressed by Ofgem in further engagement with industry, both informally and formally through any upcoming policy consultation.

These concerns include a lack of consideration of backwardation as a cause for methodological change, as well as no discussion to date on the need for any transitional arrangements between the current methodology and the introduction of any changes.

## Response Timeframes

While Energy UK welcome's Ofgem's consideration of methodological changes to the price cap to adapt it for resilience in volatile markets, we are concerned that the significantly restricted timescales for responses across the holiday period (which is replicated across the whole of its "Winter Package" of consultations) will severely limit the ability of stakeholders to provide informed scrutiny of Ofgem's proposals. This is exacerbated by the interlinkages and dependencies between proposals across different consultations.

We acknowledge the speed at which Ofgem will have to work to ensure that where short-term modifications are being progressed, they are in place ahead of the April price cap period. However, for modifications not linked to the April price cap period, such as those under consideration in this call for input, Ofgem should maximise its engagement with industry during their ongoing development. To that end, we welcome the recent workshop held by Ofgem examining these proposals, and we would

strongly encourage Ofgem to take further steps following this call for input to formally and informally engage across industry ahead of and during any upcoming policy consultation.

## **Intervention Focus**

Given the tight timescales involved in responding, Energy UK is not putting forward detailed views on the specific policy proposals raised in the Call for Input at this time. However, there is an overall concern that this call for input shows Ofgem's focus is singularly on volume risk and does not explore the impacts of ongoing backwardation in the market under the price cap. Ofgem should ensure that in its considerations for intervention it reflects upon the impacts of backwardation, and how they will be addressed by any proposed methodological changes.

We believe that there are fundamental structural issues that have been highlighted by the current market conditions – issues that cannot be adequately addressed by minimalist tweaks to the methodology. It is therefore disappointing that Ofgem has dismissed proposals put forward by some industry parties for more wide-ranging modifications to the workings of the price cap which could potentially address the fundamental issues. Without passing judgment on the merits of these proposals, Energy UK would urge Ofgem to include them within its ongoing thinking about price cap modifications and engage further with industry to ensure that it has fully explored all potential options.

More generally, we are concerned that there is no clear lead on price cap reform, and where the role of Government and Ofgem sit in relation to one another when it comes to reforming the price cap to make it fit for purpose in the current market, as well as in the future. If the optimal fix for the price cap methodology sits outside of Ofgem's current powers under the Tariff Cap Act, then there is a clear need for the Government to lead on overall price cap reform. However, to date, there has been no indication the Government (via BEIS) is seeking to take on that role. We would welcome a clearer understanding from Ofgem on any engagement it has had with Government on this issue.

## **Transitional Considerations**

In addition to backwardation, another omission from the considerations in the call for input is the need for transitional arrangements between the current methodology and any changes that Ofgem would seek to introduce for the October price cap period. Any methodological changes will impact upon suppliers' hedging strategies, and so allowances will need to be made to ensure that those strategies have sufficient time to be adapted to the changing price cap methodology. While we note that this is just an initial call for input on Ofgem's current thinking, it will need to consider and address this issue in any further policy consultation as it develops any methodological changes to the cap.

**For further information or to discuss our response in more detail please contact Steve Kirkwood on 0207 747 2931 or [Steve.Kirkwood@Energy-UK.org.uk](mailto:Steve.Kirkwood@Energy-UK.org.uk).**