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Retail Price Regulation
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Octopus Energy's response to Ofgem's consultation on amending the methodology for setting the Contracts for Difference (CfD) cap allowance

We welcome the opportunity to respond to this consultation. It is important that the Contracts for Difference (CfD) allowance is amended so that the Interim Levy Rate (ILR) can have a negative value lowering the price cap whenever negative CfD payments are forecast at the time of setting the cap. This will ensure that the price cap can be set to be more reflective of the costs/benefits suppliers are exposed to in relation to the CfD scheme, and will allow customers to see the benefit of lower prices when negative CfD payments are expected.

Firstly, we recommend that the CfD allowance for the summer and winter price caps be amended to use the same forecasting window as that used to assess the wholesale allowance in the price cap. Currently, the wholesale allowance is calculated using the average wholesale price offered during the historic observation window, whereas the CfD allowance uses LCCC forward looking forecasts for future levy costs at the point in time that the cap is set. This presents an inconsistency in how wholesale prices are estimated for calculating the allowance for wholesale prices compared to the allowance for CfD payments in the price cap, and therefore introduces inherent timing risk into the price cap.

We agree that Option 2: 'Replace LCCC published ILR with an expected levy payment based on LCCC data' is preferred. This option will allow customers to pay a price which is more reflective of supplier costs or benefits in relation to wholesale electricity prices and CfD payments. However, it is not clear whether this option would result in a change to how payments to suppliers are received eg. will the quarterly reconciliation remain or will the negative ILR result in generators making payments to suppliers? We therefore recommend that this point is clarified in Ofgem's final decision statement.

Option 3 which includes a reconciliation of actuals vs forecasted levy payments will expose suppliers to new cash flow risks as the reconciliation for a given quarter could only occur two quarters after the relevant period. This option relies on default tariff customer numbers remaining fairly consistent from period to period, and if there are fluctuations this risk will increase. A subsequent cap reconciliation would lead to customer reflexivity ie. if there's a benefit it would incentivise more customers switching to Standard Variable Tariffs and vice

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versa. This would result in suppliers not being able to capture the values required for ILR to CfD outturn reconciliations. These impacts would grow with the scale of the CfD scheme and therefore we believe that this option poses too great a risk for suppliers and should be avoided.

A continuation of Option 1, where there is a zero bound ILR, would not be appropriate as supplier revenue when wholesale prices are forecast to be above CfD strike prices cannot currently be factored into price cap calculations. This should be amended to allow the price cap to be decreased in line with the expected flow of CfD payments.