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14 June 2022

Dear Dan,

## **PRICE CAP – STATUTORY CONSULTATION ON CHANGES TO WHOLESALE METHODOLOGY**

We are pleased to respond to your statutory consultation on the changes you plan to make to the wholesale allowance methodology in the default tariff cap, notably: moving to quarterly price cap updates, including an allowance for recovery of ex ante backwardation costs and shortening the notice period for announcing new cap levels to 25 working days.

The inability of the price cap to respond to market volatility, as well as the ability for poorly managed and/or hedged suppliers to enter the market, has caused massive consumer detriment as a result of supplier failures. It has also placed the remaining suppliers under unprecedented financial stress. Ofgem must urgently proceed with reforms to address these problems at source.

Our comments on Ofgem's proposals are in Annex 1 but, in summary, we remain strongly of the view that **Ofgem should have chosen the 'price cap contract'** option instead of quarterly updates. It is better than a quarterly cap at addressing volume risk when prices increase and, in combination with a robust market stabilisation charge (MSC), provides protection should prices fall. In addition, Ofgem's own research shows that customers prefer a longer price cap since it makes their energy costs more predictable and limits engagement fatigue. Above all, the price cap contract (and the 'H1/H2' option we also proposed) completely removes the financial risk for suppliers associated with backwardation and would ensure suppliers recover, in a timely way, what Ofgem recognise to be genuine costs<sup>1</sup>.

A key concern with Ofgem's approach is its proposed methodology for recovering backwardation costs over a 12 month period. This methodology carries substantial risks of under-recovery in a falling market. We therefore believe that Ofgem should either change the methodology to eliminate backwardation (via a 3-1.5-3 approach or 3-1.5-12 plus recovery of backwardation costs in the first quarter) or, if it has firmly decided against doing that, reduce the risk of backwardation cost under-recovery by shortening the cost recovery period to 6 months.

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<sup>1</sup> Price cap – statutory consultation on changes to the wholesale methodology', Ofgem, para 5.19. p50.

Notwithstanding the above, we believe Ofgem should:

1. **Remove the deadband** from the ex-ante backwardation calculation. Forward market prices do not currently suggest that levels of backwardation and contango will return to previous levels where they net out in the way they have historically and therefore a deadband in these current circumstances is erroneous. Even if the levels of backwardation and contango were to net out going forwards, a methodology with no deadband would not lead to windfall gains and/ losses. As such, the deadband is at best unnecessary and at worst a distortion that prevents suppliers fully recovering costs recognised by Ofgem to be genuine. In the annex we estimate that the proposed £9 deadband will result in a £[3<]m cost under-recovery for ScottishPower between Q4 2022 and Q3 2025, based on current ScottishPower customer numbers and market prices on 31 May.
2. **Guarantee backwardation cost recovery** in falling markets (or over-recovery in rising markets) by taking some combination of the following steps:
  - a) ahead of each quarter, recalculate the £/customer backwardation allowance to adjust for changes in SVT customers between the quarter in which the backwardation costs were incurred and the quarter in which they will be recovered;
  - b) calculate on an ex post basis the extent of under/over-recovery in the previous quarter as a result of changes in customer numbers/consumption and carry that amount forward;
  - c) add an additional term to an enduring market stabilisation charge to account for as yet unrecovered backwardation costs (which should be passed through at 100%).
3. **Include financing costs in the backwardation allowance** to account for any delays between costs being incurred and recovered.
4. **Commit that if/when the default tariff cap comes to a final end**, recovery of any residual backwardation costs (which would otherwise be recovered beyond the end of the price cap) will be brought forward to be recovered in full under the price cap.

More generally, we note that Ofgem's previous and proposed approaches to addressing losses caused by the flawed price cap design fail to provide us with full cost recovery. We continue to seek recovery of such losses (eg costs incurred as a result of unexpected SVT customers) through a separate levy, which is a fairer approach for customers and suppliers and does not arbitrarily create winners and losers. In addition, we consider the market stabilisation charge should be extended past September 2022 and Ofgem should give us certainty of this as early as possible.

Finally, we welcome Ofgem's commitment to review the EBIT Margin and bad debt allowance as recognition of the risk for suppliers in this market so that suppliers can make a sustainable profit.

Yours sincerely,



**Richard Sweet**  
Head of Regulatory Policy

**PRICE CAP – STATUTORY CONSULTATION ON CHANGES TO THE WHOLESALE  
METHODOLOGY – SCOTTISHPOWER RESPONSE**

**1. Introduction**

Ofgem estimates that the price cap to date has delivered around £1bn in consumer benefit each year<sup>1</sup> and driven cost cutting efficiency amongst incumbent suppliers. Wholesale market volatility and the supplier losses and insolvencies resulting from this have, by most calculations, caused at least £3bn consumer disbenefit (cost). We have yet to see the final cost of the SoLR process which will be significantly above the £1.8bn for 2021 referred to in this consultation. The design of the price cap as well as the ability for poorly managed and/or hedged suppliers to enter the market and gain significant numbers of customers has led to this situation.

Beyond the timescales that this consultation addresses, Ofgem and Government must go back to first principles to remove the price cap and design a mechanism that resolves the current problems, considers the needs of more vulnerable customers and is fit for purpose in a future flexible net zero world. In balancing the needs of consumers, Ofgem must take into account consumers' interest in having a dynamic, competitive and sustainable supply market, which depends critically on supplier financeability.

We remain strongly of the view that Ofgem should have chosen the 'price cap contract' option instead of quarterly updates. Whilst the different elements proposed by Ofgem do improve some of the issues associated with the price cap, these are not completely resolved.

We consider below each of the three main elements of Ofgem's proposals:

1. moving to quarterly price updates (section 2);
2. recovery of ex ante backwardation costs (section 3);
3. shortening the notice period to 25 working days (section 4).

We then consider operational implications (section 5) and summarise the key changes that we believe are needed (section 6).

**2. Quarterly cap**

**Does the quarterly cap address volume risk?**

Ofgem states (para 3.61) "We consider suppliers are better placed to manage 'normal' levels of [volume] risk". We disagree: a key volume risk to suppliers arises from customers' virtually unrestricted ability to move onto or away from the SVT. This will not be addressed by Ofgem moving to a quarterly cap.

The difficulty that most suppliers had when prices started to increase in 2021 and unexpected numbers of customers moved to a SVT was that of needing to balance opposing risks and make a decision that could only be judged to be right or wrong with the benefit of hindsight. A supplier has been put in the position of either not hedging for potential new customers and

making losses when prices increase vs hedging and making losses when prices fall and customers move away from SVT.

Indeed, these risks have been recognised by Ofgem and a transitional MSC put in place to protect against supplier insolvencies. However, these risks are a structural feature of the cap in its current form and, although they are likely to be reduced compared to the status quo by implementing the quarterly cap, they are far from removed. In contrast, the price cap contract (our preferred option) protects suppliers almost entirely against price increases, leaving suppliers (after the transitional MSC has expired) exposed solely to price decreases and the risks associated with that. From a volume risk perspective, this is a significant improvement.

For these reasons, ScottishPower does not consider that the quarterly cap adequately addresses volume risk and an MSC may therefore be required on a more enduring basis.

#### Customer views of the quarterly cap

Ofgem's customer research referenced in this consultation found that:

- Customers want as much stability and certainty (paragraph 3.36) around the number of price changes and the size of these changes, so they can budget accordingly. We believe that the price cap contract is the best option to deliver this since it includes annual price changes for individual customers with a renewed price after 12 months based on near current market prices and with no exit fees.
- Customers would prefer more personalised notifications (paragraph 3.40) about how their bills would be changing so that they could plan their budgets. We believe the price cap contract enables better comparison with the market to limit the poor switching decisions customers might make.

Ofgem omitted to ask customers about the frequency of price changes and the possibility of engagement fatigue. We believe this will be an outcome of moving to a quarterly price changes, and one which the price cap contract option would avoid.

#### Quarterly trading and liquidity concerns, the impact on transaction costs and price availability

Ofgem acknowledges that the difference between seasonal and quarterly product liquidity may result in higher bid-offer costs. Ofgem thinks that any increase in costs would be balanced by the decrease in collateral requirements for the shorter than average hedge. In truth, it is impossible to predict how transaction costs will evolve over time and whether or not there will be cost offsets elsewhere. However, we can say that the UK market has a 20 year history of favouring trade through seasonal forward contracts which may, unless there is a change, increase basis risk for suppliers. **Ofgem should commit to monitoring these costs and, if necessary, adjust supplier allowances to compensate for them.**

Ofgem expects that, due to the inclusion of backwardation costs in the wholesale methodology (Chapter 5), suppliers who hedge to a 3-1.5-3 index will minimise their exposure to the combined impact of the 3-1.5-12 index and the backwardation adjustment. Whilst there may still be liquidity constraints, liquidity in 3-1.5-3 is expected to be a significant improvement on 3-1.5-12. We broadly agree with this assessment.

In instances where quarter prices are not available, Ofgem intends to substitute prices for the parent season of the corresponding quarter. It expects this to have a <0.5% impact on the direct fuel allowance. Ofgem consider that since it uses the same index approach and proxy when calculating backwardation, any small impact will net out against the inclusion of

backwardation costs in the wholesale methodology. We reserve judgement on this point and ask Ofgem to monitor this.

### Operational implications and costs

We expect a doubling of our operational costs related to contacting customers about the price changes as a result of doubling the number of times we potentially have to contact customers. These increased operational costs should not, as Ofgem claims, be balanced against a reduction in risk and uncertainty. We do not think the reduction in risk is clear or quantifiable enough to be balanced with the certainty of operational cost increases. Nor is this only a transitional cost as Ofgem implies (paragraph 3.67) which can be accounted for in the increased headroom allowance (noting that Ofgem has fully used and uses this headroom allowance). When commodity costs drop, the headroom allowance will also drop but the operational costs will remain. We are likely to need a full-time team working on price cap changes as well as the more obvious increase in costs of postage etc with which we have supplied Ofgem. Ofgem should instead increase the opex allowance to account for this increase in operational costs. In addition, as we have shared in bilateral engagement and set out in more detail in Section 5 below, if Ofgem requires suppliers to report on compliance with the price cap via a more frequent submission of the existing Customer Accounts and Tariffs RFI, suppliers will be exposed to the significant additional burden and operational costs of doing so. We have set out in Section 5 alternatives that we consider would provide Ofgem with sufficient oversight without creating additional costs and burden to suppliers.

We continue to think that SLC 23.6 which gives customers up to 20 working days after the effective date of a price increase to instigate a switch and avoid a change in price has the potential to create complexity and confusion for customers under a quarterly cap. For example, a customer could still be in the process of leaving a supplier under the “reasonable timescales” protections for one price cap period, when they are being notified of new prices for the subsequent price cap period. As we have previously raised with Ofgem, with the introduction of faster switching we do not consider the current form of price protections are required as customers will switch much more quickly. In addition, with quarterly price updates, this obligation requires suppliers to keep historical lower prices available to customers for at least a third of the full price cap period. This exposes suppliers to costs which they cannot recover as the previous quarter’s lower prices do not reflect the legitimate wholesale costs reflected in the cap level for the new quarter.

### **3. Backwardation cost recovery**

We remain firmly of the view that backwardation costs should be structurally eliminated, either by means of a 3-1.5-3 approach for setting allowances or Ofgem’s proposed 3-1.5-12 approach plus full recovery of ex ante backwardation costs in the first quarter.<sup>2</sup>

However, we believe the proposed ex ante backwardation allowance is an improvement on the ex post allowance proposed in the February consultation. We are also content with the design of the transition. If Ofgem decides to proceed with its proposed approach, the following aspects of the approach should be amended.

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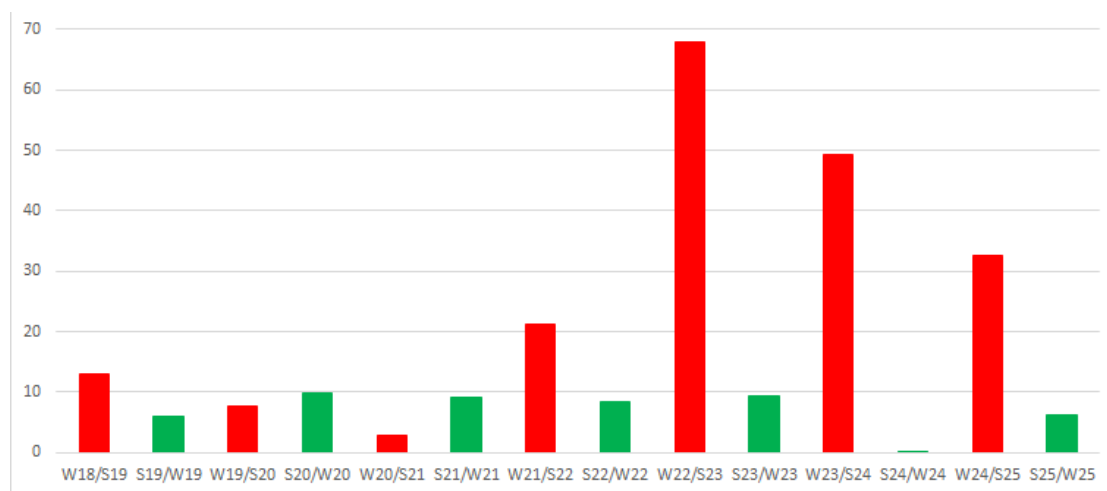
<sup>2</sup> We consider this would be preferable for the quarterly cap and note little assessment of seasonality has been undertaken. We note that for the 12 month price cap contract matching the length of hedge and price cap does not introduce seasonality.

## Deadband

If Ofgem makes any change to its proposal then it should, given the extreme financial pressures on suppliers, remove the deadband from the ex-ante calculation methodology. While market prices can change, the current forward curve does not suggest that the price spreads which determine levels of backwardation and contango will return to the previous pattern where they broadly netted out in the short to medium term (see Figure 1). Consequently, we forecast the persistence of large losses in winter periods being nowhere near offset by gains in summers. As such, including a deadband is erroneous. Assuming stable customer numbers and prices<sup>3</sup>, the proposed £9 deadband will result in £[>] million of cost under-recovery for ScottishPower across the Q4 2022 to Q3 2025 period. The deadband reduces what we are able to recover in winter quarters by an amount that forecast gains in summer quarters simply do not compensate us for. We also would like to note that the impact is forecast to be much larger in gas than electricity due to higher seasonal spark and Peak/baseload spreads benefitting summer contango for electricity relative to gas. Further, the deadband makes minimal difference to individual tariff levels and a methodology without one would not lead to windfall gains or losses being made. Costs would be recovered and benefits would be repaid. The deadband is at best unnecessary and at worst a distortion that should be removed from the calculation.

To illustrate the outlook for pricing, Figure 1 shows the seasonal gas spreads that impact contango and backwardation from when the cap began in Q1 2019 until Q3 2025. Figure 2 shows how current forward pricing is forecast to impact cap periods with there being no indication that losses incurred in winter will be offset by gains in summer. Forward prices are those as at 31 May 2022.

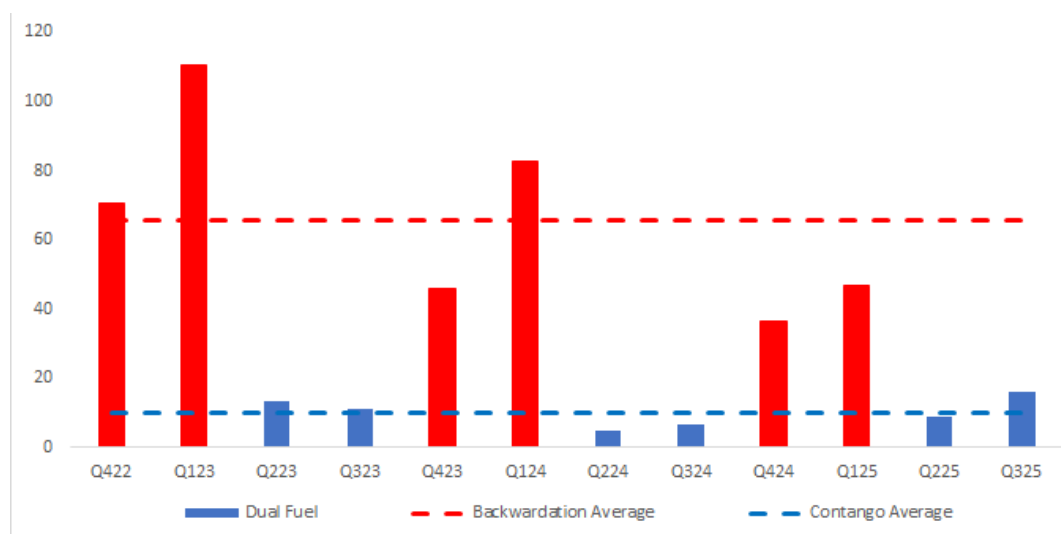
**Figure 1: Seasonal gas spreads – SVT index averages and forward (p/therm)  
(absolute values)**



<sup>3</sup> As we have noted above, this is a big assumption and if customer numbers / consumption did change recovery would be affected.



**Figure 2: Forecast backwardation and contango (£/DFC) (absolute values)**



### Recovery period: Customer number and consumption changes

Recovery of backwardation costs over a 12-month period creates a significant risk of under- or over-recovery as result of changes in SVT customer numbers (or average consumption) after the quarter in which the allowance is first set. Given the current very high SVT customer numbers and tariff levels, we believe this risk is presently skewed to the downside for suppliers. The long recovery period increases the chances that customer numbers will fall and costs will not be recovered. Ofgem has recognised that these are legitimate costs (para 2.19) and that its “aim is to ensure that a nominal supplier can recover its legitimate wholesale costs from a move to the quarterly index approach” (Appendix 2 para 1.21). It should therefore introduce measures to **guarantee cost recovery**.

Table 1 and Table 2 below illustrate the vulnerability of backwardation cost recovery to customer number changes. Table 1 shows the recovery profile under Ofgem’s proposed approach for a supplier across the period from Q4 2022 to Q3 2023. Figures are based on market prices as at 31 May 2022 and account for the proposed deadband. Assuming no change in customer numbers or consumption, backwardation costs (and contango benefits) are recovered by Q2 2024 as intended.

**Table 1: Approved backwardation allowance by quarter and recovery profile**

	Backward- ation Cost (£/DFC)	Backwardation cost recovery (£/DFC)							
		Q4 22	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Total
Q4 2022	62	19	22	12	9	-	-	-	62
Q1 2023	102	-	36	20	15	31	-	-	102
Q2 2023	-7	-	-	-1	-1	-2	-2	-	-7
Q3 2023	-5	-	-	-	-1	-2	-2	-1	-5
Total	151	19	58	30	22	28	-4	-1	151

Since July 2021, the number of capped customers ScottishPower supplies has increased by over 3% and we expect this number to increase during winter 2022/23 when backwardation costs are extremely high relative to both historical and forward periods. Table 2 illustrates the impact on backwardation cost recovery if half of these “new engaged” capped customers were to move off the cap from Q2 2023 in response to falling wholesale prices. Customer switching

to this degree would result in total cost under-recovery of £[redacted] per dual fuel customer (£151-£[redacted]). Of course if all of these new engaged cap customers moved the under-recovery would double.

**Table 2: Customer movement scenario with recovery profile; £[redacted]/DFC under-recovery**

	Backward-ation Cost (£/DFC)	Backwardation cost recovery (£/DFC)							
		Q422	Q123	Q223	Q323	Q423	Q124	Q224	Total
Q4 2022	62	[redacted]	[redacted]	[redacted]	[redacted]	-	-	-	[redacted]
Q1 2023	102	-	[redacted]	[redacted]	[redacted]	[redacted]	-	-	[redacted]
Q2 2023	-7	-	-	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Q3 2023	-5	-	-	-	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total	151	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

This highlights a key risk for suppliers that is both likely and material. Consequently, we do not believe Ofgem can reasonably implement a 12-month recovery period for backwardation costs without adjusting for customer numbers / consumption over this time.

We believe Ofgem should ideally reduce the risk of backwardation cost under-recovery by either moving to a 3-1.5-3 approach, recovering the cost of backwardation in the first quarter or shortening the cost recovery period from 12 months to 6 months. In the scenario in Table 2 (above) where half of ScottishPower's "new" capped customers are assumed to leave the cap at the beginning of Q2 2023, a 6 month recovery period (with costs split 50:50 across the cap delivery period and subsequent cap period) reduces the under-recovery gap from £12 per dual fuel customer to £6 per dual fuel customer.

However, if Ofgem insists on spreading backwardation cost recovery over 12 months, ScottishPower need to have certainty that it would be able to recover the full amount of backwardation costs. Ofgem should therefore adopt some combination of the following measures:

- Ahead of each quarter, recalculate the £/customer backwardation allowance to adjust for changes in SVT customers between the quarter in which the backwardation costs were incurred and the quarter in which they will be recovered;
- Calculate on an ex post basis the extent of under/over-recovery in the previous quarter as a result of changes in customer numbers/consumption and carry that amount forward (to the next but one quarter);
- Add an additional term to an enduring market stabilisation charge to account for as yet unrecovered backwardation costs (which should be passed through at 100%)

#### Financing costs associated with 12-month backwardation cost recovery period

Table 3 below shows ScottishPower's forecast cashflow position under Ofgem's proposed backwardation repayment and recovery methodology. There is a substantial negative balance averaging £[redacted]m in the three years from 2022 to 2024. (This of course would be lower if there were no deadband.)



**Table 3: Impact of 12 month lag on cost recovery for ScottishPower (£m)  
(stable customer numbers assumed, prices at 31 May 2022)**

£m	2022	2023	2024	2025*
Cost	[X]	[X]	[X]	[X]
Recovery	[X]	[X]	[X]	[X]
Net	[X]	[X]	[X]	[X]
Cumulative total	[X]	[X]	[X]	[X]

\*Only to Q3 2025 to include an even number of winter and summer quarters from Q4 2022

Ofgem suggests that suppliers should already have short-term financing facilities in place as part of their normal business functions to help manage the delay between incurring costs and receiving the allowance, and that no additional allowance needs to be included for financing costs. This is wrong. Ofgem must have regard to the need to ensure that efficient suppliers are able to finance their activities and there are significant incremental financing costs associated with balances of this magnitude, which cannot simply be absorbed in existing short-term financing facilities.

Ofgem should include financing costs in the backwardation allowance to account for the delay between costs being incurred and recovered. In the event that there is a positive balance due to contango benefits, the allowance could be negative, so that consumers benefit from the saving in financing costs.

#### Recovery period: End of the price cap

Given the proposal for cost recovery to occur over a 12 month period, Ofgem should commit that if/when the default tariff cap ends, recovery of any residual backwardation costs (which would otherwise be recovered beyond the end of the price cap) will be brought forward to be recovered in full under the price cap.

## **4. Reducing the notice period**

### Allocation of days between Ofgem and suppliers

Ofgem is proposing to reduce the notice period for suppliers to 25 working days, with Ofgem having an additional five working days in advance of this to calculate and publish the updated cap level after the close of the observation window.

We welcome Ofgem's revised proposal which moves from a 28 calendar day notice period for suppliers (February proposal) to a 25 working day notice period, as this provides more time for suppliers to complete the various operational processes required to ensure customers receive accurate and complete communications ahead of the price change. As we have shared with Ofgem during this consultation process, and as Ofgem itself recognises in this consultation document, there are challenges for suppliers in shortening the notice period from the current two months, and we would urge Ofgem to provide suppliers with as much time as possible by shortening its own five working days to calculate and publish the updated prices. While we understand Ofgem needs time to undertake this activity, we consider much of this could be completed in advance of the wholesale cost indexation observation period closing and a 3:28 split between Ofgem and suppliers would strike a better balance than 5:25.

### Cheapest Tariff Messaging (CTM)

Ofgem appears to be dismissing concerns raised by ScottishPower, and other suppliers, in relation to the effort and resource required to provide the prescriptive CTM within customer communications. As we have noted in our response to the policy consultation, and via bilateral engagement, this remains one of the most time-consuming and complex aspects of producing customer communications, creating complexity and potential for error and creating the need for additional controls and review to ensure customer communications are accurate. There are also questions as to its usefulness given that in many cases these tariffs are no longer available for sale when the customer receives the communication meaning the personalised nature of the information is already out of date.

Ofgem appears to have interpreted our position in relation to the removal of the CTM as a request to remove personalisation from customer communications. This is not an accurate representation of our position as we agree with Ofgem that personalisation of customer communications is important and valued by consumers. Our position was that Ofgem should remove the “prescriptive” nature of the CTM and rely on the principles-based requirements in SLC 31F. We explain our views in more detail below:

As we have noted in our previous engagement with Ofgem, the current prescriptive CTM rules require suppliers to provide customers with details of a maximum of two alternative tariffs, however the customer cannot select these from the communication, and in many cases, these tariffs are no longer available for sale when the customer receives the communication, meaning the personalised nature of the information is already out of date.

A customer’s notification has several personalised elements all of which we support maintaining:

- Personalised consumption information
- Personalised before and after prices
- Personalised estimated annual costs

Ofgem should remove the prescription of the CTM and rely on the principles based requirements of SLC 31F. In particular, the requirements of SLC 31F.4 oblige suppliers to provide customers with *“information in a Form and at a frequency that is sufficient to enable that Domestic Customer to understand that they can switch Tariff and Electricity Supplier, and may benefit from doing so, including financially”*. Alongside the obligations in SLC 31F.1, which requires suppliers to encourage customers to consider switching tariff or supplier, we believe there should be no detriment to the prompt for a customer to engage if the requirements for a Relevant Contract Change Notice were to be amended from the prescriptive elements of the CTM to rely on the principles of SLC 31F.4.

## **5. Other operational implications of the move to quarterly updates**

### Customer Account and Tariffs RFI

Ofgem currently requires suppliers to report on compliance with the Default Tariff Cap via the twice yearly Customer Account and Tariffs RFI with reporting required around a month after the start of each price cap period. As this report covers all tariffs offered by suppliers to domestic customers at a very granular level, it is particularly resource intensive for suppliers to provide to Ofgem. There has been no indication from Ofgem of its intention in relation to this RFI with the proposed move to a quarterly update of the price cap. As we have set out within our bilateral engagement, we consider it would be disproportionate for Ofgem to request

this RFI four times a year, as this would add significant burden to suppliers from an operational perspective and add significant additional costs.

We understand that Ofgem will want to ensure that suppliers remain compliant with the price cap in each charge restriction period. We consider a proportionate approach would be for Ofgem to retain a twice yearly requirement of the RFI in line with the current timetable (ie early May for the 1 April quarterly price cap period, and early November for the 1 October quarterly price cap period), with Ofgem only asking for additional information for the 1 January and 1 July price cap periods where it has reason to consider a supplier may be non-compliant.

If Ofgem considers the above not to be sufficient for it to monitor supplier compliance with the cap, we consider it should make other amendments to ensure the requirement to report on a quarterly basis is not overly burdensome for suppliers and creates additional costs for suppliers that ultimately will need to be recovered. These amendments could include either or both of the following options:

- Amending the reporting for all (or potentially only the 1 January and 1 July) price cap periods to include only those tariffs that are required to be at or below the relevant price cap level; and/or
- Working with BEIS to align similar reporting requirements to allow suppliers to reduce the burden and combine existing reports submitted to both Ofgem and BEIS. Suppliers are currently required to provide BEIS with information on tariffs on a quarterly basis which is similar to that provided to Ofgem within the Customer Accounts and Tariffs RFI. If Ofgem and BEIS were able to agree to one consistent report format that worked for both parties, this would significantly reduce the burden on suppliers and support provision of the full RFI on a quarterly basis.

We have also considered other options, for example requiring suppliers to report twice yearly but within each report provide two sets of information. We consider this would likely lead to almost the same burden to suppliers as providing the full report four times a year and therefore consider Ofgem should require the RFI from suppliers only twice a year for the relevant quarter (but with ongoing compliance activity enabling additional reporting where Ofgem identifies sufficient risk).

#### Provision of Assumed Consumption Split Information for Multi-Register Tariffs

Ofgem requires suppliers, no less than three months ahead of each charge restriction period, to provide historic information relating to the consumption split across different time periods for electricity customers with more complex meters ("Multi-Register Tariffs"). Under the proposed quarterly price cap methodology, this means that suppliers would be extracting and submitting this data during the period immediately prior to the start of the previous charge restriction period. As an example, under the current proposed licence conditions we would be required to submit the assumed consumption splits for the 1 January charge restriction period no later than 1 October 2022. This period coincides directly with the period where the same teams would be working on our activity to update prices and communicate with customers ahead of the 1 October cap period.

We do not consider the change in consumption split between the current six monthly price cap periods justifies the additional effort required to provide updated versions four times a year. Ofgem should therefore ensure that we only need to provide data every 6 months as currently by making the necessary adjustments to apply SLC 28AD.37 to only those Subsequent Charge Restriction Periods beginning on 1 April or 1 October each year.

## 6. Changes required to proposed methodology

In summary, we remain of the view that the 'price cap contract' option would be preferable to the proposed quarterly cap. A key concern with Ofgem's proposed approach is recovery of backwardation costs over a 12 month period, which carries substantial risks of under-recovery in a falling market. We therefore believe that Ofgem should either change the methodology to eliminate backwardation (via a 3-1.5-3 approach or 3-1.5-12 plus recovery of backwardation costs in the first quarter) or, if it has firmly decided against doing that, reduce the risk of backwardation cost under-recovery by shortening the cost recovery period to 6 months.

Notwithstanding the above, Ofgem should:

1. **Remove the deadband** from the ex-ante backwardation calculation. Forward market prices do not currently suggest that levels of backwardation and contango will net out in the way they have historically. Even if they were to do so, a methodology with no deadband would ensure that windfall gains and losses are not made by suppliers. The deadband is at best unnecessary and at worst a distortion that prevents suppliers fully recovering costs recognised by Ofgem to be genuine. We estimate that the proposed £9 deadband will result in a £[>]m cost under-recovery for ScottishPower between Q4 2022 and Q3 2025, based on current ScottishPower customer numbers and market prices on 31 May.

And if Ofgem insists on spreading backwardation cost recovery over 12 months, Ofgem should:

2. **Guarantee backwardation cost recovery** in falling markets (or over-recovery in rising markets) by taking some combination of the following steps:
  - a) Ahead of each quarter, recalculate the £/customer backwardation allowance to adjust for changes in SVT customers between the quarter in which the backwardation costs were incurred and the quarter in which they will be recovered;
  - b) Calculate on an ex post basis the extent of under/over-recovery in the previous quarter as a result of changes in customer numbers/consumption and carry that amount forward;
  - c) Add an additional term to an enduring market stabilisation charge to account for as yet unrecovered backwardation costs (which should be passed through at 100%).
3. **Include financing costs in the backwardation allowance** to account for any delays between costs being incurred and recovered.
4. **Commit that if/when the default tariff cap ends**, recovery of any residual backwardation costs (which would otherwise be recovered beyond the end of the price cap) will be brought forward to be recovered in full under the price cap.

Ofgem should also take this opportunity to mitigate the operational impact on suppliers of more frequent price changes and the reduced notice period. It should:

5. **Include an extra uplift in the opex allowance** to reflect the increased customer communications costs associated with resulting from more frequent price changes.
6. Adjust the allocation of **notice period days** between Ofgem and suppliers from the proposed 5:25 working days split to a 3:28 split.

7. **Remove the current prescriptive elements of the Cheapest Tariff Messaging (CTM) rules** meaning customer communications would retain the most informative elements of personalisation related to the change in tariff prices (before and after Estimated Annual Costs) and prompts to engage to understand other tariff options would rely on the principles-based requirements in SLC 31F. (We believe Ofgem has misinterpreted our previous concerns on how these rules apply - see above.)
8. **Address issues with the rules around the price protection window (PPW)** to avoid potential complexity and confusion for customers, and ensure protections for consumers reflect the evolution of the market.
9. **Reduce the burden of price cap compliance:** retain the six monthly frequency of 'Customer Account and Tariffs' RFI's covering the relevant quarter (with a risk based approach to requesting reporting for the 1 January and 1 July cap period), or make other adjustments to reporting to reduce the burden on suppliers.
10. **Retain the requirement for consumption splits for multi-register tariffs every 6 months** by making necessary adjustments to SLC 28AD.37 as noted above.

**ScottishPower**  
June 2022