

Consultation on amending the methodology for setting the Earnings Before Interest and Tax (EBIT) allowance

23 September 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 consultation on amending the methodology for setting the Earnings Before Interest and Tax (EBIT) allowance. Energy UK's members may hold different views on particular aspects of this consultation. We would be happy to discuss any of the points made in further detail with Ofgem or any other interested party if this is considered to be beneficial.

Energy UK response

We welcome the Government's move to bring forward the Energy Price Guarantee (EPG), but it is of course putting our industry under enormous pressure as we seek to ensure that we can deliver government policy in the best interest of consumers. Suppliers have little over a week to implement the necessary system changes impacting millions of accounts to ensure average customer bills do not exceed £2500 from 1 October 2022. It is with this in mind; we respond to this consultation.

As per our letter to Jonathan Brearley on 16 September, Energy UK welcomes and understands Ofgem's desire to look at ensuring the level of EBIT provided for under the DTC is correct. The energy retail supply market has on average been loss making since before the Covid-19 pandemic. A successful, efficient, and profitable retail market that can foster innovation and drive consumer engagement is fundamental to the UK meeting its net zero ambitions.

However, we have significant concerns with the timing of the Ofgem consultation and timelines for responding. This is particularly the case given Ofgem have, following publication of the consultation document, expressly requested suppliers to provide detailed information and analysis and that it will be unable to make much use of any responses that do not provide such data and analysis.

The deadline set for responding to the consultation (23rd September) and the volume of urgent work suppliers are currently undertaking with Government to support customers, make it next to practically impossible to provide Ofgem with the type and extent of information it is seeking. Furthermore, the questions Ofgem intends to consider are highly complex, with significant repercussions for the sector if incorrect decisions are made. We note that Ofgem spends months and years considering questions such as cost of capital for other parts of the energy industry. As a minimum we would, therefore, like to

Ofgem to reopen the consultation, or at least commit to continuing to review and consider information provided after the 23 September, to ensure a more appropriate timeline for the consultation that does justice to the questions Ofgem is trying to answer. Without such a move, we fail to see how Ofgem will be able to reach evidence-based policy decisions on the questions it is seeking to answer.

More generally, suppliers have also expressed strong concern about the principle of Ofgem looking to reach a decision on the level of the EBIT margin at this moment in time given the volatile and dynamic nature of the domestic energy market and the extent to which risks and business models are changing. The EPG is a fundamental change to the landscape of the retail market that is still being developed by Government, much of which is subject to a non-disclosure agreement to which many interested stakeholders in this consultation are not party. We also note that Ofgem is looking to assess the questions in the consultation in a vacuum which does not consider the wider impacts of the rest of the structure of the Default Tariff Cap and whether these are appropriate. We, therefore, consider there is merit in Ofgem re-examining what it is trying to achieve through the consultation and whether now is an appropriate time to be trying to calibrate and make decisions on the perceptions of risk in the market.

Further, as regards considerations around suppliers' profits, as highlighted on the recent Ofgem Regulation Directors call, Ofgem has spent considerable time and effort over the last year or more increasing the depth and breadth of its knowledge of supplier financial stability. We note that this information should provide Ofgem with a suitable starting point for considering many of the questions raised by the consultation and further analysis of this data could instead form the first step in a more measured and careful consideration of the various complex issues involved the consultation, in the same way as Ofgem has previously considered more complex issues such as this.

If you have any questions or would like to discuss further please contact Candice Orr at Cnadice.Orr@energy-uk.org.uk or on 0207 747 2965