

Dan Norton
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

1 March 2023

Price cap: Call for Input on Additional Wholesale Allowances Review

Dear Dan

Thank you for the opportunity to feed into the scope of Ofgem's forthcoming review of wholesale cost allowance in the default tariff cap.

Octopus Energy maintains that consumers would better benefit from a relative cap, where a competitive market is utilised to best manage and minimise these costs. A relative cap will give suppliers the ability to reflect updated costs in tariff choices much quicker than feeds into the default tariff cap calculation, such as those which feed into the wholesale allowance. The time is right for Ofgem to engage with the government and explore options for domestic price protection which supersedes the default tariff cap. We urge you to do so.

In the interim, Octopus supports Ofgem's proposed review of the additional wholesale cost element of the default cap calculation and we agree with the proposed areas of consideration.

We also support a review of shorter term issues, as it is important that the information which Ofgem uses to set the wholesales cost component is up to date and as accurate as possible. Octopus has seen that Bid-Ask spreads and liquidity for Base and Peakload products do not remain linear as wholesale price and volatility increases in the market. This clearly deviates from the fixed percentage allowance in the current default cap methodology and is made worse by the quarterly price cap.

The current allowance includes a fixed percentage, but under periods of extreme market stress these are no longer appropriate. In order for a supplier to hedge more specific block exposures, higher transaction costs are incurred. The pricing mechanism of SVT also leads to higher market concentration around the end of the trading day to match ICIS assessments and leads to lower liquidity/market flow imbalances earlier in the trading day.

In terms of a wider review for enduring issues, of the two approaches outlined, we prefer Approach 1, Review of Input Data. While the review and proposed update to the wholesale cost element of the default cap calculation, we are frustrated with the significant and ever-growing complexity of the current methodology, which would be exacerbated by Approach 2, Full review

of the methodology, especially as the call for evidence indicates that work would take us into to Summer 2024.

As we see wholesale costs fall, consumers are not seeing these feed into their prices, which undermines trust in Ofgem and the retail market as a whole. The wholesale costs consultation demonstrates how a centralised default cap has provided sub-optimal results for consumers, as it is unavoidable that Ofgem must use out of date data and inaccurate assumptions in its methodology, or else conduct lengthy consultations to propose modifications.

This response may be published on Ofgem's website. Please Let me know if you require any further information at this stage.

Yours sincerely,

Kevin Hammond
Head of Regulatory Compliance