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RECCo response to: Price Cap – Statutory consultation on removal of the cap end date from licence conditions

We welcome the opportunity to respond to this consultation. Our non-confidential response, appended to this letter, represents the views of the Retail Energy Code Company Ltd (RECCo) and is based on our role as operator of the Retail Energy Code (REC).

RECCo is a not-for-profit, corporate vehicle ensuring the proper, effective, and efficient implementation and ongoing management of the REC arrangements. We seek to promote trust, innovation and competition, whilst maintaining focus on positive consumer outcomes. We are committed to ensuring that RECCo is an "*intelligent customer*", ensuring efficacy and value-for-money of the services we procure and manage on behalf of REC Parties, including those which constitute the REC Code Manager. More recently, we have taken over responsibility for the oversight and funding of the Central Switching Service.

Whilst we acknowledge that this consultation is intended to reflect recent legislative changes[1] in energy suppliers' licences, we consider that Ofgem should ensure that the price cap reflects all non-discretionary costs faced by Suppliers. In particular, the costs associated with the operation of licence-backed industry codes such as the REC[2] can be material, in part as the scope of those codes and/or the relevant code body increase to include for the delivery of industry programmes and/or services which may previously have been delivered by price-controlled licensees, or Ofgem itself. A current example is the Market-wide Half Hourly Settlement programme, which is being funded in large part by BSC Parties, while the delivery of the REC components will be at cost to REC Parties.

Whilst we recognise the pressure to limit any increase in tariff cap allowances, we consider that the inclusion within the methodology of suppliers' contribution to the funding of industry codes would:

- ensure that the price cap is more accurately cost-reflective;
- provide greater transparency of programme costs; and,
- facilitate more targeted cost-recovery, mitigating any skewed incentive to bundle unrelated costs together with those allowed for the operation of the network

Continuing to exclude the cost of licence-backed industry codes from the methodology erodes the already thin margins for energy retailing. Therefore, we believe the inclusion of such costs would be reasonable, and help to improve margins, albeit to a small extent. This should in turn help to facilitate and sustain a more attractive retail energy market, for industry parties and potential new entrants, promoting effective competition and better consumer outcomes in the longer term.

We are happy to discuss any of the points raised in this response.

Yours sincerely,

Jon Dixon
Director, Strategy and Development

[1] Amendments made to the Domestic Gas & Electricity (Tariff Cap) Act 2018 via The Energy Prices Act 2022, which removed the price cap and associated model end dates, to instead be determined by the Secretary of State.
[2] The REC budget for 2023-24 is c.£50.5m

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Appendix – Response to consultation questions

Q1. Do you have any views or comments on the draft modification notice, published alongside this document?

It is appropriate that this notice aligns the standard energy supply licence condition 28AD with the autumn 2022 changes introduced into the overarching energy legislation, which continues the cap by default until the Secretary of State terminates it.

Whilst we recognise the final decision on whether to retain the tariff cap sits with government, we encourage Ofgem to consider not only the effectiveness of the current cap methodology and its cost-reflectivity, but also what market conditions are expected to allow a clear and timely exit-strategy.

Q2. Do you have any views or comments on the model proposals set out above and in accompanying documents?

Whilst we recognise the pressure to limit any increase in tariff cap allowances, we consider that the inclusion within the methodology of suppliers' contribution to the funding of industry codes would:

- ensure that the price cap is more accurately cost-reflective;
- provide greater transparency of programme costs; and,
- facilitate more targeted cost-recovery, mitigating any skewed incentive that may be created by the price cap methodology to bundle unrelated costs together with those allowed for the operation of the network.

We believe the inclusion of suppliers' contributions to the cost of licence-backed and mandatory industry codes would be appropriate. This would contribute to more sustainable margins for energy retailers, which will promote effective competition and better consumer outcomes in the longer term.

Q3. Have you identified any other areas of models that need to be updated?

As set out in our answer to question 2, we consider that suppliers' contribution to the funding of industry codes should be allowed for in the price-cap models.

Q4. Do you expect there to be any knock-on impact of the removal of the cap end date?

Whilst the removal of the default tariff cap end date from licence is a practical step reflecting the reality of this being a prolonged, if not enduring, market intervention we do consider that the efficacy of the policy itself should be subject to periodic review. It is possible that the existence of the price cap will continue to have a distortive effect on competition, on the one hand restricting suppliers' ability to offer cost-reflective tariffs, while on the other hand pricing in a level of risk that efficient operators may ordinarily be able to avoid. For instance, the methodology now assumes a universally conservative hedging strategy, effectively removing the downside risk to suppliers of being overly cautious. We understand that Ofgem is also considering an increased allowance for assumed future increases in bad debt. Whilst it is important that the consumers in debt are treated positively and sympathetically, it is also important that price cap allowances for bad debt write-off does not have the unintended consequence of blunting suppliers' incentives to manage their exposure effectively. That would increase the likelihood that those risks will be crystallised and passed through to bill paying consumers.