

Email response from Energy UK

It is important that the price cap is calibrated to ensure that consumers pay a fair price for energy and that suppliers are able to make fair returns. Consumers also need to trust their regulatory protections and we welcome Ofgem's attempts at supporting consumer trust that earned, fair supplier profits are necessary.

We recognise Ofgem's rationale for this review and that, in theory, there are potential benefits against all these objectives from Ofgem's recently announced review of suppliers' wholesale costs for default tariff customers between October 2022 and September 2023, alongside the forewarned review as to whether additional wholesale costs incurred over winter 22/23 that were materially and systematically different to the allowances.

The two temporary adjustments Ofgem previously made to wholesale cost allowances in February and August 2022 were designed to address failures of the price cap methodology to allow suppliers to cover costs incurred on behalf of consumers. They were designed and implemented to address specific, urgent and exceptional circumstance with a clear benefits case. This marks a significantly different context to these further reviews.

It is essential that retrospective reviews of price cap allowances do not undermine suppliers' confidence to manage risks in a way most appropriate to their own business and customers. In general, we have concerns about whether consumers will be well served by Ofgem conducting (at significant pace) a retrospective review of the fair costs incurred by suppliers if it does not adequately allow for operational diversity of suppliers or reflect that suppliers have had to manage exceptional risks to investment and resilience of the market over a protracted period (due at least in part to the adhoc approach to setting supplier cost allowances of which this is therefore a further and potentially different risk).

We think there are risks because Ofgem appear to be seeking to determine the pre and post EPG forecasts that a prudent supplier should have assumed, which is proposed to be based at least initially on forecast costs (which we assume may be replaced with actual costs when available). However, there is no previously agreed approach that suppliers should have taken in terms of forecasting the number of customers on fixed or variable tariffs pre and post EPG announcements as this will be driven by a number of underlying forecasts of e.g., price cap levels, future EPG support, fixed tariff price levels, customer engagement with the market.

There are major risks of this review if it unintentionally and informally sets prescriptive assumptions about supplier practises that limit the scope for competition, diverse business or the ability of suppliers to confidently manage their own risks during times of crisis.

We also have concerns about the process and timing of the review which we believe exacerbate these risks.

There are steps that Ofgem should take which would seek to mitigate risk. These include:

Ofgem should set out how decisions from the review will impact suppliers' financial resilience, competition and confidence in the regulatory regime. A review must consider the impact against Ofgem's consumer framework, forthcoming competition framework and potential distributional impacts to consider the risks. It should also clearly set out the risks that suppliers are reasonably expected to manage, and those that they are not.

Respond to the range of supplier evidence of additional wholesale costs that showed that headroom was more than exceeded by costs not accounted for in cap allowances. In particular, on the systematic shortfall in Contracts for Difference and network cost allowances.

Ofgem needs more granularity and consistency than the RFI will provide. Suppliers view the data being requested as unlikely to provide Ofgem with an appropriate assessment of the costs incurred over the relevant period. Ofgem need to ensure a common basis of supplier costs to minimise issues with separating different costs and the likely comparability issues between suppliers. Ofgem should consider revealing all underlying data and calculations via a confidentiality ring.

Rushed timelines - The different circumstances of any review at this point compared to previous reviews would permit a longer review period. This extra time should also be used to enable a confidentiality ring to address likely comparability issues. Three weeks is not adequate for the requisite RFI process. The timescale appears to be driven by ensuring that any adjustment can be implemented from January 2024. A robust process cannot be sacrificed. The challenge has not been helped by Ofgem not using available data to reduce the administrative burden on suppliers including:

actual and seasonal normal demand allocations can be obtained directly from Elexon and Xoserve settlement systems,

daily prices could be obtained from the relevant short term markets.