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Dear Dan,

Energy price cap wholesale costs review

We welcome Ofgem's minded-to position of making no adjustment to the price cap for wholesale costs incurred between October 2022 and September 2023 and the opportunity to comment on the scope of future reviews relevant to the wholesale allowances.

As we have previously stated in our responses, variations in supplier behaviour can drive significant differences in costs despite different decisions each being perfectly rational. Reviews of wholesale allowances need to be underpinned by specific, extreme events, in line with prior adjustments which accounted for exceptional costs that could not be recovered by suppliers due to limitations in the price cap methodology during a specific event.

We are concerned that a new approach based on a departure of costs from the cap and then attributing a cause to it introduces a significant risk of regulatory and policy uncertainty, moving the price cap towards a continuous cycle of adjustments as wholesale costs fluctuate leading towards a permanent float and true-up of as part of an actively managed price control. Such an approach creates significant uncertainty undermining business confidence which reduces incentives for investment and innovation.

Ofgem needs to be mindful of the potential longer term negative impacts of the uncertainty this approach would have, which could negatively impact customers. A claw-back precedent would significantly reduce incentives for suppliers to compete on pricing in addition to the risks it would pose to future investment in the retail energy market which is critical in the next period leading to net zero.

We welcome the technical changes to the structure of Annex 2 to improve the transparency of the demand weightings used to calculate the backwardation allowance, however, we want to note that change of inputs used in the Capacity Market Cost Allowance Methodology timing does not allow suppliers to update any internal models which use these files in advance of the price cap window starting. It would be helpful if a sample showing the structure of updated data is shared going forward for similar proposals.

We are supportive of a wider review of the wholesale allowance for future cap periods with the view to providing greater certainty regarding the risk exposures which suppliers are expected to actively manage. At the same time more engagement is needed on addressing the wider shortcomings of



the current price cap. The price cap in its current, form is unlikely to be fit for purpose as the energy retail market becomes less 'one size fits all' and starts moving towards more innovative 'time of use' (TOU) tariffs.

A complete bottom-up review of the price cap and its individual components would improve cost reflectivity and allow Ofgem to review the price cap under the lens of both future proofing and affordability. A broader reform of price regulation is needed in order to develop a structure that doesn't create risks which require continuous review and temporary adjustments.



Questions Q1. Do you agree with our minded-to position to make no adjustment to the price cap for wholesale costs incurred between October 2022 and September 2023?

We agree with Ofgem's minded-to position of making no adjustment to the price cap for wholesale costs incurred between October 2022 and September 2023.

Questions Q2. Are the three topic areas identified for medium-term review the right priorities? If not, what alternative topics should be considered?

We are supportive of a wider review of the wholesale cost allowances with the view to providing greater certainty regarding the risk exposures which suppliers are expected to actively manage. The wholesale market has fundamentally changed since the framework for the allowances has been introduced, driven by both extreme market events but also ongoing challenges presented by a lack of liquidity. A review of the allowance would ensure that the costs and risks that suppliers face are correctly calculated using up to date and transparent models, and are adequately compensated for via the price cap. As part of this process, Ofgem must ensure there is adequate transparency over the details and underlying data of the models it intends to use to make a decision on updating the price cap allowances. Any selected models must be consulted on prior to a decision, offering suppliers the opportunity to review and provide feedback.

We appreciate that the quarterly update review is taking into account market liquidity (and welcome the liquidity call for input as a step in the right direction). While the policy to move to quarterly cap update was necessary in navigating the energy crisis ensuring the volatility of increasing prices is quickly tracked, a renewed analysis of its benefits, drawbacks and other interactions with the market and customer behaviour is needed in light of the changed market context.

Q3. What is the relative order of priority between the three broad areas identified for review?

A complete bottom-up review of the price cap and its individual components would be best suited to incorporate and address all areas of priority identified for review. An overarching approach providing longer term certainty would improve business and investor confidence reducing regulatory risks and uncertainty as opposed to an incremental change process focused on specific topics.

Q4. Within each topic, are there any specific areas of focus you consider should be in scope?

The Wholesale methodology under market-wide half hourly settlement needs to take into account the move towards retail flexibility products including time of use tariffs which depart from the current "one size fits all" approach leading to a divergence in the needs of different customer segments and the emergence of different business models. Consideration as to how these innovative tariffs are encouraged and incorporated into the regulatory framework needs to be taken into account.



Q5. Do you have any initial views to share on the topics identified, or more broadly?

We are undertaking a strategic review in partnership with external consultants exploring possible options for the future of price regulation, both in the short and longer term. We will share our conclusions and evidence with Ofgem as they develop.