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“Notice period options for network charges for the start of ED3” – So Energy Response

Dear Colleague,

We welcome this review of how the market is regulated and we welcome the opportunity to provide comment. Energy suppliers need as much notice as possible in order to price changes in network charges into fixed tariffs. Option 1 is the best out of what Ofgem has presented but there is room for improvement beyond that option. We set out our reasoning below.

Fixed contracts are an intrinsic good. They help households budget over the medium term and can help insulate households from price shocks. This is especially relevant given today's geopolitical uncertainty and wholesale market volatility. Customers who signed up to a 24 month fixed contract prior to the issues in the Strait of Hormuz have insulated themselves from fossil fuel price rises.

They are popular – approaching 50% of the market are on a fixed tariff. Within the portfolio of fixed tariffs, the 24 month option is increasingly popular, given the price stability that option offers.

To sell these products, suppliers need to know the cost of providing the product at point of sale. Where we do not, a risk premium will be added by any prudent supplier. This risk premium drives up the cost of the contract. There is also the risk of less prudent suppliers not pricing in a risk premium, selling loss-making contracts and failing. Ofgem does not monitor how suppliers price, so this is a real risk.

Customers generally do not take fixed contracts that are higher than the price cap. This puts a de facto upper limit on how much suppliers can charge for fixed tariffs or they might as well withdraw them from the market.

The shorter the notice period, the greater the proportion of the contract where the costs are unknown and the greater the risk premium. The materiality is illustrated by this table:

Option	Notice Period (Months)	% of Contract at Risk	
		24 Month Contract	12 Month Contract
1	15	38%	0%
2	13	46%	0%
3	7	71%	42%
4	2	92%	83%
[Time to Apr-28]	20	17%	0%

As you can see, 20 months out, suppliers are already pricing in a risk premium based on an educated guess of network charges from April 2028. It is already raising the price on 24 month fixes as about 17% of the duration of the contract is at risk.

Option 3, Ofgem's preferred option would leave 71% of a 24 month fix and 42% of a 12 month fix at risk. This is completely untenable. These contracts' risk premiums would be so high, it would make no sense to sell them in the first place. In it's quest for stability, Ofgem would deny the choice of a fixed contract from end consumers.

The only viable Option on offer is Option 1.

As stated in Ofgem's consultation, network companies are better placed to manage the risk of under and over-recovery. They are also better placed to reduce volatility for the market:

As stated above, prudent suppliers will apply risk premiums in the face of pass-through cost uncertainty. The cutover between RIIO2 and RIIO3 in transmission and gas distribution has taught us that a potentially massive increase in charges is on the cards. However, ahead of any Ofgem decision, how much of a risk premium to apply is a case of educated guesswork, based on gut feel. We procured forecasts from 3rd parties, but they fell significant short of the outturn in T3, GT3 & GD3 charges in April 2026 and this exposed the business to material losses on contracts already sold. There is more or less a complete absence of real world data that could underpin a scientifically derived risk premium.

Suppliers who are less prudent or inexperienced may not apply a risk premium. This creates other problems. In the short term, the less prudent suppliers will grow, selling the lions share of fixed contracts and the prudent suppliers will lose market share. The less prudent suppliers will not know they have underpriced their contracts until the charges are released. Contracts that have been sold as 'profitable' will be revealed to be massively loss making. Suppliers who aren't prudent could grow rapidly in the short term, go out of business when the higher charges flow through and expose consumers and the market as a whole to SoLR costs. That is not a desirable outcome.

To sum up, the less notice given on network charges, the greater the risk of poor outcomes for the market.

Although not a replacement for advance notice of charges, official indicative forecasts can complement notice periods, allowing for a further reduction in risk premiums. If suppliers had an indicative forecast of what network charges are likely to be from April-28 today, then this could be incorporated into supplier pricing of 24 month contracts. This would reduce charges on 24 month tariffs and also reduce the risk of over-recovery. While the forecasts would be indicative and subject to change, they would surely be an improvement on the current status-quo, where all parties are in an information vacuum and forced to guess. Forecasts could begin with a broad range and that range could be iteratively narrowed as it approached the official notification of charge.

Finally, an alternative mitigation would be to allow suppliers to amend fixed contracts to account for changes in pass through costs. This would pass the risk through to end consumers, but in return many risk premiums could be removed from fixed contracts altogether, allowing them to be cheaper to enter into in the first place.

Q1. Are there any other notice periods options that may be appropriate for Year 1 of ED3?

We are 20 months away from April 2028. A 20 month notice period would best de-risk the pricing of fixed tariffs. Alternatively, an official indicative forecast could be issued at 20 months, and refined ahead of the Option 1 notice period commencing at 15 months.

The only other option in terms of shortening the notice period would be to allow suppliers to pass through rises in network costs on existing contracts. However, this would require an amendment to the supply licence.

Q2. Under Option 1, is a letter of comfort required to address the risk of over-and under-recovery – as we did for ED2?

Yes, if it helps with the acceptance of Option 1 by GDNs then it is a good idea. There is no corresponding mechanism for suppliers, which necessitates risk premiums and higher prices for end consumers. The greatest volatility is in the changeover between price controls. DNOs will have several years throughout the remainder of the price control period to balance out any initial under/over recovery.

Q3. How long do DNOs need to prepare and publish charges after receiving the final inputs relevant for a given option (for example, Final Determinations for Option 4)? Does it vary for different options?

We see no reason why DNOs could not achieve 15 months, when paired with a letter of comfort.

Q4. How long do LDNOs need to prepare and publish charges after DNO charge publication where a notice period derogation is in place?

We see no reason why LDNOs cannot achieve 14 months.

Q5. Do you agree with our initial assessment of the options for Year 1? Please provide evidence to support your views, including benefits and risks with each option. In particular, please provide evidence of the degree to which risk premia could change under Options 2, 3 and 4 as compared with the baseline of Option 1.

No. Shorter notice periods will lead to fewer options, worse options and higher prices for end consumers as it places a greater proportion of fixed tariffs at risk.

Our rationale and evidence are presented at the top of our response.

Q6. Do you agree with our initial assessment of the options for Year 2? Please provide evidence to support your views, including benefits and risks with each option.

No. Shorter notice periods will lead to fewer options, worse options and higher prices for end consumers as it places a greater proportion of fixed tariffs at risk.

Our rationale and evidence are presented at the top of our response.

Ofgem's logic is underpinned by flawed reasoning. DNOs do not know for sure what revenue they will need in year 1 of RIIO3. A letter of comfort could be issued to allow DNOs to adjust for under/over recovery in future years. However, in Ofgem's mind, it makes more sense to shorten the notice period because "the 15-month notice did not shield suppliers and consumers from risk related to year-on-year variability in allowed revenue." We reject this line of thinking:

- DNOs at least have some idea of what revenues they might need in the first year of their price control and therefore what the charges are likely to be. Suppliers have no such insight and are essentially forced to have a guess as to what network charges may be and apply a risk premium to their charges for supply. Those risk premiums are passed to consumers. Consumers are exposed to the volatility caused by the lack of certainty on network charges.
- DNOs have the option of obtaining a letter of comfort to adjust for under/over recovery in year 1. Suppliers have no corresponding to adjust for incorrect forecasts. This necessitates larger risk premiums in the first place while also driving up the likelihood of SoLR events.

Frankly, for DNOs to deploy this line of argumentation implies they either do not know anything about how suppliers price their tariffs or they are disingenuously advancing their own self-interest. DNOs do not speak for suppliers or consumers when they say "the 15-month notice did not shield suppliers and consumers from risk related to year-on-year variability in allowed revenue."

Q7. What was the impact of the year-on-year variability in charges at the start of ED2 on contractual arrangements, budgeting and any other relevant elements of your business/experience? Please include reference to the impact this had on your customers. Did the longer notice period compensate for this variability?

We are already applying a risk premium into our 24 month fixed contract. That risk premium is based on a guess of what charges are likely to be in April-28. There is distinct lack of data, insight or official forecasts on what the prices are likely to be. As of now, the risk premium impacts only a small proportion of our 24 month fix. However, as illustrated in our table, above, that proportion is set to grow and grow and, therefore, the materiality of the risk premium will grow.

Yours Sincerely,

Paul Fuller
Head of Regulation