

Ofgem Working Paper #2: Market Basket Energy UK response

13 April 2018

Introduction

Energy UK is the trade association for the GB energy industry with a membership of over 100 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership covers over 90% of both UK power generation and the energy supply market for UK homes. We represent the diverse nature of the UK's energy industry – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 27 million homes and every business in Britain. Over 730,000 people in every corner of the country rely on the sector for their jobs, with many of our members providing long-term employment as well as quality apprenticeships and training for those starting their careers. The energy industry invests £12bn annually, delivers £88bn in economic activity through its supply chain and interaction with other sectors, and pays £6bn in tax to HMT.

This is a high-level industry view; Energy UK's members may hold different views on particular issues raised by the working paper. We would be happy to discuss any of the points made in further detail with Ofgem or any other interested party if this is considered to be beneficial.

Market Basket

Given the significance of the cap for the domestic supply market and the volume of households it will impact, it is vital that the efficient costs benchmark is robustly designed to ensure suppliers of all sizes, with varying customer bases, costs and business models can continue to operate competitively. To that end, we welcome Ofgem's latest working paper and its outlining not only of current thinking on the market basket approach but also details of the work it is undertaking.

Energy UK has a wide range of membership including larger, medium and smaller suppliers, with differing views on the proposed cap and how to best determine an efficient level of costs. As we noted in our response to Working Paper #1 (WP1), Energy UK will not be putting forward a position on the preferred method for the determination of an efficient level of costs.

We expect members to respond individually to the working paper's examination of the market basket approach to setting and/or updating the level of the cap over time.

Transparency of Process

Energy UK does, however, believe that transparency it is absolutely necessary for such a significant market intervention. Transparency is needed to ensure that all market participants, whether supplier or consumer, have confidence that Ofgem is delivering against its objectives in an effective and fair way. It is on this principle that we would like to raise a number of concerns.

Working Paper #2 (WP2) notes that the responses to the WP1 have not been able to be taken into account due to the timescales of its preparation. With the third working paper already published and the fourth expected imminently in mid-April, it is difficult to envisage how there will be time for those papers to take into account responses made to WP1 and WP2. If this is the case, we would welcome clarity on how Ofgem expects to examine issues raised in responses ahead of the proposed policy consultation, which Ofgem has indicated could be as early as May.

As an example, in Energy UK's response to WP1 we raised the concern that the lack of clarity around success criteria of the tariff cap could limit the usefulness of responses of stakeholders. The lack of transparency in WP2 over these success criteria, or at least Ofgem's current thinking on what the criteria could look like, creates a barrier for respondents to judge the proposal against its likelihood of achieving success.

On this basis, we believe that Ofgem should also be seeking to promote transparency by publishing all non-confidential responses it receives to its various working papers.

Expected Milestones

In relation to the expected milestones timeline, we note the lack of a working paper to discuss how Ofgem is considering it will effectively estimate operational costs (including smart meter costs). In its open letter dated 6th March¹ giving an update on their plans for retail energy price caps, Ofgem stated that it would be a topic covered in the working papers. As we highlighted operational expenditure (and smart metering costs in particular) as an important issue in our WP1 response, we request clarity as to why this change has been made and how Ofgem will be ensuring such a significant issue is properly considered.

In addition, we note the lack of a working paper to discuss green tariff exemptions which had also been outlined in the open letter. This is especially concerning as in her recent letter to the Public Bill Committee, the Minister stated:

"...[T]he Bill places a duty on Ofgem to carry out a consultation on whether and, if so, how to exercise the power conferred by subsection (2) (b) of the Bill to exempt green tariffs from the price cap where there are actively chosen by customers and support the production of renewable electricity and gas. The consultation by Ofgem will be critical to establish a clear definition of what constitutes a green tariff for the purposes of an exemption; and to understand how best to avoid the risk of gaming."²

We would therefore welcome clarity on the reasons the previously proposed working paper on green tariff exemptions has seemingly been dropped from the policy development timeline. All stakeholders should benefit from understanding and feeding-in to Ofgem's current thinking on what will be an important part of the cap ahead of the final consultation. While Energy UK members may have differing views on the details of any exemptions, we firmly believe that the

¹ https://www.ofgem.gov.uk/system/files/docs/2018/03/update_on_our_plans_for_retail_energy_price_caps.pdf

² <https://publications.parliament.uk/pa/bills/cbill/2017-2019/0168/Perryletter.pdf>

principle of transparency should be upheld, and upheld consistently throughout the cap's development

We would also welcome some clarity as to why the expected timing of the policy consultation has seemingly been brought forward to May/June from July as it had been originally outlined in the open letter. While we recognise the pressure that Ofgem is operating under, it is important that it undertakes a rigorous design process to avoid any detriment to competition and consumers.

If you would like to discuss the above or any other related matters, please contact me directly on 020 7747 2931 or at steve.kirkwood@energy-uk.org.uk.