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THE QUEEN'S AWARDS FOR ENTERPRISE: SUSTAINABLE DEVELOPMENT 2015

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Dear Anna

Thank you for the opportunity to comment on Ofgem's "Statutory Consultation – Default tariff cap", published on 6 September 2018.

Introduction to Co-op Energy

One of the biggest differences between Co-op Energy and other energy suppliers is that we're a co-operative, which means we're owned and run by our members. Most big energy suppliers are owned by shareholders, so any profit they make goes back to their shareholders, rather than customers. When we make a profit it's our members, and our community who see the benefits.

Established in 2010, Co-op Energy has over 400,000 domestic customers and is committed to sustainability. We stopped buying electricity from coal in 2016. All our electricity tariffs are now sourced from 100% renewably generated electricity as standard.

We launched our Community Energy Strategy in March 2017 and we are helping to expand community energy in Great Britain and to be recognised as the GB's leading supporter of locally-generated low-carbon energy. Via Power Purchase Agreements (PPAs) we are enabling a fair market access for community energy, with projects including wind, solar-PV and hydroelectric technologies. The number of PPAs with community energy groups now stands at 68 compared to the nine we had at the end of 2014.

We secured Fair Tax Accreditation for the 3rd consecutive year and won the Queens Award for Enterprise 2015 in recognition of our ongoing commitment to social responsibility.

Commentary on Ofgem's proposals

Co-op Energy supports a temporary, absolute price cap as the best way to address one of the main sources of consumer price detriment in the market: customers on uncompetitive SVTs for 3 years or more. We advocated the price cap should only apply to customers on SVT for 3 years or more. In our view this struck the right balance between maintaining the benefits of competition, while protecting those who do not – or cannot – engage with the market.

1. **Impact on wholesale reference price from Ofgem's proposed suspension of the Market Maker Obligation (MMO) under Secure and Promote**

   We think the price cap in combination with Ofgem's proposed suspension of the MMO creates a serious risk of unintended, unacknowledged and undesirable consequences for the market and consumers.

   The wholesale model Ofgem proposes to use for the price cap does not take account of Ofgem's proposed suspension on MMO and the impact of the suspension of MMO is not acknowledged in the Impact Assessment. We understand Ofgem has confirmed in private its intention to suspend the MMO in November 2018.

   Ofgem's wholesale model requires a robust reference price for wholesale energy as an input so it is a fair proxy for suppliers' wholesale costs. An unintended consequence of the suspension of MMO could mean the wholesale reference price becomes a less reliable indicator of suppliers' wholesale costs; carries a greater risk of 'gaming' the wholesale price to impact the wholesale allowance under the cap; and has disproportionate impact on non-vertically integrated suppliers.

   The lower volume of trades that is likely to result from the suspension of MMO will: reduce wholesale liquidity (in addition to the reduction in liquidity Ofgem thinks likely following implementation of the price cap); increase price volatility; and increase bid and offer spreads. The net result could be that the reference price (which is an average of bid and offers) becomes a less robust measure of the real wholesale energy costs suppliers incur. The reduction in liquidity also means it becomes easier for parties to potentially manipulate the reference price to affect the price cap. The example of Libor demonstrates reference prices are sometimes rigged to increase profitability.

Vertically integrated suppliers are likely to be able to better manage their wholesale cost following the suspension of MMO, due to their generation assets and more sophisticated administration. We suggest the absence of any analysis, which investigates whether there is any difference in impact between vertically and not vertically integrated suppliers, diminishes the robustness of the analysis undertaken so far by Ofgem.

2. Confusion for prepayment customers

The methodology for determining the price cap level for customers with traditional prepayment meters and SMETS1 prepayment meters is different from the methodology to determine the cap level of customers with SMETS2 prepayment meters. While the two cap level aligns perfectly for the first cap period, it's likely, due to the different methodologies for updating the two caps, they will diverge over time. This risks creating confusion for prepayment customers if suppliers choose not to align their prepayment pricing.

3. Promoting below cost pricing

One of the benefits of Ofgem's statutory consultation analysis is it provides an implied 'break even' point for an efficient supplier. Using Ofgem's data below, the efficient supplier benchmark is £996 for a dual fuel customer. After subtracting normal profit (£18), Ofgem's analysis suggests a direct debit dual fuel tariff of less than £978 would be below cost.

Cost component	Electricity single rate	Gas single rate	Dual fuel (implied)	January 2019 cap
Wholesale	170	197	367	444
Policy costs	97	19	117	137
Network	135	122	258	258
Operating costs	79	90	169	189
Payment method	11	9	21	23
Normal profit	9	8	18	20
VAT	25	22	47	54
Benchmark	**527**	**469**	**996**	**1,124**
Headroom	5	5	10	12
Cap level	**533**	**474**	**1,007**	**1,136**

Source: Ofgem (VAT is applied to headroom)

Consumers on tariffs below cost are benefiting from lower prices and low priced tariffs allow new entrants to grow rapidly, arguably providing increased choice and competition for consumers. However, recent Supplier of Last Resort (SoLR) events suggest this may not be a sustainable business model. SoLRs cause consumer detriment as the cost of supplier failure is underwritten by consumers because of Ofgem's Safety Net (which protects consumers' credit balances by socialising the cost across remaining suppliers).

We believe promotion of below cost tariffs can erode consumers' trust in energy suppliers. Some consumers may feel if they are not on the cheapest available tariff in the market they are being 'ripped off'. Below cost tariffs are not sustainable in the long terms and all consumers could not choose a below cost tariff.

For this reason, we think Ofgem's should cease promoting below cost tariffs, or the delta between cheapest tariff available and suppliers' more expensive tariffs. We also think Ofgem's Cheapest Market Offer Letter (CMOL) should exclude below cost tariffs.

Energy Company Obligation

We note Ofgem proposes to base its assessment of suppliers' ECO costs on BEIS' forecast of annualised scheme costs taken from the most recent Impact Assessment (ie the Consultation Stage Impact Assessment for ECO3, published March 2018). This would then be divided by your latest estimates of the supply volumes used to calculate suppliers' obligations.

We think there are risks this approach could understate (obligated) suppliers' actual ECO costs. Firstly, we and others are concerned BEIS' delays in finalising ECO3 legislation will cause up to 6 months' delivery delay, which could drive up supply chain costs. BEIS' revised impact assessment will be delayed because it is contingent on the conclusion of the legislative process. There is a risk the cost of the delays is not taken account of in the IA, and any lag in updating the IA creates a risk of understating ECO costs.

Secondly, BEIS have decided for ECO3 that the installer network and suppliers must complete works to a new quality mark standard. The intent is to improve the quality of ECO measures. This new quality mark will be in addition to existing requirements and will require the installation network to be trained, certified and additional quality monitoring / governance put in place. This will increase costs of ECO administration and is not included in the current costs allowance in the price cap for ECO.

In order for ECO cost allowance to be reflective of suppliers' actual delivery costs, it is important these new cost drivers are reflected accurately and in a timely way. We would encourage Ofgem to impress upon BEIS the increased importance of timely and accurate ECO Impact Assessments and specifically account for the impacts of the quality mark. Ofgem and BEIS should consider the merits of more frequent Impact Assessments, which are aligned with the 6 monthly price cap cycle.

Derogation for green tariffs

We welcome Ofgem's approach and engagement on green tariff exemptions and welcome the inclusion of green gas. We understand Ofgem is keen to ensure clear traceability between the additional costs a supplier faces supporting renewable energy and any tariff for which it seeks an exemption as part of the proposed derogation route.

While we understand Ofgem's intent is to avoid suppliers 'moving the deckchairs round' to game the cap, this approach potentially poses some issues for us. As a cooperative, we do not have shareholders, but are member-led. Members contribute democratically to the decisions we make and over 58% of Coop Energy's customers are members. We support community energy as part of our 'co-operative values': support for communities is baked into our constitution. Support for community energy is something valued by our members based on what they tell us.

We therefore do not specifically ring fence investment in community energy or associate it with specific tariffs. We fund the additional cost of supporting community energy from general revenues, which includes margin we earn across all tariffs, including our Green Pioneer product (our SVT) and our default fixed product.

We welcome continued engagement with Ofgem on the options for green tariff derogations. We hope the derogation framework Ofgem will develop won't hinder our continued support of community energy post cap and will take account of suppliers' more constrained revenues.

We hope these comments are helpful and we are ready to implement the price cap following Ofgem's final decision.

Yours sincerely

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