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Dear Rob

Capacity market allowance in the default tariff cap

Thank you for the opportunity to provide our views in respect of Ofgem's approach to the Capacity Market (CM) allowance in the default tariff cap that you set out in your letter of 15 January 2019.

We strongly disagree with Ofgem's proposals in respect of Scenario b). There is a significant expectation that the Capacity Market (CM) scheme will resume at some point in the not-too-distant future. Therefore, whether or not supplier payments are expected to restart before or during the second cap period, as long as there is a possibility that State Aid will be approved and thus suppliers will be required to make back-payments, prudent suppliers must accrue the amount that would have been due in CM payments. Suppliers should also continue to collect the payments from customers in order to ensure the funds are available to make back-payments; under the terms and conditions of our supply contracts, these charges could not be applied in customer bills retrospectively without legal authority. If suppliers cannot recover the costs of the CM from customers, in the way that the legislative scheme and the price cap itself were set up to achieve, suppliers would not be able themselves to make back-dated CM payments if later requested to do so – they simply would not have the funds to do so.

It should be recognised that removal of CM costs from the default tariff cap is likely to provide a signal to the wider non-default and business market to remove CM costs from its products. Future recovery of costs in the event of back payments would be even more difficult and would be likely to exacerbate the financial stress for suppliers, which may result in more market exits and, potentially, more costs for suppliers from mutualisation schemes.

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Ofgem should also note that removing the CM allowance from the default tariff cap would create a further divergence between it and the prepayment (PPM) cap. The CMA has recently consulted on whether a review of the PPM cap is necessary; we have suggested they revoke the Prepayment Charge Restriction Order 2016 and make PPM customers eligible for the default tariff cap, thus simplifying the process for both suppliers and consumers.

Only if, and when, it becomes clear that State Aid will not be approved should the allowance be removed from the default tariff cap; any amount that has been accrued should then be refunded to customers and not treated as additional income for suppliers.

We understand that Ofgem intends to amend the model in Annex 2 to SLC 28AD using powers under SLC 28AD.15(a) (electricity and gas). However, given the requirements of Sections 4 and 5 of the Domestic Gas and Electricity (Tariff Cap) Act 2018, which require a consultation over a 28-day period for changes to the methodology with a further 56 days after a decision is made before any change can be implemented, we believe that Ofgem's open letter of 15 January is inadequate for the purposes of making the proposed amendment.

In the event that Ofgem did remove the CM allowance from the default tariff cap for the second cap period but, in a subsequent cap period, suppliers were required to start making CM payments again, there can be no doubt that there would be a 'justifiable rationale' to allow recovery of costs relating to the second cap period. The CM Supplier Charge provides for almost £15 per customer in the default tariff cap; the amount of headroom allowed in the first cap period was £12, and there are a number of other costs the headroom is expected to cover, for example:

- providing customers who pay by standard credit and are in receipt of the Warm Home Discount with the Direct Debit level of the cap;
- additional Energy Company Obligation costs arising out of the change in the way the obligation is calculated from April 2019;
- costs relating to mutualisation of RO and FIT;
- potentially additional network charges if Ofgem grants a derogation to network operators to apply additional charges within a Charge Restriction Period in the event of a Last Resort Supply Payment.

There can therefore be no doubt whatsoever that the additional costs would be material and recovery of costs relating to the second cap period should be allowed. Of course, it is worth noting that this would result in an increase in the level of the default tariff cap in the period in which costs were recovered.

We agree with Ofgem's approach in Scenario a). In its consultation of 19 December 2018, "Proposals for technical amendments to the capacity market", the Department for Business, Energy & Industrial Strategy (BEIS) indicated that it was minded to continue collecting capacity market payments from suppliers during the standstill period; the question was only which method should be used. Our preference is for the CM Settlement Body (the ESC) to re-start collection of Capacity Market (CM) charges. We understand that BEIS is aiming to issue its decision on the consultation in time for Ofgem to take account of its decision when determining the level of the default tariff cap for the second

charge restriction period. We therefore expect that Ofgem will have sufficient confidence that supplier payments will restart before or after the second cap period, and thus the allowance within the default tariff cap can be calculated in the same way as at present.

Yours sincerely

A handwritten signature in black ink that reads "Tracey Wilmot". The signature is written in a cursive, slightly slanted style.

Tracey Wilmot
Head of Retail Market Regulation