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Sent via email to: [RetailPriceRegulation@Ofgem.gov.uk](mailto:RetailPriceRegulation@Ofgem.gov.uk)

23 January 2018

Dear Rob,

### **Capacity Market Allowance in the Default Tariff Cap**

I am writing in response to your open letter of 15 January in which you outline Ofgem's approach to the Capacity Market (CM) calculations in the default tariff cap for the next price cap period. Energy UK and members are extremely concerned about the basis for Ofgem's approach and the manner in which it is seeking to implement that approach.

First and foremost, Energy UK believes that the Government has made sufficiently clear its intention for the collection of supplier charges to continue through the standstill period and for the CM to be fully reinstated in due course. If Ofgem were not to include the CM allowance under the cap in the second cap period, it would be contrary to the Government's clearly stated intention. It is, therefore, extremely concerning that in your letter you have not defined "insufficient confidence", nor what would determine the confidence level that will drive your ultimate decision. Ofgem should currently have a sufficient level of confidence regarding the Government's intent and we would welcome further clarity on what other factors would determine Ofgem's level of confidence.

Given the stated intention of the Government, and the potential for severe customer and market detriment that is risked if Ofgem does not allow CM charges to be appropriately recovered (highlighted below), we would urge Ofgem to urgently reframe its decision-making process. The European Commission has also confirmed that they have no objection to the Government collecting the CM Supplier Charge during the standstill, so there is no official voice suggesting otherwise. Ofgem's default position on the CM allowance should be that it will be included in the second cap period unless Ofgem is certain that suppliers will not pay the CM Supplier Charge during that period.

As part of its decision, Ofgem must consider the future impacts upon market competition and consumer experience that it risks if suppliers are not allowed to recover costs that they have incurred from paying CM charges. Ofgem should consider the importance of their decision to the stability of the UK energy sector and its ability to attract investment that benefits consumers and increases competition. The decision will likely be taken as Ofgem's judgement on the

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Government's overall plan for the CM and it is imperative that Ofgem does not unintentionally undermine investors' confidence with its decision.

Allowing suppliers to recover the CM costs in the price cap is important to provide confidence that generators will be paid retrospectively for CM agreements. Without that confidence, there is a risk that some capacity providers (particularly new build generation, and potentially, Demand Side Response (DSR) and existing projects) are not progressed. Such an outcome could create risks for security of supply, or raise the costs to consumers of ensuring security of supply.

Furthermore, Energy UK believes that there would be a real risk to suppliers' financeability during the standstill period if they were not allowed to recover CM charges as an efficiently incurred cost. This risk would be enhanced by the cumulative impact of growing mutualisation costs as a result of the higher frequency of supplier failures and SoLR events that the market is experiencing and that is already eroding the headroom allowance. Energy UK also considers that a steady recovery of costs would be much more in the interests of current and future consumers' interest than a large spike in prices later in the year, once the CM is reinstated in full.

### **Modification Process**

We are concerned about the precedent potentially set if Ofgem were to change the price cap methodology under "scenario b". Whilst we recognise that licence condition 28AD.15(a) exists, we note that there are also specific consultation and timing requirements for modifications that are outlined in Sections 4(3) and 5(4) of the Tariff Cap Act. Given the importance of the issue under consideration, and the potential risks to the market highlighted above, we would welcome clarity from Ofgem regarding how it considers this short consultation exercise aligns with the requirements of the Act, SLC 28AD.15(a) and its general approach to consultation on licence modifications.

If you would like to discuss the above or any other related matters, please do not hesitate to get in touch.

Yours sincerely,



**Audrey Gallacher**  
Director of Policy