

23 January 2019

Rob Salter-Church
Director – Retail Systems Transformation
Ofgem
10 South Colonnade
Canary Wharf
London E14 4PU

Email: alisonrussell@utilita.co.uk

Dear Rob,

Re: Capacity Market Allowance in the Default Tariff Cap, Open Letter

Thank you for the opportunity to comment on the open letter. Having experienced significant detriment due to the policy cost issues inherent in the Prepayment Charge Restriction (PCR), we are very concerned at the risk to suppliers posed by the open letter. Suppliers cannot influence in any way the level of Capacity Market Payments (CMPs), and, under the DTC (or the PCR) have no way to manage the costs of CMPs unless they are explicitly allowed for within the relevant cap.

The government has made it clear in all communications relating to the capacity market suspension that it is completely confident that the capacity market will be resumed. If Ofgem does not allow for CMPs in the Summer 2019 DTC, it is implicitly but clearly expressing a view opposed to that of government. Ofgem should clarify publicly the basis on which it considers that CMPs for April to September 2019 will never be made.

If this is not the case, then Ofgem should be aware that suppliers must make suitable provision in their accounts to meet sums which will be due. The concept of accruals-based accounting means that suppliers should charge customers for the CMPs which would be incurred in this period. Not allowing for CMPs will force losses, and possibly even market exit, on efficient suppliers - not to mention the damage to investor confidence and shareholder value.

While we welcome the implied position in the letter – that Ofgem acknowledges suppliers should be able to recover the capacity market payments made under the Default Tariff Cap (DTC) – this is not clearly stated.

Ofgem should set out explicitly the principle that suppliers must be able to fully recover the CMPs made in a timely manner. The recovery must take place in the same period as the charges are incurred. We believe that if recovery of CMPs is not provided for in a cap period, then collection of the CMPs from suppliers should be deferred into the period matching

.../2

recovery. Suppliers under a price cap cannot afford to carry such costs where recovery is in arrears.

The estimation monetary amounts carried out by Ofgem for the open letter is very helpful, demonstrating the scale of the potential risk to suppliers. Ofgem estimates that the CMPs would be around £14 per customer. This is the approximate difference proposed to be either allowed or not between scenarios (a) and (b). While the amount appears modest, in the context of the very narrow margins under the DTC (and the even narrower margins under the PCR) these amounts are significant and would have a major detrimental impact on the market. It should also be noted that while the estimates will have been carefully calculated, they remain estimates, and could in fact be higher depending on the outcome of the auctions.

Given the government's belief that the capacity market will be reinstated, Ofgem must make allowance for these amounts in the DTC, even if this requires an adjustment in the subsequent period for over-recovery. Any benefit to suppliers of slightly earlier collection of capacity market charges would be marginal. We believe this marginal benefit would be far outweighed by the costs and difficulty of providing retrospectively for supplier under-recovery.

We hope these comments have been helpful and would be happy to discuss any points in more detail.

Yours sincerely,

Alison Russell
Director of Policy and Regulatory Affairs.