The voice of the energy industry

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Sent via email to: retailpriceregulation@ofgem.gov.uk
CC: Andrew.Tuffin@ofgem.gov.uk

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Dear Anthony

Feed-in Tariffs (FIT) Allowance in the Default Tariff Cap

I am writing in response to your recent consultation letter setting out options for the most suitable successor or alternative data source to determine the FIT allowance within the default tariff cap from the fifth cap period onwards.

Energy UK is primarily concerned that none of the proposed options, including Ofgem's preferred Option 3, would take account of the significant increase in FIT costs for domestic suppliers caused by the COVID-19 lockdown. This increase in FiT cost is a consequence of the sharp reduction in overall demand, which means that domestic suppliers are now facing a much higher £/MWh cost for FiTs than expected or allowed for in the current price cap. We welcome the move toward using actual FiT costs (on a lagged basis) instead of OBR forecasts, but if suppliers are to be able to recover increased COVID-related costs, it is essential that this is accompanied by a move toward using *actual* demand instead of forecast demand to calculate the £/MWh allowance in the cap. This is essentially the approach that Ofgem already uses for BSUoS costs, and we see no reason why it should not be used for FiT costs. In principle, this move will provide for a more stable framework for the cap and better account for the immediate and longer-term impacts of COVID-19 on FiT costs.

We are also concerned that Ofgem is proposing to introduce an unnecessarily long lag between actual FiT costs and their pass-through to the price cap allowance. Ofgem's proposal involves a 24-month lag, in order to accommodate the timing of the FiT annual report. We see no reason why Ofgem should not use, as an alternative, the information contained in the quarterly FiT invoices issued by Ofgem. We realise that these invoices may be subject to a small amount of subsequent truing up/down, but the magnitude of such adjustments is small, and could easily be carried forward into a future price cap period.

As set out below, we believe Ofgem could reduce the time lag from 24 months to as little as 15 months in this way (with the proposed RPI adjustment reduced accordingly). Again, this would be closer to the approach currently used for BSUoS. Reducing the lag before suppliers can recover COVID-costs would help alleviate the cash-flow constraints faced by many suppliers, and would be good practice in any event.

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New Option for FIT Allowance

In line with the principle above, Energy UK believes that Ofgem should progress on a new option for the FIT allowance, which better reflects the actual costs incurred by suppliers and, as far as possible, allows for the recovery of additional COVID-19 costs in a shorter time span.

To achieve this, Energy UK proposes that the allowance should be based on the actual costs from the previous 12 months according to quarterly invoices, divided by the actual demand in that period. For example, in price cap period 5 starting in October 2020, the allowance will be derived from actual costs and demand between July 2019 and June 2020. This would lead to a £/MWh allowance, similar to the method used for BSUoS costs in the price cap, and provide a more reliable and stable framework.

We see no reason why Ofgem should not implement this change in time for the August announcement of the cap level for October. However, should it not be possible to do so, we have identified below alternative fall-back proposals which would still allow recover of COVID-19 costs, albeit with longer lag.

We would welcome Ofgem's further engagement with Energy UK and our members to discuss these fall-back options if the original proposal (Option A) is not able to be implemented.

#	**Option**	**P5 (Oct 20) Cap based on**	**P6 (Apr 21) Cap based on**	**P7 (Oct 21) Cap based on**
A	Lagged pass-through for P5 and P6 on (15-month lag)	Actual cost divided by actual demand in period **Jul 19 - Jun 20**	Actual cost divided by actual demand in period **Jan 20 - Dec 20**	Actual cost divided by actual demand in period **Jul 20 - Jun 21**
B	Hybrid for P5 and lagged pass-through for P6 on (15-month lag)	OBR cost forecast divided by actual demand **Jul 19 - Jun 20**	as above	as above
C	OBR for P5 and lagged pass-through for P6 on (18-month lag)	OBR cost forecast divided by BEIS forecast demand (same as Ofgem Option 2 & 3)	Actual cost divided by actual demand in period **Oct 19 - Sep 20**	Actual cost divided by actual demand in period **Apr 20 - Mar 21**
D	OBR for P5 and lagged pass-through for P6 on (21-month lag)	OBR cost forecast divided by BEIS forecast demand (same as Ofgem Option 2 & 3)	Actual cost divided by actual demand in period **Jul 19 - Jun 20**	Actual cost divided by actual demand in period **Jan 20 - Dec 20**

Yours sincerely

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