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15 July 2020

Dear Anthony

Consultation letter on changes to Feed-in Tariffs allowance in the default tariff cap

We are pleased to respond to your consultation letter of 17 June 2020 which sets out options available for calculating the Feed-in Tariff (FiT) allowance set out in Annex 4 to standard licence condition (SLC) 28AD of the electricity and gas supply licence.

Of the three options proposed by Ofgem we agree that Option 3 is the most appropriate. However, we are disappointed that in the current circumstances Ofgem is confining its consideration to very minor changes to the methodology. In light of the COVID-19 lockdown and the resulting financial stresses placed on supply businesses, there is an urgent need to consider more radical changes to the price cap methodology where it has failed to accurately reflect the cost shocks experienced by suppliers.

We note that Ofgem has committed to reviewing a 'COVID adjustment' to the price cap in time for Period 6 (starting April 2021), to include increased bad debt and other COVID cost impacts. Given the difficulty in estimating the impact of COVID on bad debt costs (and certain other costs), we can understand why Ofgem wishes to delay these aspects to April 2021. However, in situations where the impact of COVID is already clear (such as FiT costs), we see no reason why Ofgem should not take action in time for Period 5 (starting October 2020) and we urge Ofgem to reconsider its position.

We set out below a summary of our views on how Ofgem should reform its approach to calculating the FiT allowance and elaborate on these points in Annex 1.

- 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 promptly, 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.

- 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. As set out in Annex 1, 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).

Should you have any questions on this response, please do not hesitate to contact James Soundraraju (Tel: 014 1614 2421, jsoundraraju@scottishpower.com) in the first instance.

Yours sincerely,



Richard Sweet
Head of Regulatory Policy

**CONSULTATION LETTER ON CHANGES TO FEED-IN-TARIFFS ALLOWANCE IN THE
DEFAULT TARIFF CAP – SCOTTISHPOWER RESPONSE**

1. Need to use actual demand instead of forecast demand

Our primary concern is 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 COVID-19 lockdown. This increase in FiT costs 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.

As explained below, we believe this can be done by making use of the demand data in Ofgem's FiT invoices (for the same period as the FiT cost data) instead of using the BEIS forecast.

2. Lag between actual FiT costs and pass through to the price cap

Ofgem's proposal involves an unnecessarily long (24-month) lag between actual FiT costs and their pass-through to the price cap, to accommodate timing of each FiT annual report.

For example, the annual FiT report for scheme costs in the period 1 April 2019 to 31 March 2020 is not expected until December 2020. Therefore, the information from the report will only be available to set the FiT allowance in Period 6 (1 April 2021 - 30 September 2021). This creates an observation window of costs that are 24 months out of date and not reflective of increased COVID-related costs suppliers will need to recover.

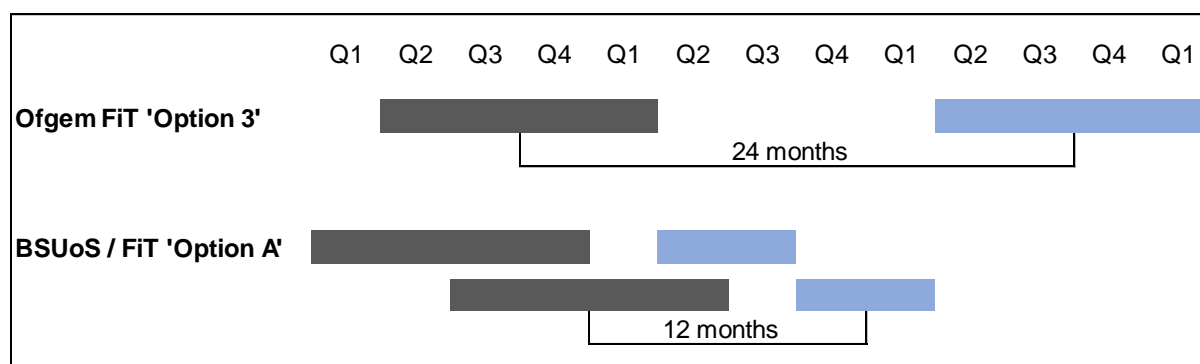
We see no reason why Ofgem should not use, as an alternative, the information in quarterly FiT invoices issued by Ofgem. The information available in these invoices¹ is sufficient for Ofgem to construct a reasonable estimate of scheme costs. These invoices may be subject to a small amount of subsequent truing up/down, but the magnitude is small, and could easily be carried forward into a future price cap period.

The invoice for the quarter April to June 2020 is due at the end of July 2020, meaning that an observation window of actual FiT supply volumes and costs over a 12 month period from July 2019 to June 2020 will be available for setting a FiT allowance in Period 5. Similarly, for Period 6, the invoice data available would allow the observation window to be shifted by six months to a 12 month period from January to December 2020. When the obligation on Ofgem to set the level of the summer cap by 7 February and the winter cap by 7 August is taken into consideration, this process would result in a rolling 15 month lag between actual FiT costs and their pass-through to the price cap.

¹ Quarterly invoices contain data on total electricity supplied, total exempt supply, total EII exempt supply, total generation payments, total deemed export payments, total deemed export electricity, total metered export payments, total metered export electricity, total qualifying costs, system sell price and levelisation fund.

We contrast in Figure 1 the lag involved in Ofgem’s preferred Option 3 with the use of quarterly invoices. The grey bars in the diagram denote the observation window of actual costs reflected in the price cap periods shown in blue.

Figure 1 – Comparison of the lag between actuals and pass through



We believe the shorter lag involved with the use of quarterly invoices will provide for a more stable framework for the cap and better account for the immediate and longer-term impact of COVID-19 on FiT costs.

Quarterly invoices are not in the public domain and may not satisfy Ofgem’s preference of linking input sources to publicly available data sources. However, we believe the relevant information in these invoices is not commercially sensitive and could easily be published on Ofgem’s website when each quarterly round of invoices are sent out.

3. Impact of different methodologies

There are a number of alternative options which would enable prompt recovery of costs and be entirely consistent with the spirit of the price cap. We outline them below and set out why we believe they represent pragmatic and fairer options than Ofgem’s preferred approach.

Option A

ScottishPower’s preferred option would be to move immediately to a lagged pass through of costs using quarterly invoices on a rolling 15 month basis from Period 5, in a manner consistent with the treatment of BSUoS costs. The allowance from Period 5 onwards would therefore be based on actual costs and actual demand determined from these quarterly invoices.

Option B

A hybrid option for Period 5 would be to use the OBR forecast costs for Period 5 (as Ofgem has proposed in Option 3) but to use actual demand from quarterly invoices for the period July 2019 to June 2020 instead of forecast demand from BEIS. Period 6 onwards would revert to the use of quarterly invoices for both cost and volume data (as in Option A).

Option C

A third option, would be to use the OBR forecast and BEIS forecast supply volumes for Period 5 (as proposed in Ofgem Options 2 and 3) but to adopt in Period 6 the use of actual invoice data from July 2019 to June 2020, and in Period 7 the invoice data between January to December 2020. This process then rolls on in a similar way for future periods and creates a 21-month lag in pass through of costs.

We summarise the impact of these three alternative options in Table 1 below. For the avoidance of doubt, we think it is appropriate in all these cases to include RPI adjustments for lags in cost recovery.

Table 1 – Impact of Alternative Options

#	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 in period Jul 19 - Jun 20	As above	As above
C	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

We have, using illustrative figures, modelled the significant shortfall (on a cumulative basis) in cost recovery from Ofgem's preferred option and the extent to which the alternative options we have proposed correct for the shortfall. The impact is illustrated in the charts below which compare the actual annualised scheme cost in £/MWh against the allowance generated in each price cap period by the methodology underpinning each option. Our preferred option (Option A outlined above) represents the lowest potential shortfall between allowances and actual costs and is more accurate than Option 3 in how it would estimate FiT costs in the price cap.

