



Reassessing the wholesale allowance in the first default cap period

Thank you for the opportunity to comment on your proposals for reassessment of the wholesale allowance in the first default tariff cap period. This response reflects the views of both E.ON and npower.

Over the past few months, Ofgem spent a lot of time and effort gathering details of suppliers' hedging strategies, clarifying assumptions for its modelling and agreeing its outputs were representative; activities which we believe were wholly unnecessary given that Ofgem had only to reverse its change of mind in September 2018¹ (the September 2018 consultation) about the observation window for the first price cap period. Instead, the final consultation uses actual costs rather than those strategies. We are concerned that Ofgem has gathered a considerable amount of commercially sensitive information from suppliers which it does not appear to have required. It is important that Ofgem only requests information from suppliers that it genuinely needs, particularly where that information is commercially sensitive.

From the information provided in the consultation, we note that Supplier 6 has significant differences between its actual cost and its hedging strategy – far greater than any other supplier. We would greatly appreciate an explanation of how this has occurred. Is this the reason why hedging strategies have not been used?

We agree with Ofgem's decision to restrict its analysis to the six largest suppliers. These suppliers have a higher proportion of customers on default tariffs and are more likely to have longer hedging strategies.

We have always maintained that Ofgem's proposals should be limited to addressing the impacts of the changes it made in the September 2018 consultation. This was the only cap period that was disputed as part of British Gas's Judicial Review and the only cap period the High Court² deemed Ofgem should consider adjusting. We welcome, therefore, Ofgem's decision to restrict its current proposals to adjusting for its Q1 2019 wholesale cost methodology.

We recognise Ofgem's concerns in setting an adjustment charge that puts suppliers back in the position they would have been had Ofgem not revised its proposals in the September 2018 consultation, considering that *"it would not protect customers to charge suppliers' remaining default tariff customers an 18% surcharge to account for suppliers' customer losses"*. We accept the use of a weighted average of suppliers' comparable costs, given the requirements of the Domestic Gas and Electricity (Tariff Cap) Act 2018 (the Act). We also believe it is right that the adjustment allowance should be recovered through the variable charge, reflecting the fact that wholesale costs vary in proportion to consumption.

It is impossible to calculate the impact on switching of the cap level in Q1 2019 being lower than it should have been, and therefore we accept Ofgem's proposal not to take this into consideration in its proposals.

¹ https://www.ofgem.gov.uk/system/files/docs/2018/09/appendix_4_-_wholesale_costs.pdf, para 1.21/22

² <https://www.bailii.org/ew/cases/EWHC/Admin/2019/3048.html>, para. 90



We are concerned, however, that the overall impact of Ofgem's change to the observation window in the September 2018 consultation has resulted in suppliers losing out. We have always asserted that the default tariff cap is set too low (we will not reiterate our arguments relating to this here); as Ofgem states that its proposals will only allow suppliers to recover 85% of their losses in Q1 2019, it is questionable whether it has met the requirement of the Act to have regard to efficient suppliers' ability to finance their licenced activities.

We are unable, however, to suggest an alternative methodology that would produce an accurate value for compensating suppliers for their losses and therefore do not challenge the proposal to set the adjustment charge on a per customer basis and not increase the charge to account for reduced customer numbers since Q1 2019.

With respect to the adjustment period, we agree that the most pragmatic solution is to adjust over a six-month period commencing 1 October 2020. Whilst an adjustment over three months would reflect the same time period as the initial cap period, if the Secretary of State determines that the default tariff cap should continue beyond the end of 2020, a cap level adjustment for Q1 2021 would be necessary. This would be disruptive for customers and costly for suppliers, who would need to notify customers of the change to their prices. In addition, if the adjustment were to be over three months rather than six months, customers would be likely to see greater fluctuations in cap levels, which may lead to distrust of Ofgem and suppliers and potentially result in increased queries/complaints to suppliers.

If, however, the Secretary of State determines that the default tariff price cap should end on 31 December 2020, the full adjustment will not have been realised. Ofgem states, in paragraph 5.54, that it will consider alternative remedies in the event that happens. We would have liked to have seen Ofgem's proposals for this in the current consultation. In the absence of that we trust that, should it be necessary, Ofgem will consult on its proposals soon after the Secretary of State has made his determination and ensure that suppliers are fully compensated for the shortfall.

We would draw Ofgem's attention to the following minor issues:

- Tab [3c Demand] shows that 56.8% (PC1)/60.5% (PC2) of electricity demand fell in cap period 1. This conflicts with paragraph 5.18 of the consultation, which states "For electricity, we halve the adjustment charge, as customer consume 27.5% of their annual energy in each of Q4 and Q1."
- We also note the typo in paragraph 5.18. We assume it should read "For gas ... 34% of their annual energy in **Q4** and 42% in Q1." [emphasis added].