



**Ofgem Policy Consultation: Default Tariff Caps Statutory Consultation**  
**Response by ENGIE Power Limited**

4 October 2018

Contact: [phil.broom@engie.com](mailto:phil.broom@engie.com)

**About ENGIE**

ENGIE is a leading energy and services company focused on three key activities: production and supply of energy, facilities management and regeneration. Our 17,000 employees combine these capabilities for the benefit of individuals, businesses and communities throughout the UK & Ireland.

We enable customers to embrace a lower carbon, more efficient and increasingly digital world. Our customers benefit from our energy efficient and smart building solutions, the provision of effective and innovative services, the transformation of neighbourhoods through regeneration projects, and the supply of reliable, flexible and renewable energy.

ENGIE improves lives through better living and working environments. We help to balance performance with responsibility, enabling progress in a harmonious way.

Globally, the ENGIE Group employs 150,000 people worldwide and achieved revenues of €65 billion in 2017.

**Executive Summary**

Thank you for the continued opportunity to respond to the consultation on default tariff caps methodology, please find our updated points below:

**Definition of Default Contracts**

- We propose a revision to Ofgem's license drafting in relation to the definition of "28AD Default Fixed Term Contract" so that some existing customers are not inadvertently affected. More information is contained in the accompanying appendix.

**Wholesale Market**

- We are uneasy about of the potential impacts on the wider wholesale markets from the proposed price calculation model as this approach instinctively encourages similar purchasing behavior from suppliers who will naturally try to hedge the price risk to mirror the calculation. Whilst this model may work for a limited number of consumers, such as those currently on pre-payment meters, it may be more disruptive

ENGIE Power Limited  
No1 Leeds, 26 Whitehall Road, Leeds, LS12 1BE, United Kingdom  
T: +44 (0)113 306 2000 F: +44 (0)113 306 2198

[www.engie.co.uk/solutions](http://www.engie.co.uk/solutions)

Registered in England and Wales No: 4236804  
ENGIE Power Limited trading as ENGIE

ENGIE Gas Limited  
No1 Leeds, 26 Whitehall Road, Leeds, LS12 1BE, United Kingdom  
T: +44 (0)113 306 2000 F: +44 (0)113 306 2198

[www.engie.co.uk/solutions](http://www.engie.co.uk/solutions)

Registered in England and Wales No: 3814495  
ENGIE Gas Limited trading as ENGIE

to wholesale market trends if hedging practices are replayed at scale for majority of the domestic market volumes. Further, this may in turn result in a less diverse range of products offered to consumers on fixed term deals because suppliers may be reluctant to price any product above the cap. Longer duration products are most at risk from this approach as they may appear to be less competitive relative to a standard SVT despite providing better budgeting certainty for consumers.

## **Green Tariffs**

- We support Ofgem’s proposal for a derogation process for green tariffs, but this process must be clearly defined and more expedient than the current derogation process to allow for market innovation. It is important that the Ofgem’s assessment process recognises cases where there is a significant and proven increase in costs, in particular to green gas products supported by valid certificates such as the RGGGo. The derogation should allow for customers who have initially chosen a Green Tariff to be rolled onto a default fixed term green tariff at the end of their initial term so long as the subsequent tariff itself has been granted a derogation so as to minimize disruption to customers.

## **Detailed response**

### Definition of Default Contracts

We propose a revision to Ofgem’s license drafting in relation to the definition of “28AD Default Fixed Term Contract” so that certain customers are not inadvertently affected. More information is contained in the accompanying appendix.

### Wholesale costs and predictability

Under a price cap environment is expected that energy suppliers will try to mitigate the risk of losses arising from higher costs from those calculated in the price cap methodology. The largest controllable cost component is the wholesale cost and to mitigate risk it is likely that suppliers will try to adopt a hedging strategy that mimics the wholesale reference price method used for the cap. This is a naturally conservative behavioural response at individual level but when followed at scale may have unintended consequences in not just the wholesale energy market but also consumer prices.

The tendency for companies to hedge to the wholesale reference price used to derive the index could initiate similar purchasing behaviours where companies are incentivised to follow the same tactic to achieve the same outcome. The diversity of different company hedging strategies would be lost. Additionally, because the scale of the volume associated with the current SVT and default contracts is so high (~60% of domestic demand) this could cause higher than expected market prices as companies buy in bulk.

This potential inefficiency in the wholesale market price is likely to follow-on into the prices that suppliers offer to consumers. Effectively the price cap methodology sets the price for all and the prices offered to consumers converge to the cap. Such price convergence has already been demonstrated to a lesser extent with the PPM cap. In relation to forecast error and imbalance allowances it is worth noting that these costs will be higher for new entrants who are growing than those who are either losing customers or in a steady state. It is more difficult for a growing supplier to be able to predict with any certainty how quickly they will gain customers, simply because of unknown competitive pressures in the market from rivals. It is easier for a larger supplier to predict how many customers it will lose, based on historic switching rates etc. because they do not need to know the recipient. For smaller growing suppliers it is much more difficult to predict gains because on average it has a slim chance (one in sixty based on current number of suppliers) of being the recipient.

## Green Tariffs

We support having a derogation framework whereby a truly green product can operate outside of the cap. The market for such products is niche and this is an area where consumers actively choose green products according to their personal values, these values are likely to be long held and it is not an obvious area where price protection is required. However, green products may inadvertently be captured by the default tariff definition where a supplier has rolled a consumer onto a further fixed term green tariff at the end of their initial contract period. This is because the green tariff is a similar product to the original one and in line with the customer's preference. The derogation should allow for customers who have initially chosen a Green Tariff to be rolled onto a default fixed term green tariff at the end of their initial term so long as the subsequent tariff itself has been granted a derogation.

The scoring criteria for the derogation process should be clear and robust and disallow simple renewable electricity products, which are supported by existing policy frameworks CfD, FiT etc. and only allow products to be derogated which offer true additionality such as investment in environmental schemes outside of those areas financed by existing policy. Green gas products are a good example of this. The production of green gas is low currently and properly certified green gas certificates (such as the Renewable Gas Guarantee of Origin RGGGo) attract a significant cost premium due to scarcity and other external influences. This is one specific area that Ofgem should address in their derogation framework.

The derogation process itself should be expedient and much quicker to gain approval than the existing licence derogation timeline, otherwise offers to consumers could be delayed, the statutory consultation does not clarify this point.

## Payment Method Differential

The current Ofgem model appears to apply the paperless discount on a percentage basis to the headline price rather to follow market practice which is to offer a standard discount amount to all customers. We would prefer the application of a standard discount amount as this better reflects reality and is less complex than the current method.

**End of response.**

**Enclosed: Appendix 1 – Proposal to amend draft licence condition 28AD.**

## Contact Details

I trust you will find this response helpful and if you have any questions please get in touch via email [phil.broom@engie.com](mailto:phil.broom@engie.com) or call me on 0113 306 2104 or 07733 322 460.

Yours Sincerely,

**Phil Broom**  
**Head of Regulation**  
**ENGIE Homes and Enterprise**