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28th September 2018

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Dear Anna,

Thank you for providing the opportunity to comment on the proposals Draft Licence Conditions for Default Tariff Cap. We have reviewed the provided technical materials and make the following recommendations and observations:

1) Wholesale

We note that Ofgem will no longer apply a transition period - the initial price cap will be based on the overall W-19/S-20 weighted average price, indexed between February-18 to end July-18.

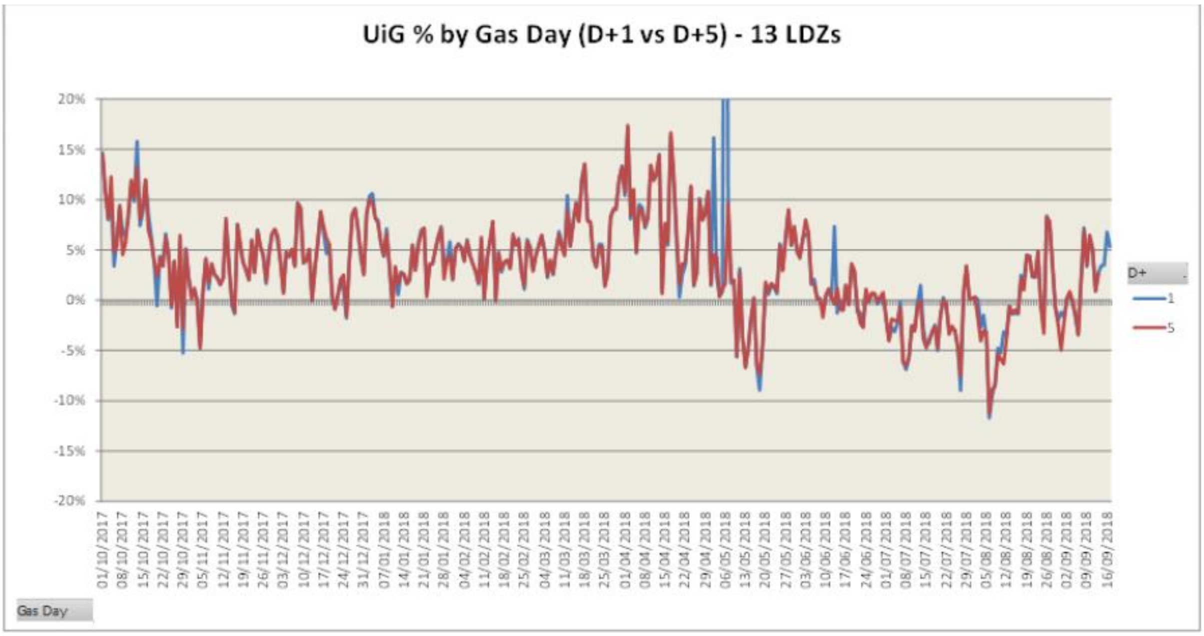
Whilst there is a concern about overpricing for big 6 SVT customers - due to longer term hedging strategies - this should be balanced against the impact on other market participants. There is a consideration expressed that the risk for smaller suppliers is not material, based on the assumption that they have limited exposure to SVT customers. However, Ofgem's SVT trends figures (published December 2017) [https://www.ofgem.gov.uk/publications-and-updates/standard-variable-tariffs-latest-trends-september-2017](https://www.ofgem.gov.uk/publications-and-updates/standard-variable-tariffs-latest-trends-september-2017) show that the average of a medium supplier is around 37% (in comparison to the big 6 at 61%), which is significant.

The publication of the minded to statement will have informed the hedging strategy pursued by smaller suppliers seeking to minimise risk. This policy will therefore be based on the transition period for the price cap period. The act of shifting the reference period to even earlier in the year will have a direct negative effect solely on these suppliers and therefore setting the cap this way will directly impact competition in the market as those affected seek to recover their costs. As such we suggest returning to the interim methodology, which would then revert at the next cap period as per the minded to statement.

Example: Supplier with 100k customers, 37% of which are on SVT, therefore 37k variable customers covered by the cap. The cost differential between minded to and current proposal (£30 annualised, £7 for cap period (assumed 3 months, Jan-Mar)) gives an annualised impact of £1.11m from this single cap period, or a cost of £259k for the quarter. Given the reasonable margin quoted by Ofgem of 1.9% (or £20 annualised for the proposed cap of £1136), that would be an implicit annualised loss of £370k for such a supplier, which they would either have to absorb, or recover through their future fixed price books.

2) Unidentified Gas

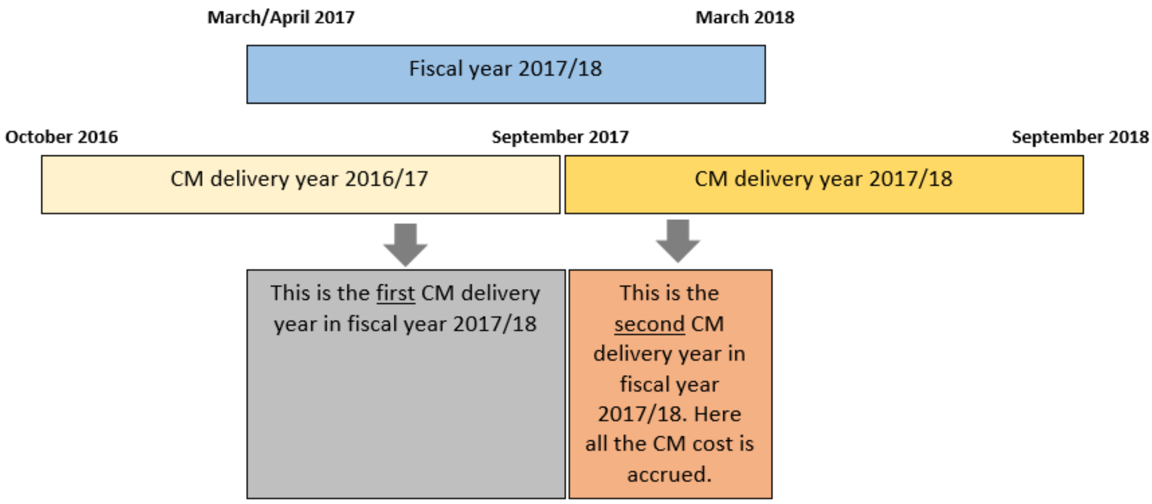
UIG will be set to 1% for the entire cap under the current methodology. Current reporting from Xoserve still shows considerable volatility for UIG, with an annual average well above 1%. To maintain consistency and reflect the ongoing work to bring this volatility down, we suggest taking a rolling average of the preceding year to set the UIG charge for each cap period. This will control for seasonality of charge (as per other methods in the cap) but also more accurately reflect the UIG position.




Source: Xoserve Weekly UIG Resolution progress reporting, [https://www.xoserve.com/wp-content/uploads/UIG-Resolution-Weekly-Industry-Update-v43-21.09.18.pdf](https://www.xoserve.com/wp-content/uploads/UIG-Resolution-Weekly-Industry-Update-v43-21.09.18.pdf)

3) Capacity Market

Ofgem propose to reflect the Capacity Market cost in a Financial Year basis, April to March, rather than in a Capacity Market delivery year, October to September. The effect of this methodology is that it rolls forward in time part of the Capacity Market cost as shown in the below figure.




Therefore, in the example presented for Financial Year 2017-18 part of the cost comes from Capacity Market Delivery Year 2016-17, when the Capacity Market costs were very low, resulting in lower p/kWh charges for this financial year, as shown in the figure below. Whilst this may benefit customers in the short term as the presented costs are cheaper, it will have the opposite effect for later delivery years as they will be more expensive.

The table below reflects the costs over time showed by both methodologies. Note that both methodologies do not recover the same costs in the same time frame. Whilst the Capacity Market Delivery Year aligns the costs and the volume that accrued to it at the same time, the Financial Year methodology pushes part of the cost into the next year (which means part of the 2021-22 costs will be recovered in 2022-23, a year not covered by Capacity Market currently). In addition, the Capacity Market Delivery Year methodology makes more sense in a cash flow point of view by claiming the cost at the same time as payment of obligations. The Financial Year view when pushing forward the cost also pushes back the collection of the cost. This has the added effect that changes in portfolio mean that the obligated cost for a specified Capacity Market year will be collected through the Financial Year method across customers who were not liable for the charge.

| Capacity Market Forecasted cost (p/kWh) | 2016-17 | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 |
|---|---|---|---|---|---|---|---|
| Capacity Market Delivery Year | 0.20 | 3.14 | 8.86 | 8.45 | 11.12 | 4.42 | 0.00 |
| Financial Year (Ofgem) | 0.11 | 1.81 | 6.33 | 8.63 | 9.92 | 7.43 | 2.12 |

This does not align with other methodologies proposed for the price cap, e.g. wholesale prices, as they are all forward looking (where this is possible). To follow established precedent and provide a more accurate costing level, we would recommend moving to a Capacity Market Delivery methodology.

4) Future Policy Changes

We note that there are no provisions made for future large scale changes to industry through regulation, whilst the SMART rollout is being specifically covered by a changeable element. We would expect additional cost elements to be built into this methodology in a similar manner where any new obligation is placed on industry and for this to be explicitly stated within the methodology.

Yours sincerely,

James Evans

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