

Anna Rossington
Deputy Director
Retail Price Regulation team
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

Vattenfall Wind Power Ltd.,
1ST Floor
Tudor Street
London
EC4Y 0AH

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By email: retailpriceregulation@ofgem.gov.uk

Vattenfall response to Default Tariff Cap consultation

Dear Anna,

Vattenfall welcomes the opportunity to respond to Ofgem's consultation on the default tariff cap. Our iSupply Energy retail business now has around 200,000 customer accounts and we have an ambition to grow in the UK. We have significant experience across Europe in bringing green and competitive tariffs, and innovative products to market, and we welcome the chance to compete in the UK.

We do not believe that a price cap on variable tariffs is the best way to support a competitive market in the UK which we think will best deliver high customer service, innovation, and the lowest possible prices for all consumers. However we welcome the opportunity to engage with Ofgem including through this consultation as the cap is designed.

Setting the Cap

Vattenfall is generally supportive of the methodology proposed in the consultation to set the cap and in particular welcomes the proposal to set the cap using a "bottom up" cost assessment. We think this will provide maximum flexibility and minimal risk to efficient suppliers.

We also welcome the proposal to set a higher cap for SVT customers paying by standard credit than for direct debit customers, reflecting the different costs to serve. We would welcome clarity on whether the differing costs of payment plans versus arrears payments will also be reflected.

Though we generally agree with the calculation methodology, there are a number of significant risks that suppliers will be exposed to once the cap is set. The most substantial risk is the uncertainty of volume (i.e. customer numbers) on the default cap.

The cap is calculated by looking at the average forward price for a period of 6 months before the cap is implemented. The averaging over a period smooths out the erratic nature of movement on wholesale prices and the view that companies can hedge their energy purchases on this basis is only applicable for companies who have a relatively static portfolio of customers and can replicate the market price movements in their hedging strategy.

This presents significant challenges to suppliers who are growing their customer numbers in this segment as they cannot be certain how many customers they will acquire in the coming months (it is driven by how competitive others choose to be) and therefore cannot be certain how much energy to hedge or at what price to hedge at to maintain economic feasibility. In addition, the ability to hedge for smaller suppliers can be more difficult, depending on their market access to both suitable products and credit.

The latest price cap, in some regions, means if suppliers have not hedged that they could be selling to customers at a loss – this cannot be the intention of a cap. In addition, we remain exposed to variations in cost that come through other aspects of wholesale risk, such as shape and swing, and areas where we can not necessarily fully pass through costs including network charges, Obligations and policy costs.

We believe a solution would be for Ofgem to look backwards at the outturn values that fed into the cap during each six-month review, and reflect any differential against what was originally envisaged in the subsequent cap.

Extending the Cap

We would welcome further clarification on the criteria under which the cap would be extended beyond August 2020, and in particular, which market indicators will be used to provide a wide, evidence-based and transparent view of the market.

Scope of the Cap

We support the proposal that default Fixed Tariffs (FT) should also be subject to the cap, so that customers coming to the end of a FPP who are auto-rolled onto a 1-year Fixed Tariff are below the cap. We welcome the recognition in the consultation of the asymmetric risk for suppliers who can't raise this FT if the cap increases, but must subsequently reduce the FT if the cap decreases.

We note Ofgem's suggestion that suppliers can manage this risk by linking the price of a default fixed tariff to the price cap. However, we believe that forcing suppliers to always keep the default FT below the cap introduces risk for suppliers and that it will encourage suppliers to default customers to the SVT cap instead. We believe this will limit the ambition of suppliers to reduce the number of customers on the SVT, encouraging inertia.

Renewable tariff derogation

We welcome the proposal that suppliers will be able to apply for a derogation from the cap for tariffs that provide additional support for renewable energy. However, we believe Ofgem should ensure that any such tariffs accurately reflect additional costs and do not reward inefficiencies in the management of renewable supply.

Best regards,

Lisa Poole
Director of Public and Regulatory Affairs UK
Vattenfall