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Sent by email to: retailpriceregulation@ofgem.gov.uk

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Dear Anna,

SSE response to Ofgem Default Tariff Cap Statutory Consultation

We welcome the publication of the Statutory Consultation and the opportunity to provide input for Ofgem's consideration on this important topic.

SSE fully recognises the challenging task at hand to deliver the objective set out in the Act, protecting current and future consumers who pay by SVTs or default tariffs, whilst having regard to the four matters within the Act, as well as the imperative for Ofgem to introduce the cap as soon as practicable. We appreciate the substantial and complex task that Ofgem has undertaken up to this point and welcome the consideration shown for stakeholder views.

SSE has previously explained why we regard price caps as damaging to effective competition and therefore to the interests of current and future customers; however, we have sought to be constructive throughout the process in order to support Ofgem in delivering the least disruptive outcome for consumers and the market.

Having considered the range of alternative approaches that Ofgem tabled, we are supportive of several conclusions that Ofgem has reached, in particular that:

- Ofgem has adopted a bottom-up approach to setting the default tariff cap. We believe this minimises risk and maximises accuracy.

- Ofgem has relied where possible on the most recent data. This will help to ensure the cap can be set accurately.
- Ofgem has isolated Smart costs and will undertake a refreshed evaluation of smart rollout costs during 2019.
- Ofgem has recognised the importance of achieving a broadly cost reflective differential between payment methods.
- Ofgem has acknowledged the fact that the cap will reduce switching in the market; and that this effect will have to be considered in the round when determining cap removal criteria.
- Ofgem has introduced a mechanism to enable cost methodologies to be reviewed and amended if errors or external factors render the cap un-reflective of an efficient supplier's costs. This will help Ofgem to ensure the cap tracks costs accurately and that upcoming policy costs are accounted for going forward.

Our aim now is to provide constructive feedback in support of Ofgem's process to ensure that the cap when implemented can deliver for consumers while minimising the longer-term adverse consequences for consumers and competition in the energy supply market. This response does not repeat the arguments of our policy consultation response (although they still stand) but is focused on those topics that we believe Ofgem should urgently address, ahead of implementation, in order to remedy avoidable adverse implications for consumers and to avoid the price cap producing disadvantages that are disproportionate to the aim.

In Annex 1 we set out our concerns – and where appropriate, propose solutions – in relation to design, process and implementation, and wider market issues. We stress that each of the design issues could have a significant impact on the overall accuracy and proportionality of the cap and erode any headroom provided within the cap design. Therefore, these issues should not be dismissed as matters of detail "in the round" but treated as errors that need to be corrected for from the outset.

Summary of SSE response

Design Issues

- The cost of unidentified gas is significantly understated and must be increased to reflect the costs suppliers are exposed to.
- There is no appropriate justification for the change in observation period. We believe Ofgem should revert to its original proposal of an April – September window.
- Insufficient allowance for risk and uncertainty has been included and we believe an additional allowance of 0.65% should be included as a network cost risk to cover BSUoS uncertainty and gas transportation risk.
- The proposed level of headroom has insufficient capacity to absorb any meaningful upward flex in uncontrollable costs or volume variances, and must be increased,

particularly given the experience of the PPM cap and the low levels of EBIT proposed by Ofgem

- Inaccuracies and flawed assumptions in respect of policy costs need correction – ECO and the smart meter rollout represent a substantial part of consumers' bills and suppliers' costs must be accurately accounted for.
- An allowance for GSP Group Correction Factor has not been provided for in the cap and we believe this must be corrected.

Process and Implementation Issues

- Compressed timelines for consultation and minimum notice periods for implementation introduce risk by limiting suppliers' ability to engage constructively and put in place robust programmes for implementation. SSE has already raised its specific implementation issues directly with Ofgem. In particular, the fact that new requirements are only now being consulted upon (such as splitting payment method differentials between Standing Charges and Unit Rates) has major implications for SSE.
- Ofgem must view credible requests for time-limited alternative compliance routes pragmatically where additional time is required to modify core IT systems to achieve full compliance.
- The proposals to align the safeguard tariff to the level of DD discount customers (irrespective of payment type) has operational consequences and will represent a source of confusion for vulnerable customers.
- Errors in Ofgem's publications must be corrected.
- The regulatory reporting regime for the Default Tariff Cap must be clear and manageable.

Wider Market Issues

- The issues with the PPM cap methodology must now be addressed.

We have also provided – in Appendix A (confidential) – the report commissioned by our economic advisors (Charles River Associates), who have reviewed and reported on the information provided by Ofgem in the Disclosure Room, in respect of smart metering costs. This report should be considered as part of SSE's consultation response.

We would welcome the opportunity to discuss our response in more detail or to provide supporting material to Ofgem, if helpful.

Yours sincerely

Patricia Hall
Regulation Manager

Annex 1: SSE response to Statutory Consultation – Default Tariff Cap

Design issues

1 The cost of unidentified gas is significantly understated and must be increased to reflect the costs suppliers are exposed to.

SSE welcomes Ofgem's decision to have an explicit cost allocation for Unidentified Gas (UIG), however we believe that Ofgem has grossly underestimated the allocation for UIG (at 0.96%) based on the unsubstantiated assumption that the benefit of industry improvements will be realised much sooner than SSE expects they will be achieved. We would also add that, independent of the UIG taskforce, a number of UIG modifications are being developed by a UNC UIG Workgroup to help improve UIG, but these will not be implemented until October 2019 at the earliest, and so any benefit that results from this work (in terms of lower or less volatile UIG levels) could not possibly be realised until this time.

We note Ofgem's assertion that suppliers have the ability to control their exposure to UIG costs. For example, at para 3.31 of Appendix 4 (Wholesale Costs) Ofgem explain that suppliers have the ability to control their exposure to UIG costs both in the short and long term, e.g. through the submission of more regular meter reads. At para 3.42 Ofgem states that it does not agree with those suppliers claiming that gas losses are uncontrollable and that there are actions suppliers could take – for example to tackle theft (one of the largest causes of UIG) which would reduce the level of these costs. Finally, Ofgem note that at an individual level, an efficient supplier could (through their shipper) utilize the new gas settlement arrangements to control their exposure to UIG costs through the submission of more regular meter reads into the central gas systems. SSE does not dispute these claims, but we remain firmly of the view that despite the efforts taken by suppliers (as listed above) to minimise the costs of UIG, the impact of UIG volatility remains higher than Ofgem's assessment.

In line with our policy consultation response, our view is that 4% should be included as a cost allowance, and a further 2% provided to cover risk. This proposal is supported by our assessment of UIG between June 2017 and March 2018, during which time an average UIG level of 6% was observed.

Ofgem's proposal would represent a material understatement of expected costs and risks, and so would seriously undermine Ofgem's efforts to meet its objectives and duties under the Act, to the long-term detriment of customers. We would encourage Ofgem to urgently engage with Xoserve, who are well placed to provide a specialist view on the appropriate level of allocation. We understand Xoserve have established an advanced analytics team looking at UIG and Non-Daily Metered demand algorithms.

The work this analytics team are conducting is due to be completed at the end of the year, anticipated outcomes are that initial improvements will relate to UIG volatility (rather than the level of underlying gas). It is important to accept that even if the underlying causes of volatility can be resolved, the average volume of UIG is unlikely to drop below current levels in the near term.

SSE believes that the only appropriate approach would be for Ofgem to increase the allowance for UIG until such time that there is clear data available to Ofgem that provides empirical evidence of the benefits resulting from system improvements; this would mirror the approach already proposed for smart metering costs where Ofgem has scheduled a review in 2019 and would remove Ofgem's concern about building in a permanent increase to the cap.

We note that the headroom scenario selected by Ofgem provides limited protection against any errors in the UIG allowance calculation; and even if a more prudent level of headroom were incorporated in the cap design, setting the UIG allowance at a low and unsubstantiated level reduces the availability of headroom to absorb risks and uncertainties arising from other aspects of the benchmark design, in accordance with the intention of the cap design. We believe Ofgem must increase the allowances for UIG before the cap goes live.

2 There is no appropriate justification for the change in observation period. We believe Ofgem should revert to its original proposal of an April – September window.

Ofgem set out at policy consultation stage its intention to apply an observation period running from April to September 2018 in order to determine the level of the initial cap; however, this has been changed at the point of Statutory Consultation to February to July 2018 without justification. We believe that this is unreasonable and that this change should be reversed.

We acknowledge the challenge Ofgem has faced in designing and implementing a price cap as soon as practicable and indeed the political appetite to deliver the cap by the end of the year. However, we also believe that given the compressed timeframes, and the lack of regulatory certainty on which to base energy procurement decisions, it was reasonable for suppliers to turn to the consultation proposals to inform their hedging approach. We believe that by proposing only *one* possible observation period – rather than a range of options – Ofgem failed to make it clear that a range of options were under consideration. As such Ofgem limited the ability of suppliers to optimise their hedging approach and prevent unnecessary losses.

Had Ofgem presented a range of observation window options then SSE would have been able to provide feedback on those proposals, and it would have been clear that a range of possible outcomes existed. We believe that for Ofgem to consult on one proposal and then change the observation window to something that was not originally proposed or consulted upon not only conflicts with Ofgem's consultation policy on being open and transparent but has severe consequences to market operators that could have been avoided.

In this context, we note that the Impact Assessment makes clear Ofgem's expectation that suppliers would adopt the hedging profile of the cap and it follows from this that suppliers might reasonably also seek to align their hedging profiles with that proposed in May for the initial cap period. Ofgem should have taken this into account when considering whether it was reasonable to depart from the position set out during the policy consultation in May.

As Ofgem will be aware 2019, wholesale prices increased substantially since the February to July window, meaning that out of date, artificially low wholesale prices will be locked in to the cap unless Ofgem reverts to its original proposal. We believe that Ofgem would be wrong to progress with its proposals as they stand and that the proposal to adopt the February to July observation period lacks justification. SSE believes that Ofgem should revert to its original proposal.

3 Insufficient allowance for risk and uncertainty has been included and we believe an additional allowance of 0.65% should be included as a network cost risk to cover BSUoS uncertainty and gas transportation risk.

We believe that Ofgem has incorrectly judged that retail suppliers are not exposed to network cost risks, and that it is essential Ofgem recognises – and makes allowances in the cap for – the inherent uncertainty in BSuoS charges. As per our policy consultation response, it is helpful to turn to an assessment of BSUoS prices during 2017/18 to illustrate the BSUoS risk faced by suppliers. We note that half-hourly BSUoS prices reached a high of c.£19.5/MWh versus an average of c.£2.5/MWh over the period. Our view is that an additional allowance of 0.65% should be included as a network cost risk to cover BSUoS uncertainty. This 0.65% would allow for an additional c.£0.5/MWh of cost and cover 75% of BSUoS prices observed during 2017/18.

In addition, given gas transportation costs are set based on customer AQ, there is a risk that Ofgem's calculation of costs based on TDCV demand will underestimate cost if TDCV demand is less than customer AQ. Our view is that an allowance of 5% should be added to network costs to cover this risk.

We note that Ofgem has not considered the impact of a changing wholesale price curve between the observation period used to calculate the wholesale component of the cap and

the time when actual supplier price shaping is likely to take place for each cap period. Although this could work for or against suppliers, it introduces an additional risk associated with hedging the price-capped product that needs to be costed.

We are also concerned by Ofgem's view that differences between actual and forecast policy costs will offset each other over the lifetime of the cap (page 30 Default Tariff Cap - Consultation Overview Document). We do not believe this to be a reasonable assumption (especially given the time limited nature of the cap, which may only be in operation for 2 years, and in the context of a market in which policy costs have been steadily increasing for a decade). SSE would expect Ofgem to keep this under strict review; if Ofgem (or suppliers) discover this assumption to be incorrect then Ofgem should use the mechanism described in 3.33 of the Consultation Overview Document to change the model used to update the policy costs, and thus ensure better cost-reflectivity of the cap.

4 The proposed level of headroom has insufficient capacity to absorb any meaningful upward flex in uncontrollable costs or volume variance, and must be increased, particularly given the experience of the PPM cap and the low levels of EBIT proposed by Ofgem

As we have set out previously, SSE strongly believes that headroom is a vital component of any price cap and must be sufficient to account for risk and uncertainty, as well as to enable competition. We note Ofgem's proposal for 1.45% of headroom and acknowledge (although disagree with) Ofgem's decision not to apply any headroom to facilitate competition. While SSE welcomes the inclusion of some level of headroom, we believe the proposed level is too low and introduces a high probability that even slight upward movements in uncontrollable supplier costs or volume variance would entirely erode the cap's ability to absorb those costs.

The issues that result from the inclusion of inadequate headroom are exacerbated by the understatement of UIG costs (noted in Section 1 above), and the exclusion from the model design of supplier exposure to BSuoS (explained in Section 3 above). These two issues if unaddressed would be highly likely to reduce effective headroom to a negative number.

If headroom is eroded, there would be no margins left for suppliers to operate within and not only would the cap be functioning in a way it was not designed to, it would not ensure that holders of supply licences who operate efficiently are able to finance activities authorised by the licence. Furthermore, it carries risk of diminishing incentives to switch as a result of reducing the ability of suppliers to compete. This would have adverse consequences for customers in terms of such reduced competition in the market both for the duration of the cap (as is clear from Ofgem's own Impact Assessment) and after the cap is lifted. The long-term risks are that customers may take time to re-engage with the market and that

market concentration may have increased as a result of suppliers exiting the market, as acknowledged, but not quantified, by the Impact Assessment.

Indeed, an effective case-study of this risk manifesting is provided when we examine the effect of the PPM cap, where a trend of price convergence and reduced switching is clear; and where the inaccurate treatment of costs and risks within the model have ✂. We are concerned that in setting the headroom so low, Ofgem has neither given sufficient weight to the need to enable competition and provide incentives to switch, nor to the need to ensure that efficient suppliers can finance their licensed activities. We refer Ofgem to our response to Working Paper 3 where we set out these points in detail.

Furthermore, Ofgem should consider the impact of volume variances in suppliers' profitability and headroom. Warmer than normal weather can significantly reduce the income suppliers receive, particularly from gas customers. A large proportion of costs are not affected by this change and therefore the impact on suppliers' profitability and ability to continue to operate can be considerable. Over time weather effects should balance out but the annual risk is considerable and should be accounted for in headroom.

We welcome Ofgem's provision in the SLCs to review and amend the cost methodologies in the event errors or events render the cap non-reflective of an efficient supplier. However, it is unlikely to be pragmatic or efficient for such a review to be triggered on a frequent basis in response to minor changes in uncontrollable costs or risks. By increasing headroom to a more suitable level Ofgem can ensure that the cap is able to absorb minor movements in uncontrollable costs. Ofgem had identified a range of £0 - £75, and has opted for 1.45% which is at the lower end of the scale; we believe this is inconsistent with the level of risk that will still exist in the cap. This is exacerbated by the compressed timescales allowed for consultation and therefore the model error risk that exists as a result of this. Accordingly, we believe that Ofgem should revisit (and increase) the level of headroom ahead of making any final decision.

In respect of Ofgem's approach to setting EBIT, we believe that Ofgem's decision to adopt the CMA's conclusion is not adequately justified with evidence. SSE does not recognise an EBIT allocation of 1.9% as being appropriate, especially given the low level of headroom proposed. All of this together gives rise to the risk that even an efficient supplier will be unable to make sustainable profits. Thus, SSE believes that it is vital for Ofgem to monitor the actual EBIT levels achieved by the most efficient of the suppliers that feature in their benchmarking sample and stand ready to adjust the EBIT allocation if it is clear that 1.9% is not able to be realised in practice. If such low levels of EBIT are provided for in the cap, this further emphasises the need for Ofgem to increase the headroom allowance to a level that enables efficient supplies to account for risk and uncertainty, and in doing so, retain the opportunity to make sustainable profits.

The Impact Assessment (IA) explicitly sets out that "*The results of our analysis suggest that at our proposed cap level, there will be some suppliers who despite improving efficiency to the same level as the most efficient large supplier operating within the market, would still make negative or subnormal profit. In order for these suppliers to achieve normal profit under the default tariff cap they would need to increase the price of their fixed tariffs. If competitive constraints within the market do not allow for these suppliers to increase prices of fixed tariffs without losing customers, then it is likely that these suppliers seek to cut controllable costs. This may have an impact on customer service levels or innovation. Alternatively, this could lead to an increased likelihood of these suppliers exiting the market*".

It is deeply concerning that Ofgem appears to have accepted that efficient suppliers might be driven to leave the market as a result of this regulatory intervention, which is entirely at odds with the need to ensure that an efficient operator is able to finance its activities. This implies that the headroom allowance (and therefore the level of the cap) has been set at a level which is inappropriately low and is disproportionate to the aim of the intervention.

5 Inaccuracies and flawed assumptions in respect of policy costs need correction –the smart meter rollout and ECO represent a substantial part of consumers' bills and suppliers' costs must be accurately accounted for.

5.1 Methodology to account for smart metering costs

SSE commissioned economic advisors to access Ofgem's Disclosure Room to scrutinise the smart cost model and the data underpinning it. We have attached their report from that exercise (please refer to Appendix A), which documents inaccuracies that we consider will affect the outcome of the model. There are also a series of assumptions that we believe do not accurately reflect reality; the impact of which will be an understatement of the net change in the smart cost elements of the cap.

If not addressed these errors will give rise to a risk that efficient suppliers become unable to finance their licenced activities. We believe Ofgem must correct the errors in the model before go-live, and that these issues should further be considered and corrected for as part of the review taking place in September 2019, which SSE would expect suppliers to be invited to contribute towards.

We note that the smart cost model does not provide any allowance for Smart Marketing Costs. This is in line with the position that Ofgem explains in the Statutory Consultation (Appendix 7, 3.74 - 3.79), where Ofgem sets out that SEGB – which is allowed for on a pass through basis – will play an increasing role in engaging customers, and that overall marketing costs (including any investment in generating demand for smart meters) would

have remained broadly similar to those marketing costs that would otherwise have been budgeted for.

We note that in addition to the escalating SEGB costs, and to evidence that 'all reasonable steps' have been taken to complete the rollout, SSE has had to undertake its own marketing activity✂. This is a substantial cost and demonstrates the importance of allowing for (non-SEGB) smart marketing costs in the smart cost model component of the Default Tariff Cap.

Furthermore, we note that the IA explores issues relating to customer switching and engagement, and notes that in the central case assumptions switching is likely to reduce by 35%. SSE believes that this will inevitably feed through to lower customer engagement, which is particularly problematic when considered in concert with the challenge of engaging customers with the Smart Meter rollout. These assumptions relating to smart marketing costs and customer engagement are not in our view compatible and will inevitably lead to a deterioration in momentum around the smart meter rollout challenge.

We strongly believe that Ofgem must reconsider building into the smart costs model an allowance for smart marketing costs.

5.2 Methodology to account for ECO costs

In respect of ECO, we are concerned that the use of gross supply volumes instead of obligated supply volumes in the calculation is not sustainable throughout the possible duration of the cap. Reviewing small supplier growth over the last 5 years, it is entirely plausible that a large number of small suppliers could grow at a rate to enable them to be marginally over the 150,000 account threshold for ECO in 2021. This means that they will become narrowly obligated, but their entire gross supply volume is being counted in the £/MWh calculation. The cumulative effect of this results in the pool of exempted supply taking up an ever-increasing proportion of the gross supply used in the £/MWh calculation. This spreads the £/MWh too thinly for most obligated suppliers, effectively discriminating against those with larger obligations. We believe Ofgem should use obligated supply volumes in the calculation or find a way to update the methodology to ensure the calculation remains sustainable. Again, the lack of a meaningful headroom allowance makes it difficult to ascertain how larger suppliers can accommodate this structural approach which does not allow them to fully recover their costs.

Additionally, in relation to Ofgem's approach to changing the methodology during the price cap period, we note in paragraph 2.41 of Appendix 5 that Ofgem would update the ECO allowance if a revised impact assessment were published. ECO is a market mechanism with fluctuating market prices, which are reported to Ofgem. These cost changes do not result in changes to an impact assessment. A more regular update based on average market rates

would be more reflective of suppliers' actual costs (average rates being appropriate, given that third party delivery costs are not influenced by the operational efficiency of suppliers).

5.3 The cost of emerging new policies

We are supportive of Ofgem's proposal to introduce a mechanism to enable cost methodologies to be reviewed and amended if errors or external factors render the cap un-reflective of an efficient supplier's costs. We believe this mechanism is essential in ensuring accuracy within the methodology and to ensure that suppliers' policy costs which are not yet being incurred, are accounted for in the cap methodology going forward. As we explained in our response to the Policy Consultation and in our bilateral meeting (and follow up material) of 9 August 2018, there are numerous and substantial regulatory programmes that suppliers will be implementing in the coming months and years, the costs of which are significant.

One example we discussed at our bilateral was the Switching Programme. This is an enormous operational undertaking for industry and requires substantial financial contributions from suppliers. ✂. Given this is just SSE's costs, we can expect the industry figure to be of a much greater magnitude. Furthermore, these costs do not account for the DCC costs, which we expected to be made available later in 2019.

The costs of implementing the Switching Programme – and other upcoming regulatory obligations – need to be accounted for in the Default Tariff Cap going forward and we expect Ofgem to use this mechanism accordingly.

6 An allowance for GSP Group Correction Factor has not been provided for in the cap and we believe this must be corrected.

We also note that Ofgem has made no allowance for GSP Group Correction in the design of the cap. Based on an assessment of Group Correction Factors (GCFs) we believe the cap model should be updated to include allowances for both wholesale and network costs. In particular, a 0.5% allowance should be included against wholesale electricity costs, a 5% allowance against capacity market costs, a 4% allowance against TNUoS costs and a 0.3% allowance against BSUoS costs.

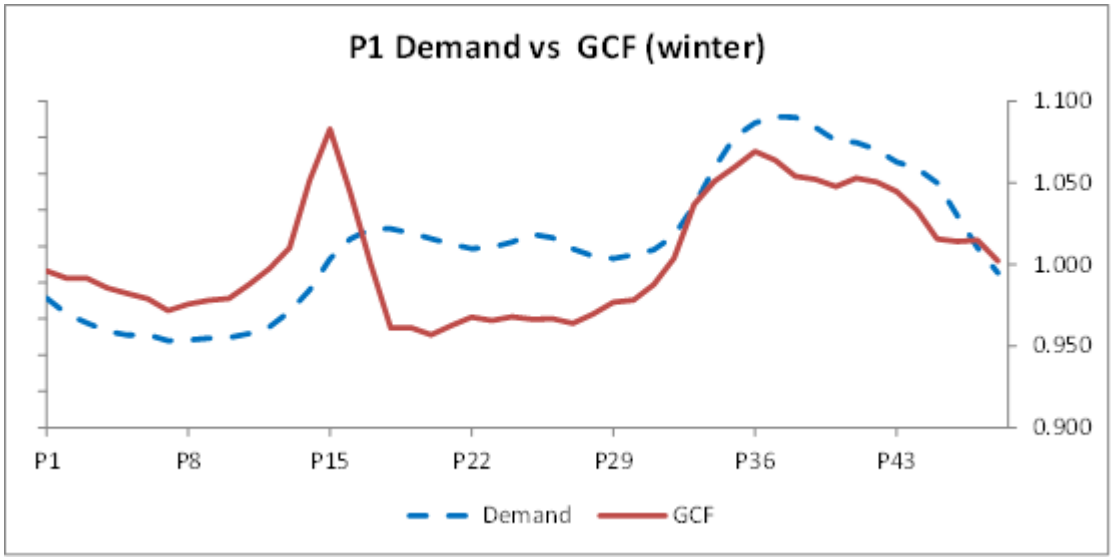
The table below shows demand weighted average GCFs across half hour periods in summer, winter and on an annual basis over 2017/18.

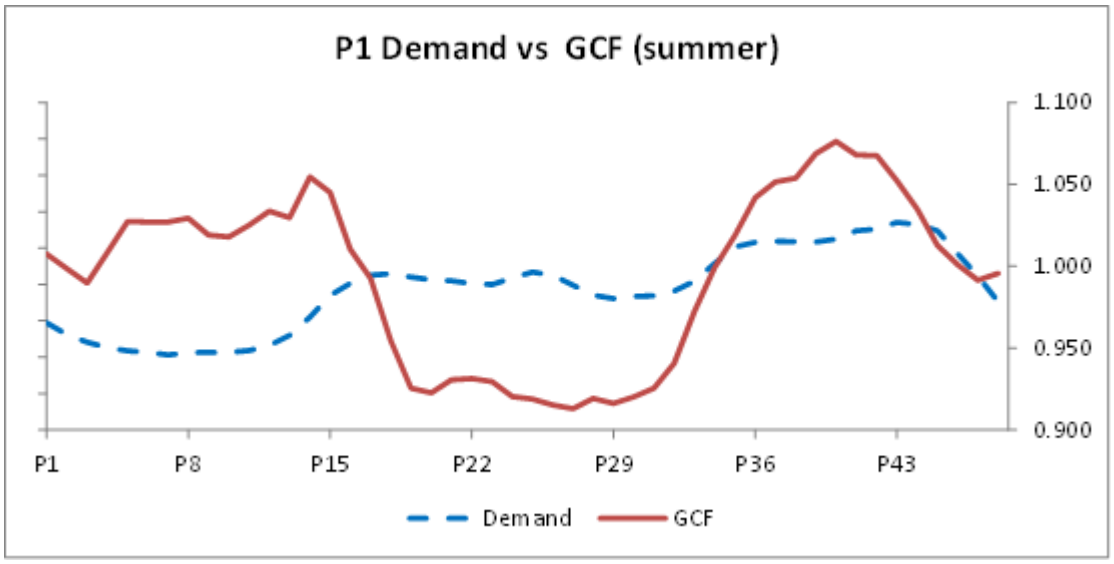
Volume Weighted GCF	All Day	4pm – 7pm
Summer	0.996	1.025
Winter	1.013	1.057

Annual	1.006	1.045

Group Correction is a cost to suppliers if GCF is greater than 1. The table highlights that GCF is high during the 4pm - 7pm demand period used to calculate capacity market and TNUoS costs. This supports the need for an allowance against these costs. More generally, GCF is greater than 1 across the year supporting the need for an allowance against wholesale electricity and BSUoS costs.

We do note that GCF can be a benefit to suppliers during the summer in part due to solar penetration. However, the positive correlation between GCF and demand during winter results in an increase in annual cost to suppliers. The charts below – which show summer and winter demand vs. GSF – support this assessment (GCF data sourced from Elexon).





Process and Implementation Issues

7 Compressed timelines for consultation and implementation

The Default Tariff Cap is a highly complex regulatory change which has substantial commercial and market implications (as identified by Ofgem's own Impact Assessment). As we set out in our response to the Policy Consultation, we believe that the immensely compressed timeframes for the working papers, the policy consultations – and now the Statutory Consultation – conflict with Ofgem's consultation policy and the Governments best practice guidance for consulting. Ofgem should be providing 12-weeks for stakeholders to respond to this Statutory Consultation to align with this policy. Through the compression of timelines Ofgem has created operational and financial risks; and by increasing the complexity of the intervention there is now a heightened risk of customer confusion.

7.1 Changes in the allocation of the Direct Debit discount will lead to customer confusion

We believe that proposals to implement Direct Debit discounts partially through a fixed reduction and partially through changes to unit rates will lead to customer confusion and complaints. In practice, we found that our decision to remove the DD discount following the introduction of the safeguard tariff led to increased dissatisfaction from customers even

where customers' usage projections indicated overall savings on their bills. We also note that Ofgem's proposed approach for the Default Tariff Cap would lead to the cap being set above current levels for our lowest consumption customers.

While we understand some of the abstract arguments being made in favour of the complex proposals for the application of Direct Debit discounts in this way, we think that they fail to acknowledge customer preferences and the real value customers place in knowing the full value of Direct Debit discounts. We firmly believe that changing the application of the DD discount has extensive consequences for customers and suppliers as it will impact multiple internal and external processes, including customer facing communications, and will fundamentally alter the way customers compare tariffs across the market. We believe that such a wide-reaching policy and operational change warrants extensive consultation with industry. It is therefore our strong view that – until such consultation occurs – Direct Debit discounts should be applied only on a fixed basis (and therefore through the standing charge only).

7.2 There are many additional sources of customer confusion

As we explained in our bilateral of 9 August 2018, SSE is concerned not only with the rushed nature in which this cap is to be implemented and the impact this has on customer confusion, but also by the fact that in subsequent cap periods all price caps will be updated on the same date and that this could result in severe confusion and disruption to customers. The period between price notifications published by Ofgem and the implementation of each cap period leaves very little time to test and proof the substantial volume of PIN letters that will need to be sent out to our affected customer base. Working at such a pace and scale, the risk of errors, compounded by high call volumes, is significant. Without sufficient time to plan and prepare for these events, this could see a perfect storm of customers being affected by price increases, confused by communications, resulting high call volumes leading to high waiting times and abandon rates, and a backlog of complaints. Given SSE's long-standing commitment to providing excellent customer service this is of great concern to us.

The potential for customer confusion should not be understated, and a broad range of scenarios are likely to emerge. These include:

a) PPM SMETS1 customers being capped at one level, and PPM SMETS2 customer at another;
b) PPM WHD customers being capped at one level and SVT/Default WHD customers at another;
c) Customers rolling off Fixed Term Tariffs onto SVT seeing their Direct Debit Discount change in level and structure;
d) Default and SVT customers seeing their Direct Debit Discount change in level and structure;

e) Confusion during the switching process for WHD and PPM customers depending on their meter type;
f) Confusion during smart meter sign-up in the event that the customer has to change to a different tariff upon agreeing to take a smart meter.

These are all complex messages for suppliers to communicate to customers, especially against a backdrop of the need for positive engagement to support smart meter rollout, and the challenge of stimulating tariff or supplier switching in a market where price differentials are expected to reduce.

7.3 Creating three price changes for vulnerable customers in six months

The proposals to align the cap level of WHD Safeguard Tariff customers to the cap level of Default Tariff customers who pay by Direct Debit (irrespective of their payment type) has operational consequences. We believe that Ofgem should allow adequate time for the required changes to be made.

More importantly, we understand that the proposed cap changes at the end of December will be marginal for the vast majority of customers, given that they already benefit from the safeguard cap. We believe it is disproportionate to force an additional change affecting these customers, creating three complex pricing events for this vulnerable group within six months and increasing operational costs for suppliers. SSE believes that the licence conditions should be adjusted to require this change to be made in April 2019, when the current safeguard cap level expires. This would minimise the potential for customer confusion and enable suppliers to implement the change in a timely, responsible, and low-risk fashion.

7.4 The impact of compressed timeline for consultation on operational risks

We consider that inadequate time has been allowed between the point at which pricing inputs will be provided, and when implementation is expected to be required to be completed. This is especially true given that the first disclosure of the proposed level of the cap was at the Statutory Consultation stage, that new requirements are only now being consulted upon (such as splitting payment method differentials between Standing Charges and Unit Rates), and that crucial details are yet to be tabled or consulted upon. Ofgem has not for example provided any clarity on the required go-live date (which is clearly important for planning purposes) and has indicated that cap withdrawal criteria will not be considered until 2019.

Without the necessary clarity on the above points, any implementation project will carry significant risk of delay and error. We believe it is entirely unreasonable for Ofgem not to

provide early certainty on implementation (time needed, potential challenges, risk etc.) and then to compress the timeline so severely that unnecessary – and potentially unmanageable risk – is introduced. ✂ and our prioritisation of high customer service standards.

✂

7.5 The impact of compressed timeline for consultation on financial risks

We have uncovered inaccuracies in the supplementary models and annexes published by Ofgem (please refer to Annex 2 for details). Typically, during a consultation – or wider engagement programme – there would be adequate time for suppliers, their economic advisors, and Ofgem to engage in dialogue on the important details held within complex models. This allows time for the correction of errors and the dissemination of important clarifications to suppliers. With the uncomfortably compressed timelines within which we have been compelled to review and impact assess the content of the pricing models, there has not been adequate time to identify errors, engage Ofgem, seek corrections, and then reassess the corrected models and their impact on the business.

7.6 The compressed timeline for consultation and associated risks justifies a pragmatic approach to compliance through the early transition period

SSE acknowledges the challenge Ofgem has faced in designing and implementing a price cap as soon as practicable and indeed the political appetite to deliver the cap by the end of the year. However, it is clear that risks have been augmented as a result of compressed timescales, and that this may have created disadvantages for suppliers. Ultimately, a strong consultation process will provide better outcomes for the market and for consumers.

If Ofgem were to allow 12 weeks for consultation during this Statutory Consultation stage (which we believe would be in line with consultation policy) then it would imply a go live date of April 2019.

If Ofgem proceeds with plans to implement at the end of the year then Ofgem must urgently provide a corrected version of models, a log of model errors resolved, and clarity on delivery requirements. We respectfully request that sufficient time for implementation of cap period 1 and 2 be provided to suppliers and that Ofgem takes a pragmatic approach to any requests from suppliers who need to take alternative routes to compliance, where they have been disadvantaged by the delay in policy and project certainty.

With regard to customer confusion we believe that Ofgem should take steps to simplify the cap where possible to reduce areas of customer confusion, and that existing proposals relating to Direct Debit need to be adapted. We also believe that at this complex and

unprecedented juncture, Ofgem should adopt a pragmatic approach on compliance assessment that enables suppliers to safeguard the customer experience in a controlled, and responsible fashion, while remaining compliant with the cap.

8 Errors in Ofgem's publications

Through our examination and analysis of the models provided we have identified some likely errors and inconsistencies to which we would like to draw to Ofgem's attention. We trust that these will be corrected for the final document release and would welcome the opportunity to be made aware of any others that may be identified to Ofgem as the consultation progresses. These errors are listed in Annex 2.

9 Reporting regime must be clear and manageable

We note that there is a lack of clarity around the reporting regime and would welcome early visibility – and ideally discussion – around Ofgem plans or proposals for this. We would stress that our preference is for a fixed reporting regime that can be replicated by the same team, or IT code, each and every reporting period, as opposed to an ad-hoc RFI approach that is subject to change and therefore builds in inefficiencies to the process.

SSE prioritises the requirement to respond to RFIs with the utmost importance and very much welcomes the opportunity to review RFIs ahead of their publication. ✂. While we do not have sight of other suppliers' processes, we would expect a similar approach is taken and we believe that if Ofgem were to adopt an approach whereby they issued an RFI on a non-defined date and/or with content requests that varies from period to period, Ofgem would be building in avoidable, unnecessary and costly inefficiencies to the process.

Given the scale, frequency, and complexity of the Default Tariff Cap, we believe that a clear and manageable reporting regime must be developed, which is fixed in scope and frequency, and must be communicated to suppliers as quickly as possible so they can plan ahead.

Wider Market Issue

10 The issues with the PPM cap methodology must now be addressed

✂

SSE notes that the CMA will be conducting a review of the PPM price cap in January 2019 and that under the Enterprise Act the CMA has a duty to conduct a review of the function

and impacts of regulatory mechanisms introduced following a market enquiry. Given Ofgem has now completed a thorough review of the mechanisms underpinning a price cap, and given the substantial evidenced offered by suppliers that the PPM cap is not reflective of costs, we believe that the time is right for Ofgem to work with – or make a recommendation to – the CMA to conduct a thorough review and reworking of the methodology to avoid continued losses in the market and the potential for unintended consequences in the market, as required under section 162 of the Enterprise Act 2002. We consider that Ofgem has a duty to give information, advice and assistance to the CMA on the PPM cap in accordance with Section 47(3) of the Electricity Act and Section 34(4) of the Gas Act.

Annex 2: Errors in Ofgem's models that should be corrected ahead of go-live

As discussed in Annex 1, through our examination and analysis of the models provided we have identified some likely errors and inconsistencies to which we would like to draw to Ofgem's attention. We have set out these formula issues below and note that our analysts will be happy to walk through these with Ofgem in helpful.

Incorrect Reference for Gas Nil Consumption Sheets in supplementary_model_-_default_tariff_cap_level

The sheets impacted are the calculation sheets for Gas.

For the equivalent electricity spreadsheets, the *total* row checks if *operating costs – OC* contains a value, and if so – it totals up a nil consumption value (standing charge). For gas, however, the legacy totals check an erroneous cell for content, and for SVT cap 1 – it checks if *wholesale cost - DF* has a value instead of operating costs, which it does not at nil consumption, producing a nil value for the capped standing charge.

Referring to cells G25 to N25
Cell N25 in *Gas_nonSC_Nil* and *Gas_SC_Nil* has the following formula:

=IF(N2="-","-",SUM(N15:N24))

which should be

=IF(N19="-","-",SUM(N15:N24))

Referring to cells P25 to Z25
Cell P25 in the same sheets has the following formula:

=IF(P15="-","-",SUM(P15:P24))

which should be

=IF(P19="-","-",SUM(P15:P24))

These errors are repeated as the formulae are copied down through the regional variations. It should be noted that similar formulae errors are seen within the tabs Gas_SC_12000kWh and Gas_nonSC_12000kWh

Labels

Sheet *Gas_nonSC_12000kWh* rows 165:168:

8	Operating costs	PAP
9	Operating costs	E
10	EBIT	H
11	Total	Total_Northern Scotland

should read

8	Operating costs	PAP
9	EBIT	E
10	Headroom	H
11	Total	Total_Northern Scotland

Incorrect referencing for UIG in annex_2_-_wholesale_cost_allowance_methodology

There are two formulae which we have identified as creating errors within the document.

Firstly

Sheet: 1a Direct Fuel Cost Component.

Cell H26
Error : Where the formula reads =IF(H18="-","-",H18*(1+SUM('3a Allowances'!$B$20:$B$24))*(1+'3a Allowances'!$B$25)) it should read =IF(H18="-","-",H18*(1+SUM('3a Allowances'!$B$20:$B$24)))
As originally written it is including the UIG component within this element of the calculation and so not reflecting the methodology laid out in Appendix 4, Page 22, Section 3.2
This should be corrected in conjunction with the error below

Sheet: 1a Direct Fuel Cost Component
Cell: H56
Error: Where the formula reads =IF(H$26="-","-",H26*(1+'3a Allowances'!B25)) it needs to read =IF(H$26="-","-",H26*(1+'3a Allowances'!$B$25)), otherwise UIG allowance is not included beyond first period (Feb 15)
The reference sheet '3a Allowances' has a single column of assumed uplifts which we understand to be used for all periods, rather than just the initial period and so the formula should be fixed to reference the relevant values in line with the methodology laid out in Appendix 4, Page 22, Section 3.3

Methodology for calculating the ECO cost allowance

In respect of the cost assigned to ECO, SSE would like clarification that the calculation used in rows 20 & 21 in Annex 4, tab '3e ECO', only takes into account the costs and gross supply volumes of *fully* obligated suppliers. This means that until March 2019 the costs and supply volumes for suppliers on the ECO taper are excluded from the calculation, and the £320m cost is adjusted for that accordingly. However, from April 2019 all suppliers with an obligation will be considered to be fully obligated. This means that from April 2019 the only adjustment made to the £320m figure will be to allow for inflation. The formulas in rows 20 & 21 appear to be incorrect (as they not been updated to remove the adjustment to the scheme cost). We would appreciate clarification of the position.