

All stakeholders

Email: RetailPriceRegulation@ofgem.gov.uk

Date: 20 July 2021

Dear Stakeholders,

Industry change related to gas End User Categories and implications for the Prepayment Meter level of the default tariff cap.

We were recently informed by Citizens Advice that the introduction of new End User Categories (EUCs) in the Peak Load Factors (PLFs) may have implications for the Network Cost Allowance in the default tariff cap ('cap') for Prepayment Meter (PPM) customers. Through this we also became aware of a similar impact on the Annual Load Profiles (ALPs) which has implications for the Wholesale Cost Allowance for PPM customers.

We are notifying industry of our intention to consult in the autumn on whether to implement changes related to the new EUCs in the cap methodology for cap period 8 onwards (ie from 1 April 2022).¹

We had insufficient time to consult, reflect the outcome of the consultation, and issue a decision ahead of cap period 7 given the proximity to the forthcoming cap level change (which will be announced on 6 August 2021, coming into effect on 1 October 2021). Given the potential materiality of the impacts, we believe it is in the interest of consumers to consider as part of the autumn consultation whether it is appropriate to review costs associated with the new EUCs with respect to cap period 7 (ie 1 October 2021 – 31 March 2022). We will also consider whether it is appropriate to take into account any over / undercharge in setting future price cap levels.

Background and context

The Competition and Markets Authority (CMA) designed and introduced a price cap for Prepayment Meter (PPM) customers in April 2017 as part of the package of remedies resulting from the energy market investigation.² This price cap is referred to in this document as the 'CMA Prepayment Meter Price Cap'.

¹ For the purposes of this document, we refer to a relevant Charge Restriction Period as 'cap period'

² <https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

In August 2020, Ofgem announced that the default tariff cap would continue to protect default prepayment meter customers after 31 December 2020, the date the CMA Prepayment Meter Price Cap expired.³ This currently covers around 4 million customers.

Under the default tariff cap methodology, we combined information on supplier's costs with assumptions about demand and losses to estimate the costs to a supplier for each customer type for a given period. For gas wholesale costs and gas network charging, the methodologies historically used specific inputs reflecting gas ALPs and PLFs as published by Xoserve,⁴ for each region:

- to estimate the quarterly share of gas demand in the Wholesale Allowance methodology, ALPs are weighted by region. These are then summed in each quarter and inputted as quarterly gas demand shares in the Wholesale Allowance methodology.
- to estimate total capacity charges in the Network Cost Allowance methodology, we combine our assumed level of annual domestic consumption with the regional PLFs to produce an estimate of peak daily load. This is then multiplied by capacity charges as published in the network companies' charging statements.

How the introduction of new EUCs affects the price cap methodology

Before the new EUCs were introduced, Xoserve published ALPs and PLFs (by region) that applied to all domestic gas customers, regardless of their payment method. For that reason, when the Wholesale and Network Cost Allowance methodologies were designed - they did not include the capability to include separate gas demand shares and load factors for customers paying by different payment methods.

The industry led modification XRN 4665 was introduced in August 2019,⁵ resulting in changes to how industry report and account for gas ALPs and PLFs for different categories of consumers. In particular, for domestic consumers, this modification introduced separate ALPs and PLFs for gas PPM customers as a unique EUC, which more accurately reflects the consumption behaviours of gas PPM customers.

The most recent gas demand shares are set out in '*Annex 2 - Wholesale Cost Allowance methodology v1.7*'.⁶ The most recent load factors are in '*Annex 3 - Network Cost Allowance methodology Gas v1.7*'.⁷ The gas demand shares have been calculated using the ALPs for non-prepayment customers. The load factors are also consistent with PLFs for non-prepayment customers. However, our current view is that using these inputs on an ongoing basis no longer most accurately represents consumption behaviour for PPM customers. As such, using these inputs going forward, without any change to the Wholesale Cost, Network Cost and possibly other methodologies may prevent the prepayment cap level from reflecting the efficient cost of supplying energy to these customers.

How we plan to address this issue going forward

The introduction of unique gas ALPs and PLFs creates an opportunity to consider amending methodologies for the Wholesale Cost, Network Cost and possibly other methodologies to ensure they reflect the most accurate information available to us. Our priority is to consider this issue as soon as reasonable and practicable to ensure the PPM cap level continues to reflect the efficient cost of supplying energy to these customers.

³https://www.ofgem.gov.uk/sites/default/files/docs/2020/08/protecting_energy_consumers_with_prepayment_meters_-_august_2020_decision.pdf

⁴ UK Link Secured Documentation: <https://www.xoserve.com/systems/extranet-secured-sites/>

⁵ <https://www.xoserve.com/change/change-proposals/xrn-4665-creation-of-new-end-user-categories/>

⁶ https://www.ofgem.gov.uk/sites/default/files/docs/2021/02/annex_2_-_wholesale_cost_allowance_methodology_v1.7_data_removed.xlsx

⁷ https://www.ofgem.gov.uk/sites/default/files/docs/2021/02/annex_3_-_network_cost_allowance_methodology_elec_v1.7.xlsx

Timeline for reflecting new EUCs from Price Cap Period 8 onwards

We will issue a consultation in autumn 2021 to consult on proposals for amending Standard Licence Condition 28AD, including the Wholesale Cost, Network Cost and possibly other methodologies, to reflect the introduction of different EUCs for PPM customers and those who pay by direct debit / standard credit. After considering stakeholder responses, we expect to publish a decision in winter 2021, setting out the methodology that will be in place from period 8 (1 April 2022 – 30 September 2022). We will ensure to keep industry aware of the timings of this consultation and invite all stakeholders to provide representations in due course.

A note on implications for Price Cap Period 7

Due to the proximity to the announcement of the forthcoming cap levels (announcement on 6 August 2021) we are unable to consider any outcome of a consultation and implement any resulting change to the price cap methodology for period 7.

We believe it is in the interests of consumers to consider whether to review the costs associated with the new EUCs with regard to the PPM cap level during period 7. The purpose of this review would be to better understand whether the cap level for period 7 reflects the efficient costs of supplying energy to PPM customers. In the interests of transparency and to make clear our expectations to industry – if, following a thorough review, it is clear that the introduction of the new EUCs has materially changed the costs facing suppliers with PPM customers, we will consider taking cost over / under recovery into account when setting future cap levels as part of the autumn 2021 consultation.

We would like to thank Citizens Advice for contacting us on this matter. If you have any questions in relation to this matter, please email RetailPriceRegulation@ofgem.gov.uk

Yours Faithfully,

Dr. Karen Mayor
Deputy Director Retail Monitoring, Compliance and Price Cap Policy (interim)