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Consultation

Reviewing the potential impact of increased wholesale volatility on the default tariff cap: November 2021 policy consultation

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The price cap was put in place to make sure that customers on default tariffs pay a fair price for their energy, but no more than this.

Recent market conditions have seen an unprecedented rise in wholesale gas prices and, as a result, Ofgem will need to consider changes to the wider price cap design in order to consider any possible unintended consequences. We will be consulting shortly on possible broader reforms to the price cap as a part of a wider ranging review. However in the immediate term we will consider the case for more targeted changes to the current price cap methodology to reflect market circumstances in recent months.

We are consulting on whether the recent rise in wholesale prices has caused the level of the price cap to materially depart from the efficient cost level allowed for in the price cap. It is in the interests of both consumers and industry to ensure that the price cap appropriately reflects the costs, risks and uncertainties facing suppliers. We invite stakeholders to provide evidence on the extent to which these costs are accounted for under the current cap methodology in response to this consultation. If the outcome of the consultation supports the case for amending the price cap methodology, we also set out in this consultation the options for doing so and our minded to position.

We welcome views from people with an interest in the level of the default tariff cap. We particularly welcome responses from suppliers and consumer groups. We would also welcome responses from other stakeholders and the public.

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at **Ofgem.gov.uk/consultations**. If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

Contents

Executive summary

The default tariff cap ("the cap") protects default tariff customers by limiting the amount they can be charged for their gas and electricity. The need for a price cap is set out in section 1(6) of the Domestic Gas and Electricity (Tariff Cap) Act 2018 legislation which states that Ofgem must set the cap "with a view to protecting existing and future domestic customers who pay standard variable and default rates". The cap is currently extended annually by the Secretary of State. It was due to end in December 2023 at the latest, but Government is considering whether to legislate to retain the cap.[1] Ofgem sets the level of the cap to reflect the cost to suppliers of providing this energy, ensuring fair prices for all domestic energy consumers.

Under the current framework, we are unable to make amendments to the price cap levels within a cap period. To do so would require us to amend licence conditions, which would need to follow the licence amendment process set out in the Act. This is why we have also launched a consultation[2] that would allow us in exceptional circumstances to amend the cap outside of the current six-month cycle.

Wider review of the design and operation of the price cap

The unprecedented recent market conditions have brought into question whether wider reforms should be made to the price cap design, for example, whether the eight-month lag between wholesale price movements and their reflection in the price cap is the optimal approach. This limits the risk of price spikes for default tariff consumers, but in periods of price volatility exposes suppliers to additional costs and risks that are challenging to manage. As we set out in our open letter of 29 October,[3] we are examining how the current design and operation of the price cap might evolve given increased volatility of energy prices and intend to consult soon on options for reform. This consultation will consider reform of the price cap structure – with a focus on how best to deliver fair prices for consumers whilst enabling us to have regard to suppliers financeability of efficient costs, among other matters, and also considering how the

[1] BEIS (2021), Update on the Energy Price Cap and Energy Retail Strategy. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1005308/open-letter-price-cap-announcement.pdf
[2] Ofgem (2021), Consultation on the process for updating the Default Tariff Cap methodology and setting maximum charges. https://www.ofgem.gov.uk/publications/price-cap-consultation-process-updating-default-tariff-cap-methodology-and-setting-maximum-charges
[3] Ofgem (2021), Rising wholesale energy prices and implications for the regulatory framework | Ofgem. https://www.ofgem.gov.uk/publications/rising-wholesale-energy-prices-and-implications-regulatory-framework

price cap, if government retains it, might need to evolve as we move to mandatory half hourly settlement.

Ahead of that, we are consulting now on whether to make adjustments to the existing price cap methodology, specifically the wholesale price elements of the price cap, to account for costs and risks suppliers have been facing during the current period of high and volatile energy prices.

How the cap currently allows for uncertain wholesale costs

The existing cap methodology allows for suppliers to pass on the higher wholesale forward contract prices for gas and electricity through a core direct fuel allowance, which will be reflected in the forthcoming cap level from 1 April 2022 (cap period eight).

Suppliers also incur costs related to forecasting demand before refining their positions by converting from less to more granular forward contracts closer to delivery. The current cap methodology includes a range of additional direct fuel allowances to allow suppliers to recover these costs. These allowances are indexed, based on an assessment of historic costs conducted when the cap methodology was designed. An additional wholesale risk allowance (currently set at 1% of wholesale direct fuel costs) exists within the wholesale cost allowance methodology to reflect the fact that wholesale costs are an uncertain and volatile element of suppliers' costs. Given these additional allowances are indexed to direct fuel costs, the monetary value of these allowances will increase irrespective of any adjustment from 1 April due to the higher wholesale prices.

Accounting for changes due to rising wholesale prices and volatility

When we published our decision to implement the default tariff cap in 2018,[4] we outlined that we would consider amending the methodology of the cap where there were significant and unanticipated changes in factors determining suppliers' wholesale, policy, networks or smart metering costs, which were expected to cause the allowance included for these costs within the cap to materially depart from the efficient level, looking across the market as a whole. The scale and pace of the rising wholesale prices observed in recent months is unparalleled in the GB energy market. The additional costs and uncertainties facing suppliers are likely to be beyond what is accounted for in the cap in the existing methodology.

[4] Ofgem (2018), Default Tariff Cap decision – Overview.
https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview

In particular, we expect suppliers may be currently facing higher costs across two broad areas:

- **shaping and imbalance costs** – Suppliers may face materially higher costs related to forecasting their demand before refining their positions by converting from less to more granular forward contracts closer to delivery, and the costs of imbalance; and
- **unexpected SVT demand –** Suppliers may have seen a material and sudden increase in the number of customers defaulting from fixed-term contracts (FTC) to Standard Variable Tariffs (SVT). As many suppliers hedge far in advance, the higher numbers of customers defaulting onto SVTs is likely to be beyond what suppliers would have reasonably expected and hedged for. As such, suppliers may need to procure much of this unanticipated SVT demand at short notice, and at prices above the current cap level. However, some suppliers may have at least partly anticipated this risk and adjusted their hedging strategies to reduce these losses.

On the other hand, higher wholesale prices will likely mean Contract for Difference (CfD) costs faced by suppliers are currently materially lower than the cap accounts for. We are seeking evidence as to whether the CfD allowance (and other offsetting factors) may have experienced a material deviation not captured in the price cap methodology and may take this into account in determining the appropriate level of any adjustment. We consider that costs facing industry related to backwardation may also have materially deviated from what the price cap accounts for, though do not have sufficient evidence on this. We are encouraging industry to provide evidence on the costs they are currently facing related to backwardation.

Minded to position – near term adjustment to price cap methodology

Our priority during this time is to ensure the cap continues to protect default consumers. That involves, amongst other things, having regard to the need to ensure that holders of supply licences who operate efficiently are able to finance activities authorised by the licence. Our initial view is that there are likely to be material costs, risks and uncertainties facing suppliers that are not appropriately accounted for within the existing cap methodology due to the increased wholesale prices.

If the outcome of this consultation supports the case for an adjustment, our minded to position is to introduce an upward revision to the wholesale additional risk allowance as an interim solution. This recognises the fact that we do not yet know the duration for which the current period of higher costs and volatility will continue. We would then propose to review the adjustment as part of a wider ranging review of the price cap.

We consider that an adjustment to the wholesale additional risk allowance is the most appropriate near-term change to update the cap on the basis that this allowance is specifically targeted at allowing efficient suppliers to recover uncertain wholesale costs. This option also allows us to introduce a change to the cap from April 2022, if we determine it is appropriate to do so.

Industry evidence of materiality

We put forward illustrative analysis in this consultation on the potential magnitude of an adjustment, however we do not have detailed information on the changes in costs currently facing suppliers. We set out in this consultation the information we encourage industry to provide to justify that the costs they are facing are materially different from what they can recover through the current cap methodology. In particular, we would welcome any evidence relating to whether the costs we discuss in Section 3 are likely to represent a clear, material and systematic departure from efficient costs currently accounted for in the cap, and any data that would encourage us to deviate from our preliminary estimates.

Going forward

We invite stakeholder responses to any aspect of this consultation by 17 December 2021. Industry stakeholders are also invited to provide any relevant evidence outlining the extent to which the costs as set out in Section 3 are not accounted for under the current cap methodology. We would welcome any evidence of this nature by 3 December 2021 if in a position to do so. The provision of this data is not mandatory and we will consider all evidence provided by the consultation deadline.

1. Background and context

What are we consulting on?

1.1. This consultation sets out to determine whether and how to update the cap methodology to account for the costs associated with unprecedented wholesale prices and increased wholesale volatility. This is to ensure it appropriately reflects the costs, risks and uncertainties facing suppliers.

1.2. In recognition that the perception of cost and risk facing suppliers is likely to be different going forward, the focus of our consultation is on considering options for near-term changes that can be made to ensure that the cap is not materially different than the efficient costs facing suppliers. We also signal in this consultation our proposal to conduct a wider ranging review of the cap, to ensure it continues to provide fair prices for consumers in light of the changed market conditions.

1.3. This document is split into four chapters:

- Chapter 1: this consultation, and background;
- Chapter 2: overarching considerations;
- Chapter 3: impact of rising wholesale prices; and
- Chapter 4: options to amend cap methodology.

The default tariff cap ("the cap")

The cap

1.4. We introduced the cap on 1 January 2019, which currently protects around 15 million households on standard variable and default tariffs (which we refer to collectively as "default tariffs"). The cap ensures default tariff customers pay a fair price for the energy they consume, reflecting its underlying costs.

The Domestic Gas and Electricity (Tariff Cap) Act 2018 ("the Act")

We set the cap with reference to the Domestic Gas and Electricity (Tariff Cap) Act 2018 ("the Act"). Section 1(6) states that we must protect existing and future domestic customers who

pay standard variable and default rates.[5] The objective of the Act is to protect current and future default tariff customers. In doing so, we must have regard to the following matters:

- the need to create incentives for holders of supply licences to improve their efficiency;
- the need to set the cap at a level that enables holders of supply licences to compete effectively for domestic supply contracts;
- the need to maintain incentives for domestic customers to switch to different domestic supply contracts; and
- the need to ensure that holders of supply licences who operate efficiently are able to finance activities authorised by the licence.

1.5. The requirement to have regard to the four matters identified in section 1(6) of the Act does not mean that we must achieve all of these. In setting the cap, our primary consideration is the protection of existing and future consumers who pay standard variable and default rates. In reaching decisions on particular aspects of the cap, the weight to be given to each of these considerations is a matter of judgment. Often, a balance must be struck between competing considerations.

1.6. In setting the cap, we may not make different provisions for different holders of supply licences.[6] This means that we must set one cap level for all suppliers.

The Wholesale Cost Allowance methodology

1.7. Wholesale costs account for the largest portion of a consumers' bill. The assessment of wholesale costs within the wholesale cost allowance methodology contains three parts:

- **core direct fuel allowance:** we estimate the majority of wholesale costs based on forward contracts for electricity and gas.
- **additional direct fuel allowances:** we uplift the core direct fuel allowance by an additional set percentage to reflect the expected costs of converting less to more granular forward contracts closer to delivery, transaction costs, losses and other sources of uncertainty, and forecasting error leading to imbalance.

[5] Domestic Gas and Electricity (Tariff Cap) Act 2018, Section 1(6). http://www.legislation.gov.uk/ukpga/2018/21/section/1/enacted
[6] Domestic Gas and Electricity (Tariff Cap) Act 2018, Section 2(2). http://www.legislation.gov.uk/ukpga/2018/21/section/2/enacted

- **capacity market payments:** We also provide an allowance for the capacity market (CM) scheme, designed to ensure electricity security of supply. We calculate the cost of payments by information on auction clearing prices with forecasts of gross peak demand.

1.8. The core direct fuel allowance and capacity market allowance are calculated and updated each time we update the cap. For the core direct fuel allowance, we calculate this allowance using the forward gas and electricity relevant contract prices. For capacity markets we observe capacity auction clearing prices in combination with the level of obligated capacity to calculate the costs of capacity payments to suppliers. This means that unexpected changes in direct fuel costs and CM costs are reflected in the cap level each time it is updated.

1.9. However, the additional direct fuel allowances are indexed as a fixed percentage of direct fuel costs, rather than calculated. At the time we introduced the cap, we estimated the costs associated with shaping, forecast error and imbalance costs, based on historical cost data covering the period of 2014 – 2018. Table 1 below includes a summary of the additional direct fuel allowances. We set out more detail on how we calculated these additional direct fuel allowances in Appendix 4 to our 2018 Decision.[7]

Table 1: Summary of additional direct fuel allowances for gas and electricity (as a % of direct fuel costs).

Allowance	Electricity (single rate and multi-register)	Gas
Shaping, forecast error and imbalance costs	6.0%	4.3%
Transaction costs	0.4%	0.3%
Additional risk and uncertainty	1.0%	1.0%
Total	**7.4%**	**5.6%**

Source: Ofgem.

[7] Ofgem (2018), Default Tariff Cap decision – Overview, Appendix 4 – Wholesale, paragraphs 2.13 – 2.23. https://www.ofgem.gov.uk/sites/default/files/docs/2018/11/appendix_4_-_wholesale_costs.pdf

Updating the cap methodology

1.10. When we published our decision to implement the default tariff cap in 2018,[8] we set out how we might adjust the cap if we discovered significant differences between efficient costs and those included in the cap. In the event that the cap was to materially depart from the intended level, Ofgem would (subject to consultation) consider amending the cap methodology where:

a) there were significant and unanticipated changes in factors determining suppliers' wholesale, policy, networks or smart metering costs, which were expected to cause the allowance included for these costs within the cap to materially depart from the efficient level, looking across the market as a whole. For example, a change to the way a supplier was charged in relation to a government obligation which had a material impact on costs, or a significant change to the network charging regime.

b) there were minor changes that could be made to the models to improve transparency and avoid error (eg formulae error).[9]

Rationale for consulting

1.11. We consider that the scale and pace of wholesale price increases over recent months (and the increased associated uncertainty around future prices) may have caused the cap to materially depart from the efficient cost level.

1.12. As a result, we consider it appropriate to consult on how the cap allows for uncertain costs and whether updating the methodology is appropriate. As part of this consultation, we will engage with industry and all our stakeholders on what, if any, changes are needed to ensure the cap level appropriately reflects (and allow suppliers to recover) the efficient costs of supplying energy.

[8] Ofgem (2018), Default Tariff Cap decision – Overview. https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview
[9] Ofgem (2018), Default Tariff Cap decision – Overview, Appendix 3 Updating the cap methodology, paragraphs 3.1 – 3.6. https://www.ofgem.gov.uk/sites/default/files/docs/2018/11/appendix_3_-_updating_the_cap_methodology.pdf

Consultation stages

1.13. This consultation sets out further detail on the rationale for reviewing the cap methodology, the options we are considering and our minded to position. We invite stakeholders to submit comments on any aspect of this consultation on or before by 17 December 2021.

1.14. Industry stakeholders are invited to provide any relevant supporting evidence outlining the extent to which the costs are not accounted for under the current cap methodology. Section 3 provides more detail on the evidence we would welcome. To support our thinking, we would particularly welcome any evidence of this nature to be provided by 3 December 2021. However, we will consider all evidence provided by the consultation deadline.

1.15. Responses to this consultation and any supporting evidence can be submitted to Ofgem by emailing RetailPriceRegulation@ofgem.gov.uk. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

1.16. We seek to publish a decision to this consultation in February 2022, so that any changes may come into effect from 1 April 2022 (the eighth cap period), if appropriate to do so.

Your response, data and confidentiality

1.17. You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

1.18. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

1.19. If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.

1.20. If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

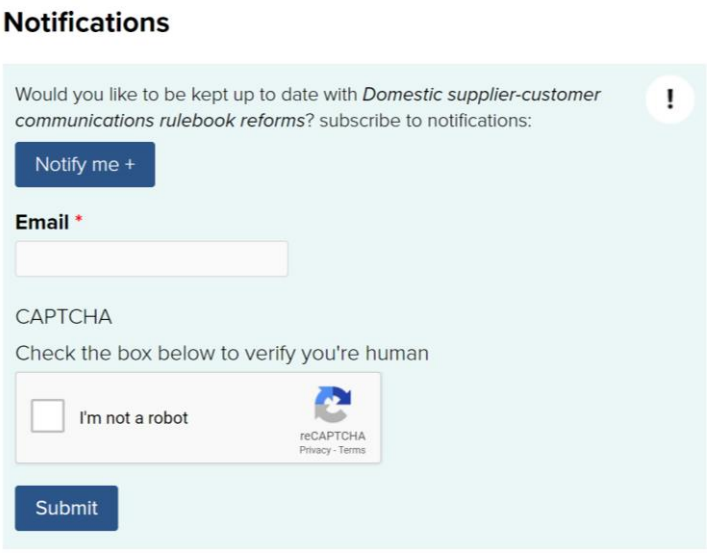
1.21. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

Please send any general feedback comments to stakeholders@ofgem.gov.uk

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. Ofgem.gov.uk/consultations.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2. Overarching considerations

Section summary

This chapter sets out further detail on the overarching considerations for this consultation, including the changing landscape of risk and uncertainty, and how costs associated with recent rising wholesale prices are accounted for under the current methodology. We also set out the scope of this consultation.

We seek suppliers' views on our considerations in general.

Changing landscape of risk and uncertainty

2.1. As stated within our open letter published in October 2021,[10] the unprecedented rise in energy prices this year has changed the perception of risk and uncertainty in this market. In order to protect the interests of consumers, we must take into account the costs, risks and uncertainties facing the supply companies we regulate.

2.2. The key focus of this consultation is to determine whether the cap is materially and systematically departing from the efficient cost level given volatility in wholesale prices.

How the price cap accounts for uncertain costs

2.3. The cap methodology includes a range of mechanisms to allow suppliers to recover uncertain costs.

2.4. There are two specific allowances within the cap methodology where the cap accounts for uncertain costs:

- **the headroom allowance** - is set as a fixed percentage of 1.46% of the efficient benchmark (excluding network costs). This is set up so that each time we update the cap level, headroom will scale with the changes in underlying costs.

[10] Ofgem (2021), Rising wholesale energy prices and implications for the regulatory framework | Ofgem. https://www.ofgem.gov.uk/publications/rising-wholesale-energy-prices-and-implications-regulatory-framework

- **wholesale additional risk allowance -** is fixed at 1% of the core direct fuel allowance, for both gas and electricity. This allowance gives regard to the fact that wholesale costs are a volatile and uncertain element of suppliers' costs. That uncertainty could result, on average, in net cost that exceeds our other wholesale allowances.

2.5. In line with our 2018 decision, recent events have given rise to the need to consider if changes to the methodology are appropriate to reflect the current exceptional circumstances.

2.6. We consider that the volatility of wholesale prices over recent months (and the increased associated uncertainty around future prices) may be causing the cap to materially depart from the efficient cost level. As a result, we consider it appropriate to consult on how the cap allows for uncertain costs. As part of this consultation, we invite industry and all our stakeholders to provide supporting evidence on whether changes to the wholesale additional risk allowance are needed to ensure the cap level continues to reflect (and allow suppliers to recover) the efficient costs of supplying energy.

2.7. This is in line with the requirements set out in legislation, which require Ofgem to have regard, among other matters, to the need for suppliers to finance their efficient costs and we believe is essential to ensure we retain a competitive retail market that delivers for consumers.

3. Impact of rising wholesale prices

Section summary

This chapter sets out further detail on how we will determine whether there are material changes to the costs facing suppliers. We also provide some illustrative analysis which represents an initial estimation of the impact of costs facing suppliers (though this is subject to change following a review of the detailed evidence).

We welcome stakeholders' views on our assessment of impact in general.

3.1. In order to protect the interests of consumers, we must ensure that the cap appropriately reflects the costs, risks and uncertainties facing the supply companies we regulate.

3.2. In this section, we set out our reasoning for considering why the costs facing suppliers may be materially higher than the cap methodology currently accounts for. We also set out illustrative analysis which represents our initial view of the potential scale of this issue. In the absence of actual evidence of the unexpected efficient costs facing industry (which we will be seeking as part of this consultation), our estimation of impact is based on what we currently consider to be reasonable, and we will adjust our thinking in response to evidence provided by industry (and all stakeholders).

Non-direct fuel costs related to rising wholesale prices

3.3. The cap methodology currently assumes that shaping and imbalance costs (costs that relate to how suppliers forecast their demand before refining their positions by converting from less to more granular contracts closer to delivery) will represent the same proportion of direct fuel costs in any given cap period. The cap also assumes that suppliers can forecast the number of standard variable tariff (SVT) customers, so they broadly know how much energy to buy.

3.4. Our initial view is that the cap level may have materially departed from the efficient cost level facing suppliers due to rising wholesale prices across two broad areas.

Shaping and imbalance costs

3.5. As suppliers refine their more granular hedging positions, they have to trade on the spot market or much closer to delivery. The additional direct fuel allowance allows suppliers

to recover (amongst other related wholesale costs) the costs related to shaping and imbalance.[11]

3.6. There are inherent risks in modelling future costs, particularly where there is uncertainty or risk (such as shaping and imbalance costs). For that reason, we explicitly sought to limit the risk of suppliers being unable to recover their efficient costs by taking prudent assumptions on our approach to setting additional direct fuel cost allowances. For example, electricity imbalance is always assumed as a cost to suppliers. Smaller suppliers tend to have higher imbalance and transaction costs, so we are also overstating costs slightly for typical, larger, suppliers serving the majority of default tariff customers.

3.7. However, wholesale gas day ahead prices are currently more than five times higher than they were 12 months ago, and the current forward curve, which reflects how much suppliers will pay today for energy delivered across a range of future timelines, suggests wholesale prices over the next year will remain higher than normal.

3.8. Shaping costs will depend on wholesale prices near to consumption, and how these compare to the price at which a supplier bought the bulk of its wholesale energy (ie its direct fuel costs). As wholesale spot prices have increased sharply, we expect the costs of shaping and imbalance may therefore have also increased during the current cap period. This is considering the current day-ahead price is over four times the average usually seen in November. On 5 October 2021 we saw the highest day-ahead price on record, almost six times the October average (and 20% higher than seen during the 'Beast from the East' gas deficit warning in March 2018); the expected increase in shaping and imbalance allowance from 1 April (within the current indexation approach) may not reflect the magnitude of additional shaping and imbalance costs facing suppliers. However, we will have regard to the likelihood that the additional direct fuel allowances will in any case increase from 1 April 2022 under the current methodology. This is on the basis that these costs are indexed to wholesale costs, which we expect to increase considerably in the forthcoming price cap period.

[11] Ofgem (2018), Default Tariff Cap decision – Overview, Appendix 3 Wholesale, Table A4.6. https://www.ofgem.gov.uk/sites/default/files/docs/2018/11/appendix_4_-_wholesale_costs.pdf

3.9. We will also have regard to the possibility of rapidly falling wholesale prices which could result in lower shaping and imbalance costs in a given cap period than what the allowance would account for.

Unexpected SVT demand

3.10. The cap was intended to protect the customers less willing or able to engage in the market, to ensure they never pay more than a fair price for their energy. It was never intended to be the cheapest tariff available in the market.

3.11. The recent rise in wholesale prices has led to the available fixed tariffs in the market being priced well above SVTs. This has resulted in an increased number of customers choosing to roll-over onto SVTs after a fixed tariff expires. We expect suppliers to have made prudent assumptions based on historic trends regarding the proportion of customers that would at the expiration of a fixed contract; (a) default onto a supplier's SVT, (b) switch to another fixed deal with the same supplier, or (c) switch to a different supplier.

3.12. Our expectation is that most suppliers may have seen higher numbers of customers defaulting onto SVTs than they could have reasonably predicted and hedged for (excluding suppliers that only offer SVTs). This will mean that these suppliers therefore need to procure this demand at a higher cost (and likely above the current cap level) given recent wholesale price increases.

3.13. We expect that an efficient supplier would regularly update its forecasts for the number of customers expected to move onto SVTs, in light of new information and adjust how it procures energy accordingly. We would have therefore expected a supplier to have taken steps to mitigate this risk. However, we also recognise that the speed and unprecedented nature of wholesale price increase would have created challenges in accurately forecasting SVT demand.[12]

3.14. We therefore expect that the costs related to procuring demand for unhedged and unexpected SVT demand is likely to result in the cap materially departing from the efficient

[12] The cost impact of additional SVT demand will therefore depend on when a supplier recognised that it's SVT customer number may need to be adjusted in line with rising prices, and what steps they took to mitigate the risk of hedging exposure.

costs facing suppliers, though we would expect suppliers to have taken mitigating action where possible to limit the impact of these costs.

CfD costs

3.15. Under the CfD scheme, generators receive a guaranteed revenue from a combination of wholesale prices and a levy on customer bills.

3.16. CfD levy rates are negatively correlated with wholesale prices. That means when wholesale prices rise, the CfD levy rates fall. CfD levy rates usually represent a cost to suppliers, as CfD strike prices have historically been higher than prevailing wholesale market prices.

3.17. When setting the policy cost allowance for each cap period, CfD costs are informed by forecasts of what future levy rates will be. When setting the cap level for the current cap period (and the previous period, cap period six), forecast levy rates were assumed to be significantly higher this winter than the actual levy rates now facing suppliers. There is no retrospective adjustment in the cap methodology to reconcile forecast levy rates to actual outturn. This means the considerable decline in CfD levy rates may represent a material departure from the cap level.

3.18. As with the costs associated with shaping / imbalance and increased SVT demand outlined above, the material departure of CfD costs from the efficient cost level is driven by the scale and pace of rising wholesale prices. We may have regard to this in determining what level of adjustment is reasonable.

3.19. We welcome views from all stakeholders on whether we should have regard to other factors which may have materially deviated from what the cap currently accounts for specifically due to the exceptional nature of the recent changes in wholesale prices.

Other costs

3.20. **Backwardation costs** – We are open in principle to the prospect that backwardation[13] costs may have materially departed from the efficient cost level. We recognise that the market is currently in backwardation, and that this will currently create costs for suppliers. When we designed the cap, we assumed that the costs and benefits of backwardation and contango[14] (the opposite of backwardation) would roughly net out over time.

3.21. Although we recognise that there may be costs associated with backwardation facing suppliers at a given point in time, we do not have sufficient evidence at present that these costs will not be offset by equivalent gains due to the opposite effect (contango) in another price cap period. to assert that these costs are likely to be material and systematic.

3.22. We are not opposed to having regard to backwardation costs within the scope of this review if there is sufficient evidence that this is appropriate. We would particularly welcome evidence from industry on the current costs of backwardation and whether they can provide evidence that the current backwardation may represent a clear, material and systematic departure from the assumption that the net costs approximate to zero over time.

3.23. **Direct fuel and capacity market costs** - We do not propose to consider whether direct fuel costs or capacity market costs have materially departed from the efficient cost level in this consultation. As these costs are calculated, our position is that the methodology already appropriately accounts for direct fuel and capacity market cost increases / decreases.

3.24. **End User Categories (EUC)** – EUCs categorise gas customers by different usage patterns and customer types. When the cap methodology was developed in 2018, there was only one EUC relevant to the cap, which was incorporated into our methodology. Since then, an industry modification has created a unique EUC for domestic PPM customers. In this consultation, we give consideration to the new EUCs and how they may impact shaping and

[13] Backwardation is when the price of forward contracts is less than the market expects the spot price to be when the contract is delivered.
[14] Contango is when the market expects spot prices at the time of delivery to be lower than the current forward price (the opposite of backwardation).

imbalance costs. We consider the impact of the new EUCs on other areas in a separate consultation.[15]

3.25. **Unidentified Gas (UIG) costs** – Changes in UIG costs are currently being considered separately as part of the EUC consultation. Therefore we do not propose to take into consideration any potential change in UIG costs as part of this consultation.

3.26. **Supplier of Last Resort (SoLR) levy claim costs** – Suppliers who take on customers of an exiting supplier through the SoLR process will be able to recover additional, reasonable costs incurred subject to Ofgem's consent via the Last Resort Supply Payment process (also known as the "SoLR levy"). We published a letter setting out how we are changing this process in light of the extreme current market conditions to ensure that the SoLR process can continue to protect consumers. In this letter we also clarified that additional wholesale costs incurred by SoLRs can be claimed for via the levy. For that reason we do not propose in this review to take into account any additional costs that suppliers may face through engaging with the SoLR process. However, we may have regard to the possibility of 'double counting' in this review, where suppliers may be able to recover (to some extent) the same additional costs through the SoLR levy and through any potential adjustment to the price cap methodology.

Our initial estimation of impact

3.27. We have set out in previous sections above the costs we believe may have materially deviated from the current cap level, and the rationale for this. The extent to which an individual supplier will face higher costs will depend on a range of supplier-specific factors. However, the Act requires us to set one cap level across the market and we must consider the market as a whole.

3.28. In particular, it will depend on how suppliers reflect low-probability, high-impact events such as a wholesale 'price-shock' in their risk management strategy, and how industry may have adapted their risk management strategy, particularly its approach to hedging, when the issue of rapidly rising wholesale prices first materialised.

[15] Ofgem (2021), Consultation on reflecting prepayment End User Categories in the default tariff cap. https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-prepayment-end-user-categories-default-tariff-cap

3.29. We wish to engage constructively with industry stakeholders to understand better a) the level of higher costs they are facing that are not accounted for in the cap, and b) how suppliers have adapted their risk management strategy and hedging to mitigate the costs they are facing.

3.30. **To assist with our assessment, we welcome evidence from industry on the points outlined in 3.29 above from industry by 3 December 2021 where possible.** However, we will consider all and any evidence provided by the consultation deadline.

3.31. Below we have also set out some illustrative analysis which sets out an initial view on the potential impact of higher costs facing suppliers. **We offer this as an initial and illustrative estimate only.** This analysis should not therefore be assumed to accurately reflect the impact of any prospective adjustment to the cap methodology, should the outcome of this consultation confirm that an adjustment is appropriate.

3.32. Table 2 sets out our summary of the potential cost impact facing suppliers.

Table 2 – Summary of costs potentially impacted by higher wholesale prices for an efficient supplier.

Cost	Initial view of whether materially departed from efficient costs	Estimate of material impact (£ per customer, per year, TDCV)[16]
Shaping and imbalance costs	Yes	£5 to £20
Unexpected SVT demand costs	Yes	£20 to £25
CfD costs	Yes	-£15 to -£20
Backwardation costs	No	-

3.33. Wholesale risks will not materialise to the same extent in each cap period, so suppliers are unlikely to have required the full wholesale additional risk allowance in each previous cap period. As part of this review we will also assess whether the 1% risk allowance has been

[16] The estimate of impact shown is calculated using the latest Typical Domestic Consumption Values (TDCVs).

required to the full extent in previous price cap periods, and are minded to have regard to any surplus against the wholesale costs which have not materialised.

Shaping and imbalance cost estimates

3.34. Preliminary analysis conducted by Ofgem indicates that shaping and imbalance costs are likely to have increased for the current cap period in comparison to the allowance set in the methodology.

3.35. On the assumption that shaping costs have increased – we anticipate this equates to £5 to £20 per customer per year (TDCV) for the current price cap period. We are conducting more analysis on shaping and imbalance costs which will further refine this initial estimate. We will refine this estimate in response to industry evidence provided as part of this consultation. However in determining the level of any adjustment, we may have regard to the likelihood that the rising wholesale costs will in any case lead to a considerable increase in the additional direct fuel cost allowance.

Unexpected SVT demand cost estimate

3.36. As fixed tariffs across the market become increasingly expensive, we expect an increasing number of customers to move from a fixed tariff and onto a 'capped' SVT when their contracts expire.

3.37. Robustly estimating the costs facing suppliers for an unhedged and unexpected increase in SVT demand raises practical methodological questions. The first is around determining whether any additional SVT demand is genuinely unhedged. The second is around determining whether any additional SVT demand is genuinely unexpected. We consider each point in turn below.

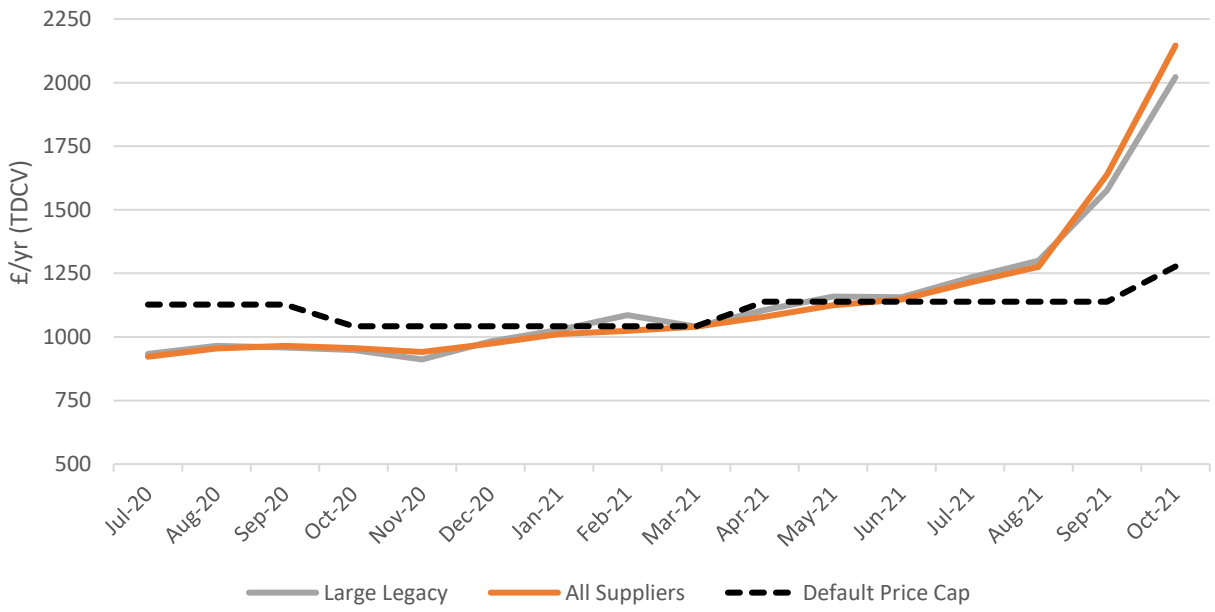
3.38. We would expect an efficient supplier to adopt a hedging strategy in line with the cap methodology for its SVT customers. As part of their wider risk mitigation strategy, suppliers may also forecast out their expected FTC demand. Other suppliers may not procure demand for FTC customers until this demand is considered 'firm' ie at the point of contract.

3.39. A supplier who forecasts and hedges its FTC demand will be less exposed to the rising wholesale prices. This is because the increase in SVT demand that is unhedged will be offset by lower FTC demand than has been hedged for, which may help the suppliers overall hedged position.

3.40. However, suppliers who do not hedge their FTC demand in advance will be more exposed to this cost increase, as they will not be able to net off their 'under-hedged SVT' position with an over-hedged FTC position.

3.41. The other consideration is whether additional SVT demand is 'unexpected'. Figure 1 below highlights that average large legacy supplier FTC offerings became more expensive than capped tariffs from May 2021, and average FTC offerings across all suppliers became more expensive from June 2021. This means suppliers were likely to have anticipated a marked increase in their SVT demand from spring / summer 2021 and we would have expected suppliers to adapt their hedging and risk management strategies accordingly.

Figure 1 – FTC vs SVT price differential from July 2020 – October 2021.



Source: Ofgem's analysis of EnergyHelpline's data.

3.42. We have conducted some preliminary analysis on the cost of unexpected and unhedged SVT demand.

3.43. Our initial view is that impact of procuring demand for fully unhedged additional SVT customers may equate to around £60 when spread across a supplier's default customer base,

considering the market as a whole. This represents our estimate of the market average cost[17] of procuring demand for 100% of expiring FTC customers during the current cap period. This estimate takes into account when FTC customers will expire over the coming months and assumes the cost to suppliers is around £700 per unhedged customer, based on customer account information provided by domestic suppliers as of 1 October 2021. However, our engagement with industry has suggested that some efficiently run suppliers were able to limit their exposure to the fully unhedged cost by 70%, by adapting their hedging strategy early, in anticipation of higher volume of SVT customers. A supplier who is able to limit their exposure to the fully unhedged costs (which equates to around £60 per customer) to 30%, would result in an equivalent net impact of £20 to £25 per customer.

3.44. Our initial view is that a £20 to £25 adjustment may therefore represent a reasonable adjustment to the cap level to account for unexpected and unhedged SVT demand. We recognise this initial view comes with considerable caveats. We note that not all suppliers may be able to limit the exposure of such costs to 30%. However, we also note that our assumption that suppliers would need to produce demand for 100% of expiring customers may be an overestimate. Given the caveats around these estimates, we particularly welcome industry evidence on this area to inform our thinking.

3.45. We note that for this cost category in particular, suppliers can take action to limit the costs they face. There are various approaches for setting an efficient cost benchmark, reflecting that costs will vary across suppliers. For example, we could determine it appropriate to set the efficient benchmark for this cost assessment at the market average level. However, we may also determine that it is appropriate to set an efficient benchmark for these costs at the lower quartile level, taking into account that suppliers can limit these costs through mitigation. We will reserve judgement on what approach is appropriate until we have reviewed the detailed evidence, however, we welcome any views from stakeholders on this.

CfD related costs

3.46. When we set the current cap level in August 2021, we used the best information on CfD levy rates available at the time, using both actual and forecast information. We estimate the CfD allowance in February using forecasts for the full year; we update this annualised estimate

[17] The market average cost is defined as the average cost impact across all suppliers for fully unhedged SVT customers.

using a mix of forecasts & actuals in the August update. That means the unprecedented rise in wholesale prices seen in recent months will result in suppliers facing lower CfD-related costs across both price cap periods 6 and 7 compared to what the cap allows for across those periods.

3.47. To illustrate the extent to which forecast levy rates have deviated from actuals, the CfD cost allowance accounted for in the current cap period is £7.62/MWh. However, the recent rise in wholesale prices has resulted in a decrease in levy rate forecasts, to the extent that we expect the revised CfD cost allowance for the current cap period to be much lower, at about £3.30/MWh.

3.48. Over cap period six (1 April 2021 – 30 Sept 2021) we expect suppliers will have recovered £22.13 per customer per year (annualised) more than the CfD allowance. Over cap period seven (1 Oct 2021 – 31 Mar 2022) suppliers are expected to recover in the region £12.51 per customer per year (annualised) more than the CfD allowance. Taking into account weighted demand in each season, we estimate that they will recover £**16.66** above the cost per customer across the full year (TDCV), based on current CfD levy forecasts. We note there is still some uncertainty around this figure, so we expect the actual figure could be in the range of -£15 to -£20 per customer. We estimate that this has likely impacted industry by **around £200m**.

3.49. Considering cap period six and seven both included a forecast of what CfD levy rates would be during the winter 2021 period, and that the actual CfD levy costs facing suppliers are currently considerably lower than forecast – we consider it appropriate to have regard to both price cap periods. As part of this assessment, we may also have regard to the historic balance of supplier and consumer costs related to CfD levy rate forecast error since the price cap was first introduced.

3.50. In our consultation assessing of the impact of COVID-19 on the cap,[18] we specifically considered the issue of CfD Interim Levy Rate (ILR) forecast error. In this consultation we noted that, *"we do not expect actual outturns or updated ILRs to match forecasts for any specific quarter. But overall, we expect the variance to balance out somewhat over time, with wholesale price fluctuations occurring in both directions".*

[18] Ofgem (2020), Reviewing the potential impact of COVID-19 on the default tariff Cap, paragraph 6.44. https://www.ofgem.gov.uk/sites/default/files/docs/2020/09/reviewing_the_potential_impact_of_covid-19_on_the_default_tariff_cap_-_september_2020_consultation.pdf

3.51. We recognise that our position in this consultation differs from the judgement above. However, we draw two important distinctions between the current situation and our consideration of the issue in the COVID-19 consultation. First, our decision[19] not to adjust the CfD allowance had regard to the fact that the any apparent under-recovery of CfD costs (due to ILR forecast error) would be largely offset by the government loan that was provided to suppliers via the LCCC. Second, we still consider that forecast error of this nature would broadly net off over time in times of normal market fluctuations. However, we note that forecast error due to a wholesale price shock of this magnitude is unlikely (or at least less likely) to net out over the duration of the temporary price cap.

Evidence from industry to support estimation of impact

3.52. In summary, we propose our initial estimates of the material higher costs facing suppliers to be in the region of £5 to £20 from higher shaping costs, £20 to £25 due to unexpected SVT demand, and with an offset of £15 to 20 for CfD ILR forecast error that is currently in suppliers' favour (as illustrated in Table 2). We make clear that our initial estimates may not reflect the actual level of material costs facing industry and again we encourage industry to provide evidence to inform our estimates, particularly evidence outlining:

- the extent of additional shaping and imbalance costs faced during the current cap period to date;
- the extent of costs associated with procuring demand for unexpected and unhedged SVT demand, and what steps suppliers have taken to mitigate exposure to such costs;
- evidence on backwardation costs facing suppliers during the current cap period. We also welcome evidence to challenge our current position that the costs of backwardation and the benefits of contango should net off over time; and
- evidence on any other cost category which any stakeholder determines may have materially and systematically departed from the current cap level and evidence to support this.

3.53. We also make the point that our initial estimation of impact may not necessarily reflect the impact of any prospective change to the cap methodology. We recognise that our initial

[19] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap.
https://www.ofgem.gov.uk/sites/default/files/docs/2021/02/decision_on_the_potential_impact_of_covid-19_on_the_default_tariff_cap.pdf

estimates presented here are illustrative and may not reflect our final view once we have reviewed the detailed evidence. Furthermore, basing any adjustment at a time of unprecedented wholesale prices risks consumers paying more than the efficient cost level once the market stabilises and returns to more normal levels. We will make a judgement regarding what we consider to be a reasonable adjustment to the cap level to appropriately reflect the level of risk and uncertainty facing suppliers going forward, as informed by stakeholder feedback and industry evidence.

4. Options to amend cap methodology

Section summary

This chapter sets out the options we are considering to allow an adjustment to the cap methodology (if appropriate) and our minded to position.

We welcome stakeholders' views on our options and minded to position.

4.1. As outlined in previous sections, our initial view is that the scale and pace of wholesale prices over recent months (and the increased associated uncertainty around future prices) is likely to have caused the cap to materially depart from the efficient cost level.

4.2. If, following this consultation, we determine that the costs facing suppliers have materially departed from the efficient cost level facing suppliers, we are considering the following five options for amending the cap methodology. These options broadly reflect the various ways uncertainty is accounted for in the cap.

Table 3 – Summary of price cap amendment options considered.

Option	Minded to position	Description of option
Option 1: Amend the wholesale risk allowance	Yes	We would revise the indexed value of the wholesale risk allowance (currently 1% of direct fuel costs).
Option 2: Amend the headroom allowance	No	We would revise the indexed value of the headroom allowance (currently 1.46% of total costs, minus network costs).
Option 3: Implement a bespoke adjustment	No	We would implement a bespoke adjustment (similar to the COVID-19 adjustment) to account for material and systematic changes in the efficient cost level due to the rising wholesale prices.
Option 4: Amend EBIT	No	We would revise the 1.9% EBIT calculated by the CMA to reflect the increased risk facing suppliers through increased uncertainty in wholesale markets.
Option 5: Do nothing	No	No change to cap methodology.

Minded to position – Amend the wholesale additional risk allowance

4.3. Our minded to position for any prospective change to the cap methodology is to implement an upward revision of the wholesale additional risk allowance from April 2022.

4.4. In determining the level of any upward revision to the wholesale additional risk allowance, we may have regard to:

- any material and systematic changes in the costs facing suppliers that are not accounted for in the current methodology, as informed by the detailed evidence;
- the risk of setting an adjustment level informed by exceptional market conditions and the likelihood that this may lead to overcompensation in future (when prices and volatility return to normal levels);
- any surplus against the 1% wholesale risk allowance that has accumulated over previous cap periods;
- any material and systematic changes that may be resulting in a benefit to suppliers relative to what the cap accounts for (for example, CfD levy costs though there may be others); and
- the likelihood that the indexed allowances (eg the wholesale risk allowance, headroom, EBIT, operating costs) will in any case increase considerably from 1 April 2022, which may offset (to some extent) the higher costs currently faced.

4.5. In terms of the methodological approach we may take in setting the level of any adjustment, we reserve judgment until after we have reviewed the detailed evidence. We may determine it appropriate to set some of the specific cost categories at the market average level or the lower quartile level.

Rationale

4.6. The wholesale additional risk allowance was specifically included within the cap methodology to account for uncertainty and volatility in wholesale costs, beyond what is already provided for in the other wholesale allowances and headroom. Our initial view is that, in the current circumstances, wholesale additional risk represents the most appropriate and

targeted mechanism to reflect material change in the costs arising from wholesale cost uncertainty and volatility.

Alternative options under consideration

Option 2: Amend headroom allowance

4.7. The headroom allowance is set as a fixed percentage of 1.46% of all cost components excluding networks under the cap. We consider this as an alternative option to our minded to position.

4.8. Although the headroom allowance is specifically included within the cap methodology to allow for uncertain costs, it considers a much wider spectrum of uncertain costs which go beyond costs and uncertainties related to wholesale markets. As a result, we consider that headroom is a less appropriate mechanism in that its purpose does not target the costs and uncertainties specifically relating to wholesale costs.

4.9. Although we are not minded to adjust the headroom allowance specifically, we may have regard to whether the indexed nature of the headroom allowance is likely to result in a potential overcompensation going forward. This is on the basis that we expect the price cap to increase considerably from 1 April 2022, which will result in a considerable increase in the absolute level of the headroom allowance. We may seek solutions for this such as an offset.

Option 3: Implement bespoke Adjustment Allowance

4.10. This option would use the existing Adjustment Allowance[20] for costs related to additional wholesale market volatility and uncertainty that are not reflected within the existing methodology. The existing Adjustment Allowance has been used previously for the Covid-19 adjustment[21] to cover the incremental costs due to COVID-19 for suppliers writing off bad debt for credit customers.

[20] An allowance covering any adjustments to the default tariff cap.
[21] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap.
https://www.ofgem.gov.uk/sites/default/files/docs/2021/02/decision_on_the_potential_impact_of_covid-19_on_the_default_tariff_cap.pdf

4.11. We are not considering this option further at this stage as we do not think it is appropriate to use an adjustment of this nature in this context given that the Adjustment Allowance is not intended to reflect uncertain costs on an ongoing basis.

Option 4 – Amend EBIT

4.12. The cap methodology includes a specific allowance for EBIT at 1.9%, as calculated by the CMA as part of its Energy Market Investigation.[22] The profit margin reflects the profit calculated by the CMA in its energy market investigation for a supplier that does not use a third party to manage its wholesale trading (ie a supplier with additional working capital requirements compared to a supplier that uses a third party). Firms will generally seek a higher rate of return in response to the introduction of an increased level of risk.

4.13. We do not propose to adjust the EBIT allowance at this time. We do not think that EBIT is an appropriate mechanism to account for material wholesale costs that are not accounted within the cap methodology. We also note that due to the unprecedented wholesale prices, the forthcoming cap level for cap period eight (1 April 2022 – 30 September 2022) will likely increase. That means a higher cap level will in any case lead to an increase (in absolute terms) in EBIT, as the 1.9% will be indexed to a higher cap level.

Option 5 – Do nothing

4.14. If we determine the cap level has not materially departed from the efficient cost level following consultation, we could determine that the existing methodology remains appropriate.

4.15. This is not our current minded to position, given our initial view is that the costs currently facing suppliers are likely to be materially higher than the cap accounts for.

[22] CMA (2016), Energy Market Investigation – final report. Appendix 9.10, paragraph 159. https://assets.publishing.service.gov.uk/media/576bcc23ed915d3cfd0000bb/appendix-9-10-analysis-ofretail-supply-profitability-roce-fr.pdf

Duration of higher costs and implications for any adjustment

4.16. Our priority during this time is to ensure the cap continues to protect default consumers and ensure they pay no more than a fair price for their energy. We generally have a high bar for considering whether there is a case for amending the cap methodology. We broadly consider the case for amending the cap methodology against the test of whether a change in the costs facing suppliers is *material* and *systematic*, considering the market as a whole.

4.17. Although we expect suppliers may be facing costs that are materially higher than the current cap methodology, the extent to which these costs will persist primarily depends on future wholesale market prices and volatility (which is unknown).

4.18. Setting any adjustment that is informed by atypically volatile market conditions risks overfunding suppliers in the long-term. We therefore propose **that any prospective adjustment be an interim solution.** We expect to review any adjustment introduced as part of this consultation in due course and whether it remains appropriate as part of a wider ranging price cap review (outlined below). In any case we would endeavour to review this decision no later than 12 months after its implementation.

Our intention to conduct a wider ranging review of the price cap

4.19. We consider that the change in the level of risk uncertainty facing suppliers is also material and systematic on the basis that shocks like this could happen again.

4.20. In our open letter to industry,[23] we set out that we would be 'raising the bar' in terms of what we expect from suppliers with regards to financial risk management. We also recognise the important role that Ofgem must play in reducing risk in the sector as a whole, in the interests of all energy consumers.

4.21. As a result, we are conducting a wider review of the design and operation of the price cap. As energy markets are inherently volatile, it is not possible to eliminate risk in the market

[23] Ofgem (2021), Rising wholesale energy prices and implications for the regulatory framework | Ofgem. https://www.ofgem.gov.uk/publications/rising-wholesale-energy-prices-and-implications-regulatory-framework

entirely. However, the exceptional market conditions experienced this year prompts a need to think more fundamentally about the role of an energy price cap in protecting customers, and the balance of risk that industry and consumers should bear.

4.22. In carrying out a review of the design of the price cap, we will need to consider key trade-offs related to the price cap design. These include whether the current eight month lag between wholesale prices and their reflection in the price cap is optimal which, along with the price cap's use of 12 month forward contract prices, exposes suppliers to costs and risks that are hard to manage at times of price volatility, whilst limiting the risk of price spikes for default tariff consumers. When assessing these trade-offs, we will consider how any options may affect different groups of customers and how the market may respond.

4.23. We expect to set out more detail on the timings and scope of this review in the coming weeks.

Mechanism to update the cap in exceptional circumstances

4.24. Under the current framework, we are unable to make amendments to the price cap levels within a cap period. To do so would require us to amend licence conditions, which would need to follow the licence amendment process set out in the Act.

4.25. Alongside this review of the risk allowance, we are also consulting on providing the ability to make a more immediate update to the price cap level outside of the current six month cycle, where exceptional circumstances occur.[24] We would expect any such mechanism to be reserved only for genuinely exceptional events ie in rare cases where waiting until the next scheduled cap update could have serious consequences for consumers or industry as a whole.

[24] Ofgem (2021), Consultation on the process for updating the Default Tariff Cap methodology and setting maximum charges. https://www.ofgem.gov.uk/publications/price-cap-consultation-process-updating-default-tariff-cap-methodology-and-setting-maximum-charges

Appendices

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Appendix 1 – Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest ie a consultation.

3. With whom we will be sharing your personal data

We may share consultation responses with BEIS.

4. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for six months after the project, including subsequent projects or legal proceedings regarding a decision based on this consultation, is closed.

5. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete

- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at https://ico.org.uk/, or telephone 0303 123 1113.

6. Your personal data will not be sent overseas.

7. Your personal data will not be used for any automated decision making.

8. Your personal data will be stored in a secure government IT system.

9. More information For more information on how Ofgem processes your data, click on the link to our "Ofgem privacy promise".