

Date: 19 November 2021

Price Cap - Consultation on the process for updating the Default Tariff Cap methodology and setting maximum charges

Summary

1. Recent market conditions have seen an unprecedented rise in wholesale gas prices. The additional costs and uncertainties facing suppliers are likely to be beyond what is accounted for in the cap in the existing methodology. As we set out in our open letter to industry, we are examining how the current design and operation of the default tariff cap ('the cap') might evolve given increased volatility of energy prices.¹
2. This consultation sets out our proposals to modify the licence to introduce an ability for us to amend the cap outside of our routine six month cycle, where exceptional circumstances (which are rare and would have high impacts without urgent action) occur. At present, while we have the ability to make changes to the cap methodology and annex models, we cannot implement these changes outside of our six month review cycle without a licence modification.
3. We propose to modify Standard Licence Condition (SLC) 28AD of the electricity and gas supply licence to introduce this within-period amendment process. We have also published, alongside this consultation, the notice of our proposal to amend these licence conditions.
4. If you wish to respond to this consultation, please send representations to retailpriceregulation@ofgem.gov.uk before close of business, Friday 17 December 2021.
5. We do not ask specific questions in this document. Rather, we welcome views on any of the matters discussed in this consultation.

¹ Ofgem (2021), Rising wholesale energy prices and implications for the regulatory framework, <https://www.ofgem.gov.uk/publications/rising-wholesale-energy-prices-and-implications-regulatory-framework>

6. We intend to publish a decision for this consultation by February 2022.

Proposed modification

7. We propose to modify the licence to allow us to amend the methodologies that set the allowances under the cap and recalculate the cap level within a cap period in exceptional circumstances. This recalculation could represent an increase or decrease from the existing cap level.
8. We propose to set the test that need to be met as events of exceptional circumstances. We consider that these would be rare and would have high impacts without urgent action.
9. We propose that any amendment would be forward-looking and apply for the remainder of the cap period from a specified point forwards.
10. We propose to modify SLC28AD of the gas and electricity licences to enact this change.

Our considerations

Rationale for proposed modification

11. We propose to introduce an ability to have an amendment within a cap period (an 'in-period adjustment') in exceptional circumstances.² We consider this is important to enable us to manage the risks to the market and customers resulting from the interaction of the cap and changing market circumstances in the future.
12. There are limits to how any cap methodology can reflect all possible scenarios in a cap period. This is why we provide allowances to reflect the uncertainty faced by suppliers and can change the cap (at scheduled updates) if it "systematically and materially departed from an efficient level of costs".³ We consider our approach to provide allowances and our mechanisms to update the cap in future cap periods are sufficient to manage normal variations in costs.
13. However, in exceptional circumstances, waiting until the next cap periods may lead to negative consequences and, consequently, risks to either suppliers or customers.

² We define an in-period adjustment as a recalculation of the cap level within a cap period.

³ Ofgem (2018), Default tariff Cap: Decision – overview, <https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview>

In those rare instances, we consider that having a mechanism that allows us to change the cap level sooner would be important to manage those risks effectively.

14. The current cap amendment process provides certainty to suppliers and customers on the cap level in each six month period. We acknowledge that, if implemented, these proposals would create additional uncertainty on the cap level in any cap period. However, we consider that a number of features of our proposals limit that uncertainty, while maintaining the benefits of allowing us to have an in-period adjustment in exceptional circumstances.

Proposed test for using power

15. Our proposed test deliberately has a high threshold. This is because we consider that the proposed provisions are only to be used for exceptional circumstances. We consider that this will limit the risk of the proposed provision creating additional uncertainty. We give further guidance on specific terms of our test below when considering an in-period adjustment; the test being **events which meet the exceptional circumstances threshold**.
16. **Exceptional circumstances** – This wording reflects the high threshold for using the power. We consider that exceptional circumstances will fulfil both of the following conditions:
 - a. **Rare** - We consider that the rarity of an event affects how foreseeable it may have been for suppliers to identify it as a risk and have actively managed it. The more frequent an event is, the more likely it is that suppliers should have been able to both foresee it and have sufficient risk management practices in place.⁴ We consider that rarity here could relate to the nature of an event, for example the COVID-19 pandemic and the impact of the associated restrictions that came with it. We also consider that rarity could relate to the scale of an event relative to historical levels, which would include the recent rise in wholesale gas prices.
 - b. **High impact without urgent action** - We consider an event is high impact if it leads to irreversible effects on the energy market or could have systemic consequences, for example the risk of significant market exit by efficient suppliers. We also consider high impact events to be those where there are

⁴ For the avoidance of doubt, we are not implying that suppliers should only manage risks related to frequent events. We expect suppliers to take appropriate steps to manage their risks, including of rare events. We are simply noting that it may be more challenging to anticipate and prepare for rare risks

concerningly large impacts on customers, particularly those that impact customers in vulnerable situations.

- i. We do not consider that all financial impacts on suppliers would meet this criteria. First, we recognise that costs may vary from our expectations and the cap design includes a headroom allowance to address this uncertainty. Second, it may be more appropriate to provide an allowance for some financial impacts on suppliers through a future scheduled update if they do not satisfy the required thresholds for what we consider are exceptional circumstances. In this second situation, any financial losses to suppliers would be transitory rather than permanent.
- ii. We recognise that it may be hard to predict the impact of a particular event. During fast-moving events it is harder to forecast all potential outcomes as they can vary significantly. In these circumstances, we may also give consideration to potential outcomes when deciding whether to amend the cap level within a cap period. However, this does not mean that we intend to adopt a precautionary approach, given that making changes to the cap level would have an immediate negative financial impact on customers or suppliers (depending on the direction of the adjustment).
- iii. We consider that the required materiality for a cap level adjustment within cap period would be larger than what is required for a normal cap level adjustment for a forthcoming cap period. We would need to assess the materiality of the impact against waiting for the next available scheduled update. If we consider this required materiality is met, this could warrant a more urgent response which could be achieved through an in-period adjustment. This means that we would not be considering the materiality of an issue on the basis that it was left unaddressed for the remainder of the cap. We would only be considering the materiality up to the next available scheduled update. An issue would therefore need to have a particularly large impact over this short time period in order to qualify as significant.

17. We do not intend for the proposed in-period adjustment to replace the need for suppliers to manage their risks proactively. The proposed provision is not intended to allow suppliers to pass through costs to customers when suppliers could have taken action upfront to mitigate these risks. For example, if the proposed provision had been available in the current market circumstances, we would not have used it

to adjust the cap to reflect the wholesale costs of suppliers who had not effectively hedged their expected demand.

18. Where we consider that the required thresholds have been met and that an in-period adjustment is appropriate, we propose to have an appropriate consultation period before implementing a cap level update within a given cap period.

Using the power

19. We intend that in-period adjustments would be forward looking only. This means if we made an in-period adjustment to the cap, the updated cap level would only apply for the remainder of the existing cap period. It would not be retrospectively applied to the period before the implementation date for the updated cap level. For example, to consider a cap period from 01 April to 30 September; if we implemented an adjusted cap level on 01 June, this would apply from 01 June to 30 September and would not apply between 01 April and 31 May.
20. SLC 28AD.1 states that suppliers must be compliant in relation to each relevant 28AD customer at all times within the cap period. This means that suppliers would be obliged to comply with the new cap level that is set for the remainder of the existing cap period if we made an in-period adjustment.
21. For the avoidance of doubt, we would assess compliance at each point in time against the cap level which applied at that point in time. We would not assess compliance for the whole cap period against the latest cap level. This means that, in the event of an upward in-period adjustment, a supplier would not be able to charge more than the cap level in the second part of the cap period and offset this against the lower amount charged in the first part of the cap period.

Next steps

22. If you wish to respond to this consultation, please send representations to retailpriceregulation@ofgem.gov.uk before close of business, Friday 17 December

2021. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

23. We do not ask specific questions in this document. Rather, we welcome views on any of the matters discussed in this consultation.

24. We intend to publish a decision for this consultation by February 2022.

25. If you have any questions please contact retailpriceregulation@ofgem.gov.uk.

Yours sincerely,

Leonardo Costa

Head of Price Cap Policy – Retail Price Regulation

Appendix 1: Your response, data and confidentiality

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.

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.

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 2.

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.

Appendix 2: Privacy note 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.

4. With whom we will be sharing your personal data

We may share consultation responses with BEIS.

5. 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.

6. 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.

7. Your personal data will not be sent overseas

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

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

10. More information

For more information on how Ofgem processes your data, click on the link to our "[Ofgem privacy promise](#)".