Making a positive difference
for energy consumers

To all market participants and
interested parties

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Dear colleagues,

Default tariff cap update from 1 April 2022

Today we have published the updated cap levels for the eighth charge restriction period (ie the eighth 'cap period'), covering the six months from 1 April 2022 to 30 September 2022. Alongside the cap levels we have also published the updated versions of the cost allowance models / annexes.

Drivers of change

The level of the cap[1,2] for the cap period eight (1 April 2022 to 30 September 2022) has increased by 54% since the last update. From 1 April 2022, the level of the cap will increase to £1,971.[3,4]

The main drivers for this change are due to updates in the model inputs for:

- **Wholesale costs** – Wholesale costs have increased by £549 since the last update. The gas price increase that started last summer continued and then accelerated significantly in September. Record high prices were seen in many European countries in October and then even higher later in December. Low imports into Europe during the summer meant that gas storage at the start of this winter was the lowest it has been for the time of year. Additionally pipeline imports from Russia into central and eastern Europe have fallen to very low levels this winter. As storage levels across Europe are likely to be at record low levels by the end of winter there will be strong demand to re-fill storage through next summer and a risk it will still be relatively low by next winter. This has increased forward prices for the whole year ahead. Wholesale electricity has increased in price mainly due to the increased cost of gas and, to a lesser extent, carbon price increases and nuclear generation outages in France.

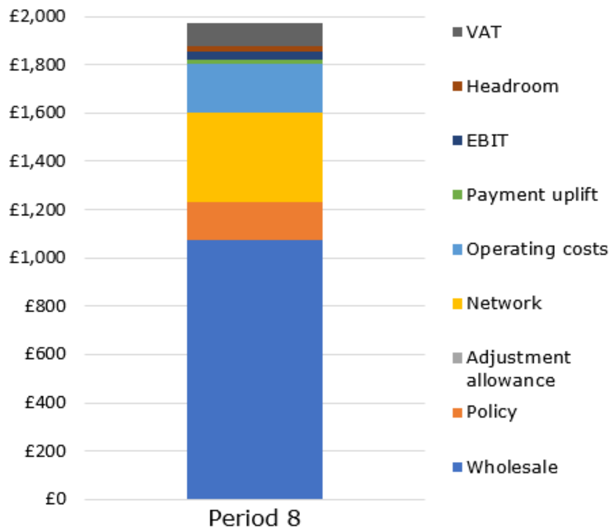
[1] The level of the cap shown is for a dual fuel, direct debit customer, calculated using the latest Typical Domestic Consumption Values (TDCVs). All values rounded to the nearest £.
[2]On 1 April 2020 Ofgem decided to decrease the Typical Domestic Consumption Values (TDCVs) for electricity to reflect continued decreases in consumption for electricity and to keep the TDCV's for gas unchanged. From 1 April 2020, Ofgem has been using the new TDCVs to express the default tariff price cap and prepayment meter cap level in all publications. Previous publications on the levels of the caps will therefore not be the same / directly comparable.
[3] The default tariff cap sets maximum prices, not maximum bills. For an individual customer, the amount they will pay under the cap varies depending on how much energy they use, where they live, and how they pay for their energy. The cap level will not depend on who a customer's energy supplier is.
[4] We do not set a 'dual fuel' cap. Caps are set for each fuel separately. When we express the dual fuel 'cap level' for a typical customer, this is the combined effect of the gas cap at typical consumption and the electricity cap at typical consumption.

- **Increased wholesale volatility costs –** In our 4 February decision[5], we concluded that suppliers have incurred material additional costs during cap period seven arising from increased wholesale market prices and volatility. We therefore decided to adjust the cap in cap periods eight and nine by amending the percentage (%) value of the wholesale additional risk allowance for gas and electricity. This equates to £59 of the above £549 increase in wholesale costs.

- **Network costs** – Network costs have increased by £103 since the last update. The main driver of this increase is due to the recovery of Supplier of Last Resort (SoLR) levy costs (£68). A supplier acting as a SoLR can make a claim for any reasonable additional, otherwise unrecoverable, costs they incur. These levy claims are paid to suppliers by the distribution network companies and recovered from consumers via their charges. Gas distribution and transmission costs have also increased (£20). The two main drivers behind this are shrinkage and inflation. Shrinkage costs are a result of gas lost during transportation. The recent high wholesale prices have resulted in increased shrinkage costs. Some gas network charges are also linked with inflation and high inflation is expected to continue into 2022/23. Electricity balancing costs have also increased significantly since the last update (£6). This is due to the current market conditions, and deferred charges from 2020 as a result of the COVID-19 pandemic.

- **Policy and other costs** – All other costs have incurred a net increase of £16. Policy costs have decreased by £6 overall. This includes ECO and WHD costs increasing by £7 and £5 respectively due to increases in the estimation of scheme costs based on impact assessments carried out by the Department of Business, Energy and Industrial Strategy. These increases are offset by a £22 decrease in Contract for Difference (CfD) costs. This is due to scheme Interim Levy Rate forecasts of 0 £/MWh, which takes into account generator payments and higher power prices. In addition, other costs such as the indexed components of the cap have increased in line with the overall cap increase or inflation. This includes EBIT (£12), Payment method uplift (£3), Headroom (£8), VAT (£33) and Operating costs (£5). Finally, as a result of our latest review of smart metering costs, Smart Metering Net Cost Change (SMNCC) costs have decreased by £6 primarily driven by a decrease in the allowance provided for rolling out smart meters.

Changes in the components making up the direct debit level of the cap (shown for dual fuel) are shown in Figure 1 below:[6]



[5] Ofgem (2022), Decision on the potential impact of increased wholesale volatility on the default tariff cap. https://www.ofgem.gov.uk/publications/price-cap-decision-potential-impact-increased-wholesale-volatility-default-tariff-cap
[6] All values shown are for a dual fuel, direct debit customer, calculated using the latest Typical Domestic Consumption Values (TDCVS). All values rounded to the nearest £.

	Period 7 (Oct 21 – Mar 22)	Period 8 (Apr 22 – Sept 22)
Wholesale	£528	£1,077
Policy	£159	£153
Adjustment allowance[7]	£9	£0
Network	£268	£371
Operating costs[8]	£204	£203
Payment uplift	£12	£16
EBIT	£23	£35
Headroom	£14	£22
VAT	£61	£94
Total	**£1,277**	**£1,971**

Figure 1: Breakdown of default tariff cap components

Other payment methods

The standard credit cap level has also increased and will be £2,100 (£731 increase) for the reasons set out above. The £2,100 per year level of the cap is based on a household with typical consumption on a dual electricity and gas bill paying by direct debit. Customers who pay by standard credit (cash or cheque) pay an additional £130 primarily based on the higher cost for suppliers to serve them.

The prepayment meter (PPM) cap level has also increased and will be £2,017 (£708 increase). As for customers who pay by standard credit, customers on prepayment meters pay an additional £47 primarily based on the higher cost for suppliers to serve them in comparison to customers paying by direct debit. In addition, as a result of our latest review of smart metering costs, the SMNCC allowance in the PPM cap level has reduced by less than the SMNCC for credit (by £2 since the last update).

Compliance with the price caps

We expect suppliers to take seriously their obligations to implement the default tariff cap and will be closely monitoring their compliance. Suppliers should continue to comply with their obligations as set out in SLC28.A and SLC28.AD, and the values used in those licence conditions. We will continue to take firm action against suppliers who fall short of their price cap requirements.

We expect any related data provided to Ofgem to be accurate, complete and provided in a timely manner. We will also continue to monitor the quality of service suppliers deliver to their customers and stand ready to take compliance and enforcement action in the event that any licence requirements are not met.

Yours faithfully,

Daniel Norton
Deputy Director, Price Cap

[7] An allowance covering any adjustments to the default tariff cap. For cap period six this includes the Covid-19 adjustment to cover the incremental cost due to COVID-19 for suppliers writing off bad debt for credit customers for cap periods four to six. For cap period seven there is not an additional adjustment related to Covid-19 to either credit or PPM customers. Therefore, the remaining float of £8.86 (at benchmark consumption) will be applied in cap period seven for credit customers in line with our February 2021 decision.
[8] Operating costs displayed in Figure 1 includes both Operating and Smart Metering Net Cost Change (SMNCC) costs.

Annex

Annex 1 – Changes to the default tariff cap split by payment method.

Cap level	Period 7 (Oct 21 – Mar 22)	Period 8 (April 22 – Sep 22)
Direct Debit	£1,277	£1,971
Standard Credit	£1,370	£2,100
Prepayment	£1,309	£2,017