

## Consultation on Medium Term Changes to the Price Cap Methodology

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We are consulting on a number of changes to the price cap methodology in response to the recent unprecedented rise in wholesale market prices and volatility. First, we are seeking feedback on the implementation of moving to quarterly price cap updates (our preferred option) or price cap contracts. These are compared to the alternative of a strengthened status quo.

We are also consulting on two additional aspects: reducing from two months to one month the advance notice Ofgem gives to suppliers of the updated price cap level before it comes into effect. And a new mechanism to address backwardation cost risk.

We particularly welcome responses from energy suppliers, consumer groups and charities. 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 and more information can be found in 'Your response, data and confidentiality' in 1.14 below.

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## Executive summary

Since Summer 2021 the scale and pace of wholesale price increases has been unprecedented and the pressure this has placed on industry is clear: over the last year 29 suppliers have exited the market - 26 since August 2021. The high and volatile market prices are creating costs and risks for suppliers beyond those provided for in the current price cap. Ofgem is today announcing changes to the price cap level from 1 April that will address these short-term risks.<sup>1</sup>

When the price cap was introduced, we stated that there may be a need to change the methodology if the external environment changed. This has happened and the case for change is clear – a view also held by stakeholders.

The challenge is to find a solution that reduces the costs and risks facing suppliers so that energy bills can be kept low, whilst preserving the wider benefits of the price cap for consumers – the choices are finely balanced. Market risks currently sit with suppliers, causing large losses and exits at times of market instability, which in turn leads to higher costs for consumers; but shifting all the risk to consumers would leave them with more volatile energy bills.

A particularly challenging risk for suppliers to manage is that the time lag between market prices and their reflection in the price cap can lead to volume risk: when energy prices rise sharply, active consumers will move to the price cap tariff, leaving suppliers with higher demand than they expected or hedged for, which they have to meet at high market prices. When prices fall, those consumers then move off the price cap tariff, this time leaving suppliers with unexpectedly low demand. In both cases, this can cause large, hard to avoid losses for suppliers, which can ultimately lead to higher prices for consumers.

Another risk is higher than normal backwardation costs that are not recoverable in reasonable timescales. The price cap is based on a 12-month price, but updated every six months, and is

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<sup>1</sup>Default tariff cap level: 1 April 2022 to 30 September 2022: <https://www.ofgem.gov.uk/publications/default-tariff-cap-level-1-april-2022-30-september-2022>; Price Cap - 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>

set using forward contract prices across the whole 12 months (to reduce seasonal fluctuation). When the market is in backwardation the forward prices in the later six months are lower than in the first six (the actual price cap period). It brings the price cap level below the cost of purchasing energy for suppliers. Contango is the opposite: the forward prices in the later six months are higher than the first six. This delivers modest gains to suppliers. Backwardation and contango normally net out over the long run. But where there is a lot of volatility and price increases as we have seen here, suppliers may not be able to recover higher than normal backwardation costs in a reasonable amount of time.

In December, we published a Call for Input<sup>2</sup> inviting stakeholder views on two potential options to reduce this risk and establish a more resilient price cap – quarterly price cap updates and price cap contracts. Informed by views from stakeholders and our analysis, we are now issuing a formal consultation on these options, seeking feedback on how changes could be implemented.

The strengthened status quo – a 6-month cap, with the possibility of in-cap reviews in exceptional circumstances, somewhat reduces the volume risk, but not as effectively as quarterly updates. Potential backwardation cost risks would remain. For consumers, they retain current levels of price stability and they would avoid price increases over winter.

Quarterly updates – a 3-month price cap updated quarterly, would significantly reduce volume risk in falling and rising markets. But it does increase potential backwardation costs for suppliers. For consumers, quarterly updates would mean generally smaller price changes but these would be more frequent, including a potential price increase in winter when demand is higher.

The price cap contract – a 6 or 12-month fixed contract without exit fees, should be the most effective at mitigating volume risks and carries either lower backwardation costs (the 6-month fixed contract), or no backwardation cost (the 12-month fixed contract), and thus results in the lowest cost for consumers overall. But the challenge of transitioning and operationalising this are significant – with potential negative impacts on the wholesale market, and challenges around perceptions of fairness for consumers.

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<sup>2</sup> [Adapting the price cap methodology for resilience in volatile markets | Ofgem](#)

Our current view, based on the analysis and stakeholder evidence, is that quarterly updates are the most appropriate price cap reform option for Ofgem to implement in October 2022. But this is finely balanced, so we are consulting on all three options, outlining the issues with each, and asking if stakeholders can offer solutions.

We are also consulting on reducing the advance notice Ofgem gives to suppliers of the updated price cap levels. This helps to reduce the volume risk faced by suppliers and therefore reduces costs that would otherwise need to be reflected in the price cap, reducing prices to consumers.

Finally, we set out options and our preference for a new ex-post mechanism for managing higher than normal costs derived from the backwardation risk. This provides certainty for suppliers, while not burdening consumers with unnecessary costs.

We are confident that these changes will increase the resilience of the price cap in the interests of consumers. Looking further ahead, as the energy market continues to evolve towards a more flexible, diverse and low carbon sector, we will be considering whether further changes are needed to ensure fair prices for consumers, including the most vulnerable, and better facilitate the transition to net zero. This will be considered as part of our wider future retail strategy work, an update on this work will be provided in the spring.

## 1. Introduction

### The context and what are we consulting on

- 1.1. The price cap was introduced in January 2019<sup>3</sup> to ensure that less engaged consumers – who were less likely to actively search for better offers in the market - would pay a fair price for their energy. It is estimated to have saved roughly £1bn<sup>4</sup> for between 10-15m customers each year since the cap was introduced, and driven increased efficiency efforts by suppliers, providing additional long-term benefits to consumers.
- 1.2. However, during periods of extreme wholesale market volatility the current price cap methodology makes it challenging for suppliers to effectively manage volume risks (described in Chapter 2 below). Suppliers also have to manage other costs associated with wholesale market volatility. Ofgem has announced a number of interventions to address these challenges, including an uplift to address high additional costs incurred during the current price cap period<sup>5</sup>.
- 1.3. This consultation sets out proposals to change the price cap to structurally reduce these risks, thereby enabling a more resilient and lower cost price cap in future: (i) two options for a systematic change to the price cap - quarterly updates and a price cap contract, these are compared to a strengthened status quo; (ii) a reduction in the advance notice Ofgem gives to suppliers of the updated price cap levels; and (iii) a new mechanism for managing backwardation costs that are higher than normal expectations.

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<sup>3</sup> [Default tariff cap: decision - overview | Ofgem](#)

<sup>4</sup> Default Tariff Cap: Decision – Final Impact Assessment (Appendix 11) [OFG952 Impact Assessment document\[4\] \(ofgem.gov.uk\)](#)

<sup>5</sup> Price Cap – Decision on the process for updating the Default Tariff Cap methodology and setting maximum charges: <https://www.ofgem.gov.uk/publications/price-cap-decision-process-updating-default-tariff-cap-methodology-and-setting-maximum-charges>



1.4. The remaining consultation is split into 5 chapters:

- Chapter 2 sets out the case for change: the issues that the current price cap methodology creates during a volatile wholesale market; and the cost to consumers now and in the future of not taking action. It asks for views on our assessment of the case for change.
- Chapter 3 sets out the design objective and choices used to develop the proposals, followed by the criteria used to evaluate proposals.
- Chapter 4 sets out proposals for substantial changes to the price cap methodology either through quarterly updates or a price cap contract, including variants of each, and considers their merits against the strengthened status quo. Our current preference is for quarterly updates but we are keen to get more input from stakeholders, in particular on the implementation challenges.
- Chapter 5 sets out our proposal to reduce the minimum notice period Ofgem gives to suppliers of the updated price cap level from 56 days to 28 days.
- Chapter 6 sets out options for addressing systemic backwardation costs.

1.5. These proposals for potential changes to the price cap methodology form part of Ofgem’s approach in responding to recent supplier failures. We are also taking action to ensure companies operating in the retail energy sector are financially resilient. Our sector needs to be much more able to respond to challenges. Ofgem will shortly be publishing a Decision on strengthening milestone assessments and additional reporting requirements, as well as a consulting on Ofgem’s guidance on applying for a gas or electricity license.

## Related Publications

1.6. The main documents relating to the cap are:

- Domestic Gas and Electricity (Tariff Cap) Act 2018: <http://www.legislation.gov.uk/ukpga/2018/21/contents/enacted>;
- Default Tariff Cap Decision: <https://www.ofgem.gov.uk/publications-and-updates/default-tariff-cap-decision-overview>

1.7. The main documents relating to Ofgem’s response on increased wholesale market volatility and the latest price cap level published today are:

- Default tariff cap level: 1 April 2022 to 30 September 2022: <https://www.ofgem.gov.uk/publications/default-tariff-cap-level-1-april-2022-30-september-2022>
- Price Cap - 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>
- Price Cap – Decision on the process for updating the Default Tariff Cap methodology and setting maximum charges: <https://www.ofgem.gov.uk/publications/price-cap-decision-process-updating-default-tariff-cap-methodology-and-setting-maximum-charges>

1.8. The main documents relating to Ofgem’s response on increased wholesale market volatility previously are:

- Adapting the price cap methodology for resilience in volatile markets: [Adapting the price cap methodology for resilience in volatile markets | Ofgem](#)
- Statutory consultation on potential short-term interventions to address risks to consumers from market volatility: [Statutory consultation on potential short-term interventions to address risks to consumers from market volatility | Ofgem](#)
- Rising wholesale energy prices and implications for the regulatory framework: <https://www.ofgem.gov.uk/publications/rising-wholesale-energy-prices-and-implications-regulatoryframework>
- Reviewing the potential impact of increased wholesale volatility on the default tariff cap: November 2021 policy consultation: <https://www.ofgem.gov.uk/publications/price-cap-consultation-potential-impact-increased-wholesale-volatility-default-tariff-cap>
- 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>

## **Our approach to Impact Assessment**

- 1.9. The policy options set out in this document could have a 'significant impact' on the domestic supply of gas and electricity markets, as described under the criteria in s.5A of the Utilities Act 2000. Therefore, an Impact Assessment is required. Due to the urgent nature of this consultation, we consider that a relatively simple Impact Assessment is proportionate in the time available.
- 1.10. Our impact assessment forms part of the discussion of the policy options in this document, rather than being set out in a separate document. The assessment includes quantitative and qualitative analysis of the impacts of potential changes for consumers, suppliers, and the effects on competition, relative to the current price cap methodology. We welcome further evidence in responses to this consultation. We will undertake further distributional analysis on specific options in the next phase of this work.

## **Consultation stages**

- 1.11. This consultation will open on the 4<sup>th</sup> February 2022 and close on the 4<sup>th</sup> March 2022. We will consider all consultation responses carefully and will in due course publish non-confidential responses on our website. We are seeking to publish statutory consultations in May.

## **How to respond**

- 1.12. We want all interested stakeholders to understand the proposal and to feel able to engage in the consultation. Recognising that not all stakeholders are equally familiar with the terminology or concepts discussed, we have provided definitions and explanations at the relevant points in this document. Appendix 1 brings these together.
- 1.13. We want to hear from anyone interested in this consultation. Please send your response to the person or team named on this document's front page.
- 1.14. We've asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

- 1.15. We will publish non-confidential responses on our website at:  
[www.ofgem.gov.uk/consultations](http://www.ofgem.gov.uk/consultations).

## **Your response, data and confidentiality**

- 1.16. 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.
- 1.17. 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.
- 1.18. 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 3.
- 1.19. 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

1.20. 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](mailto: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.](https://www.ofgem.gov.uk/consultations)



Notify me +

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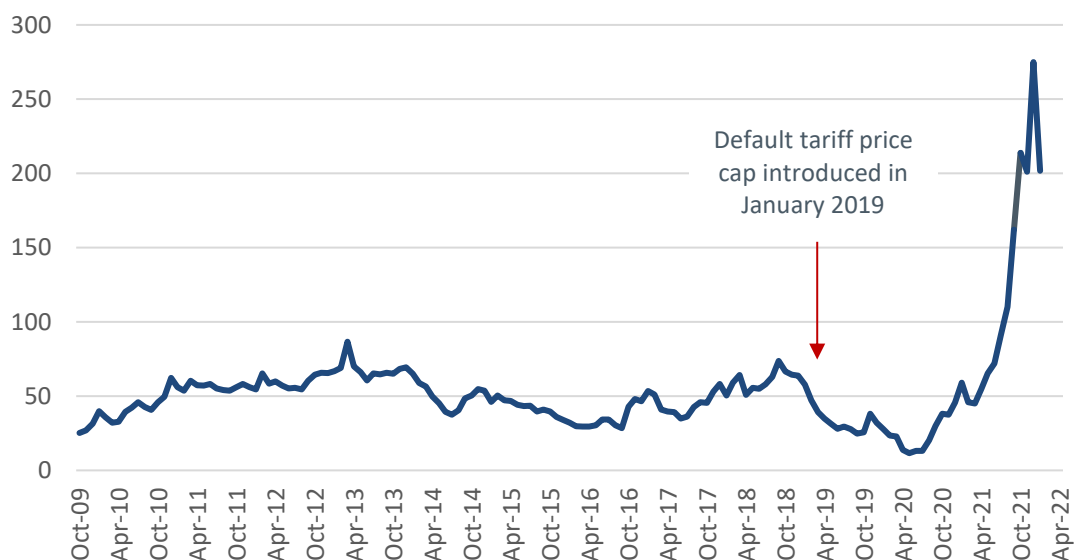
## 2. The case for change

The price cap methodology was developed and designed for a less volatile wholesale market than we currently have. The risks and costs faced by suppliers during this period of extreme wholesale volatility are ultimately borne by consumers, so systematically reducing these is in the interest of current and future consumers.

### There have been significant changes in the wholesale market

2.1. The current price cap methodology reflects the relative stability of the wholesale markets prior to and at the time of implementing the price cap (Figure 2.1). Since summer 2021, the wholesale gas and electricity markets have changed considerably, suppliers are now having to procure gas and electricity for consumers in a fundamentally different context. The chart in Figure 2.1 illustrates the scale of change. Monthly average of day-ahead gas prices remained around 50 pence per therm between 2009 and 2019, when the price cap was introduced. From 2019 to April 2021 the price fell below 50 pence. Then over 2021 the price increased rapidly, peaking at around 275 pence in December 2021.

**Figure 2.1: Monthly average of day-ahead gas prices (p/therm)**

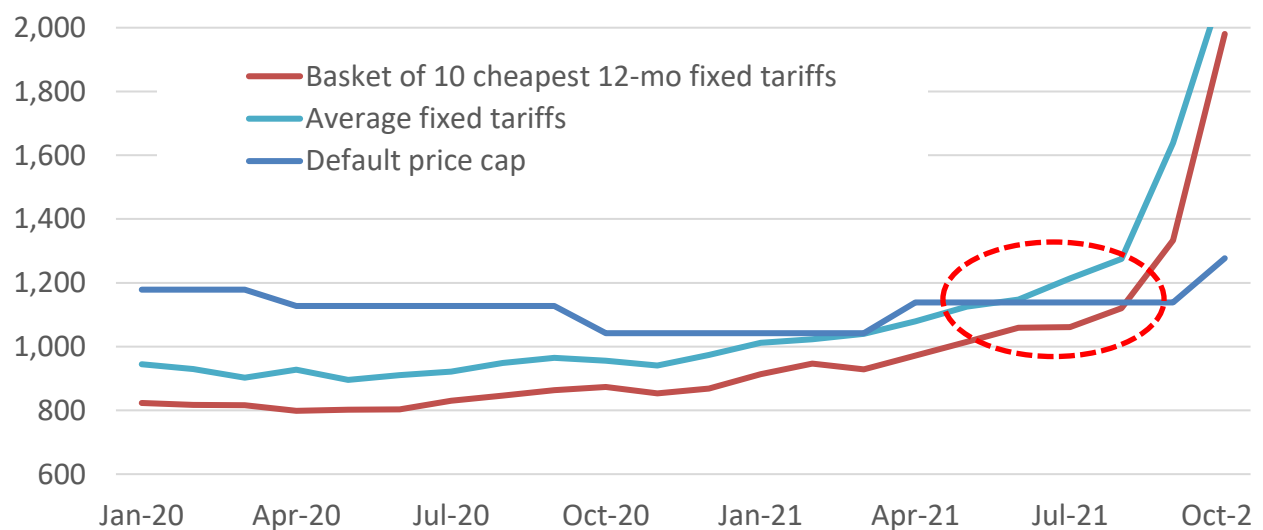


Source: Ofgem website

## The changes in the wholesale markets have changed the role of the price cap tariff in the domestic retail market

- 2.2. Prior to winter 2021 the price cap tariff fulfilled its role in providing price protection for a core, relatively limited and stable number of consumers comprised of:
- 1) Consumers who cannot and/or have not engaged in the market;
  - 2) Consumers who had defaulted onto the price cap tariffs when their fixed tariff ended, many of these people then switched away as there were better deals on the market;
  - 3) Consumers on deemed contracts – a deemed contract is a contract a consumer is on when they’ve not actively chosen to be on it (e.g. when moving to a new home, or when going through the ‘Supplier of Last Resort’ (SoLR) process and are assigned to a new supplier).
- 2.3. Since October 2021, the price cap tariff went from being amongst the most expensive tariff on the market to the cheapest (see Figure 2.2), making it a far more attractive tariff to be on. Consumers who previously would have renewed their fixed term tariffs or those on deemed contracts who would otherwise have switched to another tariff have now stayed on price capped tariffs.

**Figure 2.2: Price of fixed term tariffs vs. default tariff price cap (£/year)**



Source: Energyhelpline / Ofgem

- 2.4. Figure 2.2 is a line chart which compares the annualised price of the default price cap, the average fixed tariff, and the average of the 10 cheapest tariffs, between January 2020 and October 2021. From April 2020 to October 2020, the price cap was around £200 more expensive than the average fixed tariff, and around £300 more expensive than the 10 cheapest tariffs. The circled part of the chart shows where the price cap became the cheaper option. In June 2021 the average fixed tariff became more expensive than the price cap, and in August 2021 the 10 cheapest 12-month fixed tariffs became more expensive than the price cap. By October 2021, the average and cheapest tariffs were around £860 and £700 more expensive than the price cap.
- 2.5. Further to this, the rise in wholesale costs resulted in 26 suppliers failing since August, with their customers now being moved onto the price cap tariff with their new supplier.
- 2.6. The cumulative impact of a price cap at a significantly lower price than fixed tariff contracts, and supplier failures means there are now 22 million consumers on price cap tariffs up from 15 million in recent years, an almost 50% increase in default customers.
- 2.7. This has created a huge challenge for suppliers. Suppliers typically hedge for their price cap customers in advance, forecasting the volume of energy they will need based on the customer numbers and the season. During price cap period seven (Oct 2021 to April 2022), the unexpected increase in price cap customers meant that suppliers had not secured enough energy in advance and had to buy more energy at prices above the cap allowance. As the price they can charge customers on the price cap tariff is set, they were unable to recover the full cost of this more expensive energy. This is known as the volume risk. The cost of this unexpected price cap demand is estimated to be costing suppliers up to £900 million during price cap period seven.
- 2.8. In the addition, suppliers and consumers will also ultimately pay for the cost of failed suppliers going through the SoLR and Special Administration Regime processes. Ofgem



has provisionally approved, from September to the end of December 2021, £1.8bn of SoLR costs.<sup>6</sup>

- 2.9. As and when wholesale energy prices fall, many consumers are likely to move off the price cap tariff onto cheaper tariffs. The supplier they leave is left with more energy than it needs, purchased at a higher cost, before wholesale prices fell. This is the inverse of the period seven cost.

**In the current market conditions, the current price cap methodology creates an unfair playing field for suppliers**

- 2.10. It is the combination of the current market conditions and the current price cap methodology that result in volume risk, specifically:

- 1) **The lag between the period when the prices are set and the corresponding price cap coming into effect** – the greater the lag, the greater the chance of divergence between the prices used to set the price cap level and those in the wholesale market at the time the energy is delivered.
- 2) **Customers may freely switch onto and off of the price cap tariff** – making it difficult for suppliers to effectively forecast demand and hedge accordingly when movements in either direction may be sizeable and unpredictable.
- 3) **The length of time between price reviews** – more frequent price reviews and changes enables suppliers to adjust prices quicker and in-line with market movements, thus limiting the volume risk they face when there is significant volatility in the wholesale markets.

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<sup>6</sup> Notice of derogations to amend the Use of Systems Charges notice period to enable DNOs to recover LRSP payments via networks charges in the regulatory year 2022/23  
<https://epr.ofgem.gov.uk/Content/Documents/Notice%20of%20direction%20to%20amend%20the%20Use%20of%20Systems%20Charges%20notice%20period%20to%20enable%20DNOs%20to%20recover%20LRSP%20payments.pdf>

2.11. The reform proposals set out in this consultation (quarterly updates, price cap contracts, and the shorter notice period) represent different approaches to reducing these risks.

**There have been backwardation costs beyond what was accounted for in the price cap methodology**

2.12. The price cap is based on an annual price (of gas and electricity for 12 months) but updated every six months. The price cap level is set using forward prices, using forward contract prices right across the 12 months. This is done to reduce seasonal fluctuations in price.

2.13. This creates 'basis risk' where suppliers over-recover costs in summer and under-recover in winter. Normally the differences in the prices for winter and summer, combined with the increased demand in winter means that this nets out – i.e. that suppliers are able to recover the full costs in a reasonable period of time.

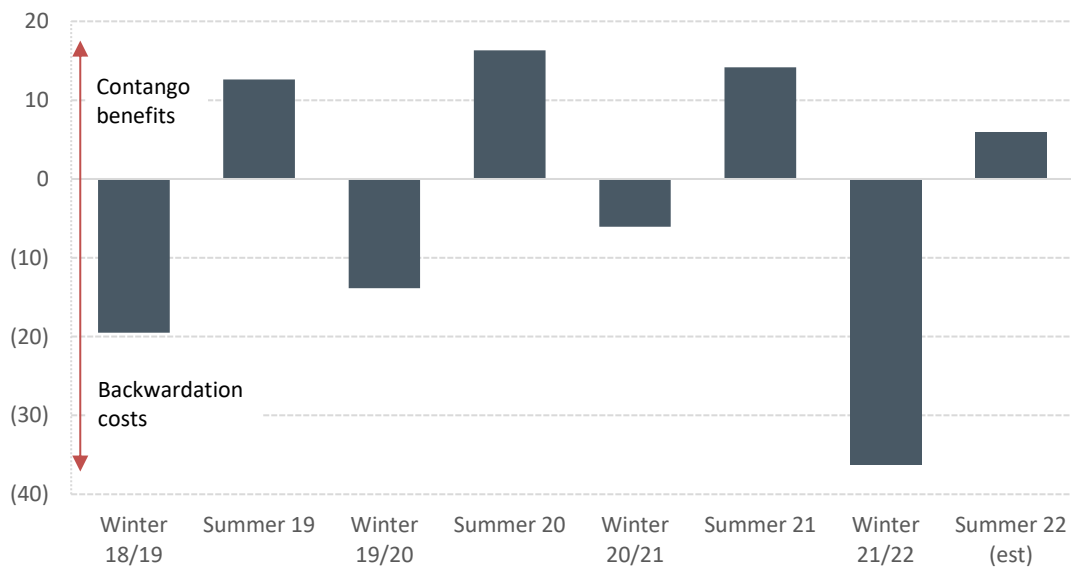
2.14. When the market is in backwardation the forward prices in the later six months are lower than in the first six (the actual price cap period). It brings the price cap level below the cost to suppliers of purchasing that energy for consumers (for that price cap period). In backwardation the market continues to fall in the next cap period so the under recovery isn't fully corrected in the next cap period. Contango is the opposite of backwardation, when the forward market prices for near-term contracts are lower than prices further in the future, a situation which delivers modest gains to suppliers.

2.15. When we first set the price cap, we assumed that the costs of backwardation and benefits of contango would roughly net off in the long run. And, from 2019 until summer 2021, this was the case - suppliers' costs and benefits broadly netted off, but this changed in winter 21/22 (Figure 2.3) – the high prices and volatility mean that backwardation costs are unlikely to net off against future contango. Reflecting this,

suppliers are receiving an uplift of £8 per customer in cap period eight (Apr-Sep 2022) to meet the additional costs they incurred in cap period seven (Oct 2021-Mar 2022).<sup>7</sup>

2.16. Figure 2.3 charts modelled backwardation costs and contango benefits for a theoretical supplier. Backwardation costs per customer are £20, £15, and £7 for winters 18/19, 19/20, and 20/21. Contango benefits per customer are £12, £16, and £13 for summers 2019, 2020, and 2021. Winter 2021 had backwardation cost of £35, with an estimated Summer 2022 contango benefit of £12 (based on prices as of 31 January 2022).

**Figure 2.3: Modelled backwardation costs and contango benefits for a theoretical supplier (£/customer)**



2.17. The extent to which backwardation costs will continue to exceed contango benefits will depend on future wholesale market prices, which are uncertain. But it is important that we have a robust approach for managing such situations.

<sup>7</sup>Price Cap - 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>

### **While the future is unknown, the risks are known**

- 2.18. There are many factors that will influence the market dynamics from weather to unplanned outages and geopolitics. It is not possible to accurately forecast what will happen in the coming months and years.
- 2.19. But as a prudent regulator and recognising the current risks, we need to act to ensure that efficient suppliers can finance themselves.
- 2.20. It is important to be clear that this is not about stacking the deck so that unviable or irresponsibly run businesses can thrive. Our concern is when otherwise well-managed suppliers become unviable or when current and prospective investors don't consider this to be a worthwhile sector to invest in.

### **Addressing this risk is in the interests of current and future consumers**

- 2.21. The current price cap methodology creates clear and immediate risks for suppliers at times of high market volatility. Addressing this is clearly in the interests of suppliers, but it is also in the interest of current and future consumers.
- 2.22. Some of the options proposed here reduce the risk that suppliers face partly by increasing the risks and costs borne by consumers. We realise that this is coming at a time when households have felt squeezed for some time and this is expected to continue.
- 2.23. But the cost to consumers of not taking action to prevent supplier failure is also substantial. In the short term, otherwise viable suppliers may fail or may choose voluntarily exit due to the high risks and low returns. The cost of these exits is met by consumers – the costs to date of suppliers going through the supplier of last resort

process from September to the end of December 2021 was £1.8bn.<sup>8</sup> And fewer suppliers means less competition in the market to drive benefits for consumers.

- 2.24. Ofgem research shows supplier failures may increase consumers' feelings of uncertainty in the market, and that this may impact on their willingness to engage. Findings from our Consumer First Panel indicate that many consumers increasingly value supplier stability, and there is an increasing preference towards the perceived stability of larger, well-established suppliers. Some are still worried about suppliers failing in the future and this risk appears to be impacting consumers' appetite to engage in the market. Restoring consumer confidence and reducing their concerns will help ensure a competitive market in future.
- 2.25. Looking further ahead, the transition to net zero requires an energy sector that is attractive to suppliers, investors and innovators. An attractive and dynamic market, with participants innovating to provide customers with value in energy products and services, is needed to make effective and efficient progress toward net zero. If the risks of participating in the market are too high, it is unlikely that there will be the investment needed for the net zero transition, in turn leading to higher costs in the future.

**Question 1: Are there any other costs and risks to consumers and suppliers that we should consider?**

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<sup>8</sup> Notice of derogations to amend the Use of Systems Charges notice period to enable DNOs to recover LRSP payments via networks charges in the regulatory year 2022/23  
<https://epr.ofgem.gov.uk//Content/Documents/Notice%20of%20direction%20to%20amend%20the%20Use%20of%20Systems%20Charges%20notice%20period%20to%20enable%20DNOs%20to%20rec%20over%20LRSP%20payments.pdf>

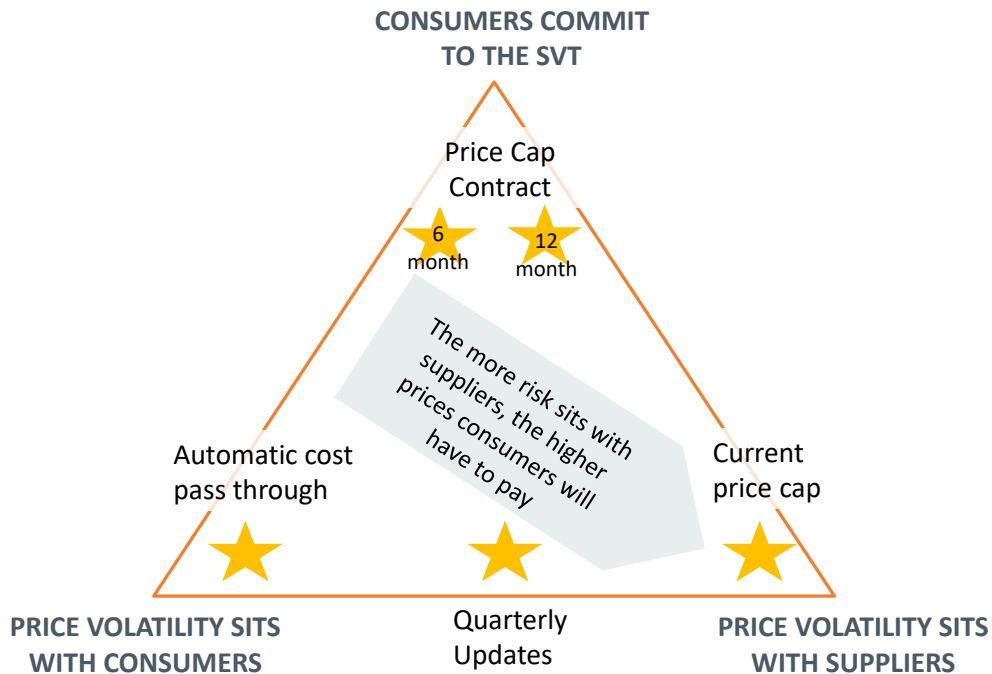
### 3. Designing and evaluating policy options

The development and assessment of the proposals set out in this consultation were guided by the design objective, choices over different elements of the methodology, and evaluation criteria set out in this chapter.

#### Design objective

- 3.1. Our objective is to make changes to the price cap methodology to retain the benefits of price cap protection for consumers while minimising longer term costs that occur due to supplier failures, a lack of confidence in the market from investors and ineffective competition.
- 3.2. We plan to reduce longer term costs to consumers by substantially reducing or removing unmanageable risk which either result in supplier failures, or in higher levels of allowances or ex-post adjustments that would need to be built into the price cap.
- 3.3. There is a balance of risks between consumers and suppliers. These risks relate to who bears the volatility risk (currently suppliers do), and how easy it is for consumers to join or leave the price cap, and on what terms (customers are currently free to join and leave at any point). These trade-offs are illustrated in Figure 3.1. This has been distilled into a series of interconnected design choices relating to:
  - the length of the cap period and frequency of the updates (how much volatility is in the price cap - shorter price caps and more frequent updates move volatility to consumers);
  - the length of the observation window and notice period; (how close the price of the price cap is to the price in the market at point the price cap starts); and
  - how freely consumers can move on and off the price cap tariff.

Figure 3.1



3.4. Figure 3.1 is a triangle-shaped diagram illustrating the trade-offs involved in designing a price cap. In the bottom right corner, energy price volatility sits with suppliers, as in the current cap design. The bottom left corner is price volatility sitting with consumers, as it would if energy costs were immediately passed through. Quarterly updates are located in between these two extremes. At the top corner of the triangle, consumers commit to a fixed-tariff, which reduces the risk of the fixed price being different from the cost of supplying the energy; the most committed option would involve an exit fee for consumers – the proposal for a fixed contract in this consultation would not include an exit fee.

### Development and evaluation of the options

3.5. In developing and evaluating the options, we have considered the costs and benefits and assessed these against the following questions:

- **To what extent does it mitigate the risk or solve the problem?** For example, does this reduce the volume risk for suppliers? What is the impact on the backwardation risk?

- **What is the short-term impact on consumers?** For example, what is the cost impact? What will the consumer experience be?
- **What are the implications for the retail and wholesale markets?** For example, how might consumers respond? Could it drive odd hedging behaviour by suppliers? Is there a risk of poor liquidity in the products suppliers need?
- **What are the implementation risks and challenge?** Can suppliers and the system manage this policy? What might the short-term impacts on the wholesale market be? how long would it take? What is the experience for consumers during the transition?



## 4. Changes to the price cap methodology - a finely balanced choice

We have developed three options - quarterly updates; price cap contract and a strengthened status quo – to improve the robustness of the price cap methodology. There are trade-offs for each. Quarterly updates significantly reduce volume risk, and is relatively simple to implement, but could mean mid-winter price changes. The price cap contract would be the lowest cost to consumers but has significant implementation challenges. The strengthened status quo is a credible fallback option, but leaves the structural problems unresolved. We consider quarterly updates to be the best option at this time. But reflecting the finely balanced nature of this, we are keen to get stakeholder views on these, in particular the feasibility of their implementation.

### There is no perfect solution

4.1. As set out in Chapter 2, the current price cap methodology presents a real challenge to suppliers in periods of high and volatile energy prices. The Call for Input<sup>9</sup> set out three options: (i) an enhanced strengthened status quo; (ii) quarterly updates and (iii) price cap contracts (previously called fixed term default). Drawing on our own analysis, and stakeholder responses to the Call for Input, we have further developed these options, and set them out below. As our analysis shows, each involves trade-offs between the risks and costs borne by consumers and suppliers. Currently, we consider that quarterly updates strike the best balance across the trade-offs.

### The options

4.2. A short description of each option is set out below, Table 4.1 compares different aspects.

- **A strengthened status quo:** As per the current price cap tariff, this has a six-month cap period, but with a reduced notice period of one month (from the current two). It is

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<sup>9</sup> [Adapting the price cap methodology for resilience in volatile markets | Ofgem](#)

enhanced further through the ability to, in extreme circumstances, adjust the price cap in-period<sup>10</sup>.

- **Quarterly updates:** A three-month cap period, updated quarterly and with a one-month notice period. We are also considering a variant which is updated every four months, with a one-month notice period.
- **Price Cap contract:** this would be either a six- or twelve-month contract, without exit fees. (We consider that exit fees disproportionately impact low-income consumers and is still a strong option without them.) There would be six or twelve price cap levels, depending on the option, updated either 6-monthly or annually respectively, on a rolling cycle. A key distinction from the strengthened status quo or quarterly update options, is that the price cap contract closes to new customers at the end of a month, and a new price cap contract with a different price level starts for new customers in the following month. There are options and complexities around implementation, these are set out below.

**Table 4.1: Overview of each price cap option**

Element	Status quo	Strengthened status quo	Quarterly updates	Price cap contract 6-month	Price cap contract 12-month
<b>Cap period / frequency of changes</b>	6 months	6 months	3 months	6 months	12 months
<b>Average price lag</b> (average time on contract and average time the related hedge was purchased)	8 months	7 months	4 months	4.5 months (but price of the contract very close to market prices at the start, with little delay)	7.5 months (but price of the contract very close to market prices at the start, with little delay)
<b>Forward contracts for determining price cap level</b>	12 month	12 month	12 month	12 month	12 month
<b>Frequency of updates for non-wholesale costs</b>	6 monthly	6 monthly	6 monthly	6 monthly	Annually

<sup>10</sup> Price Cap – Decision on the process for updating the Default Tariff Cap methodology and setting maximum charges: <https://www.ofgem.gov.uk/publications/price-cap-decision-process-updating-default-tariff-cap-methodology-and-setting-maximum-charges>

- 4.3. The following section of this chapter focuses on the assessment of these options considering: volume and backwardation risk; consumer experience; operational considerations and transitional arrangements. The analysis is then brought together in a summary.

## **Analysis Part 1 - Volume and backwardation risks**

### Volume Risk<sup>11</sup>

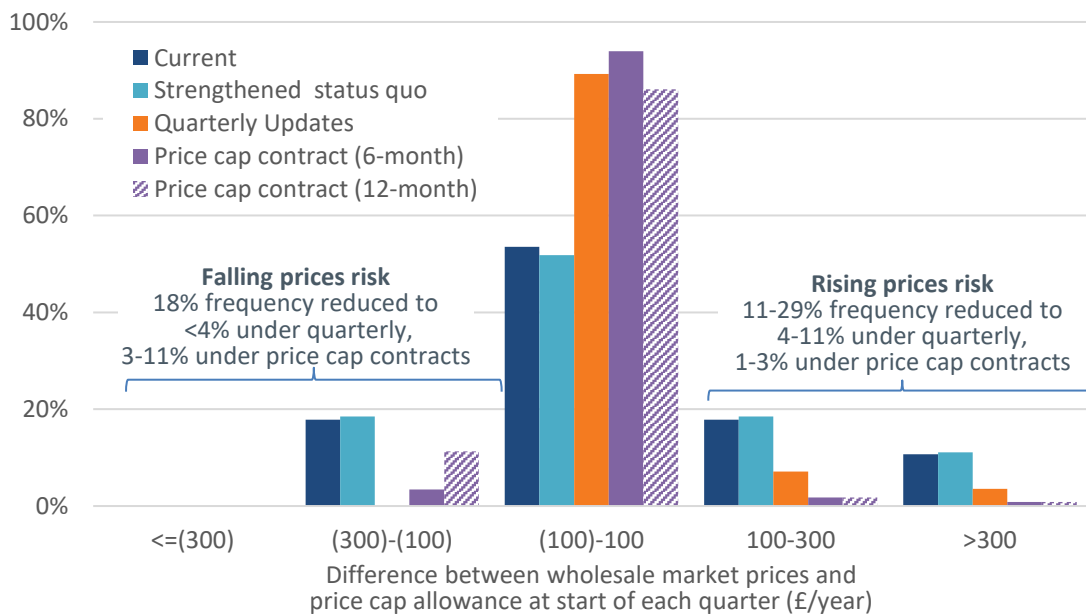
- 4.4. Given that a prudent supplier would typically purchase energy well in advance of customer demand, volume risk arises where there are significant differences between the *expected* price spread between the price cap tariff and Fixed Term Contract (FTC) market offers and the actual outturn.
- 4.5. **Strengthened status quo** provides little extra protection to suppliers in relation to volume risk compared to the current methodology (Figure 4.1). The introduction of the in-period re-opener means the strengthened status quo cap could provide some protection in a period of rising prices, in exceptional circumstances.
- 4.6. **Quarterly updates** are effective at reducing volume risk because both the observed prices are closer on average to delivery and observations are updated more frequently. We estimate from the historical counterfactual that it would reduce volume risks by 60-80%. The combination of more frequent price changes and the reduced length of the price cap period reduces the likelihood of a supplier experiencing volume risk and limits the impact of such an event.
- 4.7. **The price cap contract** is effective at managing the rising prices volume risk – almost fully mitigating it – because the price in any month will be similar to equivalent fixed term contracts in the market, and it is only open to consumers at that price who joining within a that month. There remains a falling prices volume risk under price cap

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<sup>11</sup> To assess the volume risk, we have examined the historical counterfactuals of how consumers may have responded when switching to/from price cap tariffs with the different designs (i.e. updated quarterly, etc) in effect. This provides a theoretical indication of the level of volume risk cost that an efficient supplier faces based on the information available at the time. We have also sought to assess how those different designs impact suppliers and consumers under many different possible ways in how future price may evolve using Monte Carlo analysis.

contracts as consumers are able to leave before the end of the six or twelve months. Historically around half of consumers are inactive for various reasons and many others have made choices that reveal non-price preferences (or they lacked awareness of cheapest tariffs). Furthermore, while the divergence in price between a particular price cap and the market grows over time, the remaining value (and therefore potential loss for suppliers) diminishes and the resulting risk premium is relatively small (potentially about 6% of wholesale cost for 12-month contract, about 2% for 6-month contract, depending on consumer response).

**Figure 4.1: Frequency of wholesale cost allowance deviations vs. market under historical counterfactual price cap options (£/year, Q2 2015-Q1 2022)**



Note: All options using existing methodology of 12-month forwards  
Source: Ofgem analysis

**Question 2: To what extent would a price cap contract without exit fees leave suppliers carrying volume risk in a falling prices scenario? How significant would this risk be? How might it be mitigated?**

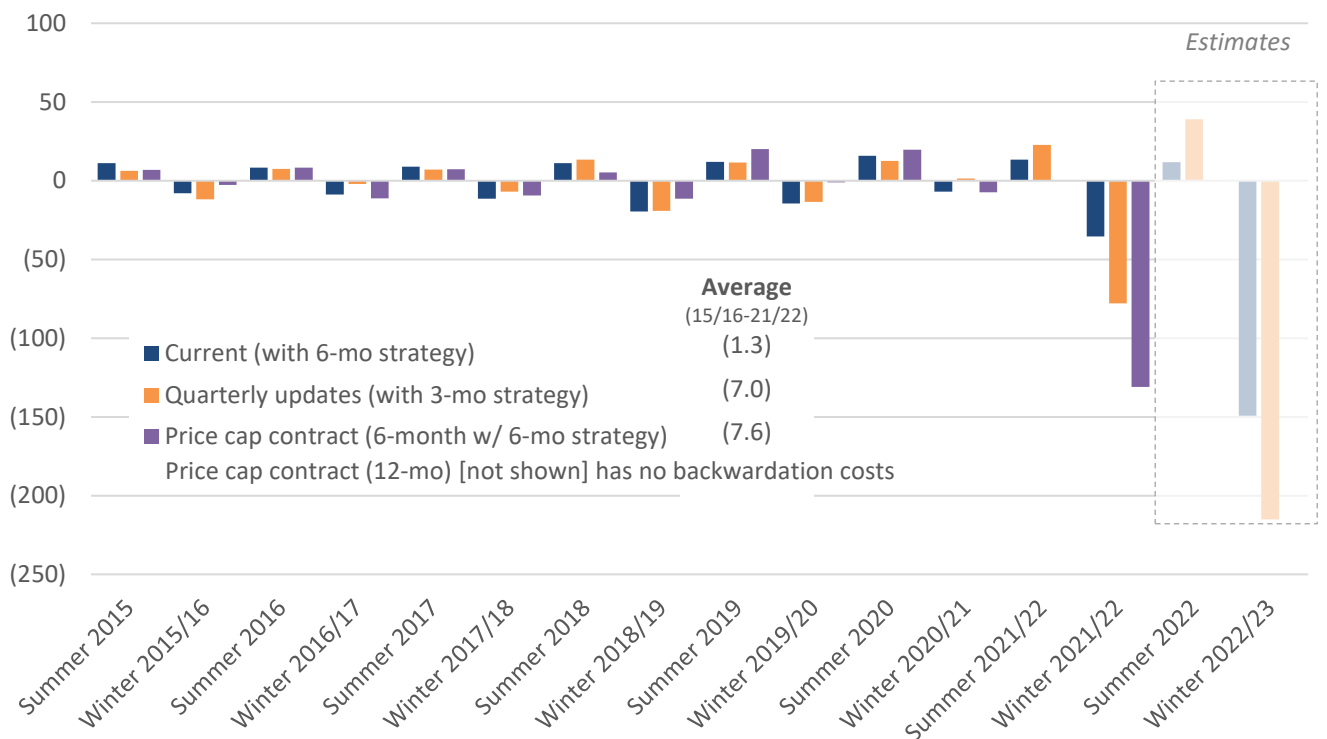
Backwardation cost risk

4.8. The **strengthened status quo, quarterly updates** and **6-month price cap contract** (based on 12-month hedges) all have a significant risk of excessive backwardation costs

(Figure 4.2). With the **12-month price cap contract**, backwardation risk is completely removed.

**Question 3: Quarterly updates are a balance between the reduced volume risks and the increase backwardation risks. Please provide evidence and data on the relative costs and benefits of this.**

**Figure 4.2: Contango benefits and backwardation costs under historical counterfactual price cap designs (£/customer)**



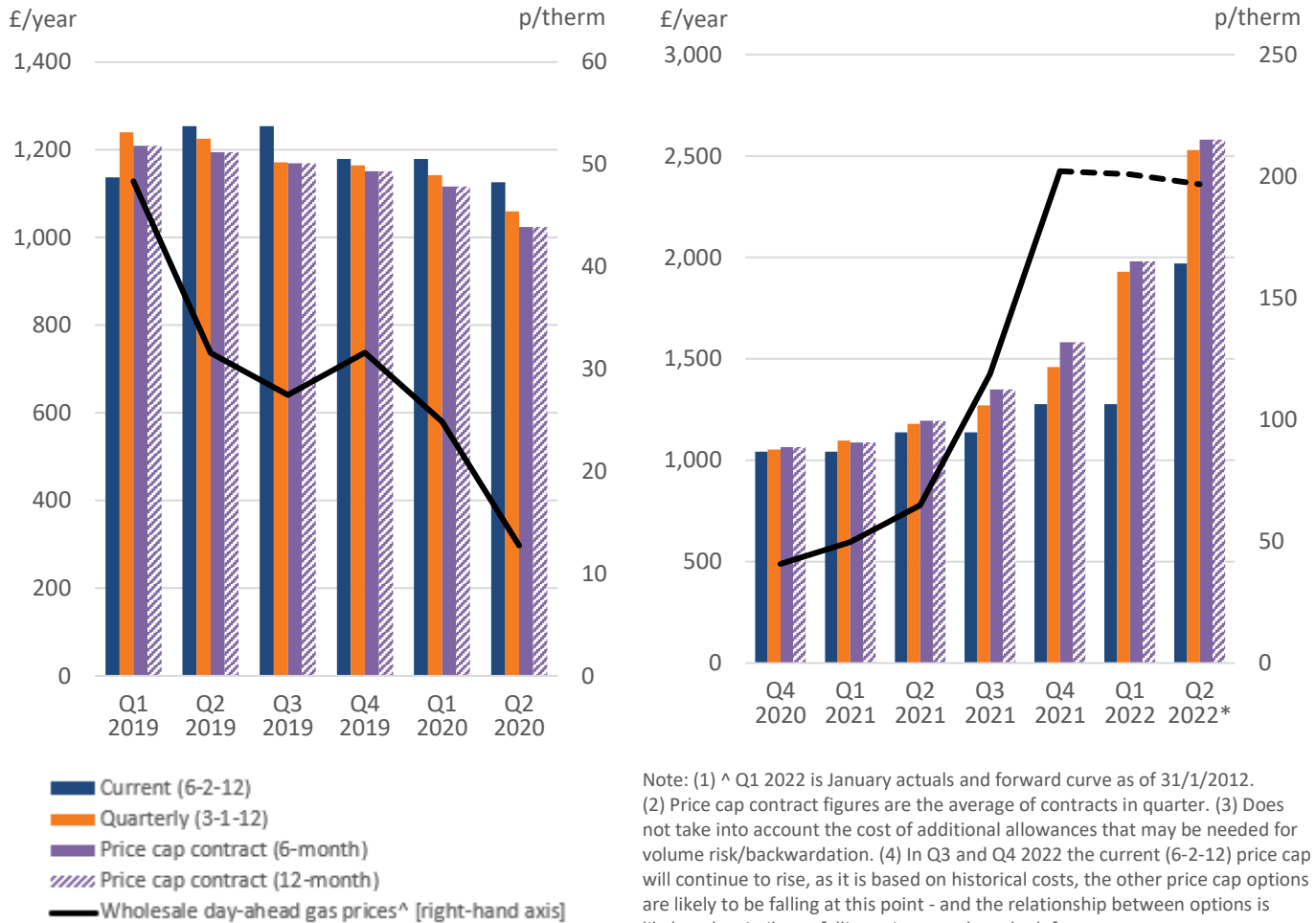
Note: All options using existing methodology of 12-month forwards. Costs at typical demand. Estimates as of 31/1/2022.  
Source: Ofgem analysis

**Analysis Part 2 - Consumer experience**

Cost

4.9. The balance of risk and costs between suppliers and consumers is at the heart of this issue. Our goal is to minimise costs for consumers, recognising that leaving suppliers facing high, hard to manage risks will ultimately lead to higher costs for consumers.

**Figure 4.3: Historical counterfactual price cap levels excluding backwardation and volume costs under periods of falling (left) and rising (right) prices (£/year)**



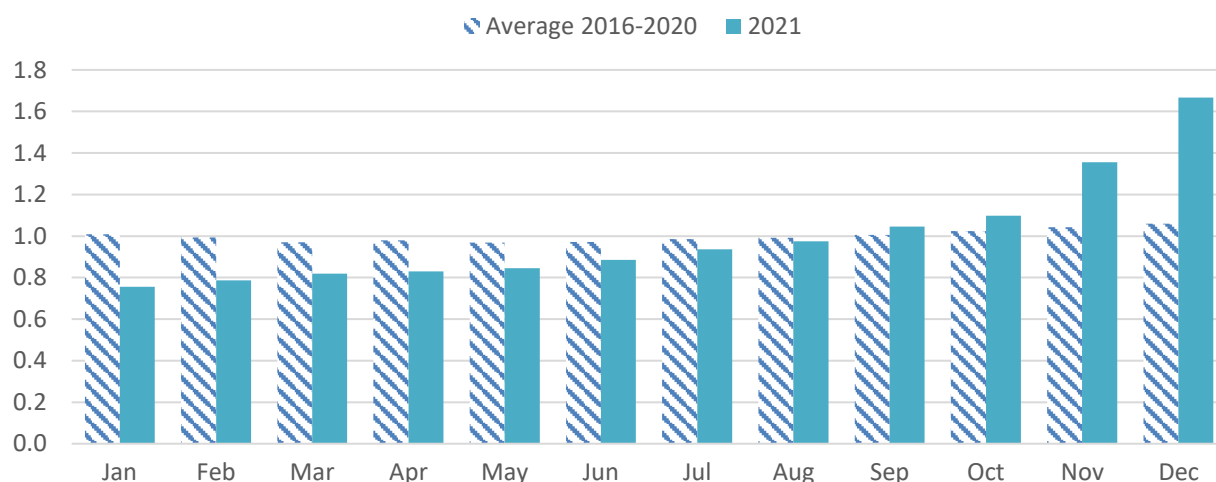
4.10. Figure 4.3 illustrates the price cap level under the different options. The **strengthened status quo** is not plotted on the chart but we consider the current (6-2-12) (blue bars) to be similar. The annual prices set out in Figure 4.3 *do not* represent the total cost to consumers. The cap level does not include uplifts for excessive backwardation costs; volume risks in rising or falling markets, nor the costs associated with supplier failures or exist. Table 4.2 below provides an overview of these additional costs and an assessment of the net outcome.

4.11. Both **quarterly updates** and **price cap contract** price levels are set by looking at observation windows which are much closer in time to the start of the price cap contract. This means both options are more closely aligned to movements in the wholesale market. However due to their shorter cap length (3 months long) **quarterly**

**updates** will expose consumers to rising prices more quickly but will also pass through falling wholesale price more quickly to consumers. The **status quo** (6-2-12) would have a longer lag before falls in wholesale prices would be passed through to consumers.

- 4.12. **Price cap contract** with a staggered transition (see 4.39) is expected to be the lowest cost for consumers (see Table 4.2). Volume risk is considerably reduced with both the 6- and 12-month options, the 12-month price cap contract also has no backwardation risk (or accordingly seasonality) and the spread of contracts expiring across the calendar year helps this further.
- 4.13. The start month is the only real difference between each price cap contract. Wholesale costs will inevitably differ as prices in the wholesale market rise and fall, so consumers would have higher or lower prices depending on the wholesale cost at the time their cohort starts the price cap contract. While the prices they are charged will reflect the economic cost of supplying energy, consumers (and others) might wonder why their neighbour is in “cheaper” cohort, or feel angry that their grandmother is on a more “expensive” cohort.
- 4.14. In reality, if their neighbour has just started a “cheaper” cohort price cap and this is due to falling wholesale prices, the consumer could switch to a very similar 12-month contract in the competitive sector for a lower cost. Conversely, if their grandmother has just received a price rise, wholesale prices will be rising for everyone, and unfortunately the economic cost of supply will have increased.
- 4.15. In extreme market conditions, such as experienced in 2021, the price cap contracts opening at the end of the year could be more than 60 percent higher than average (Figure 4.4). We recognise that this is more complex than the current arrangements and for many consumers, this is not an issue they spend much time considering – nor should we expect them to – so many consumers may find this difficult to understand or consider it to be “unfair”.

**Figure 4.4: Relative average prices of price cap contracts starting each month**



Note: Normalised so that the average of each year equals 1.  
Source: Ofgem analysis

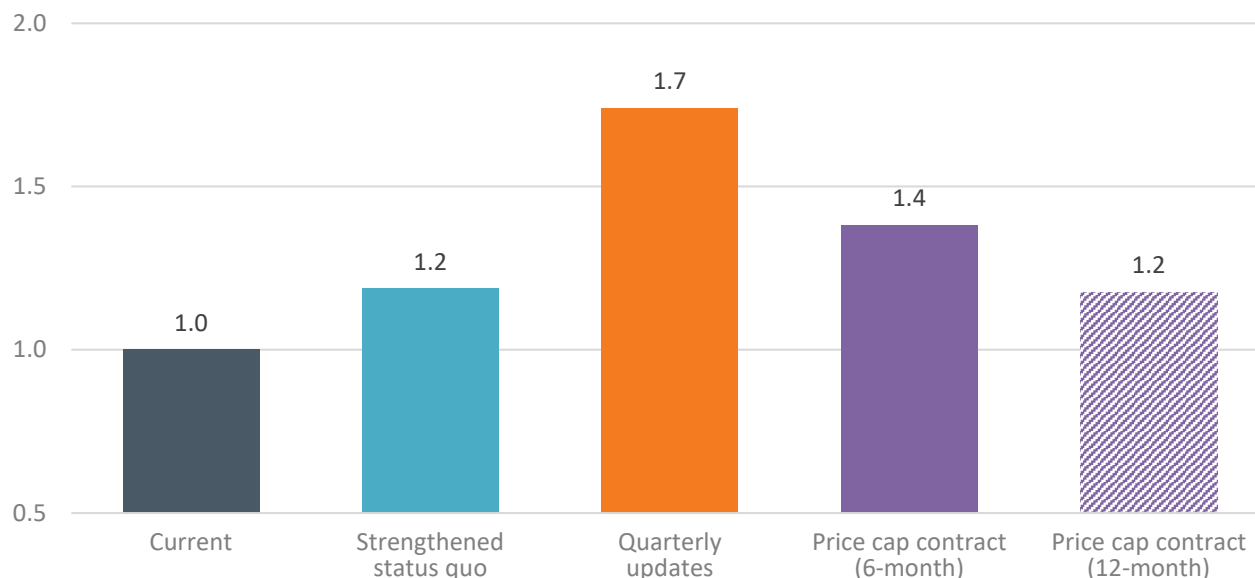
### Price volatility

- 4.16. A key element of the design of the options is whether the cost of market volatility sits with suppliers or consumers. Figure 4.5 shows the volatility of the different options. All of the options have more volatility than the current methodology – in part due to the shorter notice period. **Quarterly updates** has the highest level of volatility, with more frequent price changes, although each one would likely be a smaller change than at present or under price cap contracts. But this will include one over winter and it is a key trade-off.
- 4.17. Our Consumer First Panel found that some consumers were concerned about the potential for a price increase over winter when they would be using more energy. Given the use of 12-month futures prices to set the price cap level, prices would not usually rise significantly during the winter (historical counterfactual suggests on average by around 4% in Q1). But in extreme market situations such as this winter, there would be a large rise. The four-month variant would enable changes in mid-winter months to be avoided, although would mean less reduction in volume risks.
- 4.18. Price volatility has an impact on budgets and can increase concerns for consumers. For households with pre-payment meters (PPM) the impact is immediate. Whereas this can be smoothed to an extent for customers paying by standard credit or Direct Debit. We



will do further distributional analysis specific to the chosen option if we move to statutory consultation.

**Figure 4.5: Price volatility under historical counterfactual price cap options normalised vs. status quo (Q4 2017-Q2 2022)**



Note: Volatility expresses as quarterly standard deviation normalised vs. actual, Q4 2017-Q2 2022. Based on estimates as of 24/1/2022  
Source: Ofgem analysis

**Question 4: Please provide further evidence on the impact of quarterly updates and price cap contracts on households and their finances, and how these could be mitigated?**

**Question 5: Do you think it is unfair that consumers would sometimes have higher or lower prices depending on the wholesale cost at the time their cohort starts the price cap contract? Do you think over the longer run this would even out?**

#### Engagement

4.19. There are a number of factors that impact consumer engagement. We have focussed on how often a consumer is prompted to engage, the nature of the engagement and the size of the price changes (and potential gains from switching).

4.20. The **strengthened status quo** is likely to have a similar effect on engagement as the current approach – we would expect the changes to be of a similar magnitude – and

will be larger than those under a quarterly update option and will be every six months. Larger, less frequent changes potentially provide greater incentive for engagement, and generate more media attention than smaller, less frequent ones, which may be another effective channel for driving engagement.

- 4.21. **Quarterly updates** will have more frequent but smaller changes in magnitude than the other options. The frequency increases the likelihood that consumers will be prompted to engage in the market. But the smaller price movements might not be big enough to prompt customers to switch.
- 4.22. There is a potential added complexity regarding the Personal Projection (PP)– this is a calculation used by suppliers and switching sites to enable consumers to compare tariffs. The calculation is based on an annualised cost, as future prices for variable tariffs are not known, the PP annualises the rate the customer is paying at the time. For quarterly updates, the accuracy of their PP will be impacted by the fact that their price rate will change three more times in the year. This could lead to consumers making a poor switching choice.
- 4.23. The **price cap contract** will be easier for consumers to compare against competitive fixed term contracts in the market. There is also the potential to create an occasion around the price cap contract ending which could provide a foundation for building a habit of renewing their contracts, as consumers may do in other parts of their life. This will have been familiar to many of the consumer currently on the price cap tariff.
- 4.24. A consumer searching the market would need to be able to accurately identify their tariff – we know that consumers often don't know basic information about their tariff, such as its name. The price cap contract may add further complexity to this, there may be up to 12 price cap contract levels for a consumer to choose from. If they choose the wrong one, they could make a poor switching choice, consumers could choose the wrong one and make a poor switching decision on that basis.

**Question 6: What opportunity and impact could each proposal have on consumer engagement? Where there may be negative impacts, please provide options to address these. (Please provide evidence.)**

## **Analysis Part 3 - Operational considerations and transitional arrangements**

### **Operational considerations**

- 4.25. Operationalising the **strengthened status quo** would be the same as the current approach, albeit within a more condensed timeframe due to the shorter notice period.
- 4.26. **Quarterly updates** will mean more frequent price cap related communication, updates to direct debit levels and implementing price change. This may increase in the numbers of customer contacts at the time of price changes but the smaller price changes may dampen this. Suppliers are often in regular contact with their customers, as such this may not be a significant change in their day-to-day practices.
- 4.27. For many consumers their bills are based on estimated readings. When a price changes and an accurate meter read is provided there needs to be a reconciliation of what price is charged for what demand. Quarterly updates would need this to be reconciled four times a year.
- 4.28. The operational considerations for the **price cap contract** depend on how it is implemented. In both the six and twelve month contract options, suppliers would need to implement a price level within a month (as with the other options) and a cohort of customers would be contacted monthly. But the size of the cohort would depend on the whether an immediate or staggered transition was taken. For an immediate transition, the majority of customers would be in a single cohort. Whereas they would be split into smaller cohorts in the staggered transition.

**Question 7: What other operational impacts could a quarterly update or price cap contract have? Please provide data on the costs and benefits**

### **Transition and implementation**

- 4.29. We have not identified significant operational challenges regarding the implementation and transition to the **strengthened status quo** or **quarterly updates**.

4.30. To note, and as set out in our Guidance letter<sup>12</sup>, in the transition to a new methodology Ofgem would take into account the prices of hedges that we would expect an efficient supplier to have been purchasing from February 2022 (based on the current methodology), until suppliers are provided with updated information.

**Question 8: Are there any challenges in transitioning to quarterly updates or the strengthened status quo? If so, please provide details.**

4.31. The transition to a price cap contract is challenging. Either consumers move all together to the new system, and so the vast majority are on the same one of the six or twelve price cap contracts, with destabilising impacts for energy futures markets as suppliers try to hedge an entire year (or half year) of energy requirements in a single month; or a fair and easy to explain method has to be found to split consumers across the six or twelve contracts, which could have significantly different costs.

4.32. To facilitate feedback, we set out two options for implementation by October 2022:

- **immediate:** transition all consumers on the current price cap tariff to a single price cap contract that begins on 1<sup>st</sup> October 2022,
- **staggered:** transition all consumers on to one of six or twelve price cap contracts, determined by the date they started being billed for the price cap tariff (or its predecessor) at their current address<sup>13</sup>.

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<sup>12</sup> Guidance on treatment of reasonable risk management practices in future default tariff cap proposals, <https://www.ofgem.gov.uk/publications/price-cap-guidance-treatment-reasonable-risk-management-practices-future-default-tariff-cap-proposals>

<sup>13</sup> This date would be based on the MPAN records "Supply Effective from", and suppliers would need to link in any gas and related meters on the same account (can use REL to cross check related meters)

## Immediate transition

### Customer transition:

- 4.33. At 1st of October 2022 - All customers currently on the price cap tariff would start a six or twelve -month price cap contract on the 1st October 2022.
- 4.34. During October 2022 - Customers whose FTC ends October and don't switch tariffs, and those who go onto a deemed contract during October and again don't switch tariff would be on the October price cap contract. Consumers could also elect to switch to the tariff.
- 4.35. Subsequent months, from November – customers joining price cap contracts after October would be those whose FTC has ended and they haven't chosen a new tariff, and those who are put onto a deemed contract and again haven't switched, or those who have actively chosen to switch to that tariff.

### Hedging and wholesale market transition:

- 4.36. Year 1 - For the first year, as set out above Ofgem would take into account the prices of hedges that we would expect an efficient supplier to have been purchasing from February 2022 (based on the current methodology), until suppliers are provided with updated information. - this should help spread out supplier purchasing somewhat. There would still be an impact on the wholesale markets over August 2022, with suppliers buying any remaining required hedges not already purchased. The price cap contract methodology then assumes no purchasing of hedges until the following August 2023 (for 12-month price cap contracts), or February (for 6-month price cap contracts). This absence of demand might create problems for generators and other market participants seeking stable predictable cashflow and contracting activity spread throughout the year.
- 4.37. First renewal- six-month contract: This would be on 1<sup>st</sup> April 2023, with all the energy for the customers needing to be secured in the preceding February. This would condense the purchasing into one month and we see a similar liquidity risk as set out below.

- 4.38. First renewal- twelve-month contract: This would be on 1<sup>st</sup> October 2023, with the twelve months demand needing to be purchased in the August. This is likely to result in liquidity challenges, with very high demand for energy, and potentially not enough supply, therefore suppliers are likely to face significantly higher prices. As such, we do not think it is feasible or preferable to transition all consumers on to the same price cap contract on the month, as this is likely to create a higher cost price cap contract. In addition, everything else remaining equal, wholesale prices would likely drop following the 6-8 week observation period, and suppliers would then be able to offer lower priced competitive fixed tariffs, potentially exacerbating volume risks.
- 4.39. A price cap contract with an immediate transition will be higher cost relative to the staggered start (described below) for two reasons: (i) high demand and lack of sufficient liquidity in the wholesale markets during August (for an October start to the price cap) is likely to result in higher prices (ii) there is much less diversification of risk for suppliers - the majority of customers are in the same price cap contract cohort and cycle.

**Question 9: What would the impact be if suppliers tried to buy the energy requirements for all their customers on price cap contracts in August (for 12 month contracts) or August and February (for 6 month contracts) of each year? Do stakeholders agree there would be liquidity challenges in the wholesale markets? How damaging would this be? Are there any ways to avoid this issue?**

#### **Staggered transition**

- 4.40. The description below is for the twelve month price cap contract, the similar principles could apply for the six-month price cap contract. The time periods would just be condensed and the number of customers in each cohort would be bigger.

#### Customer transition:

- 4.41. As of 1<sup>st</sup> of October 2022: All price cap tariffs would be moved to one of twelve different cohorts. The price would be the same for each cohort but the contract for each cohort would finish on different months.

- 4.42. Allocation to the cohorts: This could be based on the month a customer (or address<sup>14</sup>) started on the price cap tariff (or its predecessor), for example:
- Customer A may have been on a fixed term contract that finished in November 2021, they would be in the November cohort;
  - Customer B may have moved house in May 2004, they would be in the May cohort,
  - Customer C may have been on a default tariff with the same supplier since privatisation in April 1998, they would be in the April cohort.
- 4.43. Suppliers would advise customers of their “cohort” prior to the start of the price cap contract.
- 4.44. For a six-month price cap contract, customers would need to be allocated into six rather than twelve cohorts. Again, this could be done based on the when the customer started on the price cap tariff – but grouping two months together. For example, customers who started in January and July could be in a single cohort, February and August in another cohort, etc.
- 4.45. From December 2022 customers would be notified of price changes: From December Ofgem would notify suppliers of the January Price Cap Contract price level. Suppliers could choose to charge at or under that level. They would notify their January cohort of the price for their January price cap contract and remind them of their options.
- 4.46. From January 2023: The process set out above would be repeated in successive months until the last cohort – the December cohort, are notified in November.
- 4.47. There will be real challenges in communicating this effectively and clearly, with concerns around fairness, particularly if the price level differs significantly between cohorts (as futures markets currently suggest would be the case).

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<sup>14</sup> As mentioned previously, this date would be based on the MPAN records “Supply Effective from”, suppliers could need to link in any gas and related meters on the same account (can use REL to cross check related meters)

**Question 10: If we were to implement the price cap contract, how should we implement it - with an immediate start and single cohort on a price cap, or with a staggered start and six or twelve different cohorts?**

**Question 11: What is a fair and practical way to allocate consumers to different cohorts?**

### **Analysis Summary**

4.48. In this Chapter we've analysed the impact four options against a number of functions. The key findings are summarised in Table 4.2 below. The analysis demonstrates that the choices are finely balance. For example:

- The strengthened status quo is simple to implement, avoids price changes in winter but does not address the volume risk;
- The value of addressing volume risk at the expense of backwardation costs and price changes during winter for winter, as we see with the quarterly updates;
- The potential benefits of price cap contracts appear clear but the implementation challenges are considerable – including issues of fairness, and there would be price changes over winter.



**Table 4.2: Summary of each price cap option, drawing on the analysis set out in this chapter**

Element	Status quo	Strengthened status quo	Quarterly updates	Price cap contract 6-month	Price cap contract 12-month
<b>Volume risk - rising prices</b> (see Figure 4.1)	£40-70 /customer in extreme circumstances	Lower cost than status quo - reopener allows changes to price cap under extreme volatility	60-80% Lower than status quo - more frequent price-cap updates	<b>Best options</b> Very small risk (small delay between observation window and market price)	
<b>Volume risk - falling prices</b> (see Figure 4.1)	£30-70/customer in extreme circumstances	Slightly lower cost than status quo due to reduced notice period	<b>Best option</b> for falling prices - risk reduced	Lower than status quo	Similar or higher than (~20%) status quo, depends on consumer behaviour
<b>Backwardation risk (£/customer)</b> (see Figure 4.2 & §)	Around £35* in price cap 7; around £140 total in periods 8/9**	Around £35* in price cap 7; around £140 total in periods 8/9**	Around £78 in price cap period 7	Around £74 in price cap period 7	<b>Best option</b> No backwardation risk (hedge matches contract length)
<b>Net cost impact to consumers</b>	<b>Highest cost:</b> need to cover volume and backwardation risk in volatile markets	Will need to price in volume and backwardation risk in volatile markets	Will need to price in volume & backwardation risk in volatile markets	Low volume risks, but backwardation risks remain	<b>Likely overall to be the cheapest option</b> (lower volume risk – rising prices, zero backwardation cost)
<b>Price levels and changes</b>		Stable prices for six months, no price rises over winter	Four price changes per year (possible price rises in winter)	Consumers might not see rapid benefit from falling prices.  Price changes for some customers over winter	Stable prices, BUT this limits consumer benefit as prices fall.  Price changes for some customers over winter
<b>Other customer impacts – engagement and fairness; cost of supplier failure (SoLR and SAR)</b>	SoLR costs: £1.8bn approved in Dec 2021, SAR costs: the government has set aside a loan of £1.69bn			Issues of fairness and complexity - different prices for consumers renewing in different months	Easier for consumers to compare with market  Issues of fairness and complexity - different prices for consumers renewing in different months
<b>Implementation</b>	N/A	<b>Best option</b> Very easy to implement (many components in place)	Simple to implement (like status quo)	Very challenging to implement by Oct 2022	Very challenging to implement by Oct 2022

Note: § Until Summer 2021, backwardation costs & contango benefits roughly netted off (approx. £4/customer) \* Based on modelled results with no deadband; \*\* Based on latest futures prices.

## Variations

4.49. There are a number of variations described below that are not mutually exclusive.

### Variants of the strengthened status quo

4.50. There could be a **six-month hedge** – this would address backwardation risks by removing the basis risk. Consumers would be exposed to increased volatility and seasonality.

### Variants of the quarterly update

4.51. A variation of the quarterly updates could be a **4-month cap**, updated every four months. This would reduce the number of price changes and budgeting adjustment consumers would need to make. It could also remove the need for a price change during the winter. For suppliers, three rather than four price changes a year would reduce their operational demands. But the reduction in volume risk would not be as great, and it might be harder for suppliers to find corresponding hedging products in the wholesale market, which currently offers quarterly contracts (although there is low liquidity of these contracts) but not 4-monthly.

4.52. The **forward prices** for setting the price cap could be based on six months rather than 12. This would expose consumers to greater price volatility and the impact of seasonality. But would significantly reduce backwardation costs.

4.53. There could be a six-month **observation window** – this would smooth prices further but would increase the disconnect between the prices used to set the cap and the prices during the price cap period, undermining the intended benefits of moving to quarterly updates.

4.54. More volatile **non-wholesale costs** such as Contracts for Difference or BSUoS could be updated on a three-month cycle in the quarterly updates. This would increase cost reflectivity, but at a higher administrative burden to both suppliers and to Ofgem.

### Variants of the price cap contract

- 4.55. In addition to the two variants described throughout the chapter (the six-month and the twelve-month contracts) other variations are:
- 4.56. The inclusion of **exit fees**. This would reduce the volume risk to suppliers due to falling prices. There was strong opposition from consumer groups. Feedback from our Consumer First panel suggested that while some consumers would accept an exit fee, this would need to be a nominal amount (£5), which is likely to be considerably lower than what would be needed. However, the presence of a visible charge would have a direct impact on consumers by acting as an upfront barrier to switching. Consumers in vulnerable circumstances would be disproportionately affected as exit fees would be a barrier to low-income households from seeking cheaper tariffs even though they would be likely to benefit most for paying less for their energy. Those that switch would spend a greater proportion of their income on exit fees in comparison to high-income households.
- 4.57. For the 6-month price cap contract, the **forward prices** for setting the price cap could be based on six months rather than 12. This would address the backwardation costs but would expose consumers to greater price volatility and the impact of seasonality.

**Question 12: Should we consider any of these variations further? If so, which one(s) and on what basis? (Please provide evidence)**

## 5. Reducing the notice period to a minimum of 28 days

Ofgem is currently required to give suppliers almost 2 months' notice of updated price cap levels. We are proposing to reduce this to 28 days because we consider doing so to have benefits to suppliers and consumers. We are proposing to implement this change by October 2022 irrespective of which of the wider price cap changes are chosen. We are looking for feedback on our analysis and the operational impacts of a reduced time period.

### A 28-day notice period

- 5.1. Our proposal is to reduce the notice period Ofgem is required to give suppliers of a subsequent price cap level from almost 2 months to 28 days (1 month) as set out in SLC28AD.19 of the standard licence conditions (SLC) for electricity supply.<sup>15</sup>
- 5.2. The current 2-month period was introduced on the basis that it provides suppliers with sufficient time to make the necessary preparations for the price change. We consider that reducing this to a minimum of 28 days has benefit to both suppliers and consumers.

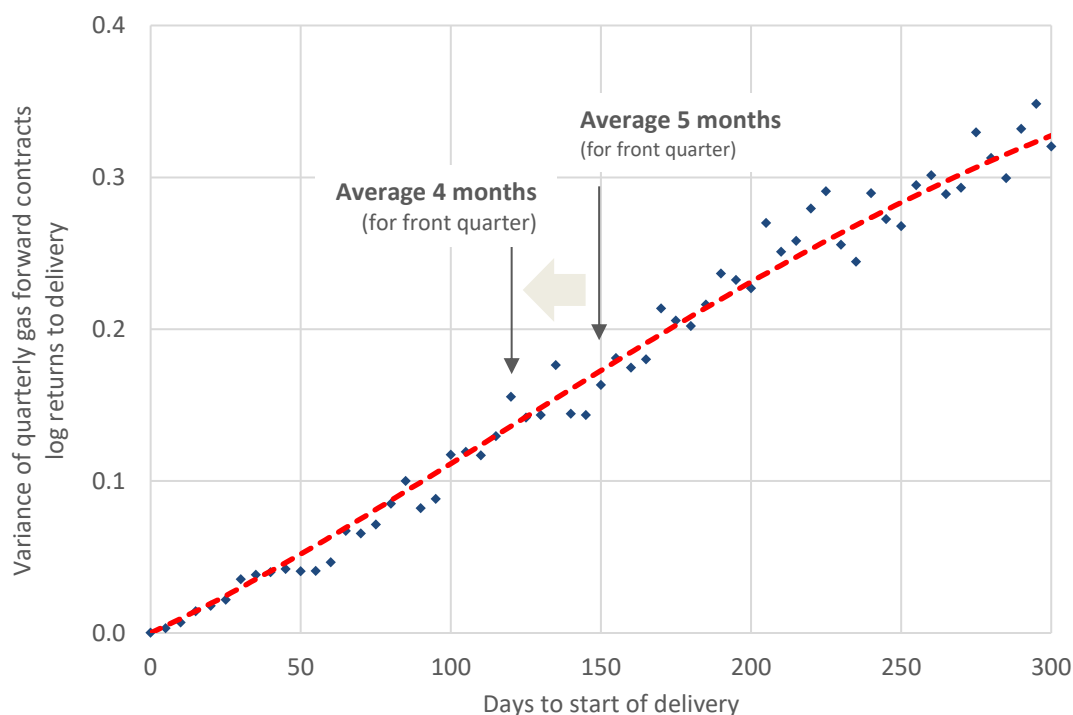
### A reduced lag between setting the price cap and it taking effect, reduces the risk to suppliers

- 5.3. Reducing the notice period, reduces the potential likelihood and extent to which wholesale market prices can diverge from the price used to set the price cap level. As the average time between hedging in the observation window to start of delivery is reduced from five to four months, this reduces the variance between forward contract and delivery prices by 20% (Figure 5.1).

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<sup>15</sup> The equivalent in respect of gas supply is standard licence condition 28AD.19.

**Figure 5.1: Average volatility of gas contracts away from delivery (2013-2021)**

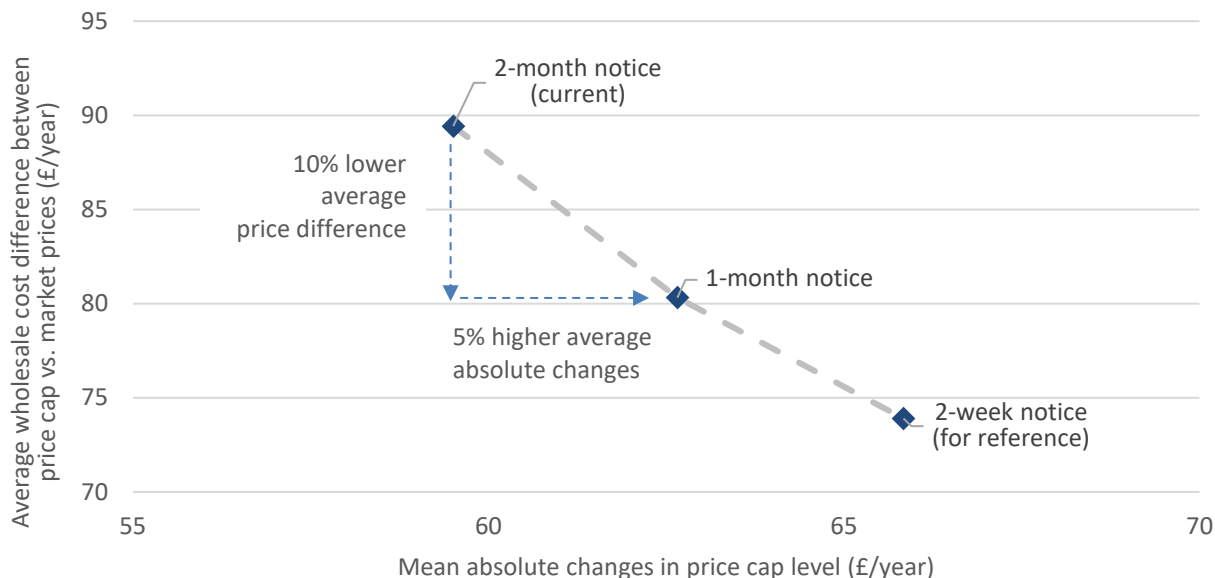


Note: Dots represented 5-day averages.  
 Log returns are defined as the logarithm of price at delivery over the forward price a number of days previously.  
 Source: Ofgem analysis

**Consumers benefit because shorter notice periods reduce the difference between the price cap tariff and market prices but slightly increase the size of price changes between price cap periods**

- 5.4. Assessing the historical counterfactual, a minimum of 28 days’ notice period would have meant 10% lower average difference between the wholesale cost component of the price cap and prevailing market prices for the same period (Figure 5.2).
- 5.5. But the reduced notice period would increase retail price volatility, partly because wholesale prices become more volatile as the contracts approach the date for delivering the contracted energy.

**Figure 5.2: Trade-off of reducing the possible wholesale cost difference between price cap and market vs. higher price cap volatility from reducing the notice period**



Note: Based on historical counterfactuals summer 2015 - summer 2022.  
Source: Ofgem analysis

### Timing is a key factor in engaging consumers to consider their options

5.6. Previous Ofgem trials have shown that a timely notice of a price change can be an effective ‘moment of change’ to prompt customers to consider their options.<sup>16</sup> Where notification is made in advance of a price change, the reminder of a clear deadline can help to reduce procrastination.<sup>17</sup> But sufficient notice must be given to allow consumers adequate time to understand the impact on them resulting from the change and what their options may be.

### Operational considerations

5.7. For the majority of suppliers, operationalising price cap changes is now a “business as usual” activity. This proposal would require them to do so in a shorter time frame. Whilst it may be more challenging, we would expect developments in billing systems,

<sup>16</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2019/09/end\\_of\\_fixed\\_term\\_communication\\_trial\\_report.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2019/09/end_of_fixed_term_communication_trial_report.pdf)

<sup>17</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2018/11/cs1\\_qualitative\\_report\\_for\\_publication\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2018/11/cs1_qualitative_report_for_publication_0.pdf)

customer service and general supplier operations to enable the necessary activities to be completed in the 28 day period.

- 5.8. For the avoidance of doubt, suppliers would still be required to comply with the requirements set out in *SLC 0 – Treating Domestic Customers Fairly* and all other relevant SLCs.

### **Implementation**

- 5.9. This would be implemented through an amendment to SLC28AD. Our intention would be to set out a minimum notice period of 28 days that Ofgem be required to give suppliers of the new price cap level.

**Question 13: Do you have any evidence or data that supports or challenges our assessment of the benefits this? What are the practical considerations for price changes over winter and Christmas?**

**Question 14: Do you have evidence or data to support a move to a shorter implementation window – such as 14 days? What are the potential risks to consumers of a shorter notice period? And what are the operational considerations?**

## 6. A new mechanism for managing backwardation costs

This chapter sets out proposals for a new mechanism to compensate suppliers when they have incurred higher than normal backwardation costs that we do not expect them to have been able to offset against contango benefits and recovered within the normal timeframes. Our preferred option is an ex-post adjustment.

### **Addressing backwardation costs that have materially departed from the efficient cost level**

- 6.1. The price cap is based on a 12-month price but updated every six months. The 12-month price cap level is set using forward contract prices for the first six months and the second six months (to reduce seasonal fluctuation). When the market is in backwardation the forward prices in the later six months are lower than in the first six (the actual price cap period). It brings the price cap level below the cost of purchasing energy for suppliers. In backwardation the market continues to fall in the next cap period so the under recovery isn't fully corrected in the next cap period. Contango is the opposite: the forward prices in the later six months are higher than the first six. This delivers modest gains to suppliers. Backwardation and contango normally net out over the long run.
- 6.2. The price cap methodology accounts for backwardation and contango on the basis that they will net off over the long run. As we set out in 2.14, until summer 2021 this was true, with the net position from previous periods totalling less than £1/customer.
- 6.3. There may be circumstances – such as in price cap period seven – where there are costs that are in excess of a normal range. However, the need for any such mechanism is linked to any decisions on the more systematic changes set out in Chapter 4. A mechanism is only needed if the price cap methodology does not sufficiently reduce the risk to suppliers of excessive backwardation costs that will not be recouped in a reasonable period.



## The options

6.4. We have considered four options including making no change. Of these, our preferred option is the introduction of a new mechanism for ex-post adjustments and more details are provided below. It is similar to the approach taken for cap period seven but is formalised, providing more comfort to suppliers.

### Option 1 – Do nothing

- **What:** Where there is evidence of excessive costs, we may make an adjustment in future periods but are not committing to this.
- **Supplier impact:** Potentially undermines financial resilience and provides no comfort that excessive costs can be managed but provides a strong incentive for suppliers to minimise volume risk or backwardation risk.
- **Consumer impact:** Does not build in costs for backwardation to price cap level. But may face increased costs due to supplier failures or higher supplier risk premium/capital costs.

### Option 2 – Ex-post adjustments

- **What:** Adjustments are made ex-post where there is evidence of costs in excess of a predetermined levels. Our current intention would be to make this adjustment based on average actual backwardation costs faced by the supplier.
- **Supplier impact:** Provides certainty that there is a mechanism and clarity around thresholds. Incentivises good risk and cost management.
- **Consumer impact:** Does not build in extra unnecessary costs for consumers. Any adjustment will be in the price cap period following a period of backwardation, so would normally smooth a falling price rather than add to a rising price.

### Option 3 – Matching the length of the hedge used in the price cap calculation with the length of the price cap period

- **What:** The price cap period would match the length of the modelled hedge used in the price cap calculation, i.e. a 12-month hedge and a 12-month price cap period.
- **Supplier impact:** This would fully address the excessive cost risk (assuming suppliers manage their own costs effectively).
- **Consumer impact:** Aligning the price setting period to the price cap period would, for three or six month contracts, significantly increase price volatility for consumers,

including regularly higher prices during the winter, which has budgetary impacts and increases anxiety.

#### **Option 4 – increase the modelled allowance for backwardation costs ex-ante**

- **What:** Develop and build in a modelled cost to the price cap levels.<sup>18</sup>
- **Supplier impact:** Addresses excessive cost risk (assuming suppliers manage their own costs effectively). Could result in windfall gains if the costs are less than the modelled costs. Does not necessarily incentivise good risk management.
- **Consumer impact:** Builds in extra costs, which at times maybe windfall gains for suppliers. An ex-ante adjustment would normally add an extra cost at a time of already rising prices.

#### **Mechanism for ex-post adjustments**

6.5. Our preferred option is a mechanism that would allow for ex-post uplift for excessive (beyond a historical average) backwardation costs. This would be an enduring mechanism to take effect from October 2022. Whilst similar to the approach taken in price cap period seven, a key difference is that it would be a formalised mechanism that sits in the licence, so provides suppliers with greater certainty.

We consider this to strike the best balance at ensuring suppliers are able to operate effectively and incentivise them to manage risk effectively, whilst ensuring that consumers are not paying excessive costs.

#### How it would work

6.6. Following the winter season when there were high and/or volatile prices, suppliers would provide Ofgem (via RFI, which we would consult on) with their backwardation costs. Using this data, once quality assured, Ofgem would determine the average

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<sup>18</sup> For interest a review of submitted supplier models can be found in the appendix of Price Cap - 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>

actual costs, and then provide an uplift for costs in excess of the deadband, to be recovered in the following price cap period.

- 6.7. For the cap period seven the deadband was calculated taking the mean modelled backwardation and contango costs across a three year period, covering cap periods one through to six. We then created a deadband at one standard deviation around this mean. We propose to use this approach going forward, potentially adjusting the historical period used to calculate the deadband if needed to exclude outliers.
- 6.8. We propose making a similar calculation for instances of contango, to ensure that, in the same way that suppliers are compensated for excessive backwardation costs, excessive contango benefits are returned to customers via price cap reductions.
- 6.9. Our preference in the price cap is generally to take an ex-ante approach. But in this instance, we believe that an ex-post position is better for consumers. Most importantly it does not build in costs to consumers that may result in windfall profits for suppliers.

**Question 15: Given the changes in the wholesale market since summer 2021, how should these be reflected in the deadband calculation?**

**Question 16: Do you have any views on the challenge of collecting backwardation costs from suppliers via RFI?**

**Question 17: Are there additional costs or benefits of taking an ex-post approach in this instance? If so, please provide details or evidence of these.**

## Appendices

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## Appendix 1 – Glossary

Term	Description
<p><b>Backwardation and contango, and basis risk</b></p>	<p>The price cap is based on an annual price (of gas and electricity for 12 months) but updated every six months. The price cap level is set using forward prices. Put very simply, the 12-month annual price level is set using forward contract prices for across the 12 months. This is done to reduce seasonal fluctuations in price.</p> <p>This creates ‘basis risk’ where suppliers over-recover costs in summer and under-recover in winter. Normally the differences in the prices for winter and summer, combined with the increased demand in winter means that this nets out – i.e. that suppliers are able to recover the full costs in a reasonable period of time.</p> <p>When the market is in backwardation the forward prices in the later six months are lower than in the first six (the actual price cap period). It brings the price cap level below the cost to suppliers of purchasing that energy for consumers (for that price cap period). Contango is the opposite of backwardation, when the forward market prices for near-term contracts are lower than prices further in the future, a situation which delivers modest gains to suppliers.</p> <p>When we first set the price cap, we assumed that the costs of backwardation and benefits of contango would roughly net off in the long run. And, from 2019 until summer 2021, this was the case.</p>
<p><b>Contracts for Difference (CfD)</b></p>	<p>CfD contracts offer a guaranteed income level for eligible generation which bid for these contracts in a competitive process overseen by the Low Carbon Contracts Company (LCCC).</p>
<p><b>Deadband</b></p>	<p>A ‘deadband’ in this document refers to an approach to quantify what a normal range of costs would be. We use a deadband in this decision to estimate the ‘normal’ basis spreads suppliers would have experienced during cap period seven.</p>
<p><b>Forward Price (or Forward Curve)</b></p>	<p>A forward price is the predetermined price for energy to be delivered in the future. A forward contract. Is a contract to buy or sell energy at price and time in the future.</p>

<b>Hedging</b>	Hedging is where suppliers purchase energy to enable them to minimise the potential risk posed by any volatility of energy prices. Often they will buy contract to get energy in the future.
<b>Interim Levy Rate (ILR)</b>	An Interim Levy Rate (ILR), which is determined by the Low Carbon Contracts Company (LCCC) by reference to forecasts (of demand, generation, market prices, weather, etc.) and paid daily by suppliers on a £ per MWh supplied basis. It is intended to cover payments to CfD generators over a given calendar quarter (known as the 'rate period').
<b>Price Cap Methodology</b>	<p>The level of the price cap is based on a broad estimate of how much it costs an efficient supplier to provide gas and/or electricity services to a customer. The level is currently updated every six months, either reflecting changes in underlying costs, or increases in inflation. The calculations cover:</p> <ul style="list-style-type: none"> <li>• Wholesale energy costs: how much a supplier has to pay to get the gas and electricity to supply households with energy.</li> <li>• Network costs: the regional costs of building, maintaining and operating the pipes and wires that carry energy across the country. This causes the level of the cap to vary by region.</li> <li>• Policy costs: the costs related to government social and environmental schemes to save energy, reduce emissions and encourage take-up of renewable energy.</li> <li>• Operating costs: the costs incurred for suppliers to deliver billing and metering services, including smart metering.</li> <li>• Payment method uplift allowance: the additional costs incurred through billing customers with different payment methods.</li> <li>• Headroom allowance: this allows suppliers to manage uncertainty in their costs.</li> <li>• Earnings Before Interest &amp; Taxes (EBIT): a fair rate of return on suppliers' investments.</li> <li>• VAT: 5% tax added to the level of the tariff.</li> </ul>
<b>Price Cap Period</b>	<p>Period six – 1 April 2021 to 30 September 2021.                      Period seven – 1 October 2021 to 31 March 2022.                      Period eight – 1 April 2022 to 30 September 2022.</p>

**Volume Risk**

Volume risk can happen in two ways. When energy prices rise sharply, active consumers will move to the price cap tariff, leaving suppliers with higher demand than they expected or hedged for, which they have to meet at high market prices. When prices fall, those consumers then move off the price cap tariff, this time leaving suppliers with unexpectedly low demand. In both cases, this can cause large, hard to avoid losses for suppliers, which can ultimately lead to higher prices for consumers.

## Appendix 2 – Stakeholder Views

In December 2021, Ofgem published a [Call for Input](#) on '*Adapting the price cap methodology for resilience in volatile markets*', which closed in January 2022. We received 21 responses from suppliers, consumer groups and charities, price comparison websites, industry participants, and individuals. The purpose of the Call for Input was to collect views on how the price cap has responded in the face of increased volatility, and comments on whether change was needed, ahead of this policy consultation.

NOTE: In the Call for Input, we used the term "fixed term default tariff", we have changed the name of this option in the consultation to "Price Cap Contract". The summary of stakeholder views has used the term "price cap contract" alongside the term "fixed term default tariff" for clarity.

### Respondent views on the case for change

There was widespread agreement from respondents that the pressure put on the price cap by current wholesale market conditions, with the price cap level substantially below wholesale energy costs and 7 million more customers' tariffs at the cap level, is undesirable from both a consumer and supplier perspective.

Consumer groups stressed the value of the price cap in shielding consumers from immediate wholesale volatility, while recognising that this was not sustainable. Supplier responses strongly articulated the challenges they face in the current price cap period (1<sup>st</sup> October – 31<sup>st</sup> March 2022), particularly the volume risk challenge in procuring energy for a customer who may be on a standard variable tariff at the price cap as prices rise, and leave for a fixed-term contract in the competitive market if prices were to fall.

Respondents agreed that doing nothing would not solve the problem. Most responses agreed that the price cap needed reform, in line with Ofgem's goal to protect the interests of consumers and rebuild consumer and investor confidence in the market. However, many respondents highlighted that there was no perfect option that fully achieves all objectives, and said that Ofgem would have to work with stakeholders over the coming months to find the right balance.

### Respondent views on the options for reform



Ofgem consulted on three main options: status quo with re-opener, quarterly updates, and price cap contract (fixed term default tariff). Alongside this, it set out three other options that had formed part of discussions but were not taken forward due to them not tackling the issue effectively. These were monthly direct pass-through, relative price cap across the market and relative price cap within suppliers.

In general, there was no preferred option across respondents. Many responses didn't state a preference out of the three main options, instead favouring a combination; many suggested further work on other options, such as the relative price cap, or measures to protect specific groups of consumers through a social tariff. There were, however, clearer trends when broken down into sub-groups.

Most consumer groups preferred the status quo with re-opener option, and as a second choice, quarterly updates. Consumer groups favoured the former as it would maintain most protections for consumers, including vulnerable and fuel poor households. On quarterly updates, there was agreement that this would help address some of the risks to suppliers, and would therefore help, but there were concerns about how this would impact costs for consumers, as well as incentives to switch. Outside of these areas there was strong support for ensuring there were no price cap increases during the winter months. On price cap contract (fixed term default tariffs), consumer groups had considerable reservations, with many deeming it unacceptable in its current form, due to exit fees and consumers paying different amounts depending on when started the tariff.

Price comparison websites tended to favour the status quo with reopener and quarterly updates over the price cap contract (fixed term default tariffs), largely due to the complexity of the latter. Further comments focused on how to ensure consumers can engage with the system, and are aware of what changes may occur, whilst ensuring the risks identified for suppliers are mitigated. These included limiting the number of reviews of the price cap within period, as well as setting timings for changes to come into effect to avoid confusion.

For suppliers, we saw differences between larger and smaller suppliers' views. Whilst many suppliers, large and small, stressed the need to consider a relative price cap as their principal option, views were less consistent on the other options. Larger suppliers, for instance, favoured a price cap contract (fixed term default tariff) over quarterly updates, whilst small suppliers had reservations. On status quo with a reopener, there was broad agreement that

this may create additional challenges for suppliers, including around hedging in the case of a reopener.

Most large suppliers favoured price cap contract (fixed term default tariffs) owing to it going the furthest in addressing structural issues with the price cap, including volume risk and backwardation. They also, generally, had a preference towards a 12 month tariff over 6 months. Concerns that they did have focused on transition and implementation challenges, including how to communicate these changes to customers. On quarterly updates, comments focused on the volume and backwardation risk remaining, as well as enduring challenges for hedging.

Conversely, small suppliers were less supportive of the price cap contract (fixed term default tariffs), due to the complexity of the system, as well as the impact it could have on attitudes towards switching. They were also more likely than large suppliers to see implementation of this model as a major barrier to its roll out in October 2022.

## Appendix 3 – Consultation questions

### Chapter 2 – The case for change

Question 1: Are there any other costs and risks to consumers and suppliers that we should consider?

### Chapter 4 – Changes to the price cap methodology

Question 2: To what extent would a price cap contract without exit fees leave suppliers carrying volume risk in a falling prices scenario? How significant would this risk be? How might it be mitigated?

Question 3: Quarterly updates are a balance between the reduced volume risks and the increase backwardation risks. Please provide evidence and data on the relative costs and benefits of this.

Question 4: Please provide further evidence on the impact of quarterly updates and price cap contracts on households and their finances, and how these could be mitigated.

Question 5: Do you think it is unfair that consumers would sometimes have higher or lower prices depending on the wholesale cost at the time their cohort starts the price cap contract? Do you think over the longer run this would even out?

Question 6: What opportunity and impact could each proposal have on consumer engagement? And where there may be negative impacts, please provide options to address these. (Please provide evidence.)

Question 7: What other operational impacts could a quarterly update or price cap contract have? Please provide data on the costs and benefits

Question 8: Are there any challenges in transitioning to quarterly updates or the strengthened status quo? If so, please provide details.

Question 9: What would the impact be if suppliers tried to buy the energy requirements for all their customers on price cap contracts in August (for 12 month contracts) or August and February (for 6 month contracts) of each year? Do stakeholders agree there would be

liquidity challenges in the wholesale markets? How damaging would this be? Are there any ways to avoid this issue?

Question 10: If we were to implement the price cap contract, how should we implement it - with an immediate start and single cohort on a price cap, or with a staggered start and six or twelve different cohorts?

Question 11: What is a fair and practical way to allocate consumers to different cohorts?

Question 12: Should we consider any of these variations further? If so, which one(s) and on what basis? (Please provide evidence)

### **Chapter 5 – Reducing the notice period to a minimum of 28 days**

Question 13: Do you have any evidence or data that supports or challenges our assessment of the benefits this? What are the practical considerations for price changes over winter and Christmas?

Question 14: Do you have evidence or data to support a move to a shorter implementation window – such as 14 days? What are the potential risks to consumers of a shorter notice period? And what are the operational considerations?

### **Chapter 6 – A new mechanism for managing backwardation costs**

Question 15: Given the changes in the wholesale market since summer 2021, how should these be reflected in the deadband calculation?

Question 16: Do you have any views on the challenge of collecting backwardation costs from suppliers via RFI?

Question 17: Are there additional costs or benefits of taking an ex-post approach in this instance? If so, please provide details or evidence of these.

## Appendix 4 – 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](mailto: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. i.e. a consultation.

#### **3. With whom we will be sharing your personal data**

***(Include here all organisations outside Ofgem who will be given all or some of the data. There is no need to include organisations that will only receive anonymised data. If different organisations see different set of data then make this clear. Be as specific as possible.)***

#### **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 ***(be as clear as possible but allow room for changes to programmes or policy. It is acceptable to give a relative time e.g. 'six months after the project 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 3<sup>rd</sup> 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** (Note that this cannot be claimed if using Survey Monkey for the consultation as their servers are in the US. In that case use “the Data you provide directly will be stored by Survey Monkey on their servers in the United States. We have taken all necessary precautions to ensure that your rights in term of data protection will not be compromised by this”.

**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.** (If using a third-party system such as Survey Monkey to gather the data, you will need to state clearly at which point the data will be moved from there to our internal systems.)

**9. More information** For more information on how Ofgem processes your data, click on the link to our “[Ofgem privacy promise](#)”.