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Decision

Price Cap – Decision on reflecting prepayment End User Categories in the default tariff cap

Subject	Details
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We consulted in November 2021 on our considerations and proposals to amend the gas supply licence conditions to reflect the introduction of prepayment End User Categories in the default tariff cap methodology. This document describes our decision to allow for the latest PPM EUCs to be used in networks and wholesale methodologies, and to adjust the Unidentified Gas allowance accordingly, updating it every cap period.

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Executive summary

The default tariff cap (cap) protects approximately 22 million domestic customers on standard variable and default tariffs (which we refer to collectively as 'default tariffs'), ensuring that they pay a fair price for their energy, reflecting its underlying costs. The cap is one of the key activities which fall within the outcome "consumers pay a fair price for energy and benefit from rights and protections" within our Forward Work Programme for 2021-22.[1] We set the cap by considering the different costs suppliers face. The cap is made up of a number of allowances which reflect these different costs.

This document sets out our decision to amend the licence conditions along with our methodology, from cap period eight, to introduce the use of End Use Categories (EUCs) specific to prepayment meter (PPM) customers, and the regular update of these levels. We have decided not to take into account any potential overfunding associated with the new EUCs during cap period seven, given current market conditions.

EUCs categorise gas customers by different usage patterns and payment type. When the cap methodology was developed in 2018, there was only one EUC relevant to the cap, which was incorporated into our methodology. Since then, an industry modification has created a unique EUC for domestic PPM customers.[2] These new parameters determine the demand attributed to customers paying by a certain payment method and affect the costs faced by suppliers to serve these customers.

In November 2021, we consulted on our proposals for amending the default tariff cap methodology for gas customers to reflect the introduction of prepayment EUCs.[3] We proposed to amend the licence to allow for the introduction of new EUCs. This covered network costs where we proposed introducing specific load factors for PPM customers. It also covered wholesale costs where we proposed amending direct fuel cost methodologies to introduce specific quarterly shares of gas demand for PPM customers. These changes were proposed from cap period 8 onwards.

[1] Ofgem (2021), Forward work programme 2021/22
https://www.ofgem.gov.uk/publications-and-updates/forward-work-programme-202122
[2] Xoserve (2019), Creation of new End User Categories XRN 4665.
https://www.xoserve.com/change/change-proposals/xrn-4665-creation-of-new-end-user-categories/
[3] Ofgem (2021), Consultation on reflecting prepayment End User Categories in the default tariff cap.
https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-prepayment-end-user-categories-default-tariff-cap

We consider that the introduction of the new EUCs impacts the gas network cost and wholesale cost allowances in a material and systematic manner. We consider that using the current EUCs on an ongoing basis no longer adequately reflects the efficient costs to supply PPM customers.

We have decided to account for the impact of introducing PPM EUC to both the direct fuel cost allowance and the networks cost allowance. To accomplish this, we have decided to proceed with the proposed changes to 'Annex 2 – Methodology for determining the wholesale cost methodology' and 'Annex 3 – Methodology for determining the network cost allowance'. We are also amending licence condition 28AD to reflect these changes.

Having reviewed stakeholder comments and analysed the most recent data, we have decided to change the levels of Unidentified Gas (UIG) allowance from those set out in the consultation for both PPM and non-PPM. When setting the original allowance, there was uncertainty around the levels of UIG, which informed our 2018 decision to have a fixed allowance of 2% for all EUCs.

The introduction of annually updated data split by EUCs has enabled a more granular allocation of UIG by PPM and non-PPM customers. We have therefore decided to update the UIG cost allocation based on the data available from Allocation of Unidentified Gas Expert's (AUGE's) annual Allocation of Unidentified Gas (AUG) statements, split by EUC. Based on the 2021/2022 AUG statement, the proposed UIG allowance would be 1.82% for non-PPM customers and 5.34% for PPM customers. Future updates will be in line with cap period reviews, using the most up-to-date data available. The data used will be from the 'Final Allocation of Unidentified Gas AUG table', which we consider to be the most appropriate rate that balances accurately reflecting costs while ensuring further movement towards efficient operations and incentivising investment in UIG reduction.

We estimate the impact of introducing the new EUCs across both networks and wholesale allowances in period eight will increase the cap level for PPM customers by around £1 per customer per year at benchmark annual consumption levels.[4] However, the actual impact, in future cap periods will vary depending on the costs determined for each specific period.

[4] The PPM network cost allowance will decrease by around £17 and the PPM wholesale allowance will increase by around £18.

1. Introduction

What are our decisions?

1.1. This document sets out our decisions to amend the default tariff cap ('cap') and gas supply licence to allow for the introduction of a specific domestic prepayment meter (PPM) end user category (EUC).

1.2. We have decided to amend gas supply standard licence condition (SLC) 28AD and annex models to allow for the introduction of the latest PPM peak load factors (PLFs) and annual load profiles (ALPs) for both the Networks and Direct Fuel cost allowances from cap charge restriction period (cap period) eight (April 2022 – September 2022) onwards. This is explained in greater detail in the End user Categories section of this decision document.

1.3. We have decided to introduce the new EUCs within the Unidentified Gas (UIG) allowance, to more accurately reflect the costs associated with PPM customers from cap period eight onwards.[5]

1.4. In addition, we have decided to update the UIG allowance for non-PPM customers from cap period eight onwards. This will allow the overall allowance for UIG across all payment methods to more accurately reflect UIG costs.

1.5. We have also decided to amend the frequency in which we update the PPM and non-PPM UIG allowances. This will be conducted in line with the February and August, summer and winter price cap updates and based on the information in AUGE's latest final statement.

1.6. We have decided not to take into account any potential historic over-recovery in cap period seven when setting future cap levels, given market conditions.

[5] AUGE (2021), Final Allocation of Unidentified Gas (AUG) Statement 2021-2022. https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2021-03/Final%20AUG%20Statement%20v1.4.pdf

Structure of this decision document

1.7. This decision document has the following structure:

- Chapter 1 summarises our decisions and the structure of this document. It also provides a general introduction to the cap and EUCs.
- Chapter 2 outlines our decision-making process.
- Chapter 3 sets out our decision to amend licence and annex models to allow for the introduction of a specific domestic PPM EUC.
- Chapter 4 sets out our decision for how we will approach new EUCs in the cap methodology and specifically in the annex models of the electricity and gas standard supply licence conditions.

The default tariff cap

1.8. We set the cap with reference to the Domestic Gas and Electricity (Tariff Cap) Act 2018 ('Act'). The objective of the Act is to protect current and future default tariff customers. We consider protecting customers to mean that prices reflect underlying efficient costs. In doing so, we must have regard to four matters:[6]

- the need to create incentives for holders of supply licences to improve their efficiency;
- the need to set the cap at a level that enables holders of supply licences to compete effectively for domestic supply contracts;
- the need to maintain incentives for domestic customers to switch to different domestic supply contracts; and

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

- the need to ensure that holders of supply licences who operate efficiently are able to finance activities authorised by the licence.

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

1.10. In setting the cap, we may not make different provisions for different holders of supply licences.[7] This means that we must set one cap level for all suppliers.

End User Categories

1.11. EUCs represent different consumption profiles for gas customers. They ensure that customers can be categorised by their usage patterns and help distinguish different gas consumption behaviours.

1.12. The cap methodology uses EUCs to estimate how customers typically consume gas during a year. Following the introduction of the new EUCs in 2019, there are individual consumer profiles for non-prepayment and prepayment domestic customers.[8] These profiles are captured by the Annual Load Profiles (ALPs) published by Xoserve.[9,10]

1.13. In the wholesale cost methodology, we weight ALPs by region to estimate the quarterly share of gas demand. This is used to weight wholesale prices to determine the direct fuel cost component of the wholesale cost allowance.

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[7] Domestic Gas and Electricity (Tariff Cap) Act 2018, Section 2(2). http://www.legislation.gov.uk/ukpga/2018/21/section/2/enacted
[8] Xoserve (2019), Creation of new End User Categories XRN 4665. https://www.xoserve.com/change/change-proposals/xrn-4665-creation-of-new-end-user-categories/
[9] Xoserve, UK Link Documentation. https://www.xoserve.com/systems/uk-link/
[10] ALPs refer to the typical annual gas consumption profile by region.

1.14. The cap methodology also uses EUCs to estimate peak daily gas load.[11] The new EUCs have resulted in individual estimates of peak gas demand for non-prepayment (non-PPM) and prepayment (PPM) domestic customers. These are captured by the Peak Load Factors (PLFs) published by Xoserve and reflected in the cap methodology as 'load factors'.[12]

1.15. In the network cost methodology, we combine regional load factors with our assumed level of annual domestic consumption to produce estimates of peak daily load. These are used to estimate total network capacity charges.

1.16. The EUCs are also used to categorise the UIG values published in Xoserve's Allocation of Unidentified Gas (AUG) statement.[13] The gas wholesale methodology was designed to allow an uplift for UIG costs. In our 2018 decision, we set out how we set the (2017) baseline with the UIG values in mind.[14] The UIG allowance was developed using the EUCs available at that time and was set as a fixed percentage of the direct fuel costs for each subsequent cap period.

1.17. The existence of new EUCs allows a further breakdown of these UIG figures, using UIG levels and forecast consumption, by payment method. This allows for greater accuracy in attributing UIG costs to the associated EUC.

[11] Peak daily gas load is the proportion of daily gas demand that is consumed at peak times.
[12] PLFs refer to the ratio of average load compared to the maximum load over a given period by region.
[13] UIG refers to gas that is off taken from the Local Distribution Zone (LDZ) system, but not attributed
to an individual Supply Meter Point or accounted for as Shrinkage. There are several reasons for UIG including leakage, theft, or consumption by unregistered supply points.
[14] Decision Tariff Cap, 2018 - https://www.ofgem.gov.uk/sites/default/files/docs/2018/11/appendix_4_-_wholesale_costs.pdf

2. Decision process

Our decision-making process

June 2021 update

2.1. We published an update in July 2021 to inform stakeholders of an industry change relating to the introduction of new EUCs and the implications for the cap, with respect to the PPM cap level.[15] It set out our intention to consult on whether to implement changes related to the new EUCs in the cap methodology for cap period eight onward (ie, from 1 April 2022). We also said that we would consider whether it is appropriate to review costs associated with the new EUCs with respect to cap period seven (ie, 1 October 2021 – 31 March 2022) and take into account any over/underfunding in setting future price cap levels.

November 2021 consultation

2.2. We published a consultation in November 2021 with our proposals and considerations for amending the licence conditions and annex models.[16] We consulted on amending the default tariff cap methodology for gas customers to reflect the introduction of prepayment EUCs.

2.3. We received 9 responses from industry party stakeholders, which includes energy suppliers, consumer organisations and trade bodies, and approximately 40,000 responses via a petition website.

[15] Ofgem (2021), Industry change related to gas End User Categories. https://www.ofgem.gov.uk/publications/default-tariff-cap-industry-change-related-gas-end-usercategories

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

February decision and future process

2.4. This decision is for cap period eight onwards, starting on 1 April 2022. We have decided to amend licence and annex models in the cap methodology to allow for the introduction of a specific domestic PPM EUC.

2.5. The inputs related to the EUCs will be updated for each subsequent cap period in the August and February updates, with the most recently available information.

Related publications

2.6. 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.

2.7. The main documents relating to the new EUCs in the default tariff cap are:

- Consultation on reflecting prepayment End User Categories in the default tariff cap ('November 2021 consultation'): https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-prepayment-end-user-categories-default-tariff-cap.
- Xoserve, creation of new EUCs: https://www.xoserve.com/change/change-proposals/xrn-4665-creation-of-new-end-user-categories/.
- Ofgem letter to industry regarding change related to gas EUCs: https://www.ofgem.gov.uk/publications/default-tariff-cap-industry-changerelated-gas-end-user-categories.

General feedback

2.8. We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
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. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments?

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

3. Introducing prepayment EUCs in the cap

Section summary

In this chapter we set out our decision to introduce new prepayment EUCs in the cap methodology. It also discusses our considerations of amending the licence and annexes to include prepayment EUCs from cap period eight onwards and the materiality to the cap level. It discusses the stakeholder comments to our consultation and sets out our responses and considerations.

Context

3.1. We set out to make changes to the cap methodology where there are clear and material systematic impacts on the costs of supplying default tariff customers that are not appropriately accounted for by the existing cap methodology.

3.2. Under the cap methodology, we combine network charges and direct fuel prices individually with estimates of demand and losses. These are used to estimate the network and wholesale costs a supplier incurs for each customer type over a given cap period.

3.3. When the networks and wholesale methodologies were designed the PLFs, ALPs and UIG values published by Xoserve reflected the historic 01 EUC that applied to all customers with Annual Quantity (AQ) less than 73,200kWh, regardless of payment method. For that reason, the network and wholesale methodologies did not include separate gas demand shares, load factors or UIG uplift for customers paying by alternate payment methods.

3.4. As a result of the new EUCs, suppliers now face different gas network and wholesale costs for customers paying by different payment methods which are exacerbated by rising wholesale prices. In our November 2021 consultation, we proposed to amend SLC 28AD of the gas supply licence to enable us to differentiate between payment methods in the wholesale cost allowance and network cost allowance.[17] We also proposed to amend the annex models and a supplementary workbook to include PPM EUCs.

3.5. We received approximately 40,000 responses via a petition website. Out of the 40,000 responses, around 28,000 responses identified as non-PPM customers and around 2,000 responses identified as PPM customers. Most responses did not state a clear preference on whether to amend the cap methodology to include the EUCs. For the remainder of this document, we refer to the responses of the stakeholders that provided specific comments on the relevant topics.

Impacts of change and meeting the materiality test

3.6. The development of PPM-specific EUCs across industry results in a more structurally granular view of PPM demand, allowing for a more accurate reflection of PPM customers' consumption behaviour. This impacts our methodology in a way such that costs in future cap periods will systematically depart from an efficient level.

3.7. We consider that the introduction of the new EUCs impacts the gas network cost and wholesale allowances in a material and systematic manner. We consider that using the current EUCs on an ongoing basis no longer adequately reflects the efficient costs to supply PPM customers.

3.8. The actual impact of introducing the new EUCs across both the networks and wholesale allowances will vary dependent on the network and wholesale costs for each specific period. We estimate the impact of introducing the new EUCs will increase the cap level for PPM customers by approximately £1 per year at the benchmark annual consumption level. This figure is based on costs in cap period eight.

3.9. In period seven, we had estimated that the impact of the new EUCs would have decreased the cap level for PPM customer by around £6 per year at the benchmark annual consumption level. The change in costs to PPM customers of the introduction

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

of the new PPM-specific EUCs between cap period seven and eight is due to the significant increase in wholesale costs.

3.10. Whilst current changes in PPM cap levels for UIG are lesser, forecasts predict future fluctuations and non-PPM users current increase means that the impact by EUC meets our test for materiality.

Network costs

Decision

3.11. We have decided to amend the network cost methodology to introduce specific load factors for PPM and customers from cap period eight onward.

Overview of stakeholder responses

3.12. All nine stakeholders who responded to our November 2021 consultation were supportive of both the principle to update the EUCs and our proposed method for updating the Network allowance. Stakeholders agreed that the changes will allow the cap to be more cost reflective for suppliers and customers.

Considerations

3.13. We consider it appropriate to amend the network cost methodology, allowing it to be more reflective of the network costs associated with PPM and non-PPM customers.

3.14. We estimate that PPM-specific load factors will reduce the network allowance for PPM customers by around £17 per year at the benchmark annual consumption level. This estimation is based on cap period eight network costs. The actual impact of this change in the next and subsequent cap periods will depend on the network costs determined for that cap period, amongst other factors.

3.15. The introduction of PPM-specific load factors will not impact the cap level for other payment methods. The load factors currently used within the methodology for the default tariff cap for standard credit and other payment types are in line with the latest domestic non-PPM EUCs available.

Wholesale costs

Decision

3.16. We have decided to amend the direct fuel cost methodology to introduce specific quarterly shares of gas demand for PPM customers from cap period eight onward.

Overview of stakeholder responses

3.17. All stakeholders who responded to our November 2021 consultation were supportive of both the principle to update the EUCs and our proposed method for updating the Direct Fuel allowance. Stakeholders agreed that the changes will allow the cap to be more cost reflective for PPM customers.

Considerations

3.18. We consider it appropriate to amend the wholesale cost methodology, allowing it to be more reflective of the wholesale costs associated with PPM customers.

3.19. In cap period eight, we estimate that PPM-specific quarterly shares of gas demand will reduce the wholesale allowance for PPM customers by around £2 at the benchmark annual consumption level.

3.20. The impact of this issue will vary in the next and subsequent cap periods depending on the wholesale costs determined for that cap period, amongst other factors.

3.21. The introduction of PPM-specific quarterly shares of gas demand will not impact the cap level for other payment methods. The quarterly shares of gas demand currently used within the cap methodology for standard credit and other payment types are the latest domestic non-PPM EUCs available.

UIG - allowance level

Decision

3.22. We have decided to amend the wholesale cost methodology to reflect the use of new EUCs within the UIG allowance for PPM and non-PPM customers from cap period eight onwards.

3.23. In addition, we have decided to use both Class 3 and 4 meters in the calculation of the UIG allowances to allow for a more complete representation of all meter types.

3.24. We have set the levels of UIG allowance at a level consistent with the 'Final Allocation of Unidentified Gas AUG table'. This is because we consider suppliers have some control over their UIG level and we want to continue to incentivise improvement.

3.25. Using the 2021/22 AUG statement's final estimates for UIG volumes and demand, we calculate the UIG uplift for PPM end users to be 5.34%.[18] This is a decrease of 0.05% points compared to our November 2021 proposal due to the inclusion of Class 3 meters.[19] Using the same methodology, we calculate the UIG allowance for non-PPM customers to be 1.82%.[20] This is a reduction from our November 2021 proposal by 0.18% points due to splitting non-PPM and PPM.[21]

Overview of stakeholder responses

3.26. All stakeholders who responded to our November 2021 consultation agreed with our proposal to amend the cap methodology to reflect the costs associated with UIG.

3.27. Three stakeholders commented on the need for different UIG levels based on EUC. Two stakeholders proposed specific values – one based on their own UIG levels and the other proposing AUGE's observed UIG 12 month rolling average benchmark.

Considerations

3.28. All stakeholders who responded to our November 2021 consultation agreed that amending the cap methodology to include the UIG allowance for PPM customers will allow to more accurately reflect efficient costs. One stakeholder argued that not

[18] UIG uplift calculated by dividing the EUC band 1PD total UIG for Classes 3 and 4 by the forecast consumption in the target year for the same EUC band and Classes.
[19] Settlement classes are used to settle more accurately non-daily metered (NDM) and daily metered (DM) supply types. Classes 3 and 4 include batched daily readings and periodic readings for meter points with Annual Quantity (AQ) under 58,600 MWhs.
[20] UIG uplift calculated by dividing the EUC band 1ND total UIG for Classes 3 and 4 by the forecast consumption in the target year for the same EUC band and Classes.
[21] Settlement classes are used to settle more accurately non-daily metered (NDM) and daily metered (DM) supply types. Classes 3 and 4 include batched daily readings and periodic readings for meter points with Annual Quantity (AQ) under 58,600 MWhs.

amending and updating the non-PPM UIG allowance will introduce a systematic error and will increase consumer detriment.

3.29. We consider it appropriate to amend the PPM and non-PPM UIG allowances in the cap from cap period eight onwards, to reflect the costs associated with PPM and non-PPM customers. By also updating the non-PPM UIG allowance, the overall allowance for UIG across all payment methods will better reflect costs.

3.30. One stakeholder also commented on the need for including Class 3 meters, suggesting their relevance to the cap.

3.31. We consider it appropriate to include both Class 3 and 4 meters in our calculation of UIG allowances. Customers, whose tariffs are covered by the cap can have either class 3 or class 4 meters. Therefore, including both classes of meters in our calculations makes the overall allowance more reflective of the costs to serve default tariff customers.

3.32. Two stakeholders argued that the UIG allowance should be higher. One suggested that AUGE's observed UIG 12 month rolling average benchmark of 2.42%, which represents roughly 6.4% for PPM customers and 2.2% for non-PPM customers, would be more appropriate. The other used estimates of their own overall UIG levels.

3.33. We do not consider it appropriate to update the UIG allowance based on individual stakeholder's estimates which reflect their individual costs, as proposed by one stakeholder. We consider the 'Final allocation of Unidentified Gas statement AUG table' to reflect more accurately efficient UIG levels and more appropriate to use for holistic market analysis.

3.34. We do not consider it appropriate to set the levels of UIG allowance at the AUG 12 month rolling average benchmark figure as proposed by one stakeholder, as we intend to maintain the incentives to improve information on UIG and its management. This may incentivise increased management of the network and settlement systems efficiently, which will ultimately reduce the costs paid by consumers. This is in line with our 2018 decision on UIG levels. [22]

3.35. We acknowledge that some suppliers may be exposed to higher UIG levels. In setting the cap, we may not make different provisions for different holders of supply licences.[23] This means we must set a single cap level across suppliers, so we cannot reflect each supplier's individual circumstances. Setting the allowance based on the highest UIG levels would lead to overfunding for many suppliers. We consider our calculation of UIG levels to better reflect the efficient costs.

3.36. Based on AUGE's analysis of Class 3 and 4 meters, the UIG levels were 5.34% for PPM customers and 1.82% for non-PPM customers. We estimate that, in cap period eight, this will increase the cap level for PPM consumers by around £18 and reduce the cap level for non-PPM consumers by around £1.

3.37. The impact of the UIG allowance will vary in the next and subsequent cap periods depending on the wholesale costs determined for that cap period, amongst other factors.

UIG – update frequency

Decision

3.38. In light of stakeholder responses to our November consultation and initial outlooks on future trends, we have decided to amend the frequency of which we will update the UIG allowance.

3.39. We have decided to use the figures from the most recent final AUG statement to determine the UIG allowances in the cap. This will allow us to adjust the PPM and non-PPM UIG allowances with the latest estimates of UIG levels.

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[22] Ofgem (2018), Default Tariff Cap Decision, Appendix 4, Page 26. https://www.ofgem.gov.uk/sites/default/files/docs/2018/11/appendix_4_-_wholesale_costs.pdf

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

Overview of stakeholder responses

3.40. Two stakeholders suggested that Ofgem should periodically review the UIG allowance.

Considerations

3.41. One stakeholder suggested that increased volatility of allocated UIG, partly due to the AUGE's factors and methodological changes, is a likely outcome in current market conditions, and therefore a periodic update of the allowance is required.

3.42. Our analysis of AUGE's draft 2022/23 statement indicates that levels of UIG may fluctuate in future periods. We consider it appropriate to update the UIG allowances on a regular basis to ensure that they continue to reflect the costs associated with UIG.

3.43. Based on AUG's draft 2022/23 statement, we estimate the UIG allowances would be 1.81% for non-PPM customers and 7.51% for PPM customers.[24,25] This could represent a material change in PPM UIG costs of an approximate £12 increase from the 2021/2022 figure.[26]

3.44. The forecasted increase in PPM UIG levels in 2022/23 is primarily due to the proportion of theft that is detected at prepayment sites. Theft represents around 71% of UIG and can vary year on year.[27] We consider it appropriate to update the UIG allowances on a regular basis to capture any fluctuations in UIG levels.

[24] AUGE (2021), Draft AUG Statement 2022-2022.
https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2021-12/Draft%20AUG%20Statement%202022-2023%20v1_0.pdf
[25] We do not consider it appropriate to use draft figures in our methodology in case of further refinements.
[26] This estimate is based on period 8 costs.
[27] Xoserve (2019), Class 3 Supply Point Migration Workshop.
https://www.xoserve.com/media/6932/class-3-supply-point-migration-workshop-20190712.pdf

3.45. We consider these forecasts and potential fluctuations to be material and potentially systematic, necessitating the frequent review of trends to ensure the accurate reflections of costs.

3.46. The UIG allowances will be updated every six months as part of our price cap update announcements as set out in SLC 28AD based on the most up-to-date data provided by industry experts. This is consistent with the other additional allowances in the wholesale cost methodology.

3.47. One Stakeholder suggested that we should commission a reconciliation to independently invoice actual UIG costs after each cap period end and true up/down the allowance accordingly.

3.48. We do not consider it appropriate to true up/down actual UIG costs on a six-monthly basis as we intend to maintain the incentives to improve information on UIG and its management.

Cap period seven costs

Decision

3.49. We have decided not to take account any overfunding, associated with the new EUCs during cap period seven, when setting future cap levels.

Overview of stakeholder responses

3.50. One stakeholder responded to our November 2021 consultation regarding period seven costs and was supportive of our proposal not to take account of historic over-recovery in cap period seven.

Considerations

3.51. Taking into account recent market conditions, we do not consider it appropriate to take cap period seven over recovery into account when setting future cap levels.

3.52. This does not preclude us from recovery of any over/underfunding in future. We will assess the recovery of any misalignment of allowances and costs on a case-by-case basis.

4. Methodology for introducing new EUC

Section summary

In this chapter, we discuss the licence amendments and methodology changes which will allow for the new EUCs in the gas network and wholesale cost calculations. This includes updates to 'Annex 3 – Network cost allowance methodology', 'Annex 2 – Wholesale cost allowance methodology' and the supplementary workbook 'The Default Tariff Cap Level'

Methodology amendments

Context

4.1. The cap includes network and wholesale cost allowances to ensure that suppliers can recover costs that are incurred through network charges and purchasing forward energy contracts respectively. The network cost allowance is calculated in 'Annex 3 – Network cost allowance methodology' and the wholesale cost allowance is calculated in 'Annex 2 – Wholesale cost allowance methodology'.

4.2. To calculate the overall cap level for different payment methods we use the supplementary workbook 'The Default Tariff Cap Level'.

4.3. In our November 2021 consultation (1.4.), we proposed to include separate gas network and wholesale allowances for PPM and non-PPM payment methods.[28] The allowances would feed into the calculation of the overall cap level for each payment method.

4.4. We also proposed to introduce modifications to SLC 28AD of the gas supply licence to amend the wholesale and network cost allowances to allow us to set separate allowances for these costs per payment method.

[28] Price Cap - Consultation on reflecting prepayment End User Categories in the default tariff cap, paragraph 1.4
https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-prepayment-end-user-categories-default-tariff-cap

Decision

4.5. We have decided to include separate gas network and wholesale allowances for Non-PPM and PPM payment methods within the annex models and supplementary workbook. This includes using load factors, quarterly shares of gas demand, and UIG inputs that reflect the different domestic EUCs to determine the individual allowances.

4.6. We have also decided to modify SLC 28AD of the gas supply licence to allow us to set separate wholesale and network cost allowances for individual payment methods. A more detailed description of the licence modifications can be found in the Notice published alongside this consultation.

4.7. These decisions mean that the updated annex models and supplementary workbook published alongside this decision will be used when updating the cap level from cap period eight onwards.[29] We have not made any changes to the methodology set out in the annex models and supplementary workbook since our November 2021 consultation.[30] Details of the specific changes to the annex models and supplementary workbook can be viewed in Appendices 1, 2 and 3 of our November 2021 consultation.

Overview of stakeholder responses

4.8. All stakeholders who responded to our November 2021 consultation were broadly supportive of our proposed method for updating the network and wholesale allowances. Two respondents requested that we updated the UIG allowance more frequently as part of our methodology.

[29] The annex models and supplementary workbook include changes from our GGL and SoLR customer charge decisions: https://www.ofgem.gov.uk/publications/price-cap-decision-changes-annex-4-policy-cost-allowance-methodology-slc-28ad-include-green-gas-levy-allowance-default-tariff-cap and https://www.ofgem.gov.uk/publications/price-cap-decision-reflecting-change-gas-solr-levy-costs-default-tariff-cap

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

4.9. We did not receive any feedback on our proposal to modify SLC 28AD of the gas supply licence to include separate network and wholesale allowance for individual payment methods.

Summary of methodology amendments

Network Cost Methodology updates

4.10. We have decided to include an input for PPM load factors in 'Annex 3 – Network cost allowance methodology' of SLC 28AD of the gas standard supply licence conditions. This input will be used to calculate a unique gas network allowance for PPM customers following the current methodology.

4.11. The PPM load factors are consistent with the latest available domestic PPM PLFs published by Xoserve. Updates will be made in line with cap review periods using the most up-to-date data available.

4.12. The current load factors used in the Network Allowance methodology, which are consistent with domestic non-PPM PLFs, are relabelled as 'non-PPM load factors'. This input will continue to be used in the calculation of the 'standard credit' and 'other payment method' gas network allowances.

Wholesale Cost Methodology updates

4.13. We have decided to include inputs for the PPM quarterly share of gas demand and PPM UIG allowance in 'Annex 2 – Wholesale cost allowance methodology' of SLC 28AD of the gas standard supply licence conditions. These inputs will be used to calculate a unique gas wholesale cost allowance for PPM customers following the current methodology.

4.14. The PPM quarterly share of gas demand will be calculated using the latest available information published by Xoserve. The PPM quarterly share of gas demand will be updated annually, as part of the August cap update, in line with the current methodology.

4.15. To estimate the quarterly share of gas demand for PPM customers, the most recent gas year's domestic PPM ALPs will be weighted by region. These will then be summed in each quarter and inputted into the wholesale cost allowance methodology.

4.16. The current quarterly share of gas demand used in the wholesale cost allowance methodology, which is calculated using domestic non-PPM ALPs, has been relabelled as 'non-PPM quarterly share of gas demand'. This input will continue to be used in the calculation of the 'standard credit' and 'other payment method' gas wholesale cost allowances.

4.17. The PPM UIG allowance will be set at 5.34% and used for UIG uplift in the calculation of the PPM wholesale cost allowance. The current UIG allowance will be set at 1.82% and relabelled as the non-PPM UIG allowance. This input will continue to be used for uplift in the calculation of the 'standard credit' and 'other payment method' gas wholesale allowances.

4.18. The UIG allowances will be updated for each subsequent cap period in the August and February updates, using the most recently available information in AUGE's annual AUG final estimates.[31]

4.19. To calculate the UIG allowances, the total UIG will be divided by the total target demand in the gas year for each EUC.[32]

Supplementary Workbook – Default Tariff Cap Level update

4.20. We have decided to include inputs for separate PPM gas wholesale and network allowances in the supplementary workbook 'Default Tariff Cap Level'. These inputs will be used to calculate the overall cap level for PPM customers.

4.21. The current gas wholesale and network allowance inputs would have been relabelled as 'non-PPM' allowances. These inputs will continue to be used in the calculation of the overall cap level for 'standard credit' and 'other payment method' customers.

[31] Joint Office of Gas Transporters, AUG Information (Post-Nexus). https://www.gasgovernance.co.uk/augenex
[32] The calculation will only include Class 3 and 4 meters.