Decision

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Price Cap - Decision on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap

Subject	Details
Publication date:	4 February 2022
Contact	Leonardo Costa, Head of Price Cap Policy, Retail
Team:	Retail Price Regulation
Email:	RetailPriceRegulation@ofgem.gov.uk

We consulted in October 2021 on our proposals to amend the default tariff cap for gas customers to provide an additional allowance for the Green Gas Levy, which will fund the Green Gas Support Scheme. This document describes our decision to include an allowance for the Green Gas Levy, and how we have amended the methodology set out in 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include the allowance in the default tariff cap.

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Executive summary

We introduced the default tariff cap ('cap') on 1 January 2019, which currently protects around 22 million households 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. This document sets out our decision to introduce an allowance for the costs associated with the Green Gas Levy (GGL) from cap period eight (April 2022 – September 2022) onwards which will fund the Green Gas Support Scheme (GGSS). We also set out our decisions and considerations on how to determine the GGL allowance in the cap, from cap period eight onwards.

The Green Gas Support Scheme Regulations 2021 came into force on 30 November 2021 and the GGSS and GGL launched on 30 November 2021.[1] The GGSS has been introduced to support the deployment of biomethane production plants to inject biomethane produced via anaerobic digestion into the gas grid, contributing to the decarbonisation of our energy system. The Department for Business, Energy, and Industrial Strategy (BEIS) expects it to contribute 3.7 $MtCO_{2e}$ of carbon savings over Carbon Budgets 4 and 5, and 8.2 $MtCO_{2e}$ of carbon savings over its lifetime which will help the government's Net Zero ambitions and reduce our reliance on natural gas.[2] This scheme is being funded by the GGL, which places an obligation on licensed fossil fuel gas suppliers in GB to pay a quarterly levy based on the number of gas meter points they supply.

There is currently no allowance within our cap for the costs associated with the GGL. The cap includes a policy cost allowance to ensure that suppliers are able to recover the costs related to their obligations under different government and social programmes. The policy cost allowance is set out in 'Annex 4 – Policy cost allowance methodology' of Standard Licence Condition (SLC) 28AD of the gas standard supply licence conditions.

We have decided to amend the cap methodology from cap period eight to introduce an allowance for the costs associated with the GGL from cap period seven onwards. This amendment will be included in 'Annex 4 – Policy cost allowance methodology' of SLC 28AD

[1] The Green Gas Support Scheme Regulations 2021.
https://www.legislation.gov.uk/uksi/2021/1335/made
[2] BEIS (2021), Green Gas Support Scheme and Green Gas Levy: final stage Impact Assessment, page 11.
https://www.gov.uk/government/consultations/future-support-for-low-carbon-heat

of the gas licence. We have decided to proceed with the model changes to the Annex 4 and default tariff cap models as proposed in our October 2021 consultation.[3]

We consider that the introduction of the GGL will lead to a systematic cost that suppliers will be exposed to on a regular basis, which over time would mean the cap could provide lower funding to suppliers than their efficient costs. We do not consider that the GGL scheme costs for either cap periods seven or eight are material. However, we expect that the costs associated with the scheme will in time become material as the scheme grows, such that they will impact the efficient costs a supplier faces going forward.

We consider that it is appropriate to amend the cap methodology from cap period eight to include an allowance for the costs associated with the GGL from cap period seven (October 2021 – March 2022) onwards, for both credit and prepayment gas customers. This means that during cap period eight and nine, suppliers will recover the associated GGL cost for the first and second scheme years.[4] However, this does not mean that we would amend the methodology in all instances if there were a potential for systematic costs to become material in the future ahead of these costs becoming material. We would consider these instances on a case-by-case basis.

The levy rates for the first and second scheme year were published by BEIS on 29 November 2021.[5] We have calculated that the cap period eight GGL allowance will be approximately £2.69 per gas meter. Customers' bills would increase by the same amount assuming that suppliers pass on these costs to them. The allowance will be updated in each subsequent cap update using the levy rates published by BEIS for the relevant scheme year.

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[3] Ofgem (2021), Consultation on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap, paragraph, Appendix 1 & 2. https://www.ofgem.gov.uk/publications/consultation-changes-annex-4-policy-cost-allowance-methodology-slc-28ad-include-green-gas-levy-allowance-default-tariff-cap
[4] The statutory instrument defined the first scheme year as the period beginning 30 November 2021 and ending 31 March 2022. The second scheme year is the financial year beginning 1 April 2022. The Green Gas Support Scheme Regulations 2021, Section 2(1). https://www.legislation.gov.uk/uksi/2021/1335/made
[5] BEIS (2021), Green Gas Levy (GGL): rates, underlying variables, mutualisation threshold. https://www.gov.uk/government/publications/green-gas-levy-ggl-rates-and-exemptions/green-gas-levy-ggl-rates-underlying-variables-mutualisation-threshold

1. Introduction

What are our decisions?

1.1. We introduced the default tariff cap ('cap') on 1 January 2019, which currently protects around 22 million households on standard variable and default tariffs (which we refer to collectively as 'default tariffs'). The cap protects domestic customers on 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.[6, 7] 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.

1.2. This document sets out our decisions to amend the cap to provide a Green Gas Levy (GGL) allowance for gas customers which will fund the Green Gas Support Scheme (GGSS).

1.3. We have decided to amend the cap to introduce a new allowance from cap period eight (April 2022 – September 2022) onwards. This will allow suppliers to recover the costs associated with the GGL for each respective cap period. In addition, the allowance for cap period eight and nine will include the costs incurred due to the GGL in cap period seven (October 2021 – March 2022). We have decided to align our methodology with that of the Department for Business, Energy, and Industrial Strategy's (BEIS) design of the scheme and allocate the allowance on a per gas meter basis.

1.4. We have decided to allow for the costs associated in the first and second scheme year to be recovered over cap period eight and nine.[8] We have also decided to amend 'Annex 4 – Policy cost allowance methodology' of Standard License Condition (SLC) 28AD of the gas licence to include a GGL allowance.

[6] Ofgem (2021), Forward work programme 2021/22
https://www.ofgem.gov.uk/publications/forward-work-programme-202122
[7] We are currently consulting on our draft Forward Work Programme for 2022-23.
Ofgem (2022), Forward Work Programme Consultation.
https://www.ofgem.gov.uk/publications/202223-forward-work-programme-consultation
[8] There are 122 days in the first scheme year and 365 days in the second scheme year.

1.5. We have calculated, using the levy rates published by BEIS, that the GGL allowance in cap period eight will be approximately £2.69 per gas customer. This was calculated in 'Annex 4 – Policy cost allowance methodology'.

Structure of this decision document

1.6. 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, GGSS and GGL.
- Chapter 2 outlines our decision-making process.
- Chapter 3 sets out our decision to amend the cap methodology to include an allowance for the GGL from cap period eight onwards.
- Chapter 4 sets out our decision for how we will set the GGL allowance in the cap methodology and in 'Annex 4 – Policy cost allowance methodology' of SLC 28AD of the gas standard supply licence conditions.

The default tariff cap

1.7. 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:[9]

- 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;

[9] 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 maintain incentives for domestic customers to switch to different domestic supply contracts; and

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

1.8. 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.

1.9. In setting the cap, we may not make different provisions for different holders of supply licences.[10] This means that we must set one cap level for all suppliers.

The GGSS and GGL

1.10. The GGSS and GGL launched on 30 November 2021 after the Green Gas Support Scheme Regulations 2021 (statutory instrument) came into force.[11] The scheme supports the injection of biomethane produced via anaerobic digestion into the gas grid. Biomethane is currently the only green gas which is commercially produced in the UK, and it can be injected into the gas grid to be used as a lower carbon substitute to natural gas. Over time, the GGSS will increase the proportion of green gas in the grid, helping to decarbonise our gas supplies. The GGSS is expected to contribute 3.7 $MtCO_{2e}$ of carbon savings over Carbon Budgets 4 and 5, and 8.2 $MtCO_{2e}$ of carbon savings over its lifetime.[12]

1.11. BEIS published its government response in relation to the GGSS and GGL in March 2021.[13] It announced that the GGSS would be funded by the GGL on all designated

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[10] Domestic Gas and Electricity (Tariff Cap) Act 2018, Section 2(2).
http://www.legislation.gov.uk/ukpga/2018/21/section/2/enacted
[11] The Green Gas Support Scheme Regulations 2021.
https://www.legislation.gov.uk/uksi/2021/1335/made
[12] BEIS (2021), Green Gas Support Scheme and Green Gas Levy: final stage Impact Assessment, page 11.
https://www.gov.uk/government/consultations/future-support-for-low-carbon-heat
[13] BEIS (2021), Future Support for Low Carbon Heat & The Green Gas Levy Government response to consultations.
https://www.gov.uk/government/consultations/future-support-for-low-carbon-heat

licensed fossil fuel suppliers of gas in GB, as defined under section 100 of the Energy Act 2008.[14] The GGL launched with a per gas meter point design where the costs are distributed among gas suppliers according to the number of gas meters that they supply.[15]

1.12. The levy rates for the first and second scheme year were published at the end of November 2021.[16] This includes, among other factors, headroom and an adjustment factor. It is expected that this will be required to account for events that otherwise might cause a delay or deficit in GGL funds collected such as forecast errors.[17] The levy rate also includes Ofgem's forecasted administrative costs associated with both the GGSS and GGL.

1.13. The first and second scheme year GGL levy rates are in a pence per meter per day format. BEIS has also provided a breakdown of the underlying variables which were used to calculate the levy rates. We expect that BEIS will publish the daily levy rates and underlying variables in the same format for subsequent scheme years.

1.14. Under the statutory instrument, a licensed gas supplier will be exempt from the levy in a scheme year if Ofgem determines that at least 95% of the gas supplied by the gas supplier in a scheme year was certified biomethane.[18]

1.15. The GGL payments will be collected quarterly from obligated gas suppliers, and they will also need to lodge credit cover. Suppliers' credit cover requirement will need to cover 115% of their next quarterly levy payment using a forecast and meter point

[14] BEIS (2021), Future Support for Low Carbon Heat & The Green Gas Levy Government response to consultations.
https://www.gov.uk/government/consultations/future-support-for-low-carbon-heat
[15] BEIS (2021), Future Support for Low Carbon Heat & The Green Gas Levy Government response to consultations, page 50.
https://www.gov.uk/government/consultations/future-support-for-low-carbon-heat
[16] BEIS (2021), Green Gas Levy (GGL): rates, underlying variables, mutualisation threshold.
https://www.gov.uk/government/publications/green-gas-levy-ggl-rates-and-exemptions/green-gas-levy-ggl-rates-underlying-variables-mutualisation-threshold
[17] The headroom allowance will cover any small shortfall in the levy that would cause funds for the scheme to be less than required. This is different to the headroom allowance within the cap.
[18] The Green Gas Support Scheme Regulations 2021, Section 38.
https://www.legislation.gov.uk/uksi/2021/1335/made

data from the previous quarter.[19] The formula for calculating this credit cover is in the statutory instrument.[20]

1.16. BEIS has estimated using its central scenario that gas customers could see their annual bills rise by approximately £4.70 at the peak of the levy in 2028, assuming a transition to a volumetric levy in the future.[21]

[19] BEIS (2021), Future Support for Low Carbon Heat & The Green Gas Levy Government response to consultations, page 58.
https://www.gov.uk/government/consultations/future-support-for-low-carbon-heat
[20] The Green Gas Support Scheme Regulations 2021, Section 41(1).
https://www.legislation.gov.uk/uksi/2021/1335/made
[21] BEIS (2021), Future Support for Low Carbon Heat & The Green Gas Levy Government response to consultations, page 51.
https://www.gov.uk/government/consultations/future-support-for-low-carbon-heat

2. Decision process

Our decision-making process

June 2021 update

2.1. We published an update in June 2021 which set out that we were aware that BEIS intended to launch the GGSS in Autumn 2021 which would be funded by the GGL.[22] We also said that we intended to review whether it would be appropriate to include an allowance for the GGL in the cap and that we would engage with stakeholders on this. In the June 2021 update, we stated that if we decided to introduce an allowance, we would consider whether and how to reflect cap period seven costs as part of that methodology.[23]

October 2021 consultation

2.2. We published a consultation in October 2021 with our proposals and considerations for introducing a GGL allowance in the cap and amending the Annex 4 methodology from cap period eight onwards. We consulted on allowing suppliers to recover the costs associated with the GGL for each respective cap period, and the cap period eight and nine allowance including the costs which incurred due to the GGL in cap period seven. We consulted on amending the default tariff cap methodology for gas customers to provide an additional allowance for the GGL, which will fund the GGSS.[24]

February 2022 decision and future process

2.3. This decision is for cap period eight onwards, starting on 1 April 2022. We have decided to amend the Annex 4 methodology of the default tariff cap to include a GGL allowance.

[22] The statutory instrument stated that the scheme began on 30 November 2021. The Green Gas Support Scheme Regulations 2021, Section 2(1). https://www.legislation.gov.uk/uksi/2021/1335/made

[23] Ofgem (2021), Update on the Green Gas Levy and default tariff cap. https://www.ofgem.gov.uk/publications/price-cap-update-green-gas-levy-and-default-tariff-cap

[24] Ofgem (2021), Consultation on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap. https://www.ofgem.gov.uk/publications/consultation-changes-annex-4-policy-cost-allowance-methodology-slc-28ad-include-green-gas-levy-allowance-default-tariff-cap

2.4. The allowance will be updated for each subsequent cap period in the August and February updates.

Related publications

2.5. 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.

2.6. The main documents relating to reviewing the Green Gas Levy on the default tariff cap are:

- Consultation on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap ('October 2021 consultation'): https://www.ofgem.gov.uk/publications/consultation-changes-annex-4-policy-cost-allowance-methodology-slc-28ad-include-green-gas-levy-allowance-default-tariff-cap.

- June 2021 Price Cap – Update on the Green Gas Levy and default tariff cap ('June 2021 update'): https://www.ofgem.gov.uk/publications/price-cap-update-green-gas-levy-and-default-tariff-cap.

- The Green Gas Support Scheme Regulations 2021 ('statutory instrument'): https://www.legislation.gov.uk/uksi/2021/1335/made.

- Green Gas Levy: rates and exemptions: https://www.gov.uk/government/publications/green-gas-levy-ggl-rates-and-exemptions.

- March 2021 Future Support for Low Carbon Heat & The Green Gas Levy Government response to consultations ('BEIS's March 2021 government response'): https://www.gov.uk/government/consultations/future-support-for-low-carbon-heat.

- October 2020 Consultation Stage impact assessment: Green Gas Levy ('BEIS's October 2020 impact assessment'): https://www.gov.uk/government/consultations/green-gas-levy.

- September 2020 consultation on a Green Gas Levy ('BEIS's September 2020 consultation'): https://www.gov.uk/government/consultations/green-gas-levy.

General feedback

2.7. We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We would 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 a GGL allowance into the default tariff cap

Section summary

In this chapter we set out our decision to introduce an allowance for the costs associated with the GGL in the cap methodology. We also set out our considerations on amending the cap methodology to include an allowance from cap period eight onwards.

Context

3.1. Energy suppliers are subject to a number of environmental and social obligations, designed to achieve various policy goals. These obligations result in additional charges to suppliers, which in turn are passed onto energy customers through their energy bills.

3.2. When we developed the cap in 2018, we allowed suppliers to recover the costs incurred due to these schemes as set out in our 2018 decision.[25] We also set out to only make changes 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. For example, we might consider making a modification if there were a fundamental change to the environmental and social obligations that suppliers face.

3.3. The GGL came into force on 30 November 2021 to fund the GGSS and there is currently no allowance for the costs associated with this policy scheme in the cap methodology. In our October 2021 consultation, we proposed to amend the cap methodology to introduce a GGL allowance from cap period eight onwards for the costs associated with the GGL from cap period seven onwards.[26]

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[25] Ofgem (2018), Decision – default tariff cap – Appendix 5 – policy and network costs. https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview
[26] Ofgem (2021), Consultation on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap, paragraph 3.4. https://www.ofgem.gov.uk/publications/consultation-changes-annex-4-policy-cost-allowance-methodology-slc-28ad-include-green-gas-levy-allowance-default-tariff-cap

Decision

3.4. We have decided to amend the cap methodology to introduce a GGL allowance from cap period eight onwards. This is because the cap could materially depart from an efficient level of costs over time if we do not reflect the levy in a cap amendment.

3.5. We have decided that the allowance for cap period eight and nine will include the costs associated with both the first and second scheme year in our determination of the GGL allowance.[27] This will allow suppliers in cap period eight and nine, to recover the backdated levy payments associated with GGL from cap period seven.

Overview of stakeholder responses

3.6. Four stakeholders who responded to our October 2021 consultation agreed with our proposal to amend the cap methodology to reflect the costs associated with the GGL.

3.7. Suppliers said that the costs associated with the GGL would become material and systematic which they would have to bear.

Considerations

3.8. We consider it appropriate to introduce an allowance from cap period eight onwards for the costs associated with the GGL from cap period seven onwards. This is because the GGSS has introduced a new levy on suppliers which is currently not included in the cap methodology. The GGL allowance will allow suppliers to recover the costs associated with the GGL for each respective cap period. In addition, the allowance for cap period eight and nine will include the costs incurred due to the GGL in cap period seven. This means that the overall cap allowance will be systematically lower than it would have otherwise been prior to the introduction of the levy.

3.9. BEIS published the GGL levy rates at the end of November 2021 for the first and second scheme year, and also set out the underlying variables in line with the

[27] The statutory instrument defined the first scheme year as the period beginning 30 November 2021 and ending 31 March 2022. The second scheme year is the financial year beginning 1 April 2022. The Green Gas Support Scheme Regulations 2021, Section 2(1). https://www.legislation.gov.uk/uksi/2021/1335/made

regulations.[28] The GGL levy rate for the first scheme year is 0.484p per meter per day and 0.576p per meter per day for the second scheme year.

3.10. Following our methodology set out in 'Annex 4 – Policy cost allowance methodology' of SLC 28AD of the gas and electricity licences' which is explained in Chapter 4, we calculated that the GGL allowance in cap period eight will be approximately £2.69 per gas meter.

3.11. Two suppliers who responded to our October 2021 consultation, said that suppliers should be able to recover the costs associated with the GGL regardless of materiality. One of these suppliers argued that there was no case to further postpone the introduction of an allowance and it would be both arbitrary and inappropriate to do so.

3.12. Any introduction of an allowance for a cost should be considered on a case-by-case basis. We would not amend the cap methodology in all cases if there were an immaterial new cost. We set out in our 2018 default tariff cap decision, that we would only consider making changes to the methodology if the cap systematically and materially departed from an efficient level of costs.

3.13. Due to the systematic nature of the impact of the levy, along with the expectation set out by BEIS that the levy rate will increase as the scheme expands, we consider that it is appropriate for suppliers to be able to recover the costs associated with the GGL. This is because over time the cap could materially depart from an efficient level of costs without a GGL allowance.

3.14. Three suppliers supported our proposal to include an allowance for the costs associated with the GGL which were incurred in cap period seven. One of these suppliers said that it was disappointed we did not include a prospective GGL allowance in cap period seven.

3.15. As set out in our October 2021 consultation, we agree that it is appropriate to allow suppliers to recover the GGL costs associated with cap period seven across cap period eight and nine, which will be in line with the cost recovery for the second

[28] BEIS (2021), Green Gas Levy (GGL): rates, underlying variables, mutualisation threshold. https://www.gov.uk/government/publications/green-gas-levy-ggl-rates-and-exemptions/green-gas-levy-ggl-rates-underlying-variables-mutualisation-threshold

scheme year.[29] We set out in our open letter the reasons we did not include an allowance in cap period seven and we maintain our previous considerations on this.[30]

[29] Ofgem (2021), Consultation on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap, paragraph 3.10. https://www.ofgem.gov.uk/publications/consultation-changes-annex-4-policy-cost-allowance-methodology-slc-28ad-include-green-gas-levy-allowance-default-tariff-cap

[30] Ofgem (2021), Update on the Green Gas Levy and default tariff cap. https://www.ofgem.gov.uk/publications/price-cap-update-green-gas-levy-and-default-tariff-cap

4. Methodology for calculating the GGL allowance

Section summary

In this chapter we discuss the methodology which will be used to calculate the GGL allowance in 'Annex 4 – Policy cost allowance methodology'.

Methodology amendments

Context

4.1. The cap includes a policy cost allowance to ensure that suppliers are able to recover the additional costs related to their obligations under different government environmental and social programmes. The policy cost allowance is set out in 'Annex 4 – Policy cost allowance methodology'.[31] There are currently six policy schemes in operation which are accounted for in the policy cost allowance.

Annex 4 updates

Context

4.2. In our October 2021 consultation, we proposed including a GGL allowance in 'Annex 4 – Policy cost allowance methodology' of SLC 28AD of the gas standard supply licence conditions. We also summarised our proposed modifications to Annex 4 and the default tariff cap models based on these proposals.[32] A revised Annex 4 and default tariff cap model were also published alongside our consultation.

Decision

4.3. We have decided to include an allowance for the GGL in 'Annex 4 – Policy cost allowance methodology' of SLC 28AD of the gas standard supply licence conditions.

[31] Licence Conditions on Ofgem website.
https://www.ofgem.gov.uk/licences-industry-codes-and-standards/licences/licence-conditions
[32] Ofgem (2021), Consultation on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap, paragraph 4.2-4.8, Appendix 1 & 2.
https://www.ofgem.gov.uk/publications/consultation-changes-annex-4-policy-cost-allowance-methodology-slc-28ad-include-green-gas-levy-allowance-default-tariff-cap

We have also decided to proceed with our proposed modifications to the Annex 4 and default tariff cap models.

4.4. We have decided to update the GGL allowance in the cap based on the latest available information published by BEIS in 'Annex 4 – Policy cost allowance' methodology.

4.5. We have decided to align our cap methodology with BEIS's design of the GGL and allow the recovery of associated costs on a per gas meter basis, ie to allocate it to the standing charge through the cap at nil consumption.[33]

4.6. We have decided to convert the levy rate, which the Secretary of State for BEIS will publish in a pence per meter per day format, to a pound per meter per year format so that it is consistent with the cap calculation. The levy rate in pence per meter point per day will be multiplied by the number of days in the scheme year and divided by 100 to express it in pounds per meter per scheme year. There are 122 days in the first scheme year and 365 days in the second scheme year.[34]

4.7. These decisions mean that the updated Annex 4 and default tariff cap models published alongside this decision will be used when updating the cap level for cap period eight onwards.[35] We did not make any changes to our methodology which was set out in these models since our October 2021 consultation. Details of the specific changes to the models can be viewed in Appendix 1 and 2 of our October 2021 consultation.[36]

[33] BEIS (2021), Future Support for Low Carbon Heat & The Green Gas Levy Government response to consultations, page 50.
https://www.gov.uk/government/consultations/future-support-for-low-carbon-heat
[34] We have added a statement clarifying the number of days in the first scheme year in the notes section of our Annex 4 model.
[35] The default tariff cap model includes changes from our decision on reflecting prepayment End User Categories in the default tariff cap.
Ofgem (2022), Decision on reflecting prepayment End User Categories in the default tariff cap.
https://www.ofgem.gov.uk/publications/price-cap-decision-reflecting-prepayment-end-user-categories-default-tariff-cap
[36] Ofgem (2021), Consultation on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap, Appendix 1 and 2.
https://www.ofgem.gov.uk/publications/consultation-changes-annex-4-policy-cost-allowance-methodology-slc-28ad-include-green-gas-levy-allowance-default-tariff-cap

Overview of stakeholder responses

4.8. One supplier said that our proposals would penalise suppliers who adopted tariffs with no standing charge. It said that its cash flow would be impacted by the policy demand in summer months.

Considerations

4.9. In our October 2021 consultation, we said that since suppliers would be charged the GGL based on the number of gas meters they supply, the GGSS costs to suppliers would not vary by consumption and the cost would be flat across an obligated suppliers' gas meter points.[37] We therefore still consider that it is appropriate to introduce the GGL allowance to the standing charge element of the cap. This will better align with the revenue suppliers can recover from customers and for when the quarterly levy payment is due.

4.10. In setting the cap, we may not make different provisions for different holders of supply licences.[38] This means that we must set one cap level for all suppliers, so we cannot set the cap to suit a particular supplier tariff format. Our approach of allocating the allowance to the standing charge is also similar to that which we have taken for the Warm Home Discount.[39]

4.11. The GGL allowance for cap period eight and nine includes the costs associated with both the first and the second scheme year. The first scheme year backdated cost has been calculated using the same method as the second scheme year.[40]

[37] Ofgem (2021), Consultation on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap, paragraph 4.5.
https://www.ofgem.gov.uk/publications/consultation-changes-annex-4-policy-cost-allowance-methodology-slc-28ad-include-green-gas-levy-allowance-default-tariff-cap
[38] Domestic Gas and Electricity (Tariff Cap) Act 2018, Section 2(2).
http://www.legislation.gov.uk/ukpga/2018/21/section/2/enacted
[39] Ofgem (2018), Decision – default tariff cap – Appendix 5 – policy and network costs, paragraph 2.1.
https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview
[40] This will allow recovery of the backdated levy payments for the period between 30 November 2021 to 31 March 2022.

Cap allowance updates

Context

4.12. Under the statutory instrument, the Secretary of State must publish the levy rate for the scheme year beginning 1 April 2023, and each subsequent scheme year, by 31 December in the preceding scheme year.[41]

4.13. In our October 2021 consultation, we noted that the statutory instrument stated that the Secretary of State may review the levy rate for the first scheme year and the scheme year beginning April 2022.[42] This means that the levy rate may either increase or decrease when it is published by 1 March 2022.

Decision

4.14. We have decided to update the GGL allowance in each subsequent cap update using the levy rates published by BEIS for the relevant scheme year.

Overview of stakeholder responses

4.15. One supplier raised concerns around the publication of future levy rates.

Considerations

4.16. The Secretary of State published the levy rates for the first and second scheme years which will be used for both the cap period eight and nine GGL allowance.[43] For subsequent scheme years, the Secretary of State must publish the levy rate by 31 December in the preceding scheme year.[44, 45] This will allow us to use it as an input for future summer and winter allowances.

[41] The Green Gas Support Scheme Regulations 2021, Section 39(2). https://www.legislation.gov.uk/uksi/2021/1335/made
[42] The Green Gas Support Scheme Regulations 2021, Section 39(3). https://www.legislation.gov.uk/uksi/2021/1335/made
[43] BEIS (2021), Green Gas Levy (GGL): rates, underlying variables, mutualisation threshold. https://www.gov.uk/government/publications/green-gas-levy-ggl-rates-and-exemptions/green-gas-levy-ggl-rates-underlying-variables-mutualisation-threshold
[44] The Green Gas Support Scheme Regulations 2021, Section 39(2). https://www.legislation.gov.uk/uksi/2021/1335/made
[45] Ofgem (2021), Consultation on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap, paragraph 4.10. https://www.ofgem.gov.uk/publications/consultation-changes-annex-4-policy-cost-allowance-methodology-slc-28ad-include-green-gas-levy-allowance-default-tariff-cap

4.17. One supplier said that we needed to ensure licensed gas suppliers would be aware of future levy rates when they are published via an open letter and through the daily update email. BEIS is responsible for the design of the GGL and GGSS, including the publication of levy rates, therefore this is a matter for BEIS.

4.18. Suppliers will also be able to view the levy rate and GGL allowance in tab '3j GGL' of 'Annex 4 – Policy cost allowance methodology' (in February and August). The same is true for other policy costs in Annex 4. Suppliers who are signed up to Ofgem's daily email update would be notified when we publish our summer and winter cap levels which includes subsidiary documents, one of which is Annex 4 – Policy cost allowance methodology.[46]

4.19. One supplier assumed that if BEIS makes any adjustment after the February update, that a retrospective adjustment will be made in the subsequent cap period.

4.20. We believe this supplier may have misinterpreted our proposal in our October 2021 consultation. We stated that we would use the most up to date levy rates when determining the GGL cost allowance in both the February and August updates. This means that if BEIS makes any change to the levy rate for the first or second scheme year after the February update, we will use the updated levy rate when determining the GGL allowance for cap period nine (October 2022 – March 2023). This means that any misalignment would only last for one period.[47]

4.21. Our position here is different to that in our February 2022 decision on the Energy Company Obligation scheme (ECO) and Warm Home Discount (WHD) scheme allowance methodologies in the default tariff cap which has been published alongside this decision. This reflects the potential materiality of any change to these scheme costs. There is less uncertainty over the GGL. The GGSS is a new scheme, is formally in place, and the levy rate for the first or second scheme year have already been published. Given these factors, and our understanding that the current levy rates are not material, we consider it unlikely that any change in scheme will be material. This reduces the value of introducing additional complexity through an

[46] Ofgem (2021), Subscribe to our news and communications. https://email.ofgem.gov.uk/p/1QCB-JWW/subscribe-to-our-news-and-communications
[47] Ofgem (2021), Consultation on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap, paragraph 4.12–4.13. https://www.ofgem.gov.uk/publications/consultation-changes-annex-4-policy-cost-allowance-methodology-slc-28ad-include-green-gas-levy-allowance-default-tariff-cap

allowance correction mechanism. This is not the case for ECO and WHD. The extension of these programmes has not been finalised or published yet. Moreover, the costs for ECO and WHD are material to suppliers, and any changes to these costs has the potential to be material. We discuss in more detail our reasoning for including this potential allowance correction for ECO and WHD in that decision document.[48]

Costs to a fully obligated supplier

Context

4.22. The GGL applies to all licensed fossil fuel gas suppliers except those who evidence that at least 95% of the gas they supplied supplier in a scheme year was certified biomethane using green gas certificates from eligible certification bodies.

Decision

4.23. We have decided to set the GGL allowance to reflect the costs that we would expect a fully obligated gas supplier to incur.

Overview of stakeholder responses

4.24. No stakeholders commented on this aspect of our October 2021 consultation.

Considerations

4.25. We have decided to set the policy cost allowance to reflect the cost that we expect a fully obligated gas supplier to incur as we expect that most suppliers will be fully obligated to pay the levy. We maintain our previous considerations from our October 2021 consultation.[49]

4.26. This will mean that a licensed gas supplier who is exempt from the GGL will incur costs beneath the level allowed in the cap. This is because we can only set one cap

[48] Ofgem (2022), Decision on the Energy Company Obligation scheme and Warm Home Discount scheme allowance methodologies in the default tariff cap**,** Chapter 3 and 4. https://www.ofgem.gov.uk/publications/price-cap-decision-energy-company-obligation-scheme-and-warm-home-discount-scheme-allowance-methodologies-default-tariff-cap

[49] Ofgem (2021), Consultation on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap, paragraph 4.14-4.15. https://www.ofgem.gov.uk/publications/consultation-changes-annex-4-policy-cost-allowance-methodology-slc-28ad-include-green-gas-levy-allowance-default-tariff-cap

level for all licensed gas suppliers, as we may not make different provisions for different holders of supply licences.[50]

Payment method

Decision

4.27. We have decided to introduce the GGL allowance for gas standard credit, other and prepayment meter customers. We have also decided to apply the allowance equally across each payment method.

Overview of stakeholder responses

4.28. No stakeholders commented on this aspect of our October 2021 consultation.

Considerations

4.29. We maintain our previous considerations from our October 2021 consultation.[51]

Other

4.30. One supplier was concerned that additional credit cover would be required from suppliers. It said that it was unclear if collateral costs were included within the policy cost allowance.

4.31. The policy cost allowance itself does not include collateral costs, however, the earnings before interest and taxes (EBIT) margin does. Since the EBIT margin is a fixed percentage of the cost components in the cap, this means that the value of the EBIT allowance will increase as the GGL allowance is introduced. We decided to use the EBIT margin analysis calculated by the Competition and Markets Authority (CMA) as part of its energy market investigation in our 2018 decision.[52] As we set out in

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

[51] Ofgem (2021), Consultation on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap, paragraph 4.16. https://www.ofgem.gov.uk/publications/consultation-changes-annex-4-policy-cost-allowance-methodology-slc-28ad-include-green-gas-levy-allowance-default-tariff-cap

[52] Ofgem (2018), Default Tariff Cap; Decision. Appendix 9 – EBIT, paragraph 1.4. https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview

2018, the CMA had already considered a range of submissions and evidence in the area of regulatory collateral.[53]

4.32. One supplier said that suppliers will be liable for the bad debt risk associated with collecting the GGL allowance from customers. It said that if innovation is expected from suppliers, then there needs to be recognition that suppliers carrying bad debt associated with schemes is not sustainable, with liability being equal among other market participants.

4.33. We allow for debt-related costs in the cap through a combination of the operating cost allowance and payment method uplift. These allowances themselves change over time. The payment method uplift scales with other components in the cap, and therefore would change in line with the policy cost allowance.

4.34. One supplier asked for clarity on whether suppliers will be required to include the GGL within any future Fuel Mix disclosure reporting.

4.35. The Electricity (Fuel Mix Disclosure) Regulations 2005 currently requires all electricity suppliers in GB to disclose to their customers the mix of fuels used to generate the electricity they supply annually.[54] It does not require a licensed electricity supplier to report specifically on the proportion of electricity generated from green gas, but it does require suppliers to report on electricity generated from renewable sources for which Renewable Energy Guarantees of Origin certificates (REGOs) or EU Guarantees of Origin (GoOs) have been issued.

Next steps

Potential transition to a volumetric levy by BEIS

4.36. Two suppliers accepted that it would be appropriate for us to review and reconsider the cap methodology as the levy transitions towards a volumetric levy if and when BEIS sets the scheme parameters.

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[53] Ofgem (2018), Default Tariff Cap; Decision. Appendix 9 – EBIT, paragraph 3.40. https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview

[54] Ofgem (2021), Fuel Mix Disclosure (FMD). https://www.ofgem.gov.uk/environmental-and-social-schemes/renewables-energy-guarantees-origin-rego/energy-suppliers/fuel-mix-disclosure-fmd

4.37. We agree that it would be appropriate for us to review our cap methodology to reflect any transition to a volumetric levy if or when it occurs. We will consider whether there are material and systematic changes which requires us to revisit our GGL allowance methodology at that time.

4.38. One supplier said that the per meter point levy would mean that low consuming gas customers will be impacted more than higher consuming customers. It would like to see a move to a volumetric levy as soon as possible.

4.39. We are reflecting the design of the policy which is set by BEIS by setting the allowance on a per gas meter point format. We have aligned our methodology with BEIS’s design of the scheme to allow the recovery of associated costs in a similar manner to which suppliers will be charged. Suppliers will be charged based on the number of gas meter points they serve and therefore the cost from the levy that a supplier is exposed to will not vary by gas consumption.