# Decision

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## Price Cap - Decision on reflecting change to gas SoLR levy costs in the default tariff cap

| Subject | Details |
| --- | --- |
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We consulted in December 2021 on our proposal to amend the default tariff cap to take account of proposed changes to how Supplier of Last Resort (SoLR) levy costs are recovered from gas customers. This document explains how we will amend the cap methodology due to the introduction of a volumetric charge to recover SoLR levy costs through suppliers.

We have carefully considered all responses to our consultation and published non-confidential responses alongside this decision.

# Contents

## 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'). 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 calculated using allowances for different types of costs suppliers incur providing gas and electricity. The costs associated with transferring customers through the Supplier of Last Resort ('SoLR') process (known as 'SoLR levy costs') are recovered through allowances for network costs. These SoLR levy costs have increased over the past year due to the rise in wholesale gas prices, causing a number of suppliers to leave the market.

Two UNC modifications were submitted to us that proposed changes to how SoLR levy costs are recovered by suppliers. These were 'UNC687V - Creation of new charge to recover Last Resort Supply Payments' and 'UNC797 - Last Resort Supply Payments Volumetric Charges'.[1] On 20 January 2022, we approved UNC797, which created a new volumetric charge to allow for more targeted recovery of SoLR levy costs from domestic and non-domestic suppliers.

We are amending the cap to reflect the decision to approve UNC797 by including a new SoLR customer charge input in the gas network cost allowance methodology of the retail price cap methodology. Aligning the cap methodology with the UNC decision will ensure that suppliers can recover the costs they will face through the new charge, supporting the accuracy of the cap.

For customers with a typical consumption profile, we estimate gas SoLR levy costs of around £33 per direct debit and standard credit customer and £30 per prepayment meter (PPM) customer at the next price cap period.[2] However, our changes will ensure that customers who consume relatively small amounts of gas will pay a proportionately smaller increase than larger consumers of gas.

[1] Copies of the modification proposals can be found on the Joint Office of Transporters website: https://www.gasgovernance.co.uk/

[2] Benchmark consumption level is 12,000 kWh.

# 1. Introduction

**Section summary**

In this chapter, we summarise the purpose of the default tariff cap and the consultation we published on 15 December 2021 that proposed changes to how the cap incorporates SoLR levy costs. We also explain the UNC modifications that proposed changes to how SoLR levy costs are recovered from gas suppliers.

## Subject of this decision

1.1. This document explains our decision to amend the default tariff cap ('cap') to take account of a modification to how Supplier of Last Resort (SoLR) levy costs are recovered from suppliers. This change will include a new 'SoLR customer charge' in the cap methodology to make sure the cap continues to reflect how these charges will be recovered from suppliers.

1.2. For customers with a typical consumption profile, we estimate gas SoLR levy costs of around £33 per direct debit and standard credit customer and £30 per prepayment meter (PPM) customer at the next price cap period.[3] Recovering these costs through a volumetric charge will ensure that customers who consume relatively small amounts of gas will pay a smaller proportion of the overall charge than larger consumers of gas.

1.3. The cap aims to protect customers who pay 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 works by setting the maximum price suppliers can charge customers on default tariffs.

1.4. The cap includes allowances for different types of costs, such as wholesale costs, policy costs, network costs and operating costs. We use different methodologies to

[3] Benchmark consumption level is 12,000 kWh.

set the level of each of these allowances, which, in turn, allow us to set the cap level.

1.5. Under the current cap methodology, there is no separate charge to recover SoLR levy costs from domestic gas customers. Instead, SoLR levy costs are integrated into existing gas distribution charges contained in the gas network costs allowance methodology. This forms part of Annex 3 of Standard Licence Condition (SLC) 28AD of the gas standard supply licence conditions ('Annex 3').

1.6. Annex 3 includes allowances for the costs of building, maintaining, and operating gas distribution network and system infrastructure used to deliver gas to customers. This consists of several charges, including Local Distribution Zone (LDZ) system commodity charges, LDZ system capacity charges, and customer capacity charges. SoLR levy costs are recovered through these charges.

## Structure of this decision document

1.7. This decision document has the following structure:

- Chapter 1 summarises our decision and the structure of the document. It also explains our decision-making process.
- Chapter 2 sets out our decision to introduce a SoLR customer charge in the cap. It explains the reasons for this decision and summarises relevant consultation feedback.
- Chapter 3 sets out our changes to the methodology for introducing a SoLR customer charge. This chapter explains the changes we will make to Annex 3.

# Our decision-making process

### December 2021 consultation

1.8. We published the 'Consultation on reflecting change to gas SoLR levy costs in the default tariff cap' on 15 December 2021.[4] This consultation set out proposals to amend the cap to reflect modifications to how SoLR levy costs are recovered from gas suppliers.

1.9. The consultation proposed to make this change by including a new input for SoLR customer charges in Annex 3. A revised version of Annex 3 was included in the consultation that set out the modelling changes that could be made.

1.10. A UNC modification - ('UNC687 - Creation of new charge to recover Last Resort Supply Payments') – had been submitted to us that proposed changes to how SoLR levy costs are recovered from suppliers. We sent UNC687 back to the UNC Panel on 7 December 2021 to review the legal text contained in the modification.[5] However, we based the modelling changes included in the annex on the proposals contained in UNC687. As we used UNC687 as the basis for setting out example changes to Annex 3, we also proposed changes to the supplementary workbook, 'Default Tariff Cap Level', to include the gas network costs allowance at nil consumption cap level. This was necessary as UNC687 proposed to recover SoLR levy costs through a fixed charge.

1.11. While UNC687 was used as the basis for the modelling changes set out in the annex, the consultation was clear that our objective was to align SoLR customer charges with the allowances in the cap. If other modifications were submitted and approved that charged SoLR levy costs in a different way, we would align the model with those changes.

[4] Ofgem (2021), Consultation on reflecting change to gas SoLR levy costs in the default tariff cap. https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-change-gas-solr-levy-costs-default-tariff-cap
[5] Ofgem (2021), Authority decision to 'send back' Uniform Network Code ("UNC") 687 ("UNC687"): 'Creation of new charge to recover Last Resort Supply Payments'. https://www.ofgem.gov.uk/publications/authority-decision-send-back-uniform-network-code-unc-687-unc687-creation-new-charge-recover-last-resort-supply-payments-0

1.12. Our consultation closed on 17 January 2022. Eight responses were submitted to it, seven of which were non-confidential and have been published on our website. We summarise and respond to relevant consultation feedback in chapters two and three.

**UNC modification decision**

1.13. On 13 January 2022, two UNC modifications were submitted to Ofgem that proposed changes to how SoLR levy costs are recovered. These were 'UNC687V - Creation of new charge to recover Last Resort Supply Payments' and 'UNC797 - Last Resort Supply Payments Volumetric Charges'. Both modifications proposed to create new charges to recover payments from SoLR suppliers and better target costs to the market sector they originated in.

1.14. The modifications differed on the type of cost recovery charge they would put in place. UNC687V proposed to recover SoLR levy costs from suppliers using a fixed charge per meter. UNC797 proposed a volumetric charge that would apportion costs based on energy usage.

1.15. Ofgem approved UNC797 and rejected UNC687V on 20 January 2022. We have taken into account the decision to introduce a volumetric charge to apportion costs when making this decision.

## Related publications

1.16. 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.

1.17. The main documents relating to reflecting changes to gas SoLR levy costs in the Default Tariff Cap:

- Consultation on reflecting change to gas SoLR levy costs in the Default Tariff Cap ('December 2021 consultation'): https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-change-gas-solr-levy-costs-default-tariff-cap

- Authority decision on UNC0797 (Urgent) - Last Resort Supply Payments Volumetric Charges: https://www.ofgem.gov.uk/publications/authority-decision-unc0797-urgent-last-resort-supply-payments-volumetric-charges
- Authority decision to 'send back' UNC687 - 'Creation of new charge to recover Last Resort Supply Payments': https://www.ofgem.gov.uk/publications/authority-decision-send-back-uniform-network-code-unc-687-unc687-creation-new-charge-recover-last-resort-supply-payments-0

# Your feedback

### General feedback

1.18. 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

# 2. Introducing a SoLR customer charge in the cap

**Section summary**

In this chapter, we set out our decision to introduce a separate SoLR customer charge input in the cap.

## SoLR customer charge

### Context

2.1. In December 2021, we consulted on including a separate SoLR customer charge in the cap to reflect changes that could be made to how SoLR levy costs are recovered from suppliers.[6] Our consultation was clear that we would aim to amend the cap methodology to reflect whatever new cost recovery mechanism was put in place for suppliers.

### Decision

2.2. We have decided to amend the cap methodology to introduce a separate SoLR levy customer charge from cap period eight onwards. This reflects our decision to approve UNC797, which introduces a new volumetric charge to recover SoLR levy costs.

### Stakeholder responses

2.3. Stakeholders supported the need for Ofgem to amend the cap methodology to reflect any new SoLR cost recovery mechanism that is approved. No stakeholder disagreed with us amending the cap methodology.

2.4. Some stakeholders provided a rationale for their agreement. One stakeholder said this is a practical way forward to recover gas SoLR costs. Another said that, although there are provisions for recovery of these costs through LDZ charges, having a separate input would increase the level of transparency in the cap.

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[6] Ofgem (2021), Consultation on reflecting change to gas SoLR levy costs in the default tariff cap. https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-change-gas-solr-levy-costs-default-tariff-cap

2.5. Stakeholders also said we should not delay amending the cap, regardless of which UNC modification we approved so that the cap methodology accurately reflects network costs. For example, one stakeholder said that if we approved a UNC modification alternative to UNC687V, we should amend the cap methodology to ensure it reflects this decision. This aligns with the objective we set out in the consultation of aligning the cap methodology with SoLR customer charges.

2.6. One stakeholder asked how the methodology would be applied. They were unclear if SoLR levy costs are to be recovered from customers on an SVT tariff or whether a supplier can recover these costs across the whole portfolio of its customer base. The cap only applies to default customers. However, the SoLR customer charge input will be incurred by suppliers in relation to all domestic customer types.

*Out of scope stakeholder responses*

2.7. Another supplier questioned whether similar provisions would be in place to recover electricity SoLR costs via the same mechanism through the cap. Currently, these costs are captured by Distribution Network Use of System (DUoS) charges within the 'Annex 3 - Network cost allowance methodology – electricity' in the cap. We consider this to be out of scope for this consultation.

2.8. Several respondents acknowledged the alternative UNC modification UNC797 which was published after our consultation. Some respondents stated their preferred UNC modification. For example, one respondent preferred UNC687V because it was simpler to implement within the cap. Another respondent preferred UNC797 as it would apportion SoLR levy costs on a volumetric basis. Although we note this feedback, decisions on the UNC modifications were outside the scope of our consultation.

2.9. One supplier said that Renewable Obligation Certificate obligations should be treated in the same way as SoLR levy costs. This falls outside the scope of the cap, and we consider stakeholders should raise these issues in the appropriate industry forums or mechanisms.

# 3. Methodology for introducing a SoLR customer charge

**Section summary**

In this section, we explain the methodology changes to allow for the new SoLR customer charge input in Annex 3.

## Methodology amendments

### Context

3.1. In our December 2021 consultation, we proposed to include a separate input for SoLR customer charges in the Annex 3 model.[7] Our example changes were based on a standing charge, but we also said that there was a possibility that we would recover these costs through another charge type.

3.2. We also proposed changes to the supplementary workbook, 'Default Tariff Cap Level', to include the gas network costs allowance at nil consumption cap level.

### Decision

3.3. We have decided to include a separate input for SoLR customer charges in 'Annex 3 Network cost allowance methodology' of SLC 28AD of the gas standard supply licence condition.

3.4. We have decided to recover these costs through a volumetric charge. This will align the cap methodology with the changes to how SoLR levy costs are recovered due to UNC797's approval.

3.5. We have decided not to amend the supplementary workbook 'Default Tariff Cap Level'. As the charge is volumetric, suppliers will not incur any costs where a customer has nil consumption. We, therefore, do not need to include a gas network cost allowance at nil consumption.

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[7] Ofgem (2021), Consultation on reflecting change to gas SoLR levy costs in the default tariff cap. https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-change-gas-solr-levy-costs-default-tariff-cap

**Stakeholder responses**

3.6. Three stakeholders supported our proposed approach for reflecting the UNC proposal at the time in the methodology.

3.7. They said they would also support our decision to change the proposed approach if an alternative UNC modification was approved with a different cost recovery mechanism (ie to reflect a volumetric charge).

3.8. One stakeholder said that if we implement UNC0687V, the text 'The value of the gas Network Cost Allowance at Benchmark Annual Consumption Level nil kWh is zero' should be deleted from the worksheets in the network methodology workbook.

**Summary of gas network cost methodology amendments**

3.9. The proposed amendments to the cap methodology contained in the December 2021 consultation paper reflected the approach proposed under UNC687. However, the approval of UNC797 means that we have amended our proposed methodology to reflect this decision.

3.10. We consider that our decision to align cost recovery under the cap with the UNC797 methodology will make sure there is consistency between the charges suppliers pay to recover SoLR costs and the recovery of these costs from consumers. It will also make sure customers who consume relatively small amounts of gas will pay a lesser charge than larger consumers of gas.

3.11. We have included an input for SoLR customer charges in 'Annex 3 Network cost allowance methodology' of SLC 28AD of the gas standard supply licence conditions. The input will be used to calculate SoLR customer charge allowance at the benchmark annual consumption levels from cap period eight.[8] This will feed into the calculation of the total gas distribution charge in the Annex 3 model.

[8] The SoLR customer charge is a pence per peak day kWh per day charge and would be applied at benchmark annual consumption level m kWh (typical consumption).

3.12. SoLR customer charges will be updated with the latest notice of charges published by the gas distribution network companies.[9] They will also be updated in line with the current methodology for calculating the gas distribution charges in the cap.

3.13. We consider it is appropriate to have 'The value of the gas Network Cost Allowance at Benchmark Annual Consumption Level nil kWh is zero' in the Annex 3 model. Therefore it is not removed from the model. This is because we have decided to recover SoLR levy costs through a volumetric charge, so the gas network allowance at benchmark annual consumption level nil KWh would be zero.

3.14. Details of the specific changes to the Annex 3 model can be viewed in Appendix 1. We have published revised versions of the models alongside this decision document. The revised models include changes from the PPM EUC decision.[10]

[9] Joint Office of Gas Transporters, Notice of DN charges: https://www.gasgovernance.co.uk/DNnotice

[10] Ofgem (2022), Price cap - 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

# Appendices

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# Appendix 1: Detail model modification: Annex 3 'Network cost allowance methodology gas'

1.1. This appendix summarises modifications to 'Annex 3 – Network cost allowance methodology' of SLC 28AD of the gas standard supply license conditions based on the decision to approve UNC797. We have published alongside this consultation a revised Annex 3 that would come into effect from cap period eight onwards. The revised model includes changes from the Prepayment End User Categories (PPM EUC) decision.[11]

1.2. Note that the SoLR customer charge input is used to calculate a separate SoLR customer charge for PPM and Non-PPM customers (see below) to reflect the PPM EUC decision.[12]

Tab '3g Gas distribution charges'
- Cells B51:AA63 – table extended to include SoLR customer charge input.

Tab' 2d Gas distribution'
- Cells B103:Z11 - table extended to include total Non-PPM SoLR customer charge.
- Cells B116:Z128 - table extended to include total PPM SoLR customer charge.
- Cells W129:Z41 - formulas updated to include Non-PPM SoLR customer charge.
- Cells B103:Z115 - table extended to include total PPM gas transmission charge (formula includes the PPM SoLR customer charge).

[11] Ofgem (2022), Price cap- 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
[12] Ofgem (2022), Price cap - 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