

Ofgem: Price Cap – Consultation on the process for updating the Default Tariff Cap methodology and setting maximum charges

Summary and introduction

1. This legal annex forms part of Centrica's response to Ofgem's price cap consultation on the process for updating the Default Tariff Cap ("DTC") methodology and setting maximum charges, dated 19 November 2021 ("Consultation").
2. The Consultation correctly identifies that recent events in the UK energy retail market, with the unexpected and unprecedented rise in wholesale gas prices, has left suppliers with additional costs, risks and uncertainties that are not accounted for in the price cap under the existing methodology (as evidenced by past months' supplier failures). Accordingly, Ofgem are right to examine the current design and operation of the default tariff cap.
3. However, the proposals to modify Standard Licence Condition ("SLC") 28AD of the gas (and electricity) supply licence to introduce an ability for Ofgem to – 'in exceptional circumstances' - amend the DTC outside the current six-month cycle, without going through the statutory process for licence modification (hereinafter referred to as the "proposed self-modification process"), is legally flawed for the following reasons:
 - a. if Parliament had intended for Ofgem to be able to introduce self-modification measures in the SLCs, as the ones now proposed, it would have made specific provisions for this in the Domestic Gas and Electricity (Tariff Cap) Act 2018 (the "Act");
 - b. Ofgem's rationale for the proposed measures is unclear; and
 - c. it is unlikely that the proposals are necessary or proportionate, given the lack of justification and the increased uncertainty it would give rise to if implemented.
4. In summary, if Ofgem were to proceed with the proposals to amend the SLCs to introduce the proposed self-modification process, its decision would be vulnerable to challenge.

The Act does not give Ofgem specific powers to implement the proposed ‘out of cycle’ SLC amendments

5. The Act sets out that Ofgem may “*modify the tariff cap conditions from time to time*”, including a power to make “*consequential, incidental, supplemental and transitional modifications of the standard supply licence conditions*”.¹
6. Specific statutory safeguards – a duty to consult, and statutory lead times – apply to such modifications.
7. However, the Act does not grant Ofgem specific powers to amend the SLCs to introduce self-modification processes such as the one now proposed. In fact, if Parliament had the intention to grant Ofgem such powers, it would have explicitly done so.
8. We understand that Ofgem does not intend to use the modification powers in the Gas and Electricity Acts (see e.g. section 7B(7)(b) of the Gas Act 1986 and section 7B(5)(B) of the Electricity Act 1989). In case our understanding is incorrect, we highlight that to do so would be legally flawed, as general powers are subordinate to specific legislated powers, and, of course, use of such general powers would be appealable on their merits to the CMA.
9. The same is true of the statutes which govern economic regulation in other sectors. For example, in the Civil Aviation Act 2012, Parliament included an express power for the Civil Aviation Authority to include self-modification provisions in the relevant license conditions.²
10. The absence of such an express power in the Act is telling. Parliament decided to legislate specifically for the default tariff cap. The measures required by the Act are highly intrusive and should be read narrowly. If Parliament had intended licence conditions set under it to contain their own modification rules it would have said so directly.

Self-modification provisions can only be permitted in limited circumstances

11. Self-modification provisions in SLCs, as the ones now proposed, can only be permitted in limited circumstances. This was recently confirmed by the CMA in their final determinations in the RIIO-2 appeals.
12. Importantly, in RIIO-2, the CMA found that Ofgem had acted wrong in law when it decided to introduce the relevant self-modification procedure. The CMA further clarified that Ofgem could only impose self-modification provisions in the relevant SLCs, under the Gas and Electricity Acts, if it could ensure a framework which clearly defines the scope of

¹ Section 5 of the Act.

² Sections 21(3) and (4) of the Civil Aviation Act 2012.

the potential modification (including time, manner/nature, and circumstances) and if licensees have a possibility of a meaningful challenge against the scope of the condition at the point at which it is adopted.³ This is a high bar to meet.

13. Based on the limited information provided in the Consultation, and the vague definition of ‘exceptional circumstances’ as events that are ‘rare’ and would have a ‘high impact without urgent action’, it is likely that Ofgem’s proposed self-modification process, if implemented, would be vulnerable to appeal.
14. Thus, even if Ofgem were to use the modification powers in the Gas and Electricity Acts (which we do not understand to be the intention) its ability to introduce the proposed modifications would be clearly limited.

Ofgem has failed to justify the proposals and even if it had, it is unlikely that they could be deemed necessary or proportionate

15. Given Ofgem’s current powers to make licence modifications, within and outside the relevant 6-month review period, as long as it follows the statutory modification process, it is unclear why the proposed self-modification process is required.⁴
16. In the Consultation, Ofgem notes that “*while we have the ability to make changes to the cap methodology and annex models, we cannot implement these changes outside of our six month review cycle without a licence modification*” (emphasis added).⁵
17. However, the statutory modification processes are there to ensure procedural safeguards and regulatory certainty. Accordingly, if Ofgem were to introduce a measure which would effectively undermine this, a well-reasoned justification as to why these additional powers are indeed required (which they seemingly are not) could be expected. Yet, the Consultation fails to provide a well-reasoned rationale for the proposed self-modification measures.
18. Further, in the Consultation Ofgem itself notes that “*if implemented, these proposals would create additional uncertainty on the cap level in any cap period*” (emphasis added).⁶ Given the lack of justification as to why these proposed changes are indeed necessary (which they are not) and the uncertainty they would bring if implemented, it is highly unlikely that the proposals could be considered proportionate.

³ RIIO-2 Appeals, CMA Final Determination, Volume 2B, see e.g. paragraphs 8.123 and 8.132.

⁴ As set out in section 4 and section 5 of the Act.

⁵ Consultation, paragraph 2.

⁶ Consultation, paragraph 14.