

To: All holders of a gas and/or
electricity supply licence

Email: priceprotectionpolicy@ofgem.gov.uk.

Date: 25 May 2023

Domestic Gas and Electricity (Tariff Cap) Act 2018

Section 4(2)

Notice of statutory consultation on a proposal to modify the standard licence condition 28AD of all Gas and Electricity Supply Licences (the "Notice")

1. Each of the companies to whom this notice is addressed holds either (1) an electricity supply licence granted, or treated as granted, pursuant to section 6(1)(d) of the Electricity Act 1989; or (2) a gas supply licence granted, or treated as granted, pursuant to section 7A(1) of the Gas Act 1986.
2. The Gas and Electricity Markets Authority ('the Authority')¹ gives notice that it proposes to modify the standard conditions of all gas and electricity supply licences granted or treated as granted under section 6(1)(d) of the Electricity Act 1989 and section 7A(1) of the Gas Act 1986, pursuant to section 1 of the Domestic Gas and Electricity (Tariff Cap) Act 2018 ('the 2018 Act'), by amending Standard Licence Condition (SLC) 28AD (Regulation of charges for Domestic Customers supplied under certain Domestic Supply Contracts), namely the conditions which impose a cap on all standard variable and default rates that may be charged by the holders of a supply licence for the supply of gas or electricity under domestic supply contracts, subject to section 3 of the Act (exemptions from the tariff cap). The proposed modifications are set out in Annex 1 and Annex 2.
3. The Authority proposes to amend SLC 28AD and Annex 1 of SLC 28AD of the Gas and Electricity Supply Licences.

¹ The terms "the Authority" and "we" are used interchangeably in this document.

4. The effect of this proposed modification is to amend the Earnings Before Interest and Tax (EBIT) allowance in the default tariff cap to revise the allowance and introduce a hybrid methodology which the Authority considers is more appropriate. The modifications will introduce a new fixed EBIT component and alter the EBIT percentage from the current value. This will help ensure that the EBIT allowance remains cost- and risk-reflective, contributing to the resilience of the sector and to better quality of services – which both protects and benefits customers. The modifications also include the addition of the Adjustment Allowance to the EBIT definitions under paragraph 28AD.40 to align these descriptions with the current formula and methodology.
5. This Notice is published alongside a consultation setting out the case for change and our detailed considerations of the proposed methodological approach. Further details of the reasons for and effects of these proposed modifications can be found in the main statutory consultation document, which is available at: <https://www.ofgem.gov.uk/publications/price-cap-statutory-consultation-amending-methodology-setting-earnings-interest-and-tax-ebit-allowance>
6. A copy of the proposed modifications and other documents referred to in this Notice have been published on our website (<https://www.ofgem.gov.uk>). Alternatively, you can request a copy by emailing foi@ofgem.gov.uk.
7. Any representations with respect to the proposed licence modifications must be made on or before 28 June 2023 to: Price Protection Policy team, Office of Gas and Electricity Markets, 10 South Colonnade, Canary Wharf, London, E14 4PU or by email to priceprotectionpolicy@ofgem.gov.uk.
8. We normally publish all responses on our website. If you do not wish for your response to be made public then please clearly mark it as not for publication. We prefer to receive responses in electronic form so they can be placed easily on our website.
9. If we decide to make the proposed modifications, they will take effect not less than 25 days after the decision is published.

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Dan Norton

Deputy Director, Retail Price Protection

Duly authorised on behalf of the Gas and Electricity Markets Authority

25 May 2023

Annex 1 – Draft of proposed modifications to the standard licence conditions of electricity supply licences

Deletions are denoted with a strike-through and new text is denoted with a double underlining.

Condition 28AD of the electricity supply licence

Proposed modification: Amend existing paragraph

28AD.13 For the purposes of paragraph 28AD.7, the Earnings Before Interest and Tax Allowance in Charge Restriction Region i , in 28AD Charge Restriction Period j , at Benchmark Annual Consumption Level k , for Benchmark Metering Arrangement l , for Payment Method p , shall be calculated as follows:

$$E_{i,j,k,l,p} = \text{EBIT Fixed Component}_i + ((\text{EBIT Percentage}_i \times (\text{WC}_{i,j,k,l} + \text{NC}_{i,j,k,l} + \text{PC}_{i,j,k,l,p} + \text{AA}_{i,j,k,l} + \text{OC}_{j,k,l,p} + \text{PA}_{i,j,k,l,p})))$$

where:

EBIT Fixed Component means the Baseline Value for the Earnings Before Interest and Tax Margin Fixed Component, as published by the Authority by way of a statement in Writing pursuant to paragraph 28AD.17.

EBIT Percentage means the Baseline Value for the Earnings Before Interest and Tax Margin Percentage, as published by the Authority by way of a statement in Writing pursuant to paragraph 28AD.17.

Proposed modification: Amend selected definitions from existing paragraph

28AD.40

'Baseline Value' means the values as specified by the Authority by publishing a statement in Writing in accordance with paragraph 28AD.17 and in the format set out at Annex 1. These are the values of the Baseline Value for the Operating Cost Allowance, the Headroom Allowance Percentage, the Earnings Before Interest and Tax Margin Percentage, the Earnings Before Interest and Tax Margin Fixed Component, the Payment Method Adjustment Additional Cost and Payment Method Adjustment Percentage;

'Earnings Before Interest and Tax Allowance' means the amount to reflect a return on capital, calculated by the sum of

- a) the figure arrived at by applying the Earnings Before Interest and Tax Margin Percentage by the sum of the Wholesale Cost Allowance, the Network Cost Allowance, the Policy Cost Allowance, the Adjustment Allowance, the Operating Cost Allowance and the Payment Method Adjustment, in Charge Restriction Region i , Charge Restriction Period j , at Benchmark Annual Consumption Level k , for Benchmark Metering Arrangement l , for Payment Method p ; and
- b) the Earnings Before Interest and Tax Fixed Component,

which the Authority is to calculate for the periods and within the timeframes specified in this condition 28AD in accordance with paragraph 0;

'Earnings Before Interest and Tax Fixed Component' means the amount, expressed as a value as specified by the Authority by publishing a statement in Writing in accordance with paragraph 28AD.17 and in the format set out in Annex 1, in order to calculate part of the Earnings Before Interest and Tax Allowance;

'Earnings Before Interest and Tax Margin Percentage' means the value, expressed as a percentage as specified by the Authority by publishing a statement in Writing in accordance with paragraph 28AD.17 and in the format set out in Annex 1, by which the Wholesale Cost Allowance, the Network Cost Allowance, the Policy Cost Allowance, the Adjustment Allowance, the Operating Cost Allowance and the Payment Method Adjustment is to be multiplied in order to calculate part of the Earnings Before Interest and Tax Allowance;

Proposed modification: Amend table in Annex 1

Annex 1 – Format for publishing Baseline Values and Initial Value of the CPIH Index

Baseline Values

Earnings Before Interest and Tax Margin Percentage Allowance

<u>EBIT Fixed Component</u>	
<u>EBIT Percentage</u>	

Annex 2 – Draft of proposed modifications to the standard licence conditions of gas supply licences

Deletions are denoted with a strike-through and new text is denoted with a double underlining.

Condition 28AD of the gas supply licence

Proposed modification: Amend existing paragraph

28AD.12 For the purposes of paragraph 28AD.6, the Earnings Before Interest and Tax Allowance in Charge Restriction Region i , in 28AD Charge Restriction Period j , at Benchmark Annual Consumption Level k , for Benchmark Metering Arrangement l , for Payment Method p , shall be calculated as follows:

$$E_{i,j,k,l,p} = \frac{\text{EBIT} \text{ EBIT Fixed Component}_i + ((\text{EBIT Percentage}_i \times (\text{WC}_{i,j,k,l} + \text{NC}_{i,j,k,l} + \text{PC}_{i,j,k,l,p} + \text{AA}_{i,j,k,l} + \text{OC}_{j,k,l,p} + \text{PA}_{i,j,k,l,p})))}{2}$$

where:

EBIT Fixed Component means the Baseline Value for the Earnings Before Interest and Tax Margin Fixed Component, as published by the Authority by way of a statement in Writing pursuant to paragraph 28AD.16.

EBIT Percentage means the Baseline Value for the Earnings Before Interest and Tax Margin Percentage, as published by the Authority by way of a statement in Writing pursuant to paragraph 28AD.16.

Proposed modification: Amend selected definitions from existing paragraph

28AD.40

'**Baseline Value**' means the values as specified by the Authority by publishing a statement in Writing in accordance with paragraph 28AD.16 and in the format set out at Annex 1. These are the values of the Baseline Value for the Operating Cost Allowance, the Headroom Allowance Percentage, the Earnings Before Interest and Tax Margin Percentage, the Earnings Before Interest and Tax Margin Fixed Component, the Payment Method Adjustment Additional Cost and Payment Method Adjustment Percentage;

'**Earnings Before Interest and Tax Allowance**' means the amount to reflect a return on capital, calculated by the sum of

- a) the figure arrived at by applying the Earnings Before Interest and Tax Margin Percentage by the sum of the Wholesale Cost Allowance, the Network Cost Allowance, the Policy Cost Allowance, the Adjustment Allowance, the Operating Cost Allowance and the Payment Method Adjustment, in Charge Restriction Region i , Charge Restriction Period j , at Benchmark Annual Consumption Level k , for Benchmark Metering Arrangement l , for Payment Method p ; and
- b) the Earnings Before Interest and Tax Fixed Component,

which the Authority is to calculate for the periods and within the timeframes specified in this condition 28AD in accordance with paragraph 02;

'Earnings Before Interest and Tax Fixed Component' means the amount, expressed as a value as specified by the Authority by publishing a statement in Writing in accordance with paragraph 28AD.16 and in the format set out in Annex 1, in order to calculate part of the Earnings Before Interest and Tax Allowance;

'Earnings Before Interest and Tax Margin Percentage' means the value, expressed as a percentage as specified by the Authority by publishing a statement in Writing in accordance with paragraph 28AD.16 and in the format set out in Annex 1, by which the Wholesale Cost Allowance, the Network Cost Allowance, the Policy Cost Allowance, the Adjustment Allowance, the Operating Cost Allowance and the Payment Method Adjustment is to be multiplied in order to calculate part of the Earnings Before Interest and Tax Allowance;

Proposed modification: Amend table from Annex 1

Annex 1 – Format for publishing Baseline Values and Initial Value of the CPIH Index

Baseline Values

Earnings Before Interest and Tax Margin Percentage Allowance

<u>EBIT Fixed Component</u>	
<u>EBIT Percentage</u>	