

**To – all stakeholders**

Email: [Retailpriceregulation@ofgem.gov.uk](mailto:Retailpriceregulation@ofgem.gov.uk)

Date: 7th February 2024

Dear Stakeholders,

**Consultation on the timing of price cap inputs for capacity market cost allowance, and the introduction of proposed policy changes relating to energy intensive industries (EII) - February 2024**

This consultation sets out our proposals for dealing with late or uncertain inputs to the price cap calculation for April 2024 relating to Capacity Market (CM) and planned changed to the Energy Intensive Industry (EII) exemption scheme. Below, we set out the background to the issues relevant to each area and the changes we propose to implement from charge restriction period 12a (commencing 1 April 2024), due to be announced later in February 2024.

In summary, we propose to:

- Allow the Capacity Market (CM) Allowance to be updated on a quarterly basis (rather than six-monthly), where there is more up to date information available to do so.
- Use relevant Policy Cost Allowance inputs which assumes 100% EII exemption for the February 2024 announcement, in anticipation of the relevant legislation being in place by 1 April. We also propose to update the Policy Cost Allowance in May 2024 (rather than the next six-monthly update) should the relevant legislation not be in place as expected.

We wish to ensure transparency with stakeholders and provide this opportunity to

comment on the intended changes set out in this letter ahead of the February 2024 price cap announcement.

**Responses can be sent via email to [RetailPriceRegulation@ofgem.gov.uk](mailto:RetailPriceRegulation@ofgem.gov.uk) by close of business on 16 February 2024.**

## **Capacity Market**

The CM scheme is designed to ensure electricity security of supply. We include an allowance within Annex 2 of the price cap methodology to reflect costs to energy suppliers associated with this scheme known as the Capacity Market Allowance. We calculate these costs using various inputs, including information on auction clearing prices and capacity obligations<sup>1</sup>.

When we moved to quarterly Price Cap updates in August 2022<sup>2</sup>, we decided to continue to update the CM allowance every six months (only) rather than every quarter, on the basis of how frequently the CM allowance inputs would ordinarily be available.

### **Issue**

We have encountered an issue that one of the relevant inputs will not be available in time for inclusion within the price cap calculation for February 2024. Specifically, the T-1 2023 Auction for the 24/25 CM year which is due to take place over the 20<sup>th</sup> and 21<sup>st</sup> of February 2024 with preliminary clearing prices not available until after the auction is completed. Given the detailed and complex processes and timings for completing the price cap calculation – it would not be possible to take account of the T-1 2023 auction input for price cap period 12a which will be announced on 23<sup>rd</sup> February 2024. This means that (absent any change to the methodology), the next opportunity to refresh the CM allowance with the latest inputs would be as part of the August 2024 announcement.

### **Proposal**

In line with 28AD.20 in the Electricity Suppliers Licence Standard Conditions, we propose to use the result of the previous year's T-1 auction (T-1 2022) as the clearing price for the T-1 2023 auction. For the amount of capacity obligated we propose to use the targeted capacity for the T-1 2023 auction<sup>3</sup> as an input. Both of these measures are the best and latest information we can take account of.

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<sup>1</sup> Ofgem (2023), Energy price cap table of public information: guidance for industry, <https://www.ofgem.gov.uk/publications/energy-price-cap-table-public-information-guidance-industry>

<sup>2</sup> Ofgem (2022), Price cap - Decision on changes to the wholesale methodology, <https://www.ofgem.gov.uk/publications/price-cap-decision-changes-wholesale-methodology>

<sup>3</sup> DEZNEZ (2024), Capacity Market auction parameters: letter to National Grid ESO, January 2024, <https://www.gov.uk/government/publications/capacity-market-auction-parameters-letter-to-national-grid-eso-january-2024>

To ensure the most up to date CM allowance inputs can be accounted for in the price cap as quickly as possible, we propose to update the CM allowance on a quarterly (rather than six-monthly) basis, where there is more up to date information available at an interim charge restriction period announcement (i.e. May and Nov announcements). This would allow Ofgem to have regard to the latest inputs (T-1 2023 auction results) can be reflected in the price cap more quickly. This will ensure that the CM allowance in the price cap tracks changes in underlying costs more closely than it would otherwise.

## **Anticipated Energy Intensive Industries (EII) legislation change**

### **The Issue**

The Department for Energy and Net Zero (DESNZ) has informed Ofgem that legislation regarding the exemption level for Energy Intensive Industries (EIIs) is set to increase from 85% to 100% and is expected to come into effect from 1 April 2024. This affects allowances for: the Renewable Obligation scheme (RO), Feed in Tariffs (FiT), Capacity Market (CM), and Contracts for Difference (CfD)

### **Our Proposal**

In anticipation of the relevant legislation being in place by April 2024 as expected, we propose to use the inputs which assume the EII 100% exemption from 1 April 2024. The prospective EII change will impact a number of Policy Cost Allowance components. We have set out our proposals for each relevant component below:

- **Capacity Market:** As set out in the technical annex to the energy price cap wholesale costs review<sup>4</sup>, we propose that the Capacity Market will assume the 100% exemption for the rates for April-June 2024 (published in February 2024), derived from the Low Carbon Contracts Company (LCCC).
- **Renewables Obligation:** The RO allowance will assume the 100% exemption cost scenario for the obligation level for the scheme year, taken from the published DESNZ Renewables Obligation Certificates (ROC). Both scenario ROC estimates have been published by DESNZ<sup>5</sup>.
- **Contracts for Difference:** For CfDs payment forecasts, we will have regard to the latest data available published by LCCC
- **Feed in Tariff:** in line with DESNZ (published as BEIS) 2022 decision<sup>6</sup>, all EII exemptions will not be accounted for in FiT allowance for the upcoming price cap

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<sup>4</sup> Ofgem (2023), Energy price cap wholesale costs review, <https://www.ofgem.gov.uk/publications/energy-price-cap-wholesale-costs-review>

<sup>5</sup> DEZNEZ (2023), Calculating the level of the Renewables Obligation for 2024 to 2025 Published 27 September 2023, <https://www.gov.uk/government/publications/renewables-obligation-level-calculations-2024-to-2025/calculating-the-level-of-the-renewables-obligation-for-2024-to-2025>

<sup>6</sup> BEIS (2022), Feed in Tariffs and Contracts for Difference: proposals relating to Guarantees of Origin, <https://www.gov.uk/government/consultations/feed-in-tariffs-and-contracts-for-difference-proposals-relating-to-guarantees-of-origin#:~:text=Consultation%20description,supplied%20to%20customers%20in%20GB.>

announcement, due to the exemption being removed from the FiT allowance from April 2023. As the methodology for FiT is backwards looking, the upcoming price cap update is the first price cap to cover the period including April 2023.

In recognising the legislative uncertainty at the time of announcing the 1 April price cap level, we propose to refresh the Policy Cost Allowance inputs, outside of the regular six-monthly sequence, in May 2024 to the relevant (85% exemption) figures should the legislation not come into place as expected. In recognising the legislative uncertainty at the time of announcing the 1 April price cap level, we propose to refresh the Policy Cost Allowance inputs, outside of the regular six-monthly update sequence, in May 2024 to the relevant (85% exemption) figures, should the legislation not come into place as expected. For the avoidance of doubt, we propose to update policy costs in May 2024 **only** if the relevant EII legislation is not in place, which we consider to be a necessary measure to ensure the best available information can be accounted for in the price cap at the earliest possible opportunity.

## **Feedback**

We welcome views on the approaches set out in this letter and ask stakeholders to send any comments to [RetailPriceRegulation@ofgem.gov.uk](mailto:RetailPriceRegulation@ofgem.gov.uk) by the close of business on 16 February 2024.

Yours sincerely,

**Dan Norton**

Deputy Director, Retail Price Protection