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Making a positive difference
for energy consumers

To all market participants and
interested parties

Email: Retailpriceregulation@ofgem.gov.uk

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Dear colleagues,

Default tariff cap update for 1 April 2019

The default tariff cap came into force on 1 January 2019. Today we have published the updated cap levels for the second charge restriction period (ie 'cap period'), covering the six months from 1 April 2019 to 30 September 2019. From 1 April 2019, the level of the cap will be £1,254 for a typical default tariff customer – a dual fuel single rate customer paying by direct debit using a typical amount of energy in annualised terms.[1,2]

Alongside the cap levels, we have published the updated versions of the models and FAQs.[3] We have also published the decision on the Capacity Market allowance following the open letter consultation in January.

Explanation

For the first cap period (1 January to 31 March 2019), the cap level was set at £1,137. The cap level for the second period (1 April to 30 September 2019) has increased by £117 (10%) since the last update.

The three main drivers for this increase are due to updates in the model inputs for:

- **Wholesale costs** – these have increased by £74 since the last update. This is based on the direct fuel cost allowance for the forthcoming period, calculated based on forward energy contracts during the observation window. Over the last 18 months global factors have pushed up wholesale costs. Higher global oil prices pushed up wholesale gas prices; given the role of gas as a source of electricity generation this in turn increased the price of wholesale electricity.

- **Network Costs** - these have increased by £12. The allowance for each period is calculated using network charging statements. The increase comes primarily through distribution costs and is driven by a combination of: the allowance profiling, an increase in pass through items (eg business rates) and corrections for under recovery from previous years.

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[1] The default tariff cap sets maximum prices, not maximum bills. For an individual customer, the amount they will pay under the cap varies depending on how much energy they use, where they live, and how they pay for their energy. The cap level will not depend on who a customer's energy supplier is.
[2] We do not set a 'dual fuel' cap. We set caps for each fuel separately. When we express the dual fuel 'cap level' for a typical customer, this is the combined effect of the gas cap at typical consumption and the electricity cap at typical consumption.
[3] https://www.ofgem.gov.uk/publications-and-updates/default-tariff-cap-level-1-april-2019-30-september-2019

- **Policy costs** - these have increased by £14. These costs are updated using a combination of scheme data, Office for Budget Responsibility (OBR) forecasts, and information on the expected demand base across which costs are recovered. The largest component increase relates to the Renewables Obligations (RO). The remainder of the increase is primarily due to increases in Contracts for Difference (CfD) and Feed-in Tariff (FiTs) schemes.

These are outlined in more detail in the below figure.

	Apr - Sep 2019
Wholesale	521
Policy	151
Network	270
Operating costs	204
Payment Uplift	12
EBIT	22
Headroom	13
VAT	60
Total	**1254**

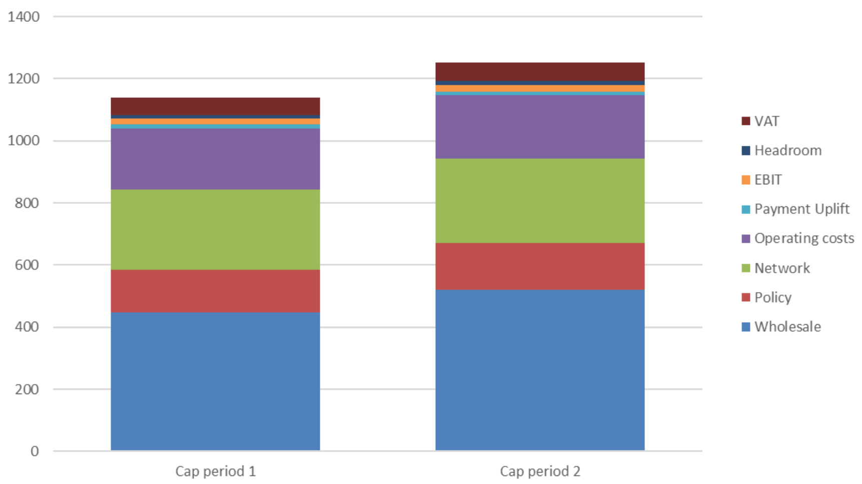

Figure 1 Breakdown of cap components

Model inputs

As part of the six-monthly update process, we have made minor changes to some of the data sources for the updated inputs to the models, largely due to the timing of data availability. These changes are detailed in the relevant annexes and have no material impact on the methodology.

Where we are required to make best estimates or updated values are not available, then as a principle, we have maintained the values that were used to determine the previous cap level. In other circumstances where a suitable successor source is available, we have used this to update the inputs. The details of each update are captured in the annexes.

Error Correction

During the cap update process, we noticed an error in Annex 5 – Smart Metering Net Cost Change Methodology. In several places within the model, we refer to a value for the Total Residential Live on supply Gas Meters. In the model published alongside the first Cap Level on 8 November (version 1.2), this value of gas meters was incorrect (by 0.04%).

We have corrected this error within the version 1.3 of the annex that has been published alongside the cap level documents. This correction has had no impact on the SMNCC allowance and therefore, the level of the cap due to the negligible difference in the values.

PPM cap update

The PPM cap has also increased for the forthcoming cap period (commencing 1 April 2019), and is now set at £1,242 for the next cap period, £12 lower than the default tariff cap. This is calculated using a separate methodology which is why the figures are different, though driven by the same underlying costs.[4]

Compliance

We expect suppliers to take seriously their obligations to comply with the default tariff cap and will be closely monitoring their compliance. We will monitor the level of service suppliers deliver to their customers and stand ready to take compliance and enforcement action in the event that any licence requirements are not met.

Yours faithfully,

Anthony Pygram
Director, Conduct and Enforcement, Consumers and Markets

[4] This methodology was set by the CMA – see final report page 935 for details.