

To all market participants and
interested parties

Email: Retailpriceregulation@ofgem.gov.uk

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Dear colleagues,

Default tariff cap update for 1 October 2019

The default tariff cap came into force on 1 January 2019. In the first cap period (1 January to 31 March 2019), the cap level was set at £1,137 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} The second cap period (1 April to 30 September 2019) saw the cap level rise to £1,254, predominantly driven by a rise in wholesale costs. Today we have published the updated cap levels for the third charge restriction period (i.e. the third 'cap period'), covering the six months from 1 October 2019 to 31 March 2020.

Alongside the cap levels we have also published the updated versions of the models / annexes.

Explanation

The level of the cap for the third period (1 October 2019 to 31 March 2020) decreased by 6% since the last update. From 1 October 2019, the level of the cap will fall to £1,179.

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

- **Wholesale costs** – These have decreased by £75 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. A combination of low demand during winter 2018/19, strong gas supply, in particular because of a high influx of LNG, and relatively healthy storage levels have pushed down wholesale prices during the observation window.
- **Headroom, EBIT and VAT** – Headroom, profit margins (EBIT) and VAT are all calculated as fixed percentages of the cap level. As the efficient cost of supplying energy has fallen for the forthcoming cap period (primarily due to the movements in wholesale costs outlined above), this means the cost allowances for headroom, EBIT and VAT have also reduced accordingly (falling 8%, 6%, and 6%, respectively).

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.

These drivers are outlined in more detail in the below figure.³

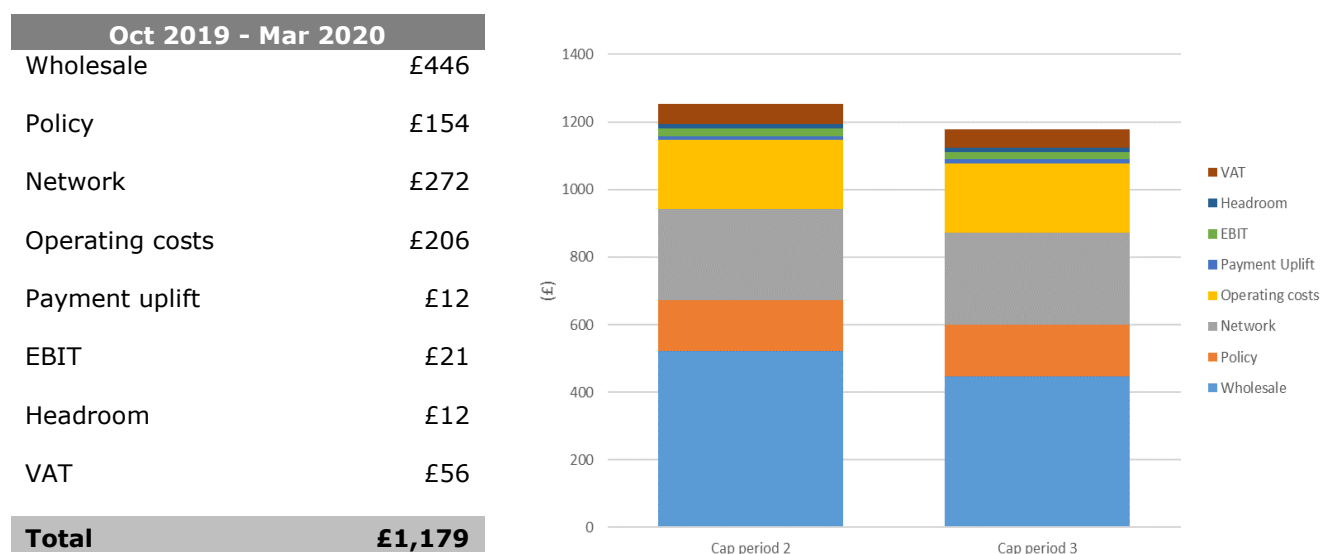


Figure 1: Breakdown of cap components

PPM cap update

The PPM cap has also decreased for the forthcoming cap period (commencing 1 October 2019), and is now set at £1,217 for the next cap period. On 31 July 2019, the CMA decided⁴ to amend the methodology used for calculating the PPM cap, bringing the methodology in line with the default tariff cap.

This methodology better reflects the true cost of providing energy to customers on pre-payment meters and ensures the market offers choice and protection to prepayment customers both now and in the future. The new PPM cap methodology will be reflected in the next cap level, starting 1 October 2019.

Compliance

We expect suppliers to take seriously their obligations to implement the default tariff cap and will be closely monitoring their compliance. We expect any related data provided to Ofgem to be accurate, complete and provided in a timely manner. 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,

Kiera Schoenemann

Deputy Director, Conduct and Enforcement, Consumers and Markets

³ All values rounded to the nearest £.

⁴ https://assets.publishing.service.gov.uk/media/5d405962e5274a4016893bd0/Final_Decision_PPPC.pdf