

23 January 2020

Email address corrected: 6 February 2020

Statutory consultation on the process for making changes to the Default Tariff Cap licence conditions

Summary

1. In this consultation we propose to modify Standard Licence Condition (SLC) 28AD in the gas and electricity supply licences, so that when we calculate the Benchmark Maximum Charges ("Cap level") for an upcoming Charge Restriction Period ("Cap period") of the Default Tariff Cap ("the Cap"), we would use the licence conditions that will have effect in that upcoming Cap period, notwithstanding that those conditions may not have effect at the time of the announcement.
2. Section 5 of the Domestic Gas and Electricity (Tariff Cap) Act 2018 ("the Act") provides that modifications to the SLCs relating to the Default Tariff Cap ("the tariff Cap conditions") have effect from the day specified by the Gas and Electricity Markets Authority, which must be after the end of the period of 56 days beginning with the day on which the modification is published.¹ In practice, there is a period of around 110 days between Ofgem publishing a decision to modify the tariff Cap conditions, and the start of the Cap period when those modifications first have effect, due to specific wording in SLC 28AD. We consider this to be an unnecessary and unintended restriction to modifying the licence to ensure the Cap remains appropriate.
3. Our proposal seeks to align the provisions of the licence and the 56 day period as required by the Act. We consider that the proposed licence modification will allow us to respond better to changes in circumstances and data availability during policy development, and in doing so better protect existing and future domestic customers who pay standard variable and default rates.

¹ Domestic Gas and Electricity (Tariff Cap) Act 2018.
<http://www.legislation.gov.uk/ukpga/2018/21/section/5/enacted>

Background

4. We introduced the Cap on 1 January 2019, protecting over 11 million customers on standard variable and default tariffs (which we refer to collectively as “default tariffs”).² The Cap ensures default tariff customers pay a fair price for the energy they consume, reflecting its underlying costs.
5. In some circumstances, we need to modify the SLC conditions, including but not limited to the way we calculate the underlying costs included in the Cap (“the Cap methodology”). For instance, this year we intend to consult on: updating the methodology for the Smart Metering Net Cost Change (SMNCC) allowance; introducing a new payment method uplift for prepayment customers; and reassessing wholesale costs in the first Cap periods (and any adjustment for those costs).³
6. Section 5(4) of the Act provides that, after consultation on modification of the Cap conditions, there is to be a minimum period of 56 days between (a) the publication of a decision to modify the Cap conditions and (b) when such modifications have effect.⁴
7. SLC 28AD.18 of the gas SLCs and SLC 28AD.19 of the electricity SLCs require us to calculate and announce the Cap level for the upcoming Cap period using the methodology that *is in effect at the time of that announcement*, not the methodology *that has effect on the first day of the relevant Cap period*. We announce the upcoming Cap level two months before the start of the relevant Cap period, on the fifth working day of that month.⁵
8. In practice, there is a period of around 110 days between when we publish a decision to modify the SLC conditions, and the start of the Cap period when those modifications first have effect. As an example, for Cap period five (1 October 2020 to 31 March 2021), any decision to modify the Cap’s methodology would need to be published by 12 June, as this is 56 days before we announce the upcoming Cap level on 7 August and, under the current licence conditions, must be in effect at that point in time. However, that means publication is 111 days before 1 October, when any modifications would first have effect on prices. A period of at least 56 days between publication of a decision to modify the SLCs and the first day of the Cap period in which they will have effect would allow publication of a decision at any point before 6 August.⁶

² Ofgem (2018), Default tariff Cap: decision – overview. <https://www.ofgem.gov.uk/publications-and-updates/default-tariff-cap-decision-overview>

³ We will publish a timetable for these consultations, and an update on our considerations for each consultation, in late January 2020.

⁴ Domestic Gas and Electricity (Tariff Cap) Act 2018, Section 5 (3-4). <http://www.legislation.gov.uk/ukpga/2018/21/section/5/enacted>

⁵ Ofgem (2018), Statutory notice of reasons for modification of electricity and gas standard licence conditions. <https://www.ofgem.gov.uk/publications-and-updates/default-tariff-cap-decision-overview>

⁶ For subsequent Cap periods, the number of days varies between 109 days and 112 days depending on when the 5th working day of the month falls.

Proposed modification

9. We propose to introduce modifications to SLC 28AD.18 of the gas SLCs and 28AD.19 of the electricity SLCs so that, while determining the updated Cap level for the upcoming Cap period, we will use the tariff Cap conditions that will have effect in that Cap period (ie taking into account decisions to modify that SLC that will have effect on the first day of the relevant Cap period, notwithstanding that they may not be in effect at the time of the announcement).
10. This would mean that we could publish, after appropriate consultation, decisions to modify SLC 28AD or the Cap methodology, up until 56 days before the start of the Cap period in which they will first have effect. If the gap between a Cap period and the announcement of the Cap level for that Cap period is greater than 56 days, we would only announce the Cap level using conditions with published decisions.

Our considerations

11. In response to our October consultation on the SMNCC, it was clear that many stakeholders already believed that we could publish our decision to modify the Cap methodology at any point up until 56 days before the start of the Cap period in which the modification would first have effect.⁷
12. We have considered the issues in relation to application of the 56 period and, for the reasons below, our initial view is that such an arrangement would be preferable to current arrangements.
13. After we announce an upcoming Cap level, suppliers require time to adjust their systems and inform their customers when the level of the Cap changes. For that reason, we announce the upcoming Cap level well in advance of the first day of the next Cap period when it will have effect. This proposal could affect the Cap level, but not the timing of when that level is announced.
14. If we decide to proceed with the proposal set out in this consultation, this does not affect in practice the time which stakeholders would have to consider and understand the proposed modifications as well as make representations on them. Under Section 4 of the Act we must consult on proposed modifications and their effect, and consider any representations before taking a decision. The additional time provided by publishing our decision on modifications at least 56 days before the *announcement* of the Cap level for

⁷ Suppliers' consultation responses are published alongside the consultation. Ofgem (2019), Reviewing smart metering costs in the default tariff cap: October consultation. <https://www.ofgem.gov.uk/publications-and-updates/reviewing-smart-metering-costs-default-tariff-cap-october-consultation>

the relevant Cap, rather than the first day that Cap level has effect, does not add anything to this process.

15. If we decide to proceed with the proposal set out in this consultation, we consider that stakeholders will be able to understand our decision and the reasons for it. In accordance with section 5(2) of the Act, we will: publish our decision on any modifications, bringing them to the attention of persons likely to be affected by them; state the effect of the modifications; state how we have taken account of any representations made in the consultation period, and state the reasons for any differences between the modifications and the proposals. The additional time provided by publishing our decision on modifications at least 56 days before the *announcement* of the Cap level for the relevant Cap, rather than the first day that Cap level has effect, is not necessary for this process.
16. We consider that this proposal allows us to respond better to changes in circumstances during policy development. In any case, modifications to the tariff Cap conditions will have significant lead times, for evidence gathering and analysis, consultation and consideration, as well as the operation of the 56 day period, before entering into effect. As we must update and announce the Cap on fixed dates to meet the requirements set out in SLC 28AD, we consider that the current interaction between the 56 day period and the licence arrangements unnecessarily limit our ability, and that of stakeholders, to consider developments closer to an upcoming Cap period. This proposal would allow us to take into account modifications earlier to the benefit of stakeholders (for instance, any decision that could be made between 13 June and 6 August 2020 would take effect from 1 April 2021 under the current arrangements, whereas it could have effect from 1 October 2020 under our proposal).

Next steps and interaction with other work

17. If you wish to respond to this consultation, please send representations to retailpriceregulation@ofgem.gov.uk before **close of business, Monday 24 February 2020**.
18. Should we proceed with the proposal in this consultation, the proposed arrangements would first have effect for the announcement of the Cap level relevant for Cap period five (1 October 2020 to 31 March 2021).
19. During the course of this consultation we will continue to work on proposed modifications to the Cap's methodology, specifically to update the SMNCC methodology, introduce a payment method uplift for prepayment customers, and a reassessment of wholesale costs in the first Cap periods.
20. Later this month, we will publish a proposed timetable for engaging with stakeholders on the above modifications. We will present that timetable on the basis of the licence

modification which we have proposed in this consultation. However, those timetables will be subject to our consideration of stakeholders' representations on the issue in this consultation. Should we decide not to implement the proposed modification, then we will reconsider those plans and update stakeholders on a revised timetable as appropriate. We intend to make our decision on this proposal in **early March**. At that time we will also confirm whether our proposed timetable needs adjusting or not, in order to implement modifications in Cap period five.

21. If you have any questions please contact retailpriceregulation@ofgem.gov.uk.

Yours sincerely

Anna Rossington

Deputy Director – Retail Price Regulation

Note: on 6 February, this letter was updated so that it stated correctly the email address that stakeholders should submit responses to. Please submit responses to retailpriceregulation@ofgem.gov.uk.

Appendix 1: Draft of proposed changes to modify the standard conditions of all electricity supply licences.

Condition 28AD of the electricity supply licence

The proposed modification is to add the text shown below.

28AD.19 For each Subsequent Charge Restriction Period, subject to paragraphs 28AD.20 and 28AD.21, no later than the fifth Working Day of February in relation to a forthcoming 28AD Charge Restriction Period j starting on 1 April, or no later than the fifth Working Day of August in relation to a forthcoming 28AD Charge Restriction Period j starting on 1 October, the Authority will:

- (a) determine the updated Benchmark Maximum Charges which shall apply for any forthcoming 28AD Charge Restriction Period j by calculating such values in accordance with paragraph 28AD.7;
- (b) in so determining the updated Benchmark Maximum Charges which shall have effect from the first day of any forthcoming 28AD Charge Restriction Period j , take into account any modification made to SLC 28AD, notwithstanding that any such modification may not have come into effect at the time of publication of the updated Benchmark Maximum Charges in accordance with paragraph 28AD.19(c), provided that any such modification has come into effect by no later than the first date of any forthcoming 28AD Charge Restriction Period j ; and
- (c) publish such updated Benchmark Maximum Charges so calculated in the format specified in Annex 6.

Appendix 2 – Draft of proposed changes to modify the standard conditions of all gas supply licences.

Condition 28AD of the gas supply licence

The proposed modification is to add the text shown below.

28AD.18 For each Subsequent Charge Restriction Period, subject to paragraphs 28AD.19 and 28AD.20, no later than the fifth Working Day of February in relation to a forthcoming 28AD Charge Restriction Period j starting on 1 April, or no later than the fifth Working Day of August in relation to a forthcoming 28AD Charge Restriction Period j starting on 1 October, the Authority will:

- (a) determine the updated Benchmark Maximum Charges which shall apply for any forthcoming 28AD Charge Restriction Period j by calculating such values in accordance with paragraph 28AD.6;
- (b) in so determining the updated Benchmark Maximum Charges which shall have effect from the first day of any forthcoming 28AD Charge Restriction Period j , take into account any modification made to SLC 28AD, notwithstanding that any such modification may not have come into effect at the time of publication of the updated Benchmark Maximum Charges in accordance with paragraph 28AD.18(c), provided that any such modification has come into effect by no later than the first date of any forthcoming 28AD Charge Restriction Period j ; and
- (c) publish such updated Benchmark Maximum Charges so calculated in the format specified in Annex 6.