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 2020

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 £1,104[1] 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.[2,3] The second cap period (1 April to 30 September 2019) saw the cap level rise to £1,217, before decreasing to £1,143 for the third period (1 October 2019 to 31 March 2020). The fourth cap period (1 April to 30 September 2020) saw a further decrease of the cap level to £1,126.

Today we have published the updated cap levels for the fifth charge restriction period (i.e. the fifth 'cap period'), covering the six months from 1 October 2020 to 31 March 2021. Alongside the cap levels we have also published the updated versions of the cost allowance models / annexes.

Drivers of change

The level of the cap for the fifth period (1 October 2020 to 31 March 2021) has decreased by 7% since the last update. From 1 October 2020, the level of the cap will fall to £1,042.

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

- **Wholesale costs** – These have decreased by £88 since the last update. Wholesale energy prices have significantly fallen during the observation window for this cap period, particularly on gas products. Global energy prices fell significantly amid the COVID-19 pandemic resulting in demand destruction which, combined with an already oversupplied gas market, pushed down prices. Prices started to recover in May due to less supply from liquefied natural gas (LNG) and other major gas

[1] On 1 April 2020 Ofgem decided to decrease the Typical Domestic Consumption Values (TDCVs) for electricity to reflect continued decreases in consumption for electricity and to keep the TDCV's for gas unchanged. From 1 April 2020, Ofgem has been using the new TDCVs to express the default tariff price cap and prepayment meter cap level in all publications. Previous publications on the levels of the caps will therefore not be exactly the same / directly comparible. All figures in this letter are stated using the new TDCV.

[2] 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.

[3] We do not set a 'dual fuel' cap. Caps are set 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.

producers, leading to structural tightening, as well as demand slowly returning to normal levels.

- **Wholesale adjustment** – We have decided that we should have set an allowance in line with the weighted average comparable wholesale costs of the six large suppliers in the first cap period. We have decided to include a new adjustment allowance which increases the cap level by around £15 in annualised terms. However, this adjustment will only apply to the fifth cap period (six-months).

- **Smart meter rollout costs** – Following our review of the costs of smart metering (the non-pass-through SMNCC), these costs have reduced by £4 versus the cap period four.

These drivers are outlined in more detail in Figure 1 below:[4]

	Period 4 (Apr 20 - Sept 20)	Period 5 (Oct 20 - Mar 21)
Wholesale	£395	£307
Policy	£160	£162
Wholesale adjustment	N/A	£15
Network	£265	£265
Operating costs	£209	£203
Payment uplift	£12	£11
EBIT	£20	£19
Headroom	£12	£11
VAT	£54	£50
Total	**£1,126**	**£1,042**

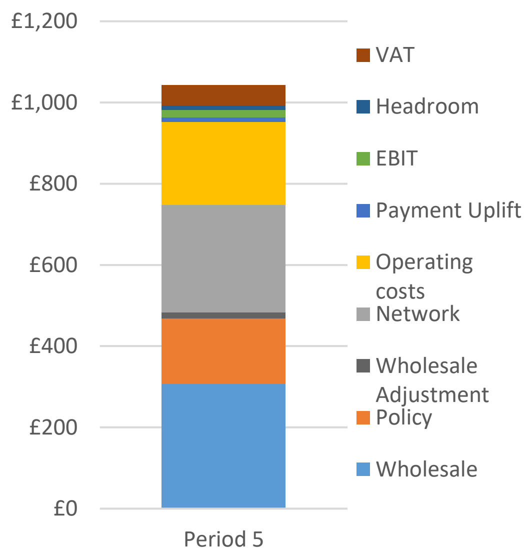

Figure 1: Breakdown of default tariff cap components

Prepayment meter price cap update

The prepayment meter (PPM) price cap has also decreased for the forthcoming cap period[5] (commencing 1 Oct 2020), and will be set at £1,070.

From 1 October 2020, the default tariff cap also includes a new cap level for the PPM payment method.[6] Once the CMA PPM price cap expires on 31 December 2020, default prepayment meter customers will continue to be covered by this cap, for as long as the default tariff cap remains in place.

Compliance with the price caps

We expect suppliers to take seriously their obligations to implement the default tariff cap and will be closely monitoring their compliance. Suppliers should continue to comply with their obligations as set out in SLC28.A and SLC28.AD, and the values used in those licence

[4] All values rounded to the nearest £.
[5] The eigth PPM charge restriction period.
[6] For the first 12 months the new cap level will be set to give the same level as the existing PPM cap methodology. This means that the non-pass-through SMNCC for PPM in the default tariff cap is set to £0 for the next two cap periods.

conditions. We will continue to take firm action against suppliers who fall short of their price cap requirements.

We expect any related data provided to Ofgem to be accurate, complete and provided in a timely manner. We will also continue to monitor the quality 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,

Anna Rossington
Deputy Director, Retail Price Protection,
Consumers and Markets