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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 2021

Today we have published the updated cap levels for the sixth charge restriction period (i.e. the sixth 'cap period'), covering the six months from 1 April 2021 to 30 September 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 sixth cap period has increased by 9% since the last update. From 1 April 2021, the level of the cap will increase to £1,138.[1,2,3]

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

- **Wholesale costs** – These have increased by £66 since the last update. For gas, the global market has begun to recover from the demand reduction caused by the pandemic over the first half of 2020. As global demand has increased, global gas prices have increased, which in turn increases the GB market price as global supplies play an integral role in GB. Gas prices have increased fivefold since the crash in March/April last year and have now returned to pre-pandemic levels. For the wholesale electricity market, there has been a reduction in available power supplies compared to last year which, combined with higher gas prices, has led to an increase in the wholesale price of electricity.

- **Network and Policy costs -** Higher electricity distribution and transmission costs have driven a network cost increase. Most policy costs have increased, with the cost of the Renewable Obligation (RO) and Contracts for Difference (CfDs) having the greatest increase. The RO level for suppliers has increased compared to the previous period due to a decrease in the forecast of electricity sales for 2021/22, caused by

[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.
[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.

the COVID-19 pandemic. CfDs have increased as we would expect due to more capacity becoming eligible and as capacity comes online.

- **Covid-19 adjustment -** We have included an adjustment for the additional COVID-19 costs suppliers have/will incur, specifically for bad debt, for the sixth cap period. The adjustment is an estimate (float) which covers the additional bad debts costs from cap periods four, five, and six (April 2020 – September 2021).[4] We will true-up the the adjustment at a later stage when information on the final costs is available. The float adjustment is £23.14[5] which is slightly higher than what we proposed in November. This is due to the incorporation of more recent customer numbers. We signalled our intention to update this in the consultation.These COVID-19 related costs are partially offset by a £15 reduction in the level of the cap, following the removal of the wholesale adjustment which was included in the previous cap level.

These drivers are outlined in more detail in Figure 1 below:[6]

	Period 5 (Oct 20 - Mar 21)	Period 6 (Apr 21 – Sept 21)
Wholesale	£307	£373
Policy	£162	£172
Adjustment allowance[7]	£15	£23
Network	£265	£268
Operating costs	£203	£204
Payment uplift	£11	£12
EBIT	£19	£20
Headroom	£11	£12
VAT	£50	£54
Total	**£1,042**	**£1,138**

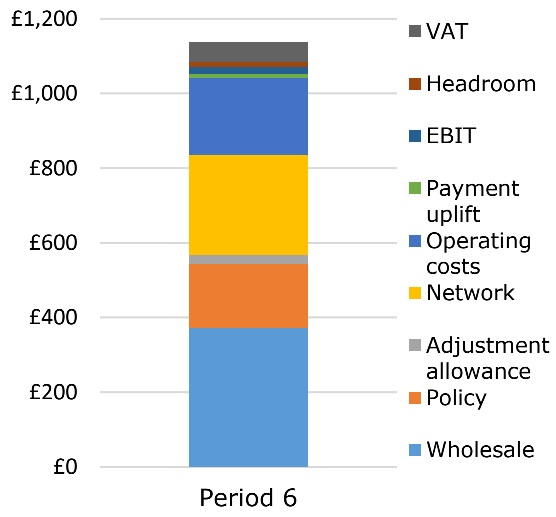

Figure 1: Breakdown of default tariff cap components for duel fuel, for a customer with typical consumption paying by direct debit

Other payment methods

The standard credit cap level has also increased and will be set at £1,223 (£101 increase). The £1,138 per year level of the cap is based on a household with typical consumption on a dual electricity and gas bill paying by direct debit. Customers who pay by standard credit (cash or cheque) pay an additional £84 based on the higher cost for suppliers to serve them.

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[4] The recovery of costs for cap period four and five is spread over two cap periods (cap period six and seven).
[5] Adjustment expressed in new TDCV. With benchmark consumption the adjustment is £23.69 which is slightly higher than the £21.48 we proposed in November.
[6] All values rounded to the nearest £.
[7] An allowance covering any adjustments to the default tariff cap. For cap period five this included the wholesale adjustment reflecting our reassessment of the wholesale allowance in the first default tariff cap period (this adjustment only applied to cap period five - the six-month winter 20/21 cap period). For cap period six this includes the Covid-19 adjustment to cover the incremental cost due to COVID-19 for suppliers writing off bad debt.

The prepayment meter (PPM) cap level has also increased and will be set at £1,156 (£87 increase). The increase is lower than the credit payment increases because we have decided not to include an adjustment for COVID-19 related costs in the PPM cap level at this time. This is because we consider that the evidence at this stage indicates that the effects of COVID-19 on supplying PPM customers are limited. We will revisit for the next cap period.

The new cap level for the PPM payment method[8] came into effect for default PPM customers when the CMA prepayment meter price cap expired on 31 December 2020. Default prepayment meter customers will continue to be covered by this cap level (£1,156), 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 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
Interim Director, Retail

[8] 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 is set to £0 for the eigth and ninth PPM charge restriction periods.