Call for Input

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Price cap: Call for Input on Additional Wholesale Allowances Review

Executive summary

The additional wholesale allowances form part of the wholesale allowance component of the default tariff cap (the 'cap'). These include, among other costs, shaping, imbalance, and transaction costs. These allowances were set as fixed percentage uplifts in 2019 when we introduced the cap. However, since then, both the energy market and the cap methodology have experienced significant changes. This raises the question of whether it is appropriate to undertake a review of these allowances, what scope any review should have and what priority we should give it, relative to other cap workstreams.

Through this Call for Input, we are seeking views and evidence from stakeholders on whether a review of the additional wholesale allowances is appropriate and if so, what form it should take. We set out our current thinking about our considerations for why a change may be appropriate, our considerations for a potential review and interactions with other workstreams.

We have split out our considerations into two areas. Firstly, we intend to consider whether a review on recent short-term impacts is appropriate (eg the impacts of market conditions this winter). Secondly, we intend to consider whether a review of the additional wholesale allowances on an enduring basis is appropriate (eg whether the overarching methodology should be changed going forward). We have set out two potential approaches in the event it is determined appropriate to review the enduring approach to setting the allowances: (1) a full review of the methodology or (2) a limited review and update of the input data. We will proceed with a review if, on balance, we consider it likely to be in customer interests to do so, particularly if we consider there to be likely material and systematic deviations from the existing allowances.

We are seeking responses by 1 March 2023 to retailpriceregulation@ofgem.gov.uk. We will use the responses and evidence provided to determine whether a review is appropriate, and if deemed so, determine the scope of the review.

Context

The cap was introduced on 1 January 2019 to protect existing and future default tariff customers, ensuring that less engaged customers pay a fair price for their energy. The cap is set out in legislation through the Domestic Gas and Electricity (Tariff Cap) Act 2018 (the "Act").[1] We describe the legislative framework in Appendix 1.

From 1 October 2022, the government has taken additional action to support customers through a period of high and volatile energy prices through the introduction of the Energy Price Guarantee (EPG).[2] The EPG limits the amount an energy supplier can charge per unit of energy used and the cap acts as a reference price for calculating the level of support offered by the government to suppliers. Ofgem's primary objective is to protect the interests of current and future consumers and there are a number of statutory considerations we must have regard to when making decisions about the cap.[3] While the EPG is in place and the cap level remains above it, related decisions will primarily impact public spending, as opposed to customers' bills.

The cap sets a maximum amount a supplier can charge default tariff customers for energy. It varies based on a number of different parameters, including, fuel type, benchmark consumption, meter types, regional differences, and payment methods.

We calculate the cap using a bottom-up assessment of a notional supplier's costs (ie we calculate each cost component individually and then add them together) and set it to reflect the notionally efficient costs of supplying energy. This approach ensures that, in aggregate, our benchmark (and cap) reflects the underlying efficient costs of supplying customers with energy.

The additional wholesale allowances sit within the wholesale cost allowance of the cap, (alongside the direct fuel costs allowance, backwardation/contango and Contracts for Difference allowances) reflecting the expected costs a notional supplier incurs when purchasing energy, in addition to their main hedging activity. These allowances currently include:

- Shaping costs
- Imbalance costs
- Transaction costs

[1] Domestic Gas and Electricity (Tariff Cap) Act 2018, https://www.legislation.gov.uk/ukpga/2018/21/crossheading/the-cap/enacted
[2] The EPG was legislated for as part of the Energy Prices Act 2022, https://www.legislation.gov.uk/ukpga/2022/44/enacted
[3] As outlined in Section 1.6 a – e of Domestic Gas and Electricity (Tariff Cap) Act 2018.

- Additional risk and uncertainty; and
- Unidentified gas (UIG)

The scope of this Call for Input is principally focussed on the first three items outlined above, though we welcome comments on any of the five areas listed. We also discuss some specific points about wider wholesale cost allowances. It is not our intention to review the overall wholesale methodology at this stage. Our November 2022 Programme of Work[4] (the "Programme of Work"), noted our intention to review the changes to the wider wholesale methodology.[5] This would provide an opportunity to consider the impacts of recent changes, including, quarterly cap updates, a 25 working day notice period and the ex-ante backwardation allowance and deadband.

The additional wholesale allowances are currently set as a fixed percentage of the direct fuel costs and backwardation allowances for each cap period. The definition of each cost and how they are calculated is set out in Appendix 2.

Following stakeholders' feedback, we will consider whether to launch a review of these allowances. We welcome stakeholders' responses to the questions set out in this document and, as far as possible, ask that responses are supported with appropriate evidence. In addition, we are issuing a draft RFI to suppliers alongside this Call for Evidence for suppliers to comment on. We intend to issue the mandatory RFI in March with the aim of collecting further quantitative and qualitative evidence. We will use responses to determine whether a review is appropriate and if so, what the scope of a review should include.

Potential considerations for change

In this section, we have provided a brief overview of some key areas we may consider when assessing whether a review of the additional wholesale allowances is appropriate.

We are seeking stakeholders' views on the areas we identify in this section. If stakeholders think there is sufficient reason to carry out a review, we ask that they provide further detail and evidence to support these views. We also welcome stakeholders' views on the priority that we should give to any review, relative to other cap workstreams.

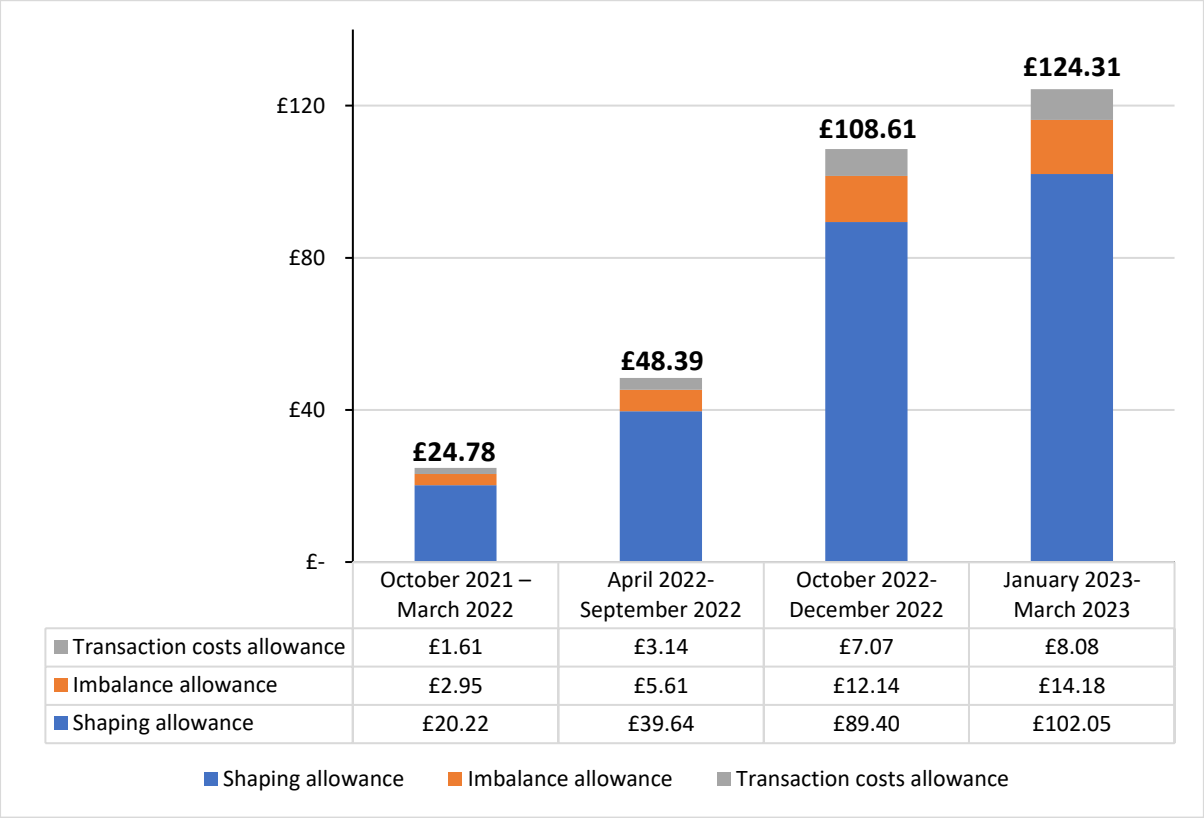
[4] Ofgem (2022) Price cap – Programme of Work, https://www.ofgem.gov.uk/publications/price-cap-programme-work
[5] Ofgem (2022) Price cap – Decision on changes to the wholesale methodology, https://www.ofgem.gov.uk/publications/price-cap-decision-changes-wholesale-methodology

To note, we intend to consider whether to carry out a review to address, either or both, short-term and enduring issues that may have impacted or continue to impact the additional wholesale allowances.

Recent market trends

We want to understand whether recent market trends have impacted the additional wholesale allowances. The current allowances, which are calculated as a fixed percentage of the direct fuel costs allowance, have increased significantly, alongside rising wholesale costs in 2022.

Figure 1: Evolution of additional wholesale allowances for a typical dual fuel customer (£/customer/year at TDCV)[6]



	October 2021 – March 2022	April 2022- September 2022	October 2022- December 2022	January 2023- March 2023
Transaction costs allowance	£1.61	£3.14	£7.07	£8.08
Imbalance allowance	£2.95	£5.61	£12.14	£14.18
Shaping allowance	£20.22	£39.64	£89.40	£102.05

Figure 1 is a bar chart showing the evolution of additional wholesale allowances over the last four cap periods where total transaction, imbalance and shaping allowances have increased fivefold between October 2021 and January 2023.

[6] All figures are quoted in £ per SVT customer per year, at TDCV (2.9 MWhe and 12 MWhg).

This raises the question of whether the actual additional wholesale costs have increased at the same rate over time as the respective allowances in a systematic way.[7] While the direct fuel costs allowance reflects overall trends in wholesale costs, there may be further changes to the shaping and imbalance costs that suppliers incur to meet domestic customers' demand. For example, in part, recent wholesale price volatility may reflect a tighter balance between available supply and demand, particularly at certain times (eg the winter peak) or for certain products. Some stakeholders have also told us that the wholesale market has experienced low liquidity in some products, and that this is affecting suppliers' ability to trade energy.

Enduring issues

There may also be enduring issues affecting the additional wholesale allowances. The retail and wholesale market conditions are different to those in 2019 when the cap was introduced. For example, hybrid working may have altered the demand profiles we use in our models. The greater proportion of weather dependent renewable generation may also have affected the cost of shaping at different times of the day.

There may also be merit in considering more dynamic allowances to adapt to future market changes. This could involve more frequent reviews and updating the methodology on a periodic basis. Equally, a review could provide the opportunity to look at the net zero future and think about how the allowances could adapt to reflect changes in the energy system. For instance, with the introduction of market-wide half-hourly settlement, it might be appropriate to look at how shaping costs could change.

We began to update the cap on a quarterly basis and provide suppliers with an ex-ante backwardation allowance from cap period 9a (October 2022-December 2022).[8] Given there is a direct link between using quarterly wholesale products and the approach to shaping contracts (which currently assumes shaping from seasonal to quarterly contracts for electricity), it may be appropriate to carry out such consequential amendments to the current methodology.

Impacts on different types of customers

A review could also enable us to reconsider how the additional wholesale allowances affect different groups of customers.

[7] To note, we acknowledge costs may vary within and between delivery periods. For determining whether a review is appropriate, we would consider where the costs of a notational efficient supplier have systematically departed from the allowances.
[8] Note, the ex-ante backwardation allowance is two-sided and would provide a discount to consumers in periods of contango where the allowance exceeds the deadband.

Economy 7 and other Time of Use Tariffs

Our current methodology does not explicitly model the additional wholesale allowances for domestic Economy 7 customers. Supplying energy to these customers may have different shaping costs to single-rate electricity customers, as they tend to consume electricity in different proportions over a day and throughout a year. Calculating separate additional wholesale allowances for Economy 7 customers could increase the accuracy of the calculations for this group of customers.

In addition, tailoring the allowances for multi-register meters will enable the cap to better reflect the costs associated with Time of Use tariffs. This could help to future proof the cap for when Market-wide Half Hourly settlement is expected to go live in late 2025.

Prepayment Meter Customers

End User Categories (EUCs) represent different consumption profiles for gas customers. They ensure that customers can be categorised by their usage patterns and help distinguish between different gas consumption behaviours. When the cap was designed in 2018, the EUCs did not differentiate between Prepayment Meter (PPM) and non-PPM customers.

Following the breakdown of EUCs by PPM and non-PPM in 2019, we decided to update the cap methodology to incorporate this change in February 2022.[9] For the wholesale cost methodology, usage of the new EUCs resulted in individual estimates of peak gas demand for PPM and non-PPM, as well as feeding into the quarterly share of gas demand. In addition, we also updated our methodology for calculating and allocating UIG costs between payment methods.

We welcome views on the impact that introducing the new EUCs has had on PPM customers and whether we should consider this in any potential review of the additional wholesale allowances.

Potential considerations for change: Areas for feedback

We are seeking views on the reasons for considering a review. We particularly welcome feedback on the following issues:

- *Do you agree with the above outlined areas of consideration?*

[9] Ofgem (2022) Price Cap – Decision on reflecting prepayment End User Categories in the default tariff cap, https://www.ofgem.gov.uk/publications/price-cap-decision-reflecting-prepayment-end-user-categories-default-tariff-cap

- *Are there any other areas we should consider?*
- *Are there sufficient reasons to indicate that it may be appropriate to carry out a review? If so, please support your view with evidence.*
- *Where would you see the additional wholesale allowance review sit in terms of priority alongside other workstreams set out in the Programme of Work?*

Considering a review for short-term issues

In this section, we outline considerations for assessing whether we should carry out a review of short-term issues that may have impacted efficient notional costs relative to the allowances over the recent period.

Following recent events in the energy market, we are keen to understand whether these have created short-term issues for additional wholesale allowances for winter 2022-23 delivery (cap periods 9a, October 2022-December 2022, and 9b, January 2023-March 2023). We have previously considered and implemented short-term ex-post adjustments for shaping costs; we decided to apply an uplift for cap period 7 (October 2021- March 2022)[10] but not for cap period 8 (April 2022-September 2022).[11]

We welcome evidence from stakeholders on whether additional wholesale allowances have materially and systematically departed from the allowances set for cap periods 9a and 9b. We will use the evidence collected through this Call for Input to consider whether it is appropriate to carry out a review of the allowances to address short-term issues.

We are interested in receiving views on both positive and negative differences between incurred costs and allowances and, as far as possible, their scale. For instance, we are seeking views on the impact of demand reductions over this winter, both because of generally mild weather to date, and consumers reacting to retail prices being unprecedently high. Equally, we are keen to understand to what extent the liquidity of some products in the wholesale market has affected suppliers' transaction costs when seeking to hedge in line with the cap wholesale methodology.

[10] Ofgem (2022) Price Cap – Decision on possible wholesale cost adjustment, https://www.ofgem.gov.uk/publications/price-cap-decision-possible-wholesale-cost-adjustment
[11] Ofgem (2022) Decision on the potential impact of increased wholesale volatility on the default tariff cap https://www.ofgem.gov.uk/publications/price-cap-decision-potential-impact-increased-wholesale-volatility-default-tariff-cap

To consider that a review is appropriate to address a short-term concern, we would need evidence of a material and systematic issue. We can highlight two points (in particular) that affect whether an issue would be material and systematic.

- We are ultimately interested in whether the additional wholesale allowances for gas and electricity have diverged from costs incurred by suppliers. If, in a particular cap period, costs have increased relative to some allowances, but decreased in others, the net effect might not be material. We are likely to give less weight to evidence which focuses on changes to particular costs than to evidence which shows whether there is an issue in the round.
- There will always be variations between allowances and costs in any cap period. We would therefore intend to limit the scope of any review to differences that are unlikely to net out over time, and which may therefore lead to systematic impacts. For example, we consider weather risk to vary within a cap period and as an issue that may materialise over several periods. Consequently, even if there were weather-related costs greater than the allowances, we would be unlikely to consider those costs for an ex-post allowance without taking a longer-term view. When doing so, we would also need to consider the additional risk allowance and headroom, as these allowances are intended, in part, to account for weather risk.

Considering a review for short-term issues: Areas for feedback

We particularly welcome feedback on the following issues:

- *Are there specific issues for this winter (2022-23) which mean that you consider a review is appropriate? If yes, please explain your understanding of the causes and potential actions required to address these issues.*
- *Please provide any evidence of whether costs this winter have materially and systematically diverged from the additional wholesale allowances.*

Considering a review for enduring issues

We are also interested in whether the current additional wholesale allowances still appropriately reflect suppliers' notional efficient costs and will continue doing so in the future. We welcome evidence from stakeholders on whether there are any enduring issues causing additional wholesale costs to materially and systematically deviate from the allowances set in the cap.

The evidence collected through this Call for Input will inform our decision on whether a review of enduring issues is appropriate. Depending on the nature and the magnitude of the issues identified, we intend to consider carrying out our review by updating the input data and/or

undertaking a full review of our models. We welcome stakeholders' views on which approach would be more appropriate to address any enduring issues.

Approach 1: Review of input data.

Currently, our models use historical data up to 2018. In Approach 1, we would consider whether it is appropriate to update our models using more recent datasets. The question would be whether this update would make the additional wholesale allowances a better reflection of the costs that suppliers are likely to face in future cap periods.

By following this approach, the review would likely be less time and resource consuming (than under Approach 2), therefore potentially allowing for a faster delivery. However, we would not review the models' assumptions and methodology and would therefore be assuming that the current methodology remains appropriate. We would also not be able to consider how to make the methodology more responsive to future market developments.

Approach 2: Full review of the methodology

Under Approach 2, we would review the input data as well as the key assumptions and methodology of our models. This could include considering the introduction of separate calculations for Economy 7 and other Time of Use customers, and a process for regular updates.

This would be a review with a much broader scope than Approach 1, considering both current and future market challenges. However, a full review would require more time and resources.

In the Programme of Work, we indicated that a review of this type could be delivered by Summer 2024.[12]

Considering a review for enduring issues: Areas for feedback

We particularly welcome feedback on the following issues:

- *Are there additional general issues which mean that you consider a review is appropriate? If yes, please explain your understanding of the causes and potential actions required to address these issues.*
- *Please provide any evidence of why you would expect costs to diverge from allowances on an enduring basis, including evidence of differences to date.*

[12] Ofgem (2022) Price cap – Programme of Work, https://www.ofgem.gov.uk/publications/price-cap-programme-work

- *Which of the two outlined approaches do you consider would be most appropriate for a review of enduring issues? What types of customers should we consider in any review (eg multi-register or PPM)? Please explain why.*

Interactions with other workstreams

Recent legislative changes and several cap workstreams influence our considerations on whether to launch a review of additional wholesale allowances and, if so, what the scope of that review could be.

Price cap extension

The Tariff Cap Act 2018 originally set out that the cap would end by December 2023 at the latest. A key change enacted in the Energy Prices Act 2022[13] is the ability for the cap to continue beyond 2023, with the default position being the cap remains in place and ceases to have effect following notice given by the Secretary of State. This new default position is a consideration in whether to review additional wholesale allowances, particularly under Approach 2 described above.

Alongside this Call for Input, we have published a consultation proposing modifications to gas and electricity (Standard Licence Conditions) SLCs and cap models, to reflect the new legislation and to prevent them from ending prematurely.[14]

Operating costs

Operating costs are a supplier's own costs of retailing energy. In many cases these costs are shared across the customer base rather than attributed to a single account. As outlined in the Programme of Work, Ofgem intends to begin a review of operating costs in due course. This would provide an opportunity to consider any operating costs associated with trading energy.

Headroom

We also note the additional wholesale allowances included in the 'additional risk and uncertainty' allowance, where a 1% uplift is applied to the direct fuel costs component in each cap period. Additionally, the headroom allowance captures further residual net uncertainty

[13] The Energy Prices Act also legislated for the EPG and an additional requirement for Ofgem to have regard to the impact of the cap on public spending.
[14] Ofgem (2023), Price cap - Consultation on removing the cap end date from the licence conditions https://www.ofgem.gov.uk/publications/price-cap-removal-cap-end-date-licence-conditions

across the cap methodology. This recognises that the cap does not explicitly cover all risks a supplier may incur when providing energy to domestic customers.

Interactions with other workstreams: Areas for feedback

We would particularly welcome feedback on the following:

- *Are there any other key interactions which you consider could affect the scope of any review? Please explain your answer.*

Next steps

Alongside this Call for Input, we are sharing a draft Request for Information (RFI) with suppliers.[15] This relates to various data points and information which we consider would help inform our decision on whether to carry out a review. We have asked suppliers to send their feedback on our draft RFI by 17 February 2023. If you consider that we should be gathering additional data or information for this purpose, please indicate which data you consider we should be collecting. Following that, we will seek to issue a mandatory RFI in March 2023.

Following the information and data collection phase, we will analyse stakeholders' responses and decide whether it is appropriate to carry out a review of the allowances at this stage. We intend to update stakeholders in early summer on our decision on whether to carry out a review. Should we decide to do so, we will inform stakeholders on the scope of the review and our plans for future consultations at this time.

Stakeholder feedback

Please send any responses to retailpriceregulation@ofgem.gov.uk by 01 March 2023, including detail and supporting evidence wherever possible. As part of your comments, please explain how any suggested approach would be deliverable in practice.

If you have any questions, please contact us at the above email address.

Yours faithfully,

Dan Norton,

Deputy Director, Price Protection

[15] Our intention is to share this with suppliers who have at least 100,000 domestic default tariff customer accounts, counting each dual fuel customer as 2 accounts. We invite suppliers below that threshold to contact us if they wish to provide comment on the draft RFI.

Appendix 1 – Legislative and consumer interest frameworks

Legislative framework

The Tariff Cap Act 2018 requires us to put in place and maintain the licence conditions which give effect to the cap. The objective of the Act is to protect existing and future default tariff customers. We consider protecting customers to mean that prices reflect underlying efficient costs. In setting the cap we must have regard to the following five matters. The need to:

- Create incentives for holders of supply licences to improve their efficiency.
- Set the cap at a level that enables holders of supply licences to compete effectively for domestic supply contracts.
- Maintain incentives for domestic customers to switch to different domestic supply contracts.
- Ensure that holders of supply licences who operate efficiently are able to finance activities authorised by the licence.
- Set the cap at a level that takes account of the impact of the cap on public spending.

The requirement to have regard to the five matters identified in section 1(6) of the Act does not mean that we must achieve all of these. In setting the cap, our primary consideration is the protection of existing and future consumers who pay standard variable and default rates. In reaching decisions on particular aspects of the cap, the weight to be given to each of these considerations is a matter of judgment. Often, a balance must be struck between competing considerations.

Consumer interest framework

The cap objective aligns with Ofgem's consumer interest framework.[16] In our framework, we set out four high-level objectives: Fair prices, Quality & Standards, Low-Cost Transition and Resilience. While the cap cuts across all of these objectives, it is most closely linked with Fair prices. The cap objectives and consumer interest framework are relevant to our decision making when making changes to the cap methodology.

[16] Ofgem (2022) Net Zero Britain: developing an energy system fit for the future, https://www.ofgem.gov.uk/publications/net-zero-britain-developing-energy-system-fit-future

Appendix 2 – Additional wholesale allowances

The cap methodology applies additional wholesale allowances as part of the direct fuel costs component calculation. These allowances reflect the costs of trading energy on the market to supply customers and account for the following areas.

Shaping costs

Suppliers typically buy electricity and gas in quarterly contracts. This is because contracts with a shorter delivery period, eg monthly contracts, are not available more than 6 months ahead of delivery. As such, the cap assumes suppliers start purchasing quarterly contracts and exchange them closer to delivery when shorter dated contracts become available, and their customers' forecast demand becomes more predictable. Suppliers incur costs in doing this, which are accounted for in the cap methodology.

Imbalance costs

Suppliers need to buy or sell energy to reflect the pattern of their customers' demand, or otherwise face imbalance charges. Imbalance costs arise as the difference between the quantity of energy delivered to the system and the quantity delivered to customers.

Transaction costs

Suppliers incur transaction costs when they trade energy. These costs differ depending on how a supplier trades (bilaterally, directly with generators, through a broker, via an exchange or a combination of those). Some suppliers have sophisticated trading capabilities while others have limited capabilities or outsource these activities. Brokers or exchanges charge various fees for their services.

Additional risk and uncertainty allowance

The additional wholesale risk allowance is currently set at 1% of wholesale direct fuel costs and exists within the wholesale cost allowance methodology. It reflects the fact that wholesale costs are an uncertain and volatile element of suppliers' costs.

Unidentified gas

Unidentified gas (UIG) refers to gas supplied to the network but not attributed to an individual Supply Meter Point (MSP) or accounted for as shrinkage. There are several reasons for UIG, including, leakage, theft, or consumption by unregistered supply points.

Evolution of the wholesale allowances

The table below shows how the main additional wholesale allowances have evolved over the last four cap periods.

Table 2: Evolution of additional wholesale allowances (£/customer/year at TDCV)[17]

Fuel	Item	October 2021 - March 2022	April 2022 - September 2022	October 2022 – December 2022	January 2023 – March 2023
Electricity Profile Class 1	Direct fuel costs allowance	£202.28	£381.06	£816.55	£960.05
	Shaping allowance	£9.47	£17.83	£38.21	£44.93
	Imbalance allowance	£2.65	£4.99	£10.70	£12.58
	Transaction costs allowance	£0.80	£1.50	£3.21	£3.78
	Additional risk allowance (1%)	£2.02	£3.81	£8.17	£9.60
Electricity Profile Class 2	Direct fuel costs allowance	£296.56	£553.64	£1,171.97	£1,447.45
	Shaping allowance	£13.88	£25.91	£54.85	£67.74
	Imbalance allowance	£3.89	£7.26	£15.36	£18.97
	Transaction costs allowance	£1.17	£2.18	£4.61	£5.70
	Additional risk allowance (1%)	£2.97	£5.54	£11.72	£14.47
Gas non-PPM	Direct fuel costs allowance	£256.68	£520.68	£1,221.96	£1,363.56
	Shaping allowance	£10.75	£21.81	£51.19	£57.12
	Imbalance allowance	£0.30	£0.61	£1.44	£1.60
	Transaction costs allowance	£0.81	£1.64	£3.85	£4.30
	Additional risk allowance (1%)	£2.57	£5.21	£12.22	£13.64
	Unidentified gas allowance	£5.13	£9.48	£22.31	£24.90
Dual fuel (elec. PC1 + gas non-PPM)	Shaping, imbalance and transaction costs allowance	£24.78	£48.39	£108.61	£124.31

[17] The Direct Fuel Costs Allowance is equivalent to 'raw' index values before any allowances or losses are applied. All figures are quoted in £ per SVT customer per year, at TDCV (2.9 MWh electricity for profile class 1, 4.2 MWh electricity for profile class 2 and 12 MWh gas).

Modelling approach

The additional wholesale allowances are currently calculated as follows.

Gas has five allowances and electricity has six. They are calculated in two separate models as percentages of the direct fuel costs allowance.

- Monthly shaping: the cost of shaping seasonal (for electricity) or quarterly (for gas) contracts to monthly contracts.
- Hourly shaping (electricity only): this is only provided for electricity and is an allowance to reshape the monthly baseload and peak load contracts to hourly contracts at seasonal normal demand. Gas settles daily and daily shaping costs are assumed to be nil, we therefore do not shape gas beyond monthly.
- Re-hedging day ahead: both models calculate a cost of re-hedging at day ahead due to an improved view of demand (eg once weather information is available).
- Imbalance costs: a cost due to imbalance volumes and the associated costs.
- Transaction costs: a cost that is calculated using a simple average based on a survey of benchmark suppliers.
- Additional risk and uncertainty allowance: an additional risk allowance of 1%[18] is added to the gas and electricity additional wholesale allowances to reflect the cap does not explicitly cover all wholesale risks that suppliers face in supplying energy to customers.

To apply these allowances to the cap, we multiply the fixed percentages to the direct fuel costs and backwardation allowances which we calculate based on forward contracts. We calculate the percentage uplifts for electricity and gas in separate models. The models are similar in structure and methodology but rely on different datasets.

[18] The additional risk allowance % for cap periods 8, 9a and 9b was over 1% to allow the recovery of wholesale additional costs incurred during cap periods 7. From P10a, the additional risk allowance will revert to 1%.