

To - all stakeholders

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Date: 23 February 2024

Dear Stakeholders,

## **Decision on changes to the timing and availability of price cap inputs - February 2024**

On 7<sup>th</sup> February 2024, we consulted on proposals for dealing with late or uncertain inputs to the price cap calculation for April – June 2024 relating to the Capacity Market (CM) Allowance and planned changes to the Energy Intensive Industry (EII) exemption scheme.<sup>1</sup> Within that consultation document we proposed to make the following changes:

- Allow the CM Allowance to be updated on a quarterly basis (rather than six-monthly), where there is more up-to-date information available to do so.
- Use relevant Policy Cost Allowance inputs which assumes 100% EII exemption for the February 2024 announcement, in anticipation of the relevant legislation being in place by 1 April 2024. We also propose to update the Policy Cost Allowance in May 2024 (rather than the next six-monthly update) should the relevant legislation not be in place as expected.

### **Decision summary**

We received five responses to this consultation. Four responses were from industry stakeholders. One response was from an individual. We have carefully considered the feedback provided in response to this consultation and have decided to proceed with our

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<sup>1</sup> Ofgem (2024), Changes to the timing and availability of price cap inputs, <https://www.ofgem.gov.uk/publications/changes-timing-and-availability-price-cap-inputs>

proposals to implement these changes from charge restriction period 12a, commencing 1 April 2024. We set out further details on our decision and stakeholder feedback below.

## **Capacity Market inputs**

We have decided to proceed with our proposals regarding CM allowance input availability. These can be summarised as follows:

- To use the result of the previous year's T-1 auction (T-1 2022) as the clearing price for the T-1 2023 auction.
- To use the targeted capacity for the T-1 2023 action as the input for the obligated capacity.
- To update the CM allowance on a quarterly (rather than six-monthly) basis, where there is more up-to-date clearing price information available to do so for an interim charge restriction period announcement (i.e. those announced in May and November).
- For interim charge restriction period announcements where we do make an update to the CM allowance (i.e. where a new clearing price is available), we will update all CM inputs to the latest information available at the time of price cap calculation.
- Although this decision will apply to future price cap periods, we consider the need to update the CM allowance (as we have committed to do in the next interim update - to be announced in May 2024) to be the exception rather than the norm, based on typical auction timings.

## **Considerations and feedback**

Stakeholders were generally supportive of our proposals in this area. All four supplier stakeholders were supportive of the overarching proposal to update the CM Allowance for 'interim' Charge Restriction Periods (i.e. periods commencing 1 January and 1 July each year, announced in November and May respectively), where there was more up-to-date information available, as there will be this year. The non-industry individual response did not support the proposed changes, outlining their view that these changes would have an adverse impact on consumers. We consider that the proposals support consumers' interests by ensuring that the level of the price cap reflects changes in underlying costs at the earliest opportunity.

*Feedback on inputs which would inform an interim update to CM Allowance* – Three of the four suppliers agreed with our approach to using previous auction clearing prices where more up-to-date figures were not available. One supplier suggested that Ofgem should

adjust the previous clearing price input using Consumer Prices Index (CPI). We do not agree that adjusting the previous clearing price to account for CPI is appropriate or proportionate. Capacity Market auction clearing prices may increase or decrease relative to the previous years' clearing price, therefore inflating the input as suggested would not be reflective of the actual costs expected to be incurred by suppliers, and therefore not in consumers' interests. We also note that the proposal to update the CM Allowance on a quarterly rather than six-monthly basis where more up-to-date inputs are available considerably reduces any potential impact of a temporary over or under allowance, relative to the status quo. The stakeholder also suggested Ofgem may consider using an average of clearing price values over 2 or 3 previous years (each indexed to CPI) rather than just the previous year's price. However, we think this option would introduce unnecessary complexity to the CM Allowance and note the majority of industry stakeholders supported our proposed approach.

*Ex-post adjustment* – One supplier who raised support for our approach noted that there have been instances in the past where clearing prices have deviated considerably year on year and that Ofgem should consider reconciling significant over or under allowances with consultation from industry. We consider that the proposed approach will ensure any deviations between the cap level and underlying costs due to capacity market input availability are limited to a single quarterly price cap period, which we expect should minimise the risk of any deviations being material (beyond the uncertainty mechanisms which already exist within the price cap to account for risks and uncertainties such as this). We also note the risk of short-term over or under-recovery to be broadly symmetrical on the basis that clearing prices may be higher or lower than for the previous year. However, where material and systematic cost departures occur in the future, we will keep under review whether further changes to the price cap methodology may be appropriate depending on the circumstances, following consultation where appropriate.

All three suppliers who responded to our proposal to use the targeted capacity as the input for the obligated capacity agreed with our approach.

## **Anticipated Energy Intensive Industries (EII) legislation change**

We have decided to proceed with the changes as proposed. These can be summarised as follows:

- Capacity Market: As set out in the technical annex for the price cap wholesale cost review<sup>2</sup>, the CM allowance will assume the 100% exemption for the rates for April-June 2024 (published in February 2024), derived from the Low Carbon Contracts Company (LCCC).
- Renewables Obligation (RO): The RO level for the scheme year will assume the 100% exemption cost scenario for the obligation level for the scheme year, taken from the published Department of Energy Security and Net Zero (DESNZ) Renewables Obligation Certificates (ROC). Both scenario ROC estimates have been published by DESNZ.
- Contracts for Difference (CfD): For CfD's payment forecasts, we will have regard to the latest data available published by LCCC.
- Feed-in Tariffs (FiT): In our 7 February consultation, we incorrectly stated that EII was due to drop out of FiT methodology. However, as our FiT methodology is backwards looking, we expect any EII exemption level increase to flow through to the cap in 2025.
- We will refresh the Policy Cost Allowance inputs outside of the regular six-monthly sequence, in May 2024 to the relevant (85% exemption) figures should the legislation **not** come into place as expected. Otherwise, we will continue to update policy costs going forward based on the routine six-monthly cycle.

### **Considerations and feedback**

Four industry stakeholders responded to our proposals in this area, indicating overarching support for the proposals. Two suppliers noted that Ofgem had misrepresented how the EII exemption would impact the FiT methodology, highlighting that our consultation position suggested that EII would fall out of the FiT methodology from 1 April 2024, so no further change to these inputs was required for the April – June cap level. We agree with the stakeholder's views on this point. We also note that as the FiT methodology relies on backward looking inputs as opposed to forward looking inputs. This means the relevant FIT inputs will not be subject to the legislative uncertainty for the February 2024 price cap announcement (for April – June 2024 cap level rates) that exists with forward looking inputs. Therefore, no assumptions need to be made about the EII exemption status for FiT inputs. These will be accounted for next year, when the legislative position of the EII exemption change will be clear.

### **General feedback**

One supplier highlighted the limited timeframe for responding to this consultation across both proposals and suggested that going forward Ofgem consults on technical changes

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<sup>2</sup> Ofgem (2024), Energy price cap additional wholesale costs decision, <https://www.ofgem.gov.uk/publications/energy-price-cap-additional-wholesale-costs-decision>

using the 'standard' consultation timeframes. The stakeholder also suggested that Ofgem should more closely align with DESNZ on potential legislative changes to ensure industry and other stakeholders are given adequate notice of the implications for the price cap methodology. We welcome this point of feedback and will endeavour to ensure stakeholders have sufficient notice to consider Ofgem's proposals and provide representations.

Although outside of the scope of this consultation, a number of suppliers also raised a suggestion for Ofgem to consider a more detailed review of the CfD methodology, based on perceived risks that the current methodology may result in deviations between the CfD allowance and CfD related incurred costs. We will consider this feedback ahead of communicating further on our intended approach to reviewing wholesale allowances in the future via an update to the Price Cap Programme of Work in spring 2024.

One supplier also highlighted that the upcoming Network Charging Compensation (NCC) scheme and its associated supplier levy might result in changes to the inputs which feed into the price cap. We monitor closely any new schemes and amendments to existing schemes that may result in changes to the inputs or methodology of the price cap. We will continue to do so, and we will consult with industry on any proposals to amend the inputs or overarching methodology to account for any new or amended policy support measures which could impact the costs incurred by suppliers, where these are material and systematic in nature.

## **Implementation**

These methodological changes will be implemented from charge restriction period 12a commencing 1 April 2024.

Yours Sincerely,

**Dan Norton**

**Deputy Director, Retail Price Protection**