



3rd Floor North
200 Aldersgate Street
London EC1A 4HD
Tel: 03000 231 231

citizensadvice.org.uk

14 December 2021

Dear Leonardo

We are writing in response to your consultation on the process for updating the default tariff cap. This submission is non-confidential and may be published on your website.

We recognise there is a case for allowing the level of the default tariff cap to be amended more frequently than once every six months, in order to respond to conditions where underlying costs have increased or decreased significantly or rapidly. But we do not support your proposals to allow for the ad hoc, effectively retrospective redetermination of the cap if a series of subjective criteria are met, which we think would result in a reduction in certainty and stability. We think that if you wish to make the price cap more responsive to fluctuating wholesale costs, it would be better to consider increasing the frequency of its recalculation, perhaps to quarterly.

While you state an intention 'that in-period adjustments would be forward looking only', it is not possible to see how an in-period adjustment could be made without it having retrospective effect. This is because the observation window for each price cap window closes in advance of that price cap period. You will be aware that in the British Gas et al judicial review of the price cap set for period 1, the plaintiffs successfully argued that a prudent supplier would have followed the hedging strategy implied by the price cap methodology in place at the time and that they could not respond to the regulator 'moving the goalposts' on the observation window after those purchasing decisions have been made. What you are proposing would replicate a scenario that the courts deemed to be procedurally unreasonable. While you propose that any in-period change to the price cap level would only be made prospectively (i.e. at a later date than the current one), it will be the case that prudent suppliers have already largely hedged their wholesale position based on an expectation that the existing methodology will be followed. While they can change their future wholesale purchasing decisions, they cannot change those that they have already made.

Your criteria for when you might make an in-period adjustment are wholly subjective. There are no hard thresholds associated with them, and they are entirely a matter of judgement. It will not be possible for stakeholders to objectively predict

when they may be triggered. Given the potentially high materiality of a go/no-go decision on reopening the cap this is likely to result in significant uncertainty overhanging both the market itself and other stakeholders. We think it is unlikely to reduce the risk of market participation in the way you envisage, given the lack of clarity and certainty on when these powers may or may not be used. Indeed, it may increase it for several reasons. Firstly, because it is less predictable than the baseline. Secondly, because the highly subjective nature of the decision combined with its partially retrospective effect (as detailed previously) may mean any decision to reopen the cap in-period is at very real risk of credible legal challenge. Finally, because giving Ofgem such material discretionary powers may risk perceptions that the regulator becomes, or is seen as becoming, politicised (given that it may come under acute external pressure to use these powers).

If there is a desire to allow the cap to respond more rapidly to changes in underlying wholesale prices, we think it may be more prudent to instead consider a move to recalculate it more frequently, perhaps on a quarterly basis. This may come with additional costs, in terms of the increasing volume of messaging from, and consumer contacts with, suppliers caused by more frequent price movements. There may also be more of a burden on Ofgem from running the process more frequently. You would need to assess what those costs are to understand the proportionality of such a move, but we find it plausible that they may be outweighed by the benefits of the reduction in structural risk if/when wholesale markets are in turmoil, as they are at present. Noting that the price cap is a ceiling not a target, there may be some scope for suppliers to mitigate their own costs by not repricing default tariffs if there are periods where the level of the cap only moves by a small amount.

There are several advantages of more frequent recalculation of the cap compared to taking powers to change it within a period in the way you envisage.

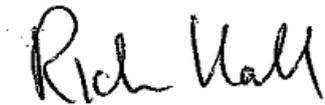
Firstly, assuming an adequate notice period for the introduction of the change, it would be wholly prospective in its effect, and would avoid the detrimental retrospective rule change implications of your proposals.

Secondly, it would be predictable and objective. Suppliers (and other stakeholders) would know in advance that the cap was being recalculated, when, and on what basis it was being recalculated. They cannot predict this under your proposals.

We note that much of the risk that is currently perceived in the market relates to volume risk - that suppliers may have far more consumers on default tariffs than they expected to since the price cap became the cheapest deal on the market, and that this situation could change rapidly once cheaper deals become available again.

Either the introduction of an hoc power to amend the price cap, or its recalculation more frequently, might allow the price cap to become more responsive to changes in prices, but they will not allow it to become more responsive to changes in volume. There are limits on the extent to which you can mitigate volume risk through price measures, and these proposals are unlikely to address it.

Yours sincerely

A handwritten signature in black ink that reads "Rich Hall". The signature is written in a cursive, slightly slanted style.

Richard Hall
Chief Energy Economist