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# Energy bills and the price cap



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## Summary

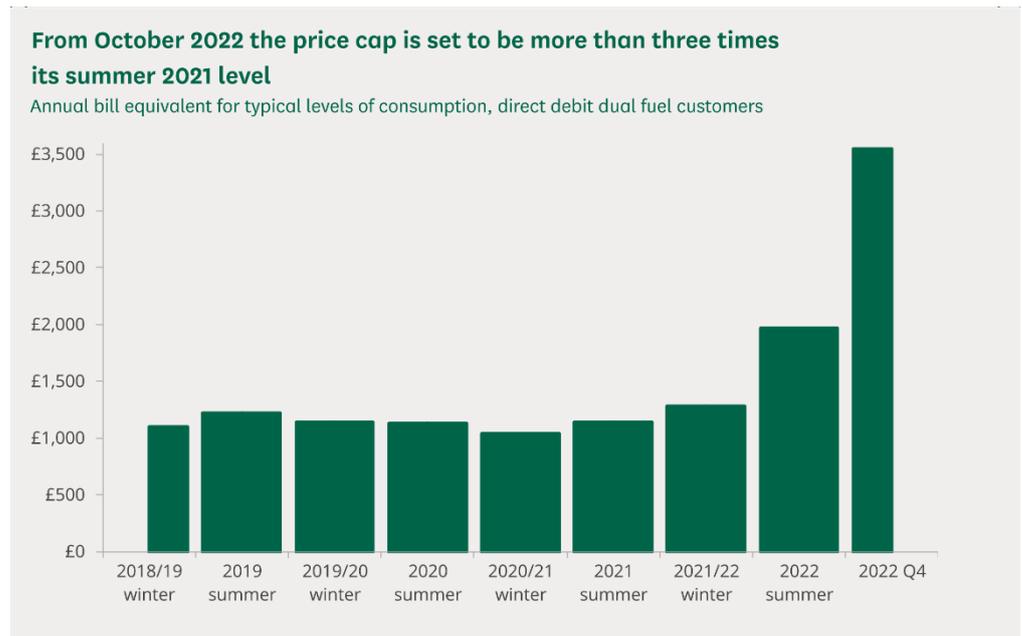
Energy bills comprise a variety of costs including wholesale, network, social and environmental, and other direct costs, as well as VAT and supplier profits. These costs can all fluctuate, meaning the causes of rises and falls in energy bills are complex.

Introduced to address a lack of competition in the energy market in 2019, the default tariff cap (also known as the energy price cap) sets an absolute, top-level price per unit of electricity and gas for customers on domestic default tariffs in Great Britain. The intention is that the cap should be low enough to protect vulnerable customers, but high enough to encourage suppliers to offer tariffs below the level of the cap, to maintain competition and incentivise switching.

Unprecedented increases in wholesale gas and electricity prices, and associated tariff rises, have meant the price cap has gone from one of the more expensive tariffs in the market, to one of the cheapest available. Currently, 24 million households are on tariffs protected by the cap.

## August 2022 cap increase

On 26 August 2022, the energy regulator Ofgem announced a further 80% increase in the cap, meaning that a ‘typical’ household (with average consumption, dual fuel and paying by direct debit) would be paying an annual bill of £3,549 from 1 October 2022. The regulator also warned that while it was not giving projections for January due to the volatility in the market, “prices could get significantly worse through 2023.”



Source: Ofgem, [Breakdown of the default tariff price cap \(direct debit\)](#)

Jonathan Brearley, CEO of Ofgem, [said the new Prime Minister would need to act to address the price rises facing consumers](#). He said Ofgem had been working with ministers, consumer groups and industry bodies on a “set of options” for the new Prime Minister, adding: “The response will need to match the scale of the crisis we have before us. With the right support in place and with [the] regulator, government, industry and consumers working together, we can find a way through this.”

## How is the price cap set?

Ofgem sets the price cap using its own estimates of the different costs that suppliers will face in the next price cap period. These mainly consist of the wholesale cost of gas and electricity, network costs, supplier operating costs and the costs of government policy which are passed on to customers. It adds an element for supplier profit of just over 1.9% of revenue. Finally, VAT is added at 5%.

In late 2021, in response to instability and a lack of resilience in the energy market, Ofgem launched consultations on measures to reform the price cap methodology and make other changes to the regulation of the market. In August 2022, the regulator announced that, following the consultations, it was making changes to come into force from 1 October 2022, including:

- Moving to a quarterly review of the price cap, from the current six-monthly assessment;
- A shortened notice period between the announcement of the cap level and its implementation;

- The inclusion of [backwardation costs in the methodology](#).

## Alternative proposals

There is widespread concern about the impact of increasing energy prices on vulnerable customers in winter 2022-23. There have been several proposals to temporarily freeze the price cap or replace it with a different method of price regulation.

The Government has provided support to help energy consumers with rising energy bills. It hasn't proposed any change to the price cap but has said it is [considering what reforms are needed to ensure the energy market is resilient and customers are protected](#). Provisions in the Energy Bill 2022-23, currently being considered in the House of Lords, would enable the existing price cap to be extended beyond 2023.

### Help with energy bills

The following links give details of the support available from government and other organisations for customers who are struggling to pay their bills:

- [Getting help if you can't afford your energy bills](#) (Ofgem)
- [Find schemes, grants and benefits to help with home energy](#) (Ofgem)
- [Energy domestic consumer advice for Autumn/Winter 2022](#) (Ofgem)
- Government [Cost of Living Support package](#) (26 May 2022) including recently announced details of the [Energy Bills Support Scheme](#)
- Charity National Energy Action's [Get Help](#) pages which include [What to do if you are struggling with your energy bills](#)
- Commons Library briefing [Energy Bills Support Scheme: Government policy and FAQs](#)
- Commons Library briefing [Help with energy bills](#)
- Commons Library briefing [Help with energy efficiency, heating and renewable energy in homes](#)

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# 1 Background

## 1.1 Privatising the energy market

Before the energy sector was privatised in the 1980s, electricity was supplied to households through 14 regional electricity companies (previously area boards) and gas was supplied by British Gas or Scottish Gas.

The supply and generation of British electricity was privatised from 1989 through the Electricity Act 1989. This provided the framework for the restructuring and privatisation of the electricity supply industry in England and Wales and Scotland. Industry regulation was through the Office of Electricity Regulation (Ofgem).

The Gas Act 1986 privatised the British Gas Corporation and established the industry regulator, the Office of Gas regulation (Ofgas).<sup>1</sup> The energy market then entered a period of liberalisation with new suppliers entering the market and establishing competition for customers.<sup>2</sup>

The industry regulator is now the Office of Gas and Electricity Markets (Ofgem) who reports to the Gas and Electricity Markets Authority (GEMA).

## 1.2 Suppliers in the energy market

Since privatisation, there has been considerable restructuring and consolidation of the energy industry. For many years the industry was dominated by the 'big six' energy companies. Now referred to as 'Large Legacy Suppliers,' there are currently five such companies. Each of these generates electricity and delivers both gas and electricity to homes and businesses. They are Centrica plc (three retail brands: British Gas, Scottish Gas and Nwy Prydain in England, Scotland and Wales respectively), E.ON UK (which acquired RWE npower in 2020), Scottish and Southern Energy (SSE) now part of Ovo, EDF Energy, and Scottish Power.

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<sup>1</sup> For more details on the privatisation of British industries, see the House of Commons Library briefing paper on [Privatisation](#)

<sup>2</sup> These Acts also privatised generation and the grid infrastructure. The energy market now involves energy suppliers buying energy from generators on the wholesale market, to then sell to the consumers on the retail market. Both suppliers and generators pay grid infrastructure (network) costs, which are then passed on to consumers. More information is available in the Library briefing paper on [Electricity grids](#).

Since 2010, there had been a growing number of suppliers in the market. There were 31 active suppliers in June 2015, rising to a peak of 70 in mid-2018.<sup>3</sup>

However, rising wholesale gas prices and increased price volatility led to the collapse of 29 energy suppliers between July 2021 and May 2022.<sup>4</sup> The wholesale price rises were initially due to the failure of gas supplies to keep up with the increased demand following the relaxation of Covid-19 lockdowns but were exacerbated by the Russian invasion of Ukraine in February 2022. More information about increases in wholesale gas prices is provided in section 1.3 below and in the Library briefing, [Domestic energy prices](#).

## What happens when an energy supplier fails?

If an energy supplier fails, Ofgem runs a competitive process to find a new supplier to take on the customers. This new supplier is known as the supplier of last resort (SoLR). Ofgem provides [a table of energy suppliers](#) that have gone into administration in 2021-22 and the new suppliers appointed, alongside more information on the process on its webpage, [Ofgem Safety Net: If your supplier goes out of business](#).

Customers should have no disruption to their energy supply when moved to a SoLR.<sup>5</sup>

In April 2022, Ofgem reported that 4.3 million customers of failed energy suppliers had been transferred to a supplier of last resort to maintain their energy supply.<sup>6</sup> Suppliers of last resort are compensated by a levy for any uncovered costs associated with taking on failed supplier customers which is paid for by a surcharge on all consumers' bills. More discussion about the SoLR process and the costs involved is provided in the National Audit Office (NAO) report, [The energy supplier market](#).

## Bulb goes into administration

The largest energy supplier to go into administration in this period was Bulb, which had 1.6 million domestic customers.

Based on existing Ofgem and the Department for Business, Energy and Industrial Strategy (BEIS) plans for the failure of a large energy supplier, the company did not go through the SoLR process and instead was placed into a Special Administration Regime (SAR) on 24 November 2021. The National Audit Office reports that the SAR process cost £0.9 billion, and a recent estimate by the consultancy Auxilione estimated the costs of supporting Bulb

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<sup>3</sup> Ofgem, [Retail Energy Markets in 2015](#), 9 September 2015

<sup>4</sup> Business, Energy and Industrial Strategy Select Committee, [Energy pricing and the future of the Energy Market](#), Third Report of Session 2022-23, 19 July 2022

<sup>5</sup> Ofgem, [Ofgem Safety Net: If your supplier goes out of business](#).

<sup>6</sup> Ofgem, [Time for suppliers to improve standards for energy consumers April 2022](#)

could reach £4 billion by spring 2023, if the Government does not sell the company.<sup>7</sup>

## Switching and recent changes to energy bills

When the energy market was privatised, customers remained with their ‘regional’ company for electricity and national company for gas. Eventually consumers were supposed to switch to save money and a competitive market would be established.

Suppliers have operated in a competitive market where they set their own prices and consumers can choose suppliers based on preferences such as price and service.<sup>8</sup>

However recent increases in domestic energy prices have effectively halted this competition. Section 1.3 below, looking at the evolution of energy bills, explains this.

## 1.3

### Evolution of energy bills

The following chart looks at average bills for typical levels of consumption, over the past decade. It focusses on the two ends of the market, the cheapest tariffs and the average standard variable tariff (SVT) of the large legacy suppliers which has been virtually the same as the price cap since its introduction. Figures are based on a typical domestic dual fuel customer paying by direct debit.

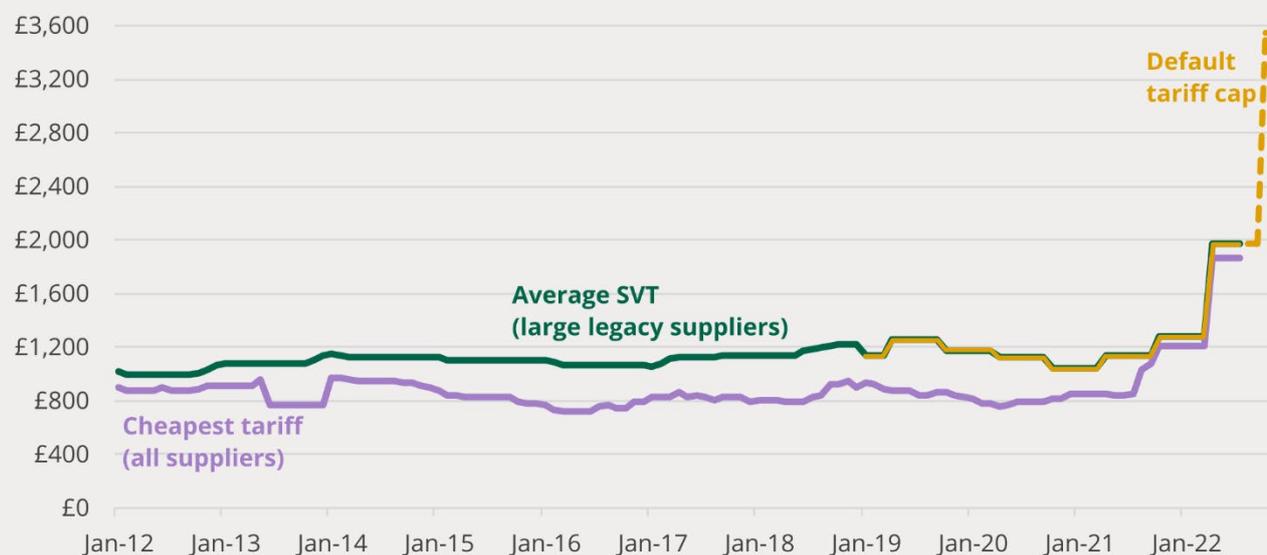
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<sup>7</sup> Financial Times, [Bulb bailout cost set to top £4bn by spring](#), 21 August 2022

<sup>8</sup> Sophie Barker, [Ofgem to end price caps on energy](#), The Telegraph, 27 November 2001

## The gap between the price cap and the cheapest tariff narrowed rapidly in 2021 and 2022. Price cap increased by 54% in April 2022 and due to increase by 80% in October 2022.

Average annual direct debit dual fuel bill for typical levels of consumption, cash prices, Great Britain



Source: [Ofgem, Retail Market Indicators, Prices and Profits](#)

Average bills increased for most customers in late 2012 and early 2013. They fell over the next three years, gradually for the average SVT customer and more rapidly for those on the cheapest tariff. Prices increased again in late 2016/early 2017 and again in late 2018 before falling during 2019 and 2020. These variations were very small compared to recent price increases.

In July 2022, the cheapest tariff on the market was £1,872 a year or almost 150% above their April 2020 level. The average SVT of the large legacy suppliers was £1,970; almost 90% above their March 2020 level.

In 2021, the gap between the price cap and the cheapest available tariff narrowed rapidly. This was because the increase in wholesale prices meant suppliers could not offer cheaper tariffs and many charged the maximum they were allowed to under the cap. The narrow gap between the price cap and the cheapest tariff in recent months shows that most customers cannot currently get a deal below the tariff cap.

This has effectively halted competition as previously switching suppliers or tariffs could save consumers money.

The briefing [Domestic Energy Prices](#) includes much more detail on price trends and variations.

## 1.4

## What makes up an energy bill?

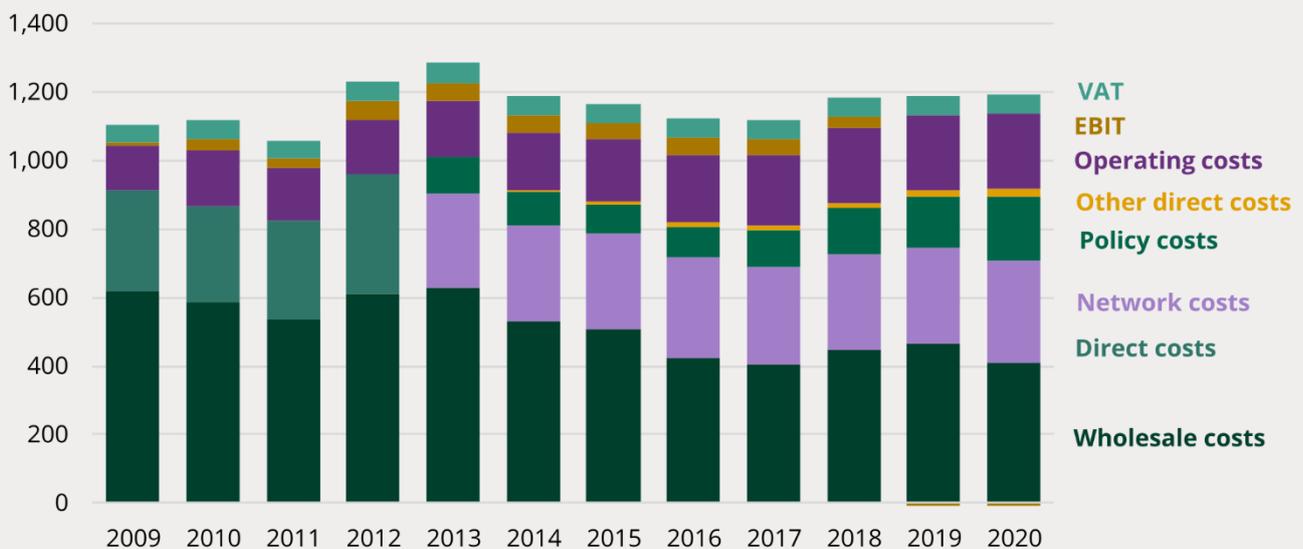
Energy bills comprise a variety of costs that change over time. The true cost of an individual energy bill for a consumer will depend on where they live, who their supplier is, how much energy they use, and how they chose to pay their bill, e.g. direct debit or otherwise.

The first chart below shows longer term trends in what energy suppliers say makes up their bills overall. The latest data on this basis is from 2020. It shows that wholesale costs were the largest single element, but only made up 35% of the total cost of a bill in 2020. The main element which increased between 2016 and 2020 was policy costs, but this was a small factor overall and outweighed by the fall in wholesale costs over the whole period.

More recent data is available on the components of the default tariff cap specifically (see section 4.1).

### In 2020, a typical domestic energy bill was 35% wholesale, 25% network, 19% operating, 15% environmental/social and 5% VAT costs

Domestic dual fuel bill breakdown of large legacy suppliers customers (£)



Notes: From 2013, direct costs is divided into network costs, policy costs and other direct costs  
EBIT is Earnings before interest and taxation

Source: Ofgem, [Retail Market Indicators](#) (Large legacy suppliers: Domestic dual fuel bill breakdown over time)

## 2

# Reform of the energy market

Price controls for domestic energy consumers were introduced during privatisation of the electricity and gas companies from the mid-1980s and early-1990s. These price controls were removed in the British market several years after the introduction of competition for domestic consumers in the late 1990s.

Controls on energy prices, through the implementation of price caps were introduced recently, as outlined below.

### 2.1

## Investigations into the energy market – the CMA review

With growing political pressure, in 2014 Ofgem referred the energy market to the Competition and Markets Authority (CMA) as there were concerns it was not working as effectively as possible for consumers.

This was not the first time the energy market had been under review. In 2008, when the big six raised their energy prices between 8% and 17% following sharp rises in wholesale costs, the then Business and Enterprise Committee launched an inquiry into energy prices, fuel poverty and Ofgem. The committee's report criticised the functioning of energy markets, saying the gap between companies' direct debit tariffs, and those for prepayment meters (PPMs) had been widening, showing failing competitiveness.<sup>9</sup>

Shortly after the committee announced its inquiry, Ofgem launched an Energy Supply Probe to investigate competition in the energy markets. The probe found that although there was no evidence of active collusion, the market was not working in the best interests of consumers.<sup>10</sup> Ofgem responded with measures aimed at improving consumer engagement and addressing price differentials.

However, two years later in 2010, Ofgem acknowledged that “many of the barriers to effective consumer engagement remained” and launched another investigation - the Retail Market Review- which led to another series of measures to simplify tariffs and promote switching.<sup>11</sup>

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<sup>9</sup> Business and Enterprise Committee, [Energy prices, fuel poverty and Ofgem](#), Eleventh report of session 2007-08, Vol. 1, 16 July 2008

<sup>10</sup> Ofgem, [Energy supply probe](#) (accessed August 2022)

<sup>11</sup> Ofgem, [Retail Market Review](#), (accessed March 2020)

In 2014, Ofgem worked with the Office of Fair Trading and the CMA on a State of the Market Assessment.<sup>12</sup> They found weak competition between suppliers, arising from “market segmentation and possible tacit coordination”. The assessment said:

these features combine and reinforce each other to deliver poor outcomes for domestic consumers [...] many of these features were identified in the Probe in 2008 and have persisted since then. Some have become worse since the Retail Market Review was carried out in 2011.

Referring the matter to the CMA was intended to be a once and for all investigation as to whether there are further barriers to effective competition. This was because the CMA has more extensive powers that can address any long-term structural barriers to competition.

The CMA published its first set of provisional decisions on remedies on 7 July 2015 and planned to publish its final report in December 2015. Due to the volume of evidence and comments on its original findings and provisional remedies, the CMA extended the inquiry to the statutory deadline. The CMA published its final report<sup>13</sup> in June 2016.

More information on reform is available in the 2017 House of Commons briefing, [The Current Energy Market Reforms in Great Britain](#).<sup>14</sup>

## 2.2

### Key findings from the CMA review

The CMA’s key findings for domestic consumers were:

- Around 70% of the domestic customers of the ‘big six’ were still on an expensive ‘default’ standard variable tariffs (SVT)
- These customers could potentially save over £300 by switching to a cheaper deal
- Customers could have been paying about £1.4 billion a year more than they would in a fully competitive market.

The principal remedies proposed by the CMA to address these challenges were:

- Ordering suppliers to give Ofgem details of all customers who have been on their default tariff for more than years, to be put on a secure database under Ofgem control to allow rival suppliers to contact customers.

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<sup>12</sup> OFT, Ofgem, CMA, [State of the Market Assessment](#), 27 March 2014

<sup>14</sup> House of Commons Library, [The Current Energy Market Reforms in Great Britain](#), 15 March 2017

- Introducing a temporary price control to protect customers on prepayment meters, whose options are more limited, which would reduce their bills by a total of £300 million a year.
- Enabling price comparison websites to play a more active role in helping customers find the best offers and give access to meter data which will enable customers to search instantly for deals.

On the Regulatory Framework the CMA's proposals included:

- Giving Ofgem much greater influence over the detailed codes that govern the working of the market. These codes currently give undue influence to established industry participants over decisions that affect competition and consumers
- Giving more powers to enable Ofgem to scrutinise the performance of the market and suppliers as well as the impact of policy

On implementation, the following have been achieved:

- A series of orders based on the recommendations were published on 14 December 2016.<sup>15</sup>
- Price caps for pre-payment meters were introduced and the cap was extended to certain vulnerable customers through a 'safeguard tariff' (see section 3 for details).<sup>16</sup>
- In 2019, Ofgem decided to not introduce the database of customers who have not switched in three years. This followed the results of a review which it said showed that there may be "more effective ways of enabling the necessary data to be shared."<sup>17</sup>
- On 28 November 2016, Ofgem modified gas and electricity suppliers' standard licence conditions to remove the four-tariff rule<sup>18</sup> to allow more tariffs for consumers to choose from.
- Also on 28 November 2016, Ofgem published an energy supplier league table to increase transparency on the number of people on expensive standard variable tariffs.<sup>19</sup>
- In January 2017, Ofgem launched a Supplier Cost Index<sup>20</sup>. The aim is to increase transparency in the energy market and help consumers understand what is behind trends in prices.

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<sup>15</sup> GOV.uk, [Energy Market Investigation](#), (accessed August 2022)

<sup>16</sup> Ofgem, [Prepayment meter price cap](#), (accessed March 2020)

<sup>17</sup> Ofgem, [Letter: Energy Customer Database](#), September 2019

<sup>18</sup> A rule that energy suppliers could only put four core tariffs on the market.

<sup>19</sup> Ofgem, [Standard variable tariff comparison](#), 28 November 2016

<sup>20</sup> Ofgem, [Supplier Cost Index](#), 19 January 2017

- In July 2017, Ofgem announced it would go forward with proposals set out in the Confidence Code Review and consult on new Confidence Code wording to help address concerns consumers had on whether to trust the results of Price Comparison Websites. On 1 September 2017 Ofgem updated the Confidence code.<sup>21</sup>
- Since 1 September 2017, energy supplier must make all their electricity single-rate tariffs available to all domestic customers on restricted meters. Switching to these tariffs cannot be made conditional on a restricted meter being replaced.<sup>22</sup>
- In October 2017, Ofgem announced customers reaching the end of fixed term contracts who had not actively chosen a new tariff, could be rolled onto another fixed term tariff so long as the new tariff met customer preferences, had no early termination fees, and was equivalent or lower in price than the standard variable tariff.<sup>23</sup>
- In November 2017, Ofgem announced its proposals for improving customer data to make switching easier for customers.<sup>24</sup>
- In July 2018, Ofgem announced it would remove the “whole of market” requirement that meant accredited price comparison websites had to display deals that were not offered directly through the site. This change was to incentivise energy suppliers to work with accredited comparison sites.<sup>25</sup>

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<sup>21</sup> Ofgem, [Publication of the new Ofgem Confidence Code](#), 1 September 2017

<sup>22</sup> Gov.uk, [Energy Market Investigation \(Restricted Meters\) Order 2016](#), 14 December 2016

<sup>23</sup> Ofgem, [Decision: Default tariffs for domestic customers at the end of fixed-term contracts](#), 11 October 2017

<sup>24</sup> Ofgem, [Open letter: improving customer data and database remedy](#), 13 November 2017

<sup>25</sup> Ofgem, [Decision on implementing the CMA’s recommendation to remove the Whole of Market requirement](#), 16 July 2018

### 3

## The introduction of tariff caps

A price cap is a form of limiting bills or tariffs; it can either be a total limit, a limit on companies' profits, or a limit on the difference between the cheapest and most expensive deal.

After privatisation, no tariffs were capped. Following the 2014 CMA review, Ofgem introduced the pre-payment meter cap which applied only to customers on pre-payment meters.

Under pressure to go further, Ofgem introduced a tariff cap known as the safeguard tariff for customers on the Warm Home Discount scheme, who are considered vulnerable. Following more political pressure, the Tariff Cap Act 2018 required Ofgem to introduce a default tariff cap. Customers on the safeguard tariff were transferred to protection under the new default tariffs, and the pre-payment meter cap has also merged with the default cap. Customers with actively chosen fixed term deals, will not have their prices capped, though these deals have, in the past, been of better value than the level of the cap.

The cap currently in force sets an absolute cap on the price **per unit** of energy on domestic default electricity and gas tariffs in Great Britain. It is not an overall cap on what a total customer's bill can be. The savings for individual customers will depend on how much energy they use – i.e. if a customer consumes more energy, their bill will still increase.

Customer bills will also vary based on whether they have both gas and electricity and how they pay for their energy. Ofgem's present cap level is based on a "typical" household with average consumption, paying by direct debit, the default cap when first introduced was £1,137 a year.

It is important to note that not all GB customers are protected by tariff caps. As set out above, the Government has implemented three forms of price caps (though all have now been merged into the Default Tariff cap):

- **Prepayment meter (PPM) cap** – for customers with prepayment meters (expired on 31 December 2020 with customers protected by the Default tariff cap)
- **The Safeguard tariff** – for customers who receive the Warm Homes Discount benefit – this merged with the Default Tariff cap at the start of 2019
- **The Default Tariff cap** – for customers on default or Standard Variable Tariffs – this came into force from 1 January 2019. Originally intended to

end in 2020, it has been extended and the [Government has made provision in the Energy Bill](#) to extend the tariff cap beyond 2023.

The context and implementation of these caps is described in more detail in the annex to this briefing.

More information is available from Ofgem's webpages on [Energy Price Caps](#).

## 4

# Ofgem and setting the cap

The levels of the default tariff cap are set by the energy regulator Ofgem. The cap sets an absolute, top-level price per unit of electricity and gas. The intention is that the cap should be low enough to protect vulnerable customers, but high enough to encourage suppliers to offer tariffs below the level of the cap, to maintain competition and incentivise switching.

However, recent unprecedented increases in wholesale gas and electricity prices, and associated tariff rises, have meant the price cap has gone from one of the more expensive tariffs in the market, to one of the cheapest available. Currently, 24 million households are on tariffs protected by the cap.<sup>26</sup>

### 4.1

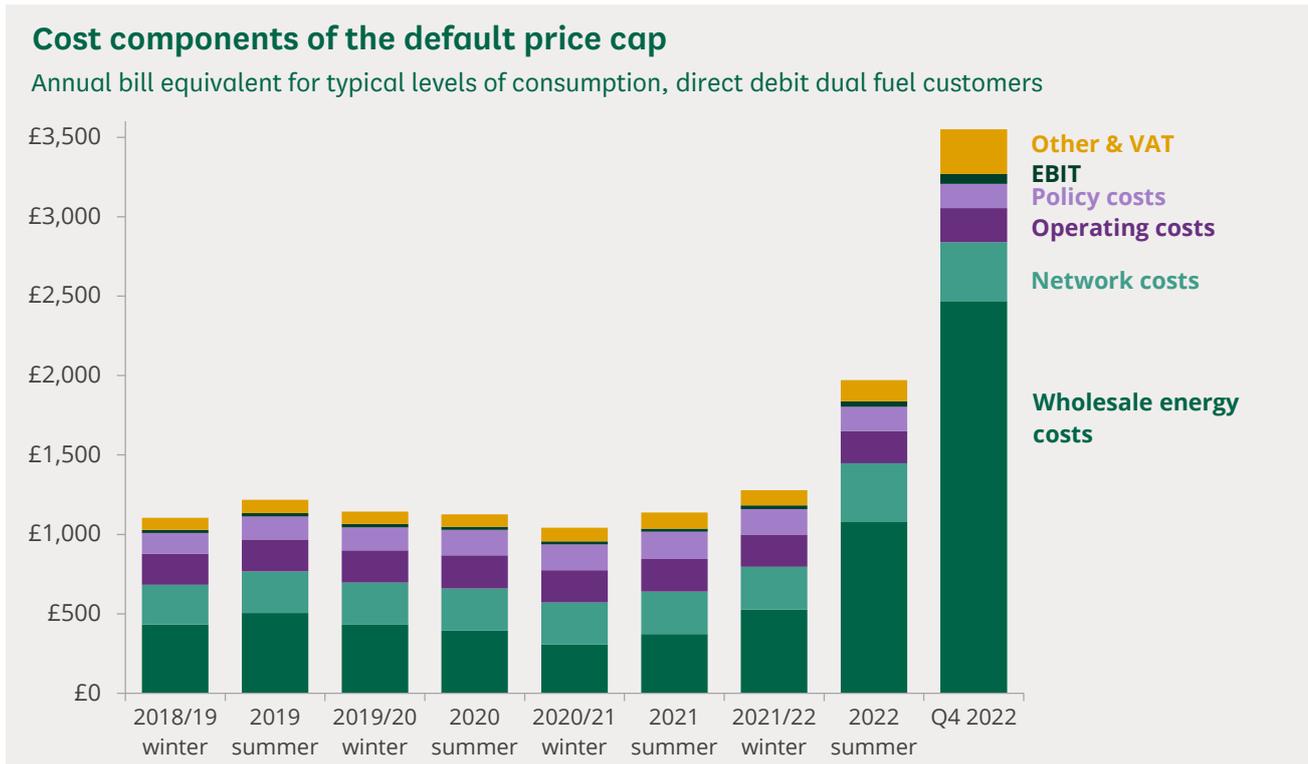
## Components of the price cap

Ofgem sets the price cap using its own estimates of the different costs that suppliers will face in the upcoming price cap period. These mainly consist of the wholesale cost of gas and electricity, network costs, supplier operating costs and the costs of government policy which are passed on to customers. It adds an element for supplier profit (Earnings Before Interest and Taxation or EBIT) of just over 1.9% of revenue. Finally, VAT is added at 5%.

The following chart shows the cost elements that Ofgem has used to set the default tariff cap since it was introduced. These should be seen as its best estimates of the costs that suppliers will face in the next review period.

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<sup>26</sup> Ofgem, [Ofgem confirms changes to the price cap methodology and frequency ahead of new rate to be announced later this month, 4 August 2022](#)



Source: [Retail market indicators](#) (Breakdown of the default tariff price cap), Ofgem

## Wholesale energy costs

Ofgem has said that record gas prices and the knock-on effect on electricity prices were largely responsible for the size of the increases in both the summer 2022 and Q4 2022 price caps.

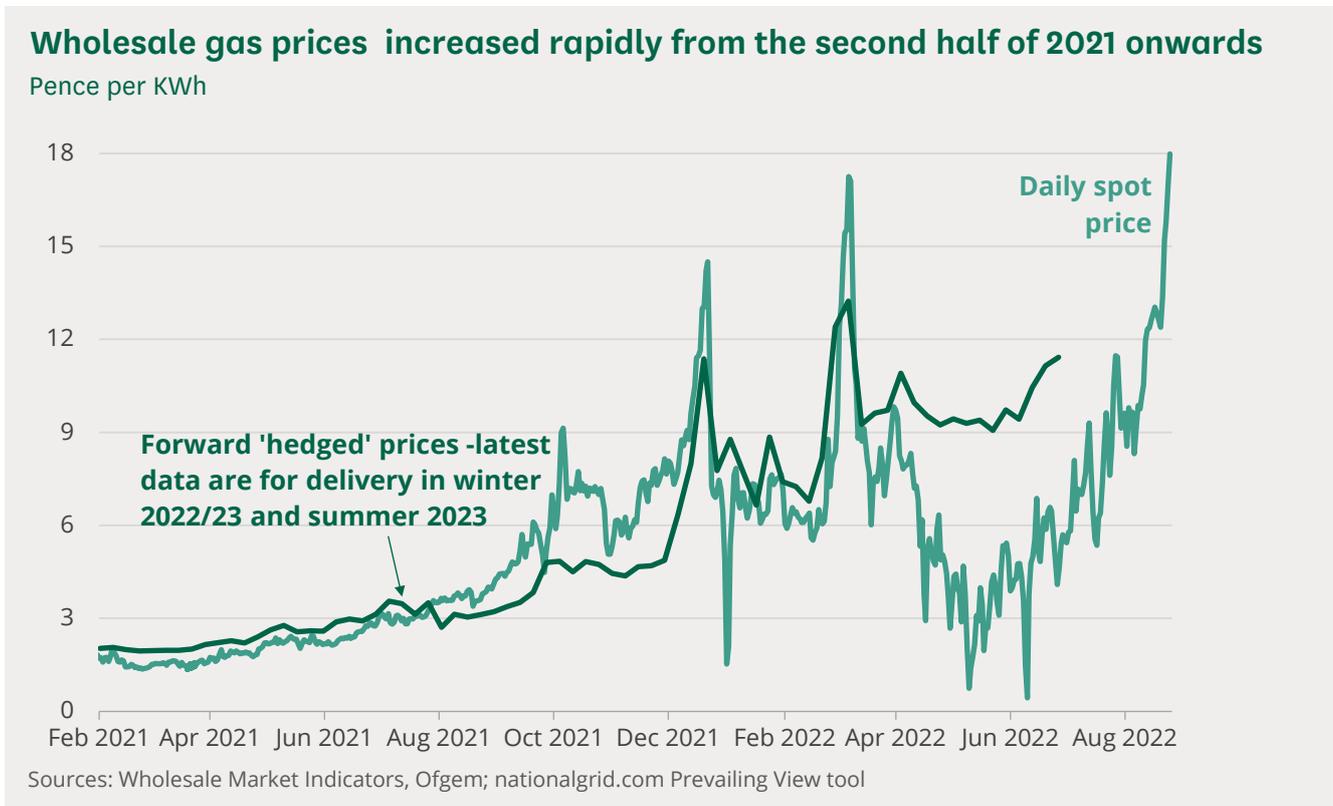
Daily spot prices on the wholesale market are highly volatile. To protect themselves from variations in prices, energy suppliers can ‘hedge’ their energy purchasing through forward-looking contracts. This means that rather than buying gas or electricity on the spot market for immediate delivery and being exposed to whatever the price may be, suppliers access the market continually, buying some energy up to years in advance. This ‘hedging’ means suppliers are less exposed to market fluctuations.

### 1 Hedging

[Hedging in the energy market](#) is when energy suppliers buy smaller quantities of energy intermittently and in advance, to match the predicted demand of their customers, instead of buying in one lump sum. Buying in advance can protect suppliers from unexpected price surges as wholesale energy prices fluctuate (for example due to external factors such as supply and demand, political tension, natural disasters, and any other unforeseen circumstance). As such, [Ofgem recognises](#) how hedging can assist “efficient suppliers” in offering competitive prices to customers.

However, if the amount of energy purchased in advance does not match the energy demand of their customers, energy suppliers encounter financial risks by having to buy or sell energy at real-time market prices in order to match this demand. These real-time prices may differ significantly to the price the suppliers paid for energy purchased in advance. This can result in a net financial loss for energy suppliers (for example, if they must sell excess energy at a loss).

Ofgem analyses forward-looking energy contracts that suppliers purchase for gas and electricity. The prices of gas in these contracts are shown in the following chart alongside the daily spot price.<sup>27</sup> While the forward prices are much less volatile than spot price, they have still increased to record levels and recent falls in the spot price of gas have not been matched by falls in the forward price.



Sources: [Wholesale Market Indicators](#) (Wholesale Forward Delivery Contracts Price Trends) Ofgem; nationalgrid.com [Prevailing View tool](#)

## Network costs

Network costs are intended to cover the costs that suppliers must pay to transmission and distribution networks for gas and electricity. However, the summer and Q4 of 2022 caps also includes an additional charge to cover 'Supplier of Last Resort' levy costs. These costs are faced by suppliers who

<sup>27</sup> These are indicative values published by Ofgem. It does not publish the actual values it uses which are said to be 'proprietary'

have taken on customers from the many smaller suppliers that have gone out of business in recent months. This made up £68 of the summer and £61 of the Q4 2022 caps. In effect, these are indirect costs of higher wholesale prices that customers have to pay.

Overall network cost estimates increased by almost 40% from £268 in the winter 2021/22 cap calculations to £371 in the summer 2022 cap. They increased slightly to £372 in the Q4 2022 cap.<sup>28</sup>

## Policy costs

Policy costs, which are additional costs for consumers because of government policies, made up £152 or just 4% of the Q4 2022 cap. Ofgem has excluded the costs of Contracts for Difference from policy costs in the latest cap. This support scheme is expected to repay money in Q4 2022 and hence reduces the level of the cap. If this is included in policy costs it becomes £129 or 3.6% of the cap. Policy costs have fallen in each of the last four caps. They cover the following policies:

- [Renewables Obligation](#): supports large scale renewable generation, paid on electricity bills
- [Feed-in Tariff](#): supports small scale renewable generation, paid on electricity bills
- [Contracts for Difference](#): (CfD) supports large scale low carbon generation, paid on electricity bills
- [Energy Company Obligation](#) (ECO): supports energy efficiency measures in homes, paid on gas and electricity bills
- [Warm Homes Discount](#): provides a discount to vulnerable households, paid on gas and electricity bills
- [Assistance for Areas with High Electricity Distribution Costs](#): paid on electricity bills
- [Green Gas Support Scheme and Green Gas Levy](#): funds the Green Gas Support Scheme, paid on gas bills

The largest element of this is the Renewables Obligation which adds around £75 to the Q4 2022 price cap. The ECO scheme is next largest at around £36 per customer.

The overall fall in policy costs is due to a fall in the costs of CfD. Generators receive support under CfD if wholesale electricity falls below an agreed level. They return money to the scheme if wholesale prices are above this level. Higher wholesale power prices meant the costs of the CfD element of the cap fell from £22 per customer in the winter 2021/22 to nearly zero in the summer

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<sup>28</sup> Ofgem, [Ofgem updates price cap level and tightens up rules on suppliers](#) (26 August 2022)

2022 cap. Forecasts of payments from generators to suppliers in Q4 2022 have cut the cap by £23 per customer in Q4 2022<sup>29, 30</sup>

Policy costs (excluding CfD repayments) make up 7.1% of the Q4 2022 price cap for electricity, 1.8% for gas and 4.73 for a dual fuel bill with 'typical' consumption levels.<sup>31</sup>

The Institute for Fiscal Studies has used a different methodology to estimate the total policy cost to customers in Q4 2022. This looks at costs in this quarter only, rather than cap calculations which look at annual consumption. They show that the expected £3 billion in repayments from CfD means that total policy costs for October to December will be just £11 or 1% of the total £1,080 for use in those months.<sup>32</sup>

## Operating costs

Operating costs cover billing, metering, customer relations, central overheads, office costs, industry charges, sales and marketing. They represent £214 of the cap level in Q4 2022 or 6.0%. Total operating costs have changed little since the cap was introduced.

## Supplier profit margins

The price cap methodology allows for an operating profit or Earnings Before Interest and Taxation (EBIT) for suppliers of 1.94% of revenue. This represents £63 per household of the Q4 2022 cap level.

This does not mean that suppliers will earn this rate of return. Their actual profit depends on the **actual** costs they face. Ofgem data on profit margins showed that only one of the large legacy suppliers (British Gas) made a profit on domestic energy supply in either 2019, 2020 or 2021.<sup>33</sup>

However, most **supply** companies also have electricity **generation** businesses which have generally performed better and benefited from high wholesale prices, with some particularly high profit margins in 2020.<sup>34</sup> The record high

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<sup>29</sup> [Default tariff cap level: 1 October 2022 to 31 December 2022](#) (Annex 4 – Policy cost allowance methodology v1.13), Ofgem, 3 February 2022

<sup>30</sup> The Library briefing [Support for low carbon power](#) (April 2020) explains payments under the Contracts for Difference scheme.

<sup>31</sup> Ofgem states that typical domestic consumption is 2,900kWh of electricity and 12,000kWh of gas for a dual-fuel household, and 4,200kWh of electricity for a household with an Economy 7 tariff. Ofgem press release, [Price cap to increase by £693 from April](#), 3 February 2022; [Decision on revised Typical Domestic Consumption Values for gas and electricity and Economy 7 consumption split](#), Ofgem, 6 January 2020

<sup>32</sup> IFS, [Cost of maintaining household support package rises by £14bn in light of new energy price cap](#) (26 August 2022)

<sup>33</sup> [Retail market indicators](#) (Pre-tax supply margins of the large legacy suppliers), Ofgem

<sup>34</sup> [Wholesale market indicators](#) (Large suppliers: Electricity generation profitability by technology type), Ofgem

power prices in late 2021 and early 2022 suggest that profits on generation will continue to remain high, particularly for renewables<sup>35</sup> and nuclear power.

## 4.2 The assessment process

From August 2019, Ofgem has used a bottom-up assessment approach for setting all the caps, which includes an estimate of efficient allowances for each cost category of a bill.<sup>36</sup> As the caps include network costs, the level of the cap varies between different regions, for example the network costs of the bill are higher in some rural areas.<sup>37</sup> Up until now, the caps have been updated twice annually, in April and October. Ofgem has announced that updates will take place every three months from October 2022.

The cap comprises several allowances to reflect changes in the underlying market.

The Tariff Cap Act does not include a route for suppliers to appeal against the level of the cap. Though this was a subject for debate during the passage of the Bill, the Government agreed with the recommendations of the BEIS Committee that appeals would slow the implementation of the cap. Suppliers can dispute the level of the cap through judicial review.<sup>38</sup>

## 4.3 Changes to the price cap methodology

In October 2021, Ofgem wrote an open letter to energy companies setting out its plans to consult on the price cap methodology “to ensure it appropriately reflects the costs, risks and uncertainties facing suppliers”.<sup>39</sup> The letter set out the regulator’s concerns about instability and a lack of resilience in the energy market, and also proposed wider reforms of the regulation of the market.

Between November 2021 and August 2022, Ofgem published a number of consultations on proposed changes to the tariff cap.

In November 2021, Ofgem consulted on five matters related to cap reform:

- [Consultation on the potential impact of increased wholesale volatility on the default tariff cap](#)

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<sup>35</sup> Those supported by the Renewables Obligation as generators supported by Contracts for Difference repay any revenue over an agreed ‘strike price’ per MWh of generation.

<sup>36</sup> Ofgem, [Default tariff cap: decision - overview](#), November 2018

<sup>37</sup> For more information on networks, see the Library briefing paper on [Electricity Grids](#), January 2019.

<sup>38</sup> House of Commons Library, [The Domestic Gas and Electricity Tariff Cap Act 2018](#), 17 August 2018

<sup>39</sup> Ofgem, [Rising wholesale energy prices and implications for the regulatory framework, 29 October 2021](#)

- [Consultation on the process for updating the default tariff cap methodology and setting maximum charges](#)
- [Consultation on the true-up process for Covid-19 costs](#)
- [Consultation on reflecting prepayment End User Categories in the default tariff cap](#)
- [Consultation on Energy Company Obligation scheme allowance methodology in the default tariff cap](#)

In May 2022, Ofgem published [a statutory consultation](#) on making the changes to the price cap, including changing how often the cap is assessed, and a shortened notice period for suppliers.

Alongside consultations on the cap methodology, Ofgem also consulted on a range of short terms measures to improve the resilience of the energy supply market. More information on this is provided in box 2 below.

## 2. Improving the resilience of the energy supply market

From 15 December 2021 to 17 January 2022, [Ofgem consulted on a range of short-term measures](#) which could be used to intervene in the GB energy market when wholesale market volatility created risks to domestic energy suppliers and customers. The consultation proposed an “enhanced regulatory approach to ensure energy suppliers pursue sustainable business models, minimising risks to customers and the market”. Its objectives were to “create a market where energy suppliers are financially resilient, so that risks are not inappropriately passed to consumers.”<sup>40</sup>

Following the first consultation, [two new measures were introduced](#) on 16 February 2022, which came into effect on 14 April 2022:

- A requirement for suppliers to make all tariffs available to new and existing customers (in effect a ban on acquisition-only tariffs); and
- A requirement for suppliers to pay a Market Stabilisation Charge when acquiring new customers if wholesale prices fall below a set threshold.<sup>41</sup>

The aim of the measures is to protect suppliers who have hedged in line with the price cap from incurring major losses. This is expected to reduce the risk of suppliers failing, which will in turn protect customers from the increased costs associated with supplier failure. (For an explanation of hedging, see section 4.1, box 1; for information on the cost of supplier failure, see section 1.2.)

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<sup>40</sup> [Action plan on retail financial resilience \(ofgem.gov.uk\)](#)

<sup>41</sup> Ofgem, [Decision on short-term interventions to address risks to consumers from market volatility](#), 16 February 2022

## Market stabilisation charge

The market stabilisation charge (MSC) aims to reduce “the risk of costly supplier failures and make sure firms buying energy in advance for their customers aren’t penalised if wholesale prices fall sharply.”<sup>42</sup>

The MSC will only apply if wholesale prices fall significantly below the level assumed in the price cap. In this case, GB energy suppliers that acquire new domestic customers will have to pay the charge to the supplier that is losing the customer. The amount paid represents a proportion of the economic loss to the losing supplier, for the energy it had already purchased on behalf of the customer. It will be based on the customer’s estimated annual energy use.

The MSC will only be triggered if wholesale energy prices fall to 10% below (ie 90% of) the wholesale prices used to set the energy price cap. The new (gaining) supplier will have to pay the old supplier 85% of the costs it had incurred by purchasing energy in advance on behalf of the customer. These parameters were originally proposed at a fall of 30% and 75% of the costs incurred, but changed following [a further consultation in April 2022](#).

Ofgem intends for suppliers to pass on the costs of a MSC to consumers via retail tariffs. When wholesale prices drop, the MSC mechanism means that retail prices available to customers from GB energy suppliers are unlikely to reflect the wholesale market decrease. There has been criticism from consumer organisations that this measure will mean a reduction in the benefits of “switching” for consumers when wholesale prices are lower. For example, in response to the Ofgem consultation on changing the parameters of the MSC calculation, [Citizens Advice, an independent consumer advice charity](#), criticised the proposals put forward:

We do not support your proposals to reduce the losing supplier trigger from 30% to somewhere in the 10-20% range and to increase the derating factor from 75% to somewhere in the 80-90% range. The effect of these proposals would be to reduce the available savings from switching, were wholesale prices to fall sharply, at a time when the need for consumers to find ways to save money on their energy costs is extremely acute.<sup>43</sup>

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<sup>42</sup> Ofgem, [Decision on short-term interventions to address risks to consumers from market volatility](#), 16 February 2022

<sup>43</sup> [Response to Ofgem consultation on changes to the Market Stabilisation Charge](#), Citizens Advice, 14 April 2022

## 4.4

## What changes are being made to the price cap?

In August 2022, Ofgem announced that, following consultation, it was making changes to the price cap and its methodology, to come into force from 1 October 2022, including:

- Moving to a quarterly review of the price cap, from the current six-monthly assessment;
- A shortened notice period between announcing the cap level and implementing it; and
- The inclusion of backwardation costs in the methodology (see box 4 below).<sup>44</sup>

### 4. Backwardation

Backwardation is when the current price of an **asset** is higher than the price in the futures market. Normally, seasonal changes in energy prices mean that any costs to the energy supplier will balance out over the year. However, suppliers have accrued costs due to the more volatile market overall recently

Ofgem is therefore introducing an allowance for exceptional backwardation costs. The changes to this, due to come into force in October 2022, will allow suppliers to recover backwardation costs within a six-month period. The investment bank, Investec estimates this change will increase the price cap by around £131 for October and £504 for January.<sup>45</sup>

Ofgem explained that the changes were needed to provide some stability to the energy market and reduce the risk of further supplier failures and the large associated costs to consumers. It said it “is not in anyone’s interests for more suppliers to fail and exit the market.”<sup>46</sup>

The regulator explained that, while the price cap will increase, the changes it was making mean that when wholesale prices fall, these reductions can be passed on to consumers more quickly. It said that, on balance, the reduction in the risk and costs associated with further supplier failure was more beneficial to consumers than not making the changes.

<sup>44</sup> Ofgem, [Ofgem confirms changes to the price cap methodology and frequency ahead of new rate to be announced later this month](#) | 4 August 2022

<sup>45</sup> Utility week, [Price cap forecast to hit £4,200 following Ofgem update, 5 August 2022](#)  
[Current News, Price cap could pass £4,200 in January, says Investec](#), 8 August 2022

<sup>46</sup> Ofgem, [Ofgem confirms changes to the price cap methodology and frequency ahead of new rate to be announced later this month](#) | 4 August 2022

The CEO of Ofgem, Jonathan Brearley said the trade-offs that Ofgem needed to make were very difficult but that the changes would ensure the price cap does its job:

I know this situation is deeply worrying for many people. As a result of Russia's actions, the volatility in the energy markets we experienced last winter has lasted much longer, with much higher prices than ever before. And that means the cost of supplying electricity and gas to homes has increased considerably.

The trade-offs we need to make on behalf of consumers are extremely difficult and there are simply no easy answers right now. Today's changes ensure the price cap does its job, making sure customers are only paying the real cost of their energy, but also, that it can adapt to the current volatile market.

We will keep working closely with the Government, consumer groups and with energy companies on what further support can be provided to help with these higher prices.<sup>47</sup>

## 4.5

### Responses to changes in the tariff cap methodology

Consumer groups and charities, such as the End Fuel Poverty Coalition, are concerned about how the decision to move to quarterly cap assessment will affect energy bills. They have highlighted that households already struggling with energy prices will be hit twice with higher prices over the winter and have described the decision as “inhumane.” The End Fuel Poverty Coalition has called on the Government to provide more support:

Households will face a two-stage cost of living crisis this winter, thanks to Ofgem's confirmation that energy bills will go up in October and again in January.

From October, millions of families across the country will face the real prospect of skipping meals to pay for energy, older people will shut themselves into one room to save on heating and disabled people will be unable to afford to charge vital equipment, such as electric wheelchairs.

Then in January, they will be asked to pay even more for their energy.

Ultimately, this decision will force more people into fuel poverty in the middle of winter, causing additional stress on the NHS and it may

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<sup>47</sup> Ofgem, [Ofgem confirms changes to the price cap methodology and frequency ahead of new rate to be announced later this month | 4 August 2022](#)

ultimately lead to increased levels of excess winter deaths this year. It is simply inhumane.

It's clear that the Government and the [Conservative Party leadership hopefuls](#) just don't get the scale of the problem facing the country, nor the public anger at rising bills. They are running out of time to act.

Only a full programme of emergency financial support, a rapid expansion of energy efficiency programmes and a commitment to bringing more cheap renewable energy on stream will help people stay [warm this winter](#) and into the future.<sup>48</sup>

Citizens Advice said it supported a move to quarterly reviews of the cap but agreed that more support for vulnerable customers was needed:

With the cost of energy only going in one direction right now, many will be worried by the idea of seeing even more frequent price changes.

Something that's added to all our bills is the cost of supplier failures. Changing to a quarterly price cap should limit the risk of any more suppliers going bust, which is a good thing. But our bills are already incredibly high and still rising.

The government was right to bring in financial support for people, but it may not be enough to keep many families afloat. It must be ready to act again before winter draws in.

Ofgem must make sure suppliers are helping customers who are struggling to pay. It should hold energy companies to account so people aren't chased by debt collectors or pushed onto prepayment meters when they can't keep up with bills.<sup>49</sup>

The Joseph Rowntree Foundation has analysed the price cap and its projected increase on different types of household. It found that low-income single adult households could see their energy bills rise to 120% of their income after housing costs, "leaving many destitute". It also found the energy bills of single parent families would rise to almost two-thirds of their income after housing costs. Peter Matejic, Chief Analyst said:

In all my years as an analyst, I haven't double-checked a piece of analysis as much as this one because it is so staggering, it feels incorrect. It is impossible to think a care worker or a shop assistant will have to scramble to find hundreds more pounds to pay for their heating or that the entirety of someone's income for a whole year will be less than their energy bill.

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<sup>48</sup> End Fuel Poverty Coalition, [Decision on January price increase branded inhumane, 4 August 2022](#)

<sup>49</sup> Citizens Advice, [Changing to a quarterly price cap will help prevent suppliers going bust, but more support is needed for people struggling to pay their bills, 4 August 2022](#)

Ministers have a choice about who shoulders most of the burden – families, businesses or the public finances. Whoever occupies number 10 next will be remembered for who they protect - they must make sure energy doesn't become a luxury only the wealthy can afford.<sup>50</sup>

In its report, [Energy pricing and the future of the Energy Market](#), the Business, Energy and Industrial Strategy (BEIS) Committee welcomed the decision to move to more regular (quarterly) assessments on the cap, but noted the serious concerns from consumer groups and charities about the impact on vulnerable customers. It called on Ofgem to:

update the cost benefit analysis of its proposal for a quarterly price cap, so it reflects the risk of prices increasing this January, in order for Ofgem, the Government, and Parliament to fully understand the potential impacts for vulnerable customers.<sup>51</sup>

In August, following announcements about changes to the cap, a non-executive director of Ofgem, Christine Farnish, resigned. It has been reported that Christine Farnish said this was because she did not believe that Ofgem had “struck the right balance between the interests of consumers and the interests of suppliers.”<sup>52</sup>

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<sup>50</sup> Joseph Rowntree Foundation, [Stratospheric energy bills will completely wipe out incomes for low income households - new JRF analysis, 26 August 2022](#)

<sup>51</sup> Business, Energy and Industrial Strategy Select Committee, [Energy pricing and the future of the Energy Market](#), Third Report of Session 2022–23, 19 July 2022

<sup>52</sup> Emily Gosden, [Ofgem director Christine Farnish quits in protest over energy price cap, The Times, 17 August 2022](#)

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## 5 Commentary on the price cap

### 5.1 When the cap was introduced in 2018

According to its proponents, a cap protects consumers who don't switch from tariffs which do not reflect the true cost of energy.<sup>53,54</sup> According to its opponents, a cap damages competition in the market by removing the incentive to switch, and risks underinvestment in infrastructure.<sup>55</sup>

In response to the 2018 cap announcement, the industry trade body Energy UK's Chief Executive, Lawrence Slade, said the cap would "present a significant challenge" for many suppliers already facing rising costs, "the vast majority of which are out of their direct control, at a time when the market is more competitive than ever".<sup>56</sup>

However, the consumer charity Citizens Advice welcomed the cap, while warning that customers could still get a better deal by switching or investing in energy efficiency:

This price cap will finally offer some much needed protection for loyal households on default tariffs, who have been exploited for too long.

While the cap will mean that people pay a fairer price, it will not be the best deal on the market. By shopping around and changing tariff or supplier, people are likely to be able to make much greater savings on their energy bills.

Households may also be able to reduce their bills and make long-term savings by improving the energy efficiency of their homes. Simple steps, such as better insulation or heating controls, are a good place to start.<sup>57</sup>

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<sup>53</sup> HL Deb 3 July 2017 [c742](#); HC Deb 16 March 2017 [c597](#) and [c602](#)

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<sup>55</sup> HL Deb 3 July 2017 [c743](#)

<sup>56</sup> Energy UK, [Energy UK responds to Ofgem's price cap announcement](#), 6 November 2018

<sup>57</sup> Citizens Advice, [Energy price cap "offers some much needed protection for loyal households", says Citizens Advice](#), 6 November 2018

## 5.2

## Responses and commentary following the energy crisis

Recent price cap changes have led to significant increases in energy bills for consumers and concerns about the impact on vulnerable households, particularly those in fuel poverty, who might not be able to heat their homes properly. The most recent forecast from the consultancy, Cornwall Insight estimates the average annual price for energy will be £5,386 by January 2023.<sup>58 59</sup>

In response to rising prices, there has been discussion about the future of the price cap, whether it is fit for purpose, what alternative approaches to price regulation could replace it and what help can be provided to customers to mitigate the impacts of higher bills.

A 2022 BEIS Committee Inquiry looked at the current issues in the energy market and energy pricing. Its report, [Energy pricing and the future of the Energy Market](#), showed there were conflicting views on the performance of the cap even when the market had been stable. Some representatives of the energy suppliers told the Committee the price cap had “contributed to a structurally loss-making market”. Whereas others said that in stable conditions “sufficient margins are ‘baked’ into the price cap to allow for healthy competition between efficient companies”, and that price protections should remain in place to protect consumers until there is sufficient competition in the market.<sup>60</sup>

However, the report found there was agreement on both sides “that the price cap was not designed to cope with price volatility and contributed to recent market instability.” The Committee heard from Ofgem that the cap’s design “forced suppliers to subsidise customers in response to wholesale price increases” which had placed a strain on suppliers.<sup>61</sup>

Following the announcement of the increase in the cap on 26 August 2022, Cornwall Insight’s, senior consultant, Dr Craig Lowery, called for the cap to be reviewed:

With every unprecedented rise in bills comes the need for greater reflection on the cap’s purpose and continued place in the energy market. Throughout the energy crisis, the government and Ofgem have remained committed to the cap and in its ability to shield consumers from a volatile

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<sup>58</sup> Cornwall Insight, [Cornwall Insight comments on the announcement of the October price cap, 26 August 2022](#)

<sup>59</sup> More information on domestic energy prices and recent increases in bills is provided in the Library paper, [Domestic energy prices](#).

<sup>60</sup> Business, Energy and Industrial Strategy Select Committee, [Energy pricing and the future of the Energy Market](#), Third Report of Session 2022–23, 19 July 2022

<sup>61</sup> Business, Energy and Industrial Strategy Select Committee, [Energy pricing and the future of the Energy Market](#), Third Report of Session 2022–23, 19 July 2022

energy market. However, the cap was never meant to be a permanent solution, was created for a different energy market than the one we face today and has not protected consumers from what will be incredible hardship this winter. We urge, as we have done previously, for the cap to be reviewed and mechanisms for protecting the most vulnerable, such as social tariffs, to be considered as viable alternatives.<sup>62</sup>

He went on to explain that any temporary solutions to rising energy prices must be accompanied by “a focus on implementing a viable long-term solution”:

Today should be seen as a wake-up call to policy makers that short-term thinking and triage of the energy system is not enough. Without real change to the energy system in this country it is consumers, suppliers and the economy that will all continue to suffer the consequences.

## Government response

In response to higher energy bills, the Government has announced support for customers, including the Energy Bills Support Scheme which provides a £400 grant to domestic electricity customers and a council tax rebate of £150 for homes in council tax bands A-D. More information about this support is provided in the Library briefing, [Energy Bills Support Scheme: Government policy and FAQs](#). The IFS has reported that, at the time the support package was introduced in May 2022, it represented around three quarters of the rise in energy costs expected but with “the energy price cap for the coming 3 months now much higher than expected, it will now only cover 47% of the rise in bills”<sup>63</sup>

The Sunday Times has reported that the Chancellor, Nadhim Zahawi, has asked officials to work on a package of measures to reduce the price cap by around £400 from January 2023.<sup>64</sup> An article published on 14 August said the proposals would remove recently added costs from the price cap and fund them through a government backed scheme. These plans are reportedly being prepared in time for consideration by the future Prime Minister.

On 26 August, in response to the Ofgem announcement of an 80% increase in the cap from October, Mr Zahawi said that the Government was “working flat out” to develop a new support plan for customers which would mean “the incoming prime minister can hit the ground running and deliver support to those who need it most, as soon as possible.”<sup>65</sup>

Conservative leadership candidate, and former Chancellor, Rishi Sunak has proposed a temporary removal of VAT on energy bills if prices rise in October.

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<sup>62</sup> [Cornwall Insight comments on the announcement of the October price cap](#), 26 August 2022

<sup>63</sup> IFS, [Comment: Cost of maintaining household support package rises by £14bn in light of new energy price cap](#), 26 August 2022

<sup>64</sup> [Harry Yorke, Tim Shipman and Oliver Shah, Plan to cut extra £400 off fuel costs, The Sunday Times, 14 August 2022](#)

<sup>65</sup> Reuters, [UK's Zahawi says he is working flat out on energy support plan](#), 26 August 2022

He has also proposed a further package of support for vulnerable households of around £5bn.<sup>66</sup> The Institute for Fiscal Studies has said that if Cornwall Insight's estimates of average energy bills are correct, this measure would save the average household £154 over the year.<sup>67</sup>

Foreign Secretary Liz Truss, the other candidate in the leadership election, has proposed suspending “the green levy” on energy bills and has proposed a cut in National Insurance Contributions.<sup>68</sup> In its analysis of support proposals, the IFS noted that there is no single “green levy” but rather a “patchwork of different policies that increase energy costs for households and businesses” These include subsidies for renewable energy sources and funding for measures such as home insulation. More information about these policy costs is provided in section 4.1.

On 1 September 2022, in an article in the Sun, Liz Truss said that she would also “deliver immediate support to ensure people are not facing unaffordable fuel bills” but would not set out the details of her plans before she had won the leadership election.<sup>69</sup>

Beyond these measures, no reform proposals for the price cap have been made by the Government. The BEIS Committee has reported that “neither the Government nor Ofgem has undertaken an evaluation of [the price cap's] costs and benefits, nor considered alternative forms of price protection”.<sup>70</sup>

However, in response to a Lords debate on provisions to extend the cap beyond 2023 in the Energy Bill, Government spokesperson, Lord Callanan said the price cap remained a temporary measure and that “BEIS is currently considering what reforms are needed for energy retail market regulation to ensure that the market is resilient and sustainable and continues to protect consumers.”<sup>71</sup>

## Freezing the price cap

The Labour Party has proposed freezing the price cap at its current level to prevent significant energy bill rises over the winter. The party proposes funding the plan (estimated to cost £29bn) through an extension to the new Energy Profits Levy<sup>72</sup> (a temporary tax on the profits from North Sea oil and

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<sup>66</sup> IFS, [Comment: Cost of maintaining household support package rises by £14bn in light of new energy price cap](#), 26 August 2022

<sup>67</sup> IFS, [Rishi Sunak's proposal to temporarily remove VAT on energy bills](#), 27 July 2022

<sup>68</sup> Peter Walker and Rowena Mason, [Liz Truss doubles down on refusal to offer support over rising energy bills](#), *The Guardian*, 9 August 2022

<sup>69</sup> Liz Truss, [Britain needs a radical solution to help the cost of living crisis and if I'm made PM I know exactly what I will do](#), 1 September 2022

<sup>70</sup> Business, Energy and Industrial Strategy Select Committee, [Energy pricing and the future of the Energy Market](#), Third Report of Session 2022–23, 19 July 2022

<sup>71</sup> [HL Deb vol 823, 18 July 2022 c1931](#)

<sup>72</sup> For more information on the Energy Profits Levy, see the Library briefings on the [Energy \(Oil and Gas\) Profits Levy Bill 2022-23](#) and the [Taxation of North Sea oil and gas](#).

gas production), halting the Energy Bill Support Scheme and lowering Government interest payments on debt.

The Guardian reported that the [Labour Party leader Keir Starmer](#) had said that under the proposed plan, the price cap would stay at the then current (pre- August increase) level, preventing the increase in energy bills. He set out further detail on the impact of the policy:

Starmer said the country was facing “a national emergency” and that Labour “wouldn’t let people pay a penny more” on energy bills as a result of his “fully funded plan”. A typical family would save £1,000, he claimed.

He said: “Britain’s cost of living crisis is getting worse, leaving people scared about how they’ll get through the winter. Labour’s plan to save households £1,000 this winter and invest in sustainable British energy to bring bills down in the long term is a direct response to the national economic emergency that is leaving families fearing for the future.”<sup>73</sup>

Former Prime Minister, Gordon Brown has also put forward plans to freeze the price cap. In [an article in the Guardian](#) in August 2022, he proposed that the Government freeze the price cap, assess current energy costs and tariffs, work with companies to cut consumption, negotiate separate company agreements and consider all options, including nationalisation as a last resort. He said:

[The Government] should work with businesses to cut consumption, as is happening in France and Spain, which have imposed their own cap on energy prices, dictated more by what people can afford than the current wholesale gas price in the marketplace.

And if the companies cannot meet these new requirements, we should consider all the options we used with the banks in 2009: guaranteed loans, equity financing and, if this fails, as a last resort, operate their essential services from the public sector until the crisis is over.

The Green Party has also expressed support for a freeze in the cap, and the renationalisation of energy suppliers.<sup>74</sup>

## A deficit tariff scheme

Energy suppliers (including E.ON, ScottishPower, Octopus, British Gas, and the energy industry body, Energy UK) have called for a deficit tariff scheme, alongside greater support for consumers through the Energy Bill Support

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<sup>73</sup> Andrew Sparrow and Philip Inman, [Labour announces plan to freeze energy price cap with reinforced windfall tax](#), *The Guardian*, 14 August 2022

<sup>74</sup> Peter Walker, [Green party calls for nationalisation of big five energy firms](#), *The Guardian*, 17 August 2022

Scheme<sup>75</sup> and the establishment of an expert energy panel to look at ways of keeping bills affordable in the long term.<sup>76</sup>

The deficit tariff scheme would involve the use of Government-backed loans to cover the increased wholesale energy costs and allow these costs to be spread over a longer period. Energy suppliers could then keep bills at the current level, and the debt from the loans would be repaid through a surcharge on bills or added taxation over a 10 to 15-year period.

A [blog post from Octopus Energy](#) explains the main advantages of a deficit tariff scheme:

- It directly tackles inflation - reducing contagion from fuel into the wider economy. Targeted support cannot do that.
- The rises are huge. By January, bills could be 4-5 times higher than 2020/21. For households on the typical incomes, fuel costs will have risen from about 5% of their post-tax income to 20%. Targeting simply doesn't work when middle-income households are affected to this degree
- Spreading the cost at a low cost of capital nationally is dramatically cheaper than households individually borrowing to get through the crisis
- The wholesale market is so volatile that "chasing" these costs with targeted support is simply not possible<sup>77</sup>

However, there are concerns over the costs of these proposals, which reportedly could reach more than £100bn over two years.<sup>78</sup>

## Alternatives to the price cap

The BEIS Committee report, [Energy pricing and the future of the Energy Market](#), noted that representatives of the energy companies, while preferring the cap is removed, supported the idea of a relative (rather than the existing absolute) price cap. They said that this would "address the issue of wholesale price volatility by returning control of hedging to retailers, giving them greater flexibility to manage risks more generally, and protect customers by limiting tariff differentials."<sup>79</sup>

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<sup>75</sup> Commons Library, [Energy Bills Support Scheme: Government policy and FAQs](#), 9 August 2022

<sup>76</sup> The Guardian, [Industry unites behind plan for crisis fund to control soaring energy bills, 18 August 2022](#)

<sup>77</sup> Octopus Energy, [An Energy Tariff Deficit Fund would help people through the crisis and tackle inflation, 19 august 2022](#)

<sup>78</sup> Financial Times Opinion: [Energy crisis: bluntly, the Scottish Power plan would cost too much | Financial Times \(ft.com\)](#)

<sup>79</sup> Business, Energy and Industrial Strategy Select Committee, [Energy pricing and the future of the Energy Market](#), Third Report of Session 2022–23, 19 July 2022

Consumer organisations and suppliers have called for a social tariff for vulnerable people which could replace, or sit alongside the price cap. The BEIS Committee has called on the Government to “consider the introduction of a social tariff for the most vulnerable customers and a relative tariff for the rest of the market, to be introduced once wholesale energy prices have stabilised.”<sup>80</sup>

More information on proposals for a social tariff for energy is provided in a July 2022 briefing produced by the consumer groups Fair by Design and national Energy Action, [Solving the cost of living crisis: the case for a new social tariff in the energy market](#).

The think tank, the Resolution Foundation, published a report on 25 August, [A chilling crisis: Policy options to deal with soaring energy prices](#). It looks at potential options to address increasing energy bills including the introduction of a social tariff.

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<sup>80</sup> Business, Energy and Industrial Strategy Select Committee, [Energy pricing and the future of the Energy Market](#), Third Report of Session 2022–23, 19 July 2022

## 6

# Timeline of changes in the price cap

The default tariff cap came into force at the beginning of 2019 at an annual equivalent level of £1,137 for typical levels of consumption.<sup>81</sup> Until August 2022 Ofgem reviewed the levels of the cap twice a year. From August 2022, Ofgem will be reviewing the cap quarterly.

## February 2019 increase in the cap

In February 2019, Ofgem announced the level of the cap would increase from April by £117 to £1,254. It also said the pre-payment meter cap would rise by £106. According to Ofgem's press release, the rise in the caps reflected "the underlying cost of energy increases" with the main change an increase in wholesale prices.<sup>82</sup>

## August 2019 decrease in the cap

In August 2019, Ofgem announced that the levels of both the pre-payment meter and the default tariff caps would decrease, the former by £25 to £1,217 and the latter by £75 to £1,179. Ofgem expected these changes to impact around 15 million customers. The Ofgem press release explained the reasons for the change:

The wholesale energy cost element of the default tariff cap fell by £75 to £446 while other costs, such as VAT and supplier profits, fell slightly.

These reductions offset cost increases totalling £7 of other elements such as operating costs, network charges and environmental schemes, resulting in an overall reduction of £75 in the level of the default tariff cap.<sup>83</sup>

The press release also explained that the pre-payment meter cap had increased above the level of the default tariff cap, due to the change in methodology:

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<sup>81</sup> At the time they were 3,100 kWh for electricity and 12,000 kWh for gas

<sup>82</sup> Ofgem, [Higher wholesale costs push up default and pre-payment price caps from April](#), 7 February 2019

<sup>83</sup> Ofgem, [Energy caps to fall this winter due to lower wholesale costs](#), 7 August 2019

Last month, the Competition and Markets Authority decided to bring the methodology for calculating the pre-payment cap in line with the default cap.

Following this change, the level of the pre-payment meter cap is higher than the default tariff cap. The pre-payment meter cap now fully reflects the higher cost of providing energy to these customers (incurred by operating pre-pay keys and cards used to top up pre-payment meters).<sup>84</sup>

As this cap period was over the winter, although the cap level had reduced, customers may have seen bills rise as they consumed more electricity and gas to light and heat their homes over winter.

## February 2020 decrease in the cap

In February 2020, Ofgem announced the levels of the pre-payment meter and the default tariff caps would both decrease by 1% to £1,200 and £1,162 respectively. In a letter to market participants, Ofgem said that although its analysis suggested that policy costs had increased by £15, this was offset by a £38 decrease in wholesale costs.<sup>85</sup>

## August 2020 decrease in the cap

In August 2020, Ofgem introduced new lower levels of typical electricity consumption<sup>86</sup> for the calculation of its price cap annual bill equivalent figures. The regulator announced the default tariff cap would reduce, on a like for like basis, by 7% from £1,126 to £1,042 for 1 October 2020 to 31 March 2021. The main reason for the reduction was a fall in wholesale costs, partly caused by the coronavirus pandemic.

From 1 October, the default tariff cap also included a new cap level for prepayment meter customers. This integrated cap replaced the prepayment meter cap which was to expire on 31 December 2020. The new prepayment meter cap level also decreased from the previous period, to £1,070.<sup>87</sup>

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<sup>84</sup> Ofgem, [Energy caps to fall this winter due to lower wholesale costs](#), 7 August 2019

<sup>85</sup> Ofgem, [Prepayment meter cap update for 1 April 2020](#) and [Default tariff cap update for 1 April 2020](#), 7 February 2020

<sup>86</sup> These were reduced from 3,100 kWh to 2,900 kWh

<sup>87</sup> Ofgem, [Default tariff cap level: 1 October 2020 to 31 March 2021](#), 7 August 2020

## February 2021 increase in the cap

In February 2021, Ofgem announced that the level of both price caps would increase from April 2021. For an average household, the increase equated to £96 for default tariff customers to £1,138, and £87 for pre-payment meter customers to £1,156. The main driver was a rise in wholesale prices. However, the default tariff cap also included an additional allowance for suppliers to recover from some of the costs related to Covid-19, including debt from customers unable to pay their bills.<sup>88</sup>

Ofgem said the cap continued to save customers an estimated £75 to £100 per year, but that consumers could save up to £150 by switching to a better tariff.

## August 2021 increase in the cap

In August 2021, Ofgem announced that the level of both caps would increase from October 2021. For an average household, the increase equated to £139 for default tariff customers to £1,277, and £153 for prepayment customers to £1,306. The increase was driven by a rise in wholesale prices.

Ofgem said that “surging” fossil fuel sources were driving up inflation for energy, including the cap as well as fixed rate tariffs (not covered by the cap), and petrol and diesel. The breakdown of the cap showed that although some components of the bill such as policy costs fell, this did not offset a 42% rise in wholesale costs.<sup>89</sup>

Ofgem repeated that the cap continued to save customers an estimated £75-£100 per year, but that consumers could save by switching to a better tariff.

## February 2022 increase in the cap

Ofgem announced that the default tariff cap would increase from April 2022.

Ofgem stated this increase would affect 22 million customers. An average customer on a default tariff who pays by direct debit would see an increase of £693 to £1,971 and an average prepayment meter customer would see an increase of £708 to £2,017.

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<sup>88</sup> Ofgem, [Energy price cap to increase in April but consumers should switch to save money](#), 5 February 2021

<sup>89</sup> Ofgem, [Record gas prices drive up price cap by £139 – customers encouraged to contact supplier for support and switch to better deal if possible](#), 6 August 2021

Ofgem highlighted the main driver for the increase in the cap being a “record rise in global gas prices over the last 6 months, with wholesale prices quadrupling in the last year.”<sup>90</sup>

## August 2022, 80% increase in the cap

On 26 August 2022, Ofgem announced that the price cap would increase by £1,578 (80%) to £3,549 per year for dual fuel for an average household from 1 October 2022 (paying by direct debit).<sup>91</sup> The prepayment cap would increase by £1,591 to £3,608. This would affect around 24 million customers, including 4.5 million prepayment meter customers.

The regulator cited increases in wholesale costs as the main driver for this rise and noted that backwardation cost allowance and an increased wholesale volatility costs and adjustment allowance accounted for some of the increase.<sup>92</sup> It also warned that while it was not giving projections for January due to the volatility in the market, “prices could get significantly worse through 2023.”

Jonathan Brearley, CEO of Ofgem, said the new Prime Minister would need to act to address the price rises facing consumers:

The price of energy has reached record levels driven by an aggressive economic act by the Russian state. They have slowly and deliberately turned off the gas supplies to Europe causing harm to our households, businesses and wider economy. Ofgem has no choice but to reflect these cost increases in the price cap.

The Government support package is delivering help right now, but it’s clear the new Prime Minister will need to act further to tackle the impact of the price rises that are coming in October and next year. We are working with ministers, consumer groups and industry on a set of options for the incoming Prime Minister that will require urgent action. The response will need to match the scale of the crisis we have before us. With the right support in place and with regulator, government, industry and consumers working together, we can find a way through this.”

Ofgem will continue to work with government, consumers groups, charities and suppliers, in supporting any new package of help or measures to ease the crisis.<sup>93</sup>

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<sup>90</sup> Ofgem, [Price cap to increase by £693 from April, 3 February 2022](#)

<sup>91</sup> Ofgem, [Ofgem updates price cap level and tightens up rules on suppliers, 26 August 2022](#)

<sup>92</sup> Ofgem, [Default tariff cap letter, 26 August 2022 \[pdf\]](#)

<sup>93</sup> Ofgem, [Ofgem updates price cap level and tightens up rules on suppliers, 26 August 2022](#)

## 7

# Annex: The implementation of tariff caps

## 7.1

### Pre-payment meter and safeguard tariffs

#### Pre-payment meter cap

Not all customers have the same meter. Some customers, including but not exclusively those who have had problems with paying their energy bills, have a pre-payment meter (PPM). Rather than using energy and receiving a bill for whatever was used as with a standard meter, these meters have a “pay-as-you-go” system of paying upfront for energy and then consuming what has been paid for. While it is possible for customers on PPMs to switch tariffs, the CMA review (see section 2.1) found that there were fewer options for customers with PPMs, resulting in less competition, and a higher likelihood of customers being overcharged. As such, the CMA recommended a temporary cap for the four million households on PPMs, which Ofgem brought force in April 2017.<sup>94</sup>

The PPM cap was projected to end in 2020 when the smart meter roll-out was (then) due to be completed, as smart meters are intended to make switching easier.<sup>95</sup> In July 2019, the CMA recommended the 2020 date to lift the cap should be reconsidered, in light of expected delays to the roll out of smart meters.<sup>96</sup> Ofgem had said the PPM cap would expire on 31 December 2020, but the Default Tariff Cap would include a new PPM cap level to ensure PPM customers continue to be protected.<sup>97</sup>

The methodology for setting the PPM cap was originally set out by the CMA as part of its investigation. The methodology included a reference price for the cost of supplying energy based on existing tariffs and then headroom for suppliers to compete under the cap.<sup>98</sup> In July 2019, the CMA recommended changing the PPM cap methodology to be the same as the default tariff cap, as the current methodology for the cap was “underestimating the costs incurred by efficient suppliers”.<sup>99</sup> At the time, the price cap was recalculated

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<sup>94</sup> Ofgem, [Ofgem sets prepayment price cap to protect over four million households least able to benefit from competition](#), 7 February 2017

<sup>95</sup> More information on smart meters is available in the Library briefing on [Energy Smart Meters](#).

<sup>96</sup> CMA, [Review of the Energy Market Investigation \(Prepayment Charge Restriction\) Order 2016](#), 31 July 2019

<sup>97</sup> Ofgem, [Prepayment meter cap level](#) (accessed November 2020)

<sup>98</sup> Ofgem, [Prepayment price cap](#) (accessed March 2020)

<sup>99</sup> CMA, [Review of the Energy Market Investigation \(Prepayment Charge Restriction\) Order 2016](#), 31 July 2019

and changed if necessary on 1 April and 1 October every year to reflect changing costs. From August 2019, Ofgem used a bottom-up assessment approach for setting all the caps and in August 2020, it announced the PPM cap would be integrated with a level in the default tariff cap, ahead of the PPM cap's expiry at the end of 2020.

## Safeguard tariff

Following the introduction of the PPM cap, in the 2017 General Election, the Conservative Party manifesto included a commitment to: “Introduce a safeguard tariff cap that will extend the price protection currently in place for some vulnerable customers to more customers.”

On 21 June 2017, Greg Clark MP (the then Secretary of State for Business, Energy and Industrial Strategy (BEIS)) wrote to Ofgem to encourage it to implement a “safe-guard tariff” .<sup>100</sup>

On 3 July 2017, Ofgem responded saying it would: “work with consumer groups to take measures, [...] including extending the current safeguard tariff in place for consumers on a pre-payment meter” .<sup>101</sup>

Ofgem's response was to extend the PPM caps to also include “vulnerable consumers” which were defined as consumers who receive the Warm Homes Discount. The Warm Homes Discount comes off the energy bills of customers who meet certain criteria, at the time worth £140 per year. The extension, known as the Safeguard Tariff Cap, came into force on 2 February 2018. This extension meant the PPM and safeguard caps covered a total of around 5 million households.<sup>102</sup>

Once the default tariff cap had come into force (see below), customers protected by the safeguard tariff cap were transferred to the default tariff cap which was designed for standard, rather than pre-payment meters.<sup>103</sup> This resulted in two caps in force; pre-payment and default. Suppliers incur different costs for supplying pre-payment and default meters which is why they remained as two separate caps, rather than being merged into one overall cap.

In October 2020, Ofgem announced a new PPM cap level as part of the default tariff cap. The PPM cap expired in December 2020, but PPM customers continued to be protected by the PPM cap level within the Default Tariff Cap.<sup>104</sup>

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<sup>100</sup> Gov.uk, [Energy retail market: letter to Ofgem](#), 21 June 2017

<sup>101</sup> Ofgem, [Ofgem reply to letter from Secretary of State](#), 3 July 2017

<sup>102</sup> Natalie Thomas and Jim Pickard, [Ofgem proposes 'safeguard' price cap for vulnerable customers](#), 3 July 2017

<sup>103</sup> Ofgem, [About energy price caps](#) (accessed March 2020)

<sup>104</sup> Ofgem, [Prepayment meter cap level](#) (accessed November 2020)

## 7.2

## The Default Tariff Cap

A default tariff cap policy first appeared in the 2015 Labour manifesto.<sup>105</sup> By the 2017 General Election, a price cap was in both the Labour and Conservative manifestos.

The then Conservative Leader, Theresa May, had announced action on energy bills at the party conference in October 2016. The policy was subsequently included in the 2017 manifesto as a “safeguard tariff” for “customers on the poorest value tariffs”<sup>106</sup> and included in the Queen’s Speech 2017.<sup>107</sup>

### Responsibility for the tariff cap - Ofgem or Government?

On 3 July 2017, Shadow Energy Minister, Dr Alan Whitehead MP, asked an urgent question on the Government’s intention for an energy price cap. During the debate, some MPs expressed concern that the “safe-guard tariff” would not protect enough consumers. The Conservative MP John Penrose said:

Some 17 million families are being ripped off by expensive standard variable tariff deals. Ofgem’s proposals will deal with at most 3 million of them, leaving 14 million still being preyed on by the big six energy firms.<sup>108</sup>

The then Secretary of State, Greg Clark said he would “wait and see” what Ofgem did but was prepared to legislate if necessary:

Following a two-year inquiry, the Competition and Markets Authority found that energy customers on standard variable tariffs were paying on average £1.4 billion a year more than would be the case in a competitive market. That is completely unacceptable, so my party’s manifesto committed to introduce a safeguard tariff to extend the price protection currently in place for some vulnerable customers—those on pre-payment meters—to more customers on the poorest-value tariffs. The energy regulator, Ofgem, has the powers necessary to impose such a price cap without delay, and I wrote to its chief executive on 21 June to ask it to use its powers to do so. Today, the regulator has replied and announced that it will work with consumer groups to take measures, including extending the current safeguard tariff for those on pre-payment meters to a wider group of consumers, and move urgently to implement these changes.

I welcome this initial proposal—it is a step in the right direction—but I will wait to see the actual proposals turned into action to cut bills, as the test

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<sup>105</sup> For example, *Ed Milliband’s energy crusade misses target say experts*, Financial Times, 25 September 2013

<sup>106</sup> Conservative Party, *The Conservative Party Manifesto 2017, Forward Together*

<sup>107</sup> Gov.uk, *Queen’s Speech 2017*, 21 June 2017

<sup>108</sup> HC Deb 3 July 2017 [c892](#)

of whether the regulator's changes go far enough is whether they move sufficiently to eradicate the detriment to consumers that the CMA identified. I remain prepared to legislate if they do not, and I hope that such legislation would command wide support across the House.<sup>109</sup>

Ofgem repeatedly said a market-wide cap required legislation as it was a change in policy and would otherwise be open to legal disputes.<sup>110</sup> Ofgem's then Chief Executive, Dermot Nolan, argued that as Ofgem had referred the energy market to the CMA, it would be implementing the CMA's suggested remedies, which specifically excluded a market-wide price cap.<sup>111</sup> However, the Government believed that setting a tariff cap was in Ofgem's power.<sup>112</sup>

At the end of September, 192 MPs, including 76 Conservative MPs, backed a letter to Theresa May and Greg Clark, calling on them to do more to protect the 17 million families the letter claimed were victims of a 'big six' "stitch up".<sup>113</sup>

## The Tariff Cap Act 2018

During her speech to the Conservative party conference on 4 October 2017, the then Prime Minister Theresa May announced the Government would publish a draft bill "to put a price cap on energy bills" intending to end "rip-off energy prices once and for all."<sup>114</sup>

The Draft Domestic Gas and Electricity (Tariff Cap) Bill was published on 12 October 2017. The Business, Energy and Industrial Strategy (BEIS) Committee scrutinised the Bill and published its report on 13 February 2018.<sup>115</sup> The Committee criticised Ofgem and the energy suppliers for failing customers. The Committee agreed with the short term, absolute tariff cap proposed in the draft Bill and suggested amendments, for example to close loopholes for green tariffs and ensure the cap is reviewed every six months.

### 3 Absolute vs relative caps

There were two main types of price cap the Government could have implemented: absolute and relative. An absolute imposes a cap on the maximum amount any supplier can charge for electricity and gas and is the

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<sup>109</sup> HC Deb 3 July 2017 [c891](#)

<sup>110</sup> HC BEIS Committee, [Oral Evidence: CMA's investigation of the UK Energy Market, HC 982](#), 22 February 2017, Q153

<sup>111</sup> HC BEIS Committee, [Oral Evidence: CMA's investigation of the UK Energy Market, HC 982](#), 22 February 2017, Q156

<sup>112</sup> PQ 8440 [[On energy prices](#)], 4 September 2017

<sup>113</sup> BBC, [Scores of Tory MPs join energy cap call](#), 29 September 2017

<sup>114</sup> BBC, [In full, Theresa May's Conservative conference speech 2017](#), 4 October 2017

<sup>115</sup> BEIS Committee, [Pre-legislative scrutiny of the draft Domestic Gas and Electricity \(Tariff Cap\) Bill](#), Fourth Report of Session 2017-19, 13 February 2018

type of tariff used for prepayment meters and vulnerable customers. A relative imposes a cap on the difference between a supplier's cheapest and most expensive tariffs.

The Tariff Cap Act required Ofgem to implement an absolute cap, as supported by the BEIS committee, though several MPs raised the possibility of a relative cap during Bill scrutiny.

There were broadly three views on market intervention in the form of an absolute price cap:

- **Supporters of an absolute price cap:** Some MPs, small suppliers and consumer groups supported an absolute price cap to protect customers from overcharging.<sup>116</sup>
- **Supporters of a relative price cap:** Some suppliers and MPs instead supported a relative price cap. Proponents said that such a cap would “restore the link between the prices which companies advertise in the marketplace and those which they charge the majority of their customers”.<sup>117</sup>
- **Opponents of a price cap:** Some MPs and the ‘big six’ energy suppliers opposed a price cap. Opponents said a price cap could hurt competition<sup>118</sup> and that consumers who do not engage with the market should expect to pay more for their energy.<sup>119</sup>

The Domestic Gas and Electricity (Tariff Cap) Bill had its first reading on 26 February 2018. The Bill proposed a temporary, absolute cap (see Box 3) on the price of standard variable and default tariffs that would be lifted by the end of 2020. On 19 July 2018, the Bill received Royal Assent and became the Domestic Gas and Electricity (Tariff Cap) Act 2018. More information is available in the Library briefing on [The Tariff Cap Act](#).

The Act provides for the cap to be extended until 2023 if conditions for effective market competition are not met. In October 2021, the [Government announced the cap would be extended](#) to December 2022.

The Government has included measures in [the Energy Bill](#) (currently in Committee Stage in the House of Lords) to amend the Act so that the tariff cap can be extended beyond 2023, providing certain conditions are met. A BEIS factsheet on this part of the Bill, [Energy Security Bill factsheet: Default tariff \(price cap\)](#) sets out how the cap will be extended. It says:

<sup>116</sup> Citizens Advice, [Citizens Advice hails the energy price cap legislation as an important step towards an energy market that works better for consumers](#), 12 October 2017

<sup>117</sup> BEIS Committee, [Pre-legislative scrutiny of the draft Domestic Gas and Electricity \(Tariff Cap\) Bill](#), Fourth Report of Session 2017-19, 13 February 2018, para 43

<sup>118</sup> Adam Vaughan, [E.ON chief: Theresa May's energy price cap will hurt competition](#), *The Guardian*, 20 October 2017

<sup>119</sup> BEIS Committee, [Pre-legislative scrutiny of the draft Domestic Gas and Electricity \(Tariff Cap\) Bill](#), Fourth Report of Session 2017-19, 13 February 2018, para 38

The Price Cap will not be automatically extended. Where the Secretary of State concludes that the conditions for effective competition have not been met for domestic supply contracts, the Secretary of State must lay an affirmative statutory instrument to extend the tariff cap conditions for two years at a time. Exceptionally, the Secretary of State will also have the option to extend the cap for a single year, if they believe there is a significant prospect of the conditions for effective competition being present in the market before the end of that year.

There is no specified longstop date in the Bill, reflecting the need to remain flexible and keep the Price Cap in place until the conditions for effective competition for domestic supply contracts are in place.<sup>120</sup>

## Implementing the cap

In the statutory consultation, published on 6 September 2018, Ofgem proposed the level of the cap:

These proposals mean that the cap, when it comes into force as soon as practicable, should cap prices at around **£1,136** for dual fuel customers paying by direct debit, and **£1,219** for those paying by standard credit.

We are proposing to set the cap at this level because it would provide a high level of protection – ensuring SVTs [Standard Variable Tariffs] reflect more closely their underlying costs of supplying energy, protecting customers from overpaying for their energy and from unjustified price rises.

Based on our analysis, 96% of SVT customers in 2017 would have paid less under our proposed default tariff cap, reducing their bills by £1.3 billion. We estimate this will equate to customer savings of about £1 billion when the cap is introduced. This figure is lower because there are now fewer customers on default tariffs than in 2017 and because suppliers' prices have not risen as quickly as wholesale prices have during this period.<sup>121</sup> (Emphasis added)

On 6 November 2018, Ofgem announced that a cap of £1,137 would apply to typical customers paying dual fuel bills by direct debit from 1 January 2019.<sup>122</sup> Ofgem's press release said this would offer price protection to 11 million people:

Customers on default tariffs will save around £76 on average and as much as £120 on the most expensive tariffs.

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<sup>120</sup> [Energy Security Bill factsheet: Default tariff \(price cap\) - GOV.UK \(www.gov.uk\)](#)

<sup>121</sup> Ofgem, *Statutory Consultation – Default tariff cap – Overview document*, 6 September 2018

<sup>122</sup> As above, note that the cap is on units of power **not** the total bill. Ofgem's figure is for a typical household but real bills could be higher or lower if a household is non-typical, e.g. has higher consumption.

Price cap will remove around £1 billion of overcharging from consumers' bills

Whilst temporary cap is in place protected customers will always pay a fairer price for their energy

Price protection for 11 million customers on poor value default tariffs will come into force on 1 January 2019, Ofgem has confirmed today.<sup>123</sup>

Ofgem argued in a press release that customers could still save more by switching to a better deal. The exact level of the autumn 2018 cap, broken down by region and meter type, is available from the [Ofgem cap webpages for industry](#).

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<sup>123</sup> Ofgem, [Energy price cap will give 11 million a fairer deal from 1 January](#), 6 November 2018

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