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# Energy bills and tariff caps

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# Contents

<b>Summary</b>	<b>3</b>
<b>1. Background</b>	<b>4</b>
1.1 Privatising the energy market	4
1.2 Competition in the energy market	4
1.3 What makes up an energy bill?	6
1.4 Evolution of energy prices and bills	9
<b>2. Reform of the Energy Market</b>	<b>11</b>
2.1 Investigations into the Energy Market – the CMA review	11
2.2 Key findings from the CMA review	12
2.3 Dieter Helm Cost of Energy review	14
<b>3. Tariff Caps</b>	<b>15</b>
3.1 Pre-payment meter and Safeguard Tariffs	16
3.2 The Default Tariff Price Cap	17
Responsibility for the tariff cap - Ofgem or Government?	17
The Tariff Cap Act 2018	18
Implementing the cap	20
3.3 Setting the Caps	20
3.4 Adjusting the caps	22
3.5 Comment on the caps	25
3.6 What can domestic customers do to lower their energy bills?	25

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# Summary

## The UK Energy Market

The supply and generation of British electricity was privatised from 1989 through the *Electricity Act 1989* and the *Gas Act 1986* privatised the British Gas Corporation. Following privatisation, customers remained with their regional company for electricity and national company for gas. Eventually, as more suppliers became available, consumers were supposed to switch to save money and a competitive market would be established.

## Energy bills

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 drivers of rises and falls in energy bills are complex.

## Concern over overcharging

Following concern that the energy market was not working for all customers, the regulator Ofgem referred the energy market to the Competition and Markets Authority (CMA) in June 2014. The CMA report found that customers are overpaying around £1.4bn a year for energy. This is largely because since privatisation, many customers have remained on default tariffs often with the 'big six' suppliers, and have not switched, resulting in consumers on poor value deals.

## Reforms to the market

The CMA suggested new measures to reform the market and increase switching. The recommendations included a price cap for customers on pre-payment meters, which was introduced in 2017. An extension of this cap (which was not specifically recommended by the CMA), known as the safeguard tariff, came into force in February 2018 to protect customers deemed to be vulnerable as they receive a benefit known as the Warm Homes Discount. Both of these caps have been merged with the default tariff cap.

## The Default Tariff Cap

Despite not being a CMA recommendation, a wider tariff cap was a key political issue and price capping appeared in both the Labour and Conservative manifestos in the 2017 election. In October 2017, the Prime Minister Theresa May announced that the Government would publish a Bill to put a temporary price cap on energy bills. On 19 July 2018, the Bill received Royal Assent and became the [\*Domestic Gas and Electricity \(Tariff Cap\) Act 2018\*](#).

On 1 January 2019, the tariff cap for the 11 million customers on default tariffs came into force. The cap is on the unit cost of energy, so prices can still rise if customers consume more. The level of the cap is reviewed twice a year. Originally intended to end in 2020, the Government has extended the cap to December 2021. The Act allows the cap to continue until 2023 if needed.

There are mixed views on the cap. Energy UK, the industry trade body, have said the cap could interfere with competition and instead advocate energy efficiency measures. Whereas the consumer charity Citizens Advice welcomed the cap as a potential "solution to runaway energy costs."

# 1. Background

## 1.1 Privatising the energy market

Prior to privatisation from the 1980's, 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 together with the establishment of industry regulation through the Office of Electricity Regulation (Offer). 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>

In the years since privatisation there has been considerable restructuring and consolidation of the energy industry. For many years the industry has been dominated by the 'big six' energy companies, Centrica plc (British Gas), EDF Energy, SSE (acquired by OVO in 2020), Scottish Power E.on and Npower (the latter two merged in 2019 though the supply businesses are managed separately). These companies have now become vertically-integrated meaning they have merged power generation, distribution networks and the supply businesses of the original companies. This consolidation was expected in the years after privatisation. They now all supply gas as well as electricity. The industry regulator is now the Office of Gas and Electricity Markets (Ofgem) who report to the Gas and Electricity Markets Authority (GEMA).

## 1.2 Competition in the energy market

Today there are a growing number of suppliers in the market. There were 31 active suppliers in June 2015,<sup>3</sup> rising to 70 in mid-2018 (the numbers have since fallen after a number of small suppliers entered administration, see Box 1). However the 'big six' still dominate, supplying about 70% of all British domestic electricity and gas in Q2 2020,<sup>4</sup> though this has declined since 2012 when they supplied over 95% of the domestic energy market.<sup>5</sup>

When the energy market was privatised, customers remained with their 'regional' company for electricity and national company for gas.

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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](#).

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

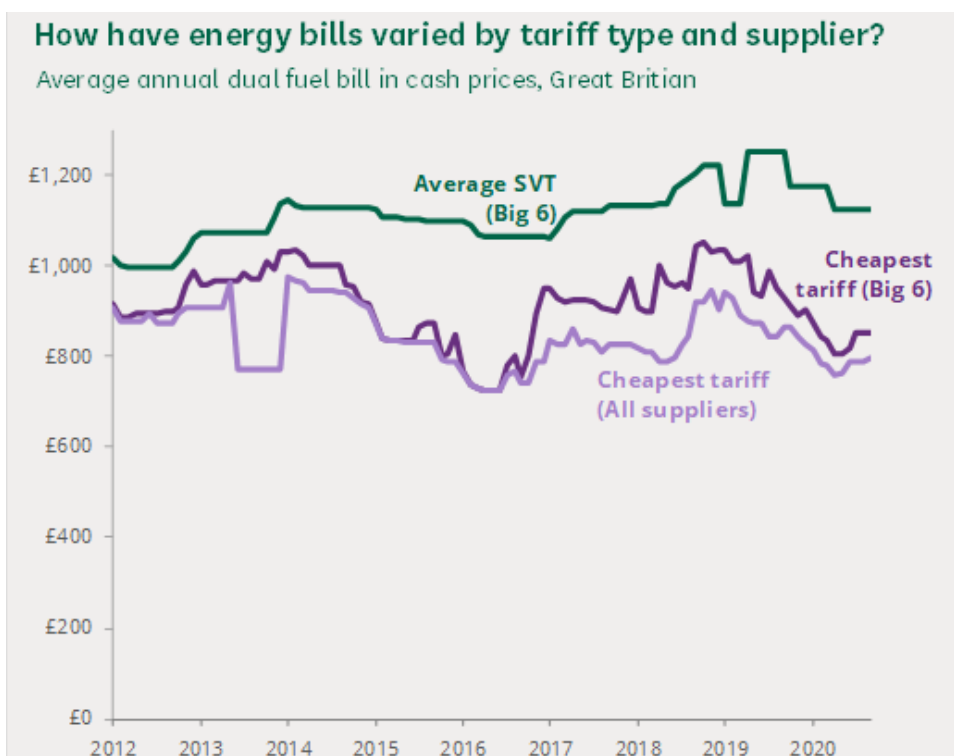
<sup>4</sup> Ofgem, [Retail market indicators](#), October 2020

<sup>5</sup> Ofgem, [State of the Market Assessment 2014](#), Figure 3 and 4

Eventually consumers were supposed to switch to save money and a competitive market would be established.

Today, suppliers operate in a competitive market where they set their own prices and consumers can make a choice of supplier based on preferences such as price and service.<sup>6</sup> Consumers are faced with a mixture of tariffs that companies have created to attract or retain customers; these can include fixed term deals, or “green” tariffs linked to low-carbon energy. The meter that a customer has can impact the tariffs available to them; some deals are only available to customers with smart meters<sup>7</sup>, and some customers can only access certain tariffs because they have a pre-payment meter (which involves a “pay-as you go” method for paying upfront for energy). There is no requirement that all customers of a company must be on the same tariff. Customers who have not switched tariffs since privatisation or the end of a fixed term tariff tend to be on the default, more expensive tariff, sometimes known as the standard variable tariff (SVT).

There is a price gap between the SVT and the cheapest tariff, even with the same supplier, as the chart below shows. Switching suppliers or tariffs could therefore save consumers money.



**Source:** Ofgem, Retail Market Indicators

Despite the potential for savings, the CMA 2016 survey of 7,000 domestic customers found 56% said they had never switched supplier, did not know if it was possible or did not know if they had done so.<sup>8</sup>

<sup>6</sup> Sophie Barker, [Ofgem to end price caps on energy](#), The Telegraph, 27 November 2001

<sup>7</sup> Commons Library, [Energy Smart Meters](#), October 2019

<sup>8</sup> CMA, [Modernising the Energy Market](#), 24 June 2016

## 6 Energy bills and tariff caps

There are many reasons for low levels of switching: a lack of knowledge of savings, concern over potential hassle, limited access to the internet, and distrust that bills won't rise again after switching.<sup>9</sup> The result is that many people are not on the best deals and are consequentially losing out. As a result of not switching, the CMA estimated in 2016 that UK consumers are unnecessarily over-paying up to £1.4 billion a year.<sup>10</sup>

There are indications that switching is increasing. Having fallen between 2008 and 2012, Ofgem said switching began to increase in 2014. Ofgem said switching in 2019 was the highest recorded since 2003 with the switching rate for both electricity and gas at 21%.<sup>11</sup>

### Box 1: Supplier challenges in the energy retail market

Several small energy suppliers entered administration at the end of 2018 and beginning of 2019. A number of reasons for this have been reported, including small suppliers being more vulnerable to increases in wholesale prices<sup>12</sup>, and a lack of financial and customer services checks for new suppliers.<sup>13</sup> Ofgem have proposed new tests for licensing energy suppliers, including demonstrating that they have adequate financial resources and can meet their customer service obligations.<sup>14</sup> In addition to small suppliers, some of the 'big six' have faced challenges in the market. As set out in section 1.3 below, the big six suppliers on average made a pre-tax loss in 2019.

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). Customer should have no disruption to their energy supply. More information on this process is available from the Ofgem webpage on [Ofgem Safety Net: If your supplier goes out of business](#).

## 1.3 What makes up an energy bill?

Energy bills comprise a variety of costs that change over time as the graph below shows (graph and statistics from 2018 data<sup>15</sup>). 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.

<sup>9</sup> Ofgem, [Consumer engagement in the energy market since the Retail Market Review 2016 Survey Findings](#), August 2016

<sup>10</sup> CMA, [Energy market investigation – Summary of final report](#), 24 June 2016 (p. 22)

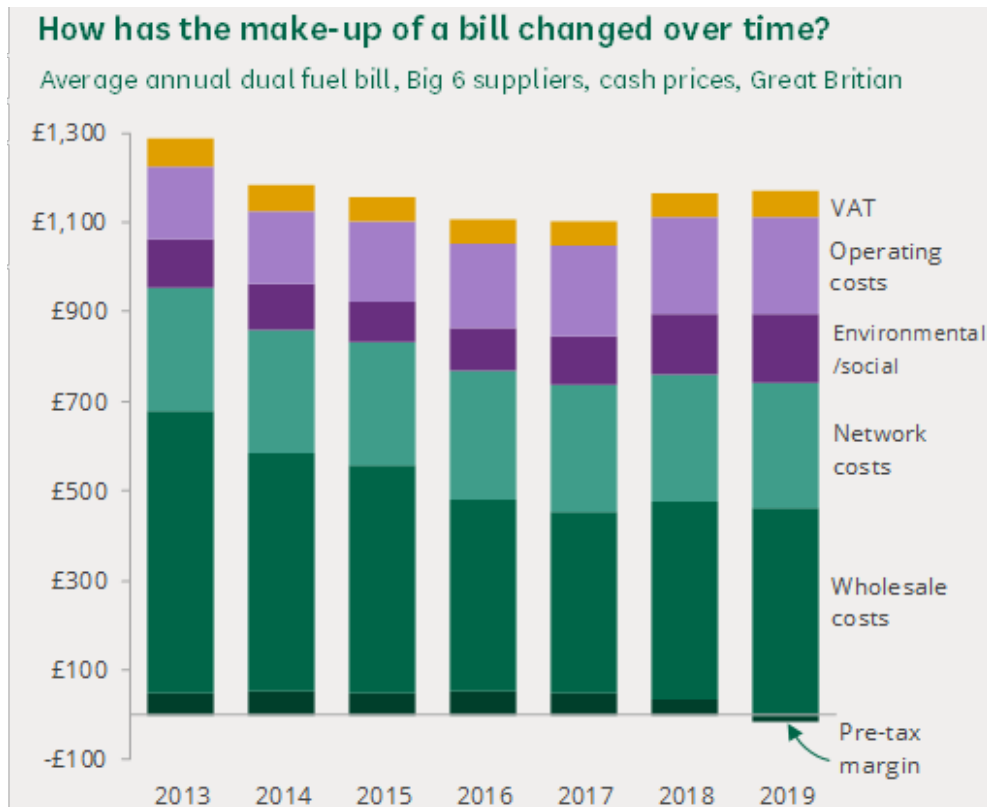
<sup>11</sup> Ofgem, [Retail highlights](#), February 2020

<sup>12</sup> This is Money, [Is ditching the Big Six worth the risk?](#) 12 December 2018

<sup>13</sup> Energy UK, [Energy UK responds to Ofgem's proposed new tests for licensing energy suppliers announcement](#), 21 November 2018

<sup>14</sup> Ofgem, [Ofgem proposes new tests for licensing energy suppliers](#), November 2018

<sup>15</sup> Data on bill breakdown from Ofgem, [Breakdown of a dual fuel bill](#)



Source: Ofgem, Retail Market Indicators<sup>16</sup>

- Wholesale costs:** 39.6%. Wholesale costs have historically been the biggest single component of energy bills as the graph shows.

Domestic energy suppliers have previously been accused of not cutting bills when wholesale costs fall. Some of Britain's biggest energy suppliers previously came under pressure in January 2016 to cut their prices to reflect the falling price of oil and gas.<sup>17</sup> Ofgem had earlier written to energy suppliers in June 2014, arguing in a competitive market, prices should be cut as costs fall.<sup>18</sup>

- Network costs:** 23.8%. Previously network costs were known jointly with environmental and social costs as direct costs. Network costs refer to the cost of using the electricity transmission and distribution grids.

As the network operators are monopolies, Ofgem enforces price controls on the operators, allowing for changes to invest in infrastructure.<sup>19</sup> Rising infrastructure costs, such as new interconnectors and grid upgrades are another key contributor to bill increases. Ofgem data shows that network costs have increased slightly on a typical dual fuel bill from £276 in 2013 to £279 in 2019. However direct costs in 2009 (when network costs and environmental obligations were combined) were only £290

<sup>16</sup> Previously network costs were known jointly with environmental and social costs as direct costs.

<sup>17</sup> The Financial Times, [Pressure mounts on UK energy suppliers to cut prices](#), 15 January 2016

<sup>18</sup> Ofgem, [Letter calling on large energy suppliers to explain wholesale price impact on energy bills](#), 10 June 2014

<sup>19</sup> Ofgem, [Energy networks should prepare for tougher price controls](#), 12 July 2017

whereas in 2019 combined they were £432.<sup>20</sup> This shows a rise over time driven by both network and environmental costs.

- **Operating costs:** 18.4%. These include staffing and office costs, sales and marketing, etc. Some suppliers include meter costs, such as aspects of the smart meter rollout, in this category.
- **Environmental and Social Obligations:** 13%. Many suppliers account the recent price rises to “green levies” (environmental and social obligation costs). These include policies such as:<sup>21</sup>
  - The Renewables Obligation (which closed in March 2017)
  - Feed in tariffs (which closed in March 2019)
  - The Energy Company Obligation
  - Carbon price floor
  - European Union Emissions Trading System

Analysis by the Committee on Climate Change finds that these green policies added approximately £105 to the average bill in 2016. However, they also note that more general energy efficiency gains in the home (through better devices and more insulation) have led to average gas and electricity use reducing by 23% and 17% respectively since 2008. This reduces consumption and therefore saves the average household money. The Committee on Climate Change believe the average household saving from this consumption fall to be £290 per year.<sup>22</sup> They also argue that future rises in costs due to green policies will have a reduced impact on consumers as energy efficiency in homes will continue to reduce consumption costs.<sup>23</sup>

- **Pre-tax margin:** usually <5%. Supplier pre-tax profits are often mentioned in the press as a factor of bill increases; they normally account for just under 5% of an average bill. In relation to the pre-tax margin in 2019, [Ofgem’s analysis states](#) “both average wholesale and environmental/social costs reported by the large suppliers increased in 2019, while other costs remained fairly unchanged. Given the continued competitive pressure and the introduction of the default price cap in 2019, suppliers could not pass through these cost increases to customers and, on average, experienced a loss.”
- **VAT:** 4.8%.
- **Other direct costs:** 1.5%. The costs put in this category vary between suppliers and are a small but increasing segment of bills. They can refer to costs of market participation, such as brokers, Elexon (a balancing and settlement organisation), and Xozerve (a gas database) participation, and some suppliers count the smart meter roll out in this category too.

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<sup>20</sup> Ofgem, [Large Suppliers: Domestic dual fuel bill breakdown over time](#). Data Portal, (accessed November 2020)

<sup>21</sup> Ofgem, [Energy Companies’ Consolidated Segmental Statements](#), 3 July 2017

<sup>22</sup> Committee on Climate Change, [Energy Prices and Bills – impacts of meeting carbon budgets](#). March 2017 (page 7)

<sup>23</sup> Ibid



## 1.4 Evolution of energy prices and bills

Between 2000 and 2008 energy prices rose steadily. Since 2008, prices have continued to rise but have fluctuated and the rate of increase in real terms has been lower.<sup>24</sup>

However, the Committee on Climate Change's Energy Prices and Bills report showed that the average household bill was lower in real terms in 2016 than in 2008 (adjusted for inflation) because greater energy efficiency in homes (leading to reduced consumption) had offset price changes.<sup>25</sup> The wider context for these complex changes in prices and consumption have been an economic slowdown and increasing pressure on household budgets. In comparison to European Union countries, domestic electricity prices in the UK are above average and gas prices in the UK are below average.<sup>26</sup>

Since the introduction of tariff caps for a number of customers in January 2019, Ofgem announced that the level of the cap which it sets based on the costs of supplying energy, would be raised in February 2019, then lowered in August 2019, February 2020, and August 2020 (see section 3).

### Box 2: Coronavirus and energy bills

#### Impact on energy system

The coronavirus pandemic has not caused any shortages or cuts to energy supply. Some of the wider aspects of the energy sector, such as the smart meter roll out, have been impacted. For more information, see the Library insight on [Coronavirus: the challenge for critical national infrastructure](#), published on 31 March 2020.

#### Consumer bills

However, the pandemic has resulted in widespread financial hardship, which has included concerns about customer's ability to pay for their energy bills. The level of customers' bills tends to vary based on two factors: the price per unit of energy (electricity or gas), and how many units the customer uses. The price per unit of energy is impacted by the wholesale price, which in 2020, had been falling. The energy regulator Ofgem reduced the tariff cap in 2020 to reflect this, but in February 2021 announced the cap would increase again. This was in part to reflect now rising wholesale prices, but also to allow suppliers to address higher levels of customer debt due to the pandemic (see section 3.4).

Even customers with a reduction in their unit price could see higher bills if they increased their consumption from more time at home. Analysis from March by the comparison site [Uswitch](#) suggested that UK consumers could spend an extra £52 million a week in total on energy bills. The research suggests households with people working from home each spend an extra £16 a month extra on energy, a total of £195 a year for those on poor-value tariffs.<sup>27</sup> In addition to rising bills, wider economic issues, such as job losses, may also result in customers struggling to pay energy bills.

National Energy Action, a fuel poverty charity, publish an annual [Fuel Poverty Monitor](#), which in 2020 warned the Covid-19 impact on households had been "stark", with increased levels of energy rationing and energy debt expected over winter.

#### Government and Ofgem response

<sup>24</sup> Gov.uk, [Annual domestic energy bills](#), 27 September 2018

<sup>25</sup> Committee on Climate Change, [Energy Prices and Bills – impacts of meeting carbon budgets](#), March 2017

<sup>26</sup> Ofgem, [Infographic Bills, prices and profits](#), 27 February 2020

<sup>27</sup> ['Stay-at-home Britons could spend an extra £52 million a week on energy bills'](#), Uswitch press release, 24 March 2020

In response to some of these concerns, in March 2020 the Government launched an [emergency package of measures](#) with energy suppliers. This was intended to protect customers from hardship during the coronavirus pandemic. The measures include:

- Support for customers with pre-payment meters to top-up;
- Options for customers with energy debt; and
- A commitment to not disconnect any credit meters during the outbreak.

Further information on the support available, and the answers to some common questions, is available from Ofgem's webpage on [Coronavirus \(COVID-19\) and your energy supply](#).

In October 2020, [Ofgem also announced new protections for customers struggling with energy bills over winter](#), aiming to reduce the number of customers who go without energy (self-disconnect) after running out of credit on pre-payment meters. The new licence conditions require suppliers to provide emergency credit to struggling customers, and "to put customers in debt on realistic and sustainable repayment plans".

While some of this action has been welcomed by consumer groups, there have also been calls for more to be done.<sup>28</sup>

### **Supplier bankruptcy**

There has also been [reported concern](#) that some energy suppliers may enter administration during the pandemic. Struggling customers are reportedly cancelling payments, leading to energy suppliers accruing debt. This pressure comes at a challenging time in the energy supply market; several suppliers have exited the market in recent years due to higher competition and the Government's cap on energy prices. In the case of a failed supplier, Ofgem has a process in place known as the [Supplier of Last Resort](#). This selects a new supplier to transfer customers of the failed supplier to, meaning there is no supply disruption for customers.

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<sup>28</sup> See for example the aforementioned [National Energy Action Fuel Poverty Monitor report](#).

## 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 market in Britain several years after the introduction of competition for domestic consumers in the late 1990's. Since this point, energy prices were not capped until recent changes.

### 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 due to concerns that energy markets were not operating competitively and in the best interests of consumers. The Committee's report<sup>29</sup> criticised the functioning of energy markets, saying the gap between companies' direct debit tariffs, and those for prepayment meters (PPM) had been widening, showing failing competitiveness.

Shortly after the committee announced its inquiry, Ofgem launched an Energy Supply Probe to investigate competition in the energy markets. The probe<sup>30</sup> found that although there was no evidence of active collusion, the market was not working in the best interests of consumers. Ofgem responded with a series of 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<sup>31</sup> - which led to another series of measures to simplify tariffs and promote switching.

In 2014, Ofgem worked with the Office of Fair Trading and the CMA on a State of the Market Assessment.<sup>32</sup> They found:

Weak competition between incumbent suppliers. This arises from market segmentation and possible tacit coordination [...] 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.

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<sup>29</sup> Business and Enterprise Committee, [Energy prices, fuel poverty and Ofgem](#), Eleventh report of session 2007-08, Vol. I, 16 July 2008

<sup>30</sup> Ofgem, [Energy supply probe](#) (accessed March 2020)

<sup>31</sup> Ofgem, [Retail Market Review](#), (accessed March 2020)

<sup>32</sup> OFT, Ofgem, CMA, [State of the Market Assessment](#), 27 March 2014

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 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>33</sup> in June 2016.

More information on reform is available in the House of Commons Note 'The Current Energy Market Reforms in Great Britain'.<sup>34</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' are 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 3 years, which will be put on a secure database under Ofgem control to allow rival suppliers to contact customers.
- 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 (PCWs) to play a more active role in helping customers find the best offers for them 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 – and which 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:

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<sup>33</sup> CMA, [Energy market investigation – Summary of final report](#), 24 June 2016

<sup>34</sup> House of Commons Library, [The Current Energy Market Reforms in Great Britain](#), 15 March 2017

- A series of Orders based on the recommendations were published on 14 December 2016.<sup>35</sup>
- Price caps for pre-payment meters have been introduced and the cap has been extended to certain vulnerable customers through a 'safeguard tariff' (see below for details).<sup>36</sup>
- Ofgem have delayed<sup>37</sup> rolling out the database of customers who have not switched in three years whilst they trial a new 'Check Your Energy Deal' online switching service. The results of the trial were published in February 2018.<sup>38</sup>
- On 28 November 2016 Ofgem modified gas and electricity suppliers' standard licence conditions to remove the four tariff rule. This will allow more tariffs for consumers to choose from.
- Also on 28 November 2016, Ofgem published an energy supplier league table<sup>39</sup> to increase transparency on the numbers of people on expensive standard variable tariffs.
- In January 2017, Ofgem launched a Supplier Cost Index<sup>40</sup>. The aim is to increase transparency in the energy market and help consumers understand what is behind trends in prices.
- In July 2017 Ofgem announced they would go forward with proposals set out in the Confidence Code Review, and consult on new Confidence Code wording to help address concerns consumers may have on whether to trust the results of Price Comparison Websites. Ofgem announced on 1 September 2017 their decision to update the code to help consumer trust and engagement.<sup>41</sup>
- From 1 September 2017, some provisions will come into force on the Order that aims to ensure suppliers make all their electricity single-rate tariffs available to all domestic customers on restricted meters, and that switching to these tariffs cannot be made conditional on a restricted meter being replaced.<sup>42</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 it the new tariff met customer preferences, had no early termination fees, and was equivalent or lower in price than the standard variable tariff.<sup>43</sup>

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<sup>35</sup> Gov.uk, [Energy Market Investigation](#), (accessed March 2020)

<sup>36</sup> Ofgem, [Prepayment meter price cap](#), (accessed March 2020)

<sup>37</sup> Ofgem, [Open letter: Update on the timing of the CMA database remedy](#), 7 July 2017

<sup>38</sup> Ofgem, [Results of qualitative research for the 'Check Your Energy Deal' service and digital trial early findings](#), 12 February 2018

<sup>39</sup> Ofgem, [Standard variable tariff comparison](#), 28 November 2016

<sup>40</sup> Ofgem, [Supplier Cost Index](#), 19 January 2017

<sup>41</sup> Ofgem, [Publication of the new Ofgem Confidence Code](#), 1 September 2017

<sup>42</sup> Gov.uk, [Energy Market Investigation \(Restricted Meters\) Order 2016](#), 14 December 2016

<sup>43</sup> Ofgem, [Decision: Default tariffs for domestic customers at the end of fixed-term contracts](#), 11 October 2017

- In November 2017, Ofgem announced its proposals for improving customer data to make switching easier for customers.<sup>44</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 intends to incentivise energy suppliers to work with accredited comparison sites.<sup>45</sup>

### 2.3 Dieter Helm Cost of Energy review

There have been further reviews to the cost of energy in addition to the CMA’s review.

The Government committed in its Industrial Strategy Green paper, published in January 2017, to “commission a review of the opportunities to reduce the cost of achieving our decarbonisation goals in the power and industrial sectors.”<sup>46</sup>

In August 2017, the Department for Business, Energy and Industrial Strategy (BEIS), launched this independent review, led by Professor Dieter Helm, an economist specialising in energy based at the University of Oxford.<sup>47</sup> [The Cost of Energy review](#) was published on 25 October 2017.<sup>48</sup> The review made a number of suggestions to restructure the market and reduce non-wholesale costs for domestic consumers. The Government responded to Helm’s report by launching a call for evidence to assess views on the report’s findings and recommendations.<sup>49</sup>

On 15 November 2018, the then Secretary of State for BEIS Greg Clark made a speech on the future of the energy market in response to the Helm review. Mr Clark suggested that the trilemma, the need to secure low cost, low carbon, and secure power, was over, as “cheap power is now green power” and proposed transforming the power sector based on new principles. Mr Clark said that the Government would set out more details through a policy paper, and a detailed White Paper would follow in 2019.<sup>50</sup> The White Paper is now expected in 2020.

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<sup>44</sup> Ofgem, [Open letter: improving customer data and database remedy](#), 13 November 2017

<sup>45</sup> Ofgem, [Decision on implementing the CMA’s recommendation to remove the Whole of Market requirement](#), 16 July 2018

<sup>46</sup> HM Government, [Building our Industrial Strategy](#). Green Paper, January 2017

<sup>47</sup> Department for Business, Energy and Industrial Strategy Press Release, [Independent review to ensure energy is affordable for households and businesses](#), 6 August 2017

<sup>48</sup> Dieter Helm, [Cost of Energy Review](#), 25 October 2017

<sup>49</sup> Gov.uk, [Cost of energy review: call for evidence](#), 7 November 2017

<sup>50</sup> Gov.uk, [After the trilemma – 4 principles for the power sector. speech by Business Secretary Greg Clark on the future of the energy market](#), 15 November 2018

### 3. 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.

The caps currently in force in the UK set an absolute cap on the price **per unit** of energy on default tariffs. **They are not overall caps 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 present the cap level based on a "typical" household with average consumption, paying by direct debit, i.e. the default cap when first introduced was presented as £1,137. However as above, it is important to note that this is an indication for an average household, not the cap on bills, and bills can rise far above this figure if households consume more than Ofgem's "typical" household.

It is also important to note that not all UK customers are protected by tariff caps. The UK 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 (will expire 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 SVTs – this came into force from 1 January 2019. Originally intended to end in 2020, it has been extended to December 2021. Legislation permits its extension to 2023 if needed.

The context and implementation of these caps is described in more detail in the following sections. In summary, after privatisation no tariffs were capped. Following the 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 are likely to remain better value than the level of the cap.

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

## 3.1 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 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>51</sup>

The PPM cap was projected to end in 2020 when the smart meter roll-out is due to be completed (see Box 4) as smart meters are intended to make switching easier. 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>52</sup> Ofgem has said the PPM cap will expire on 31 December 2020, but the Default Tariff Cap will include a new PPM cap level to ensure PPM customers continue to be protected.<sup>53</sup>

The methodology for setting the PPM cap was originally set out by the CMA as part of their 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>54</sup> In July 2019, CMA recommended that the PPM cap methodology be changed to be the same as the default tariff cap methodology (Section 3.3) as the current methodology for the cap was “underestimating the costs incurred by efficient suppliers”.<sup>55</sup> The price is recalculated and changed if necessary on 1 April and 1 October every year to reflect changing costs. From August 2019, Ofgem have used a bottom-up assessment approach for setting all the caps and in August 2020, Ofgem 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.

<sup>51</sup> Ofgem, [Ofgem sets prepayment price cap to protect over four million households least able to benefit from competition](#), 7 February 2017

<sup>52</sup> CMA, [Review of the Energy Market Investigation \(Prepayment Charge Restriction\) Order 2016](#), 31 July 2019

<sup>53</sup> Ofgem, [Prepayment meter cap level](#) (accessed November 2020)

<sup>54</sup> Ofgem, [Prepayment price cap](#) (accessed March 2020)

<sup>55</sup> CMA, [Review of the Energy Market Investigation \(Prepayment Charge Restriction\) Order 2016](#), 31 July 2019



On 21 June 2017, Greg Clark MP (the then Secretary of State for Business, Energy and Industrial Strategy (BEIS)) wrote to Ofgem to encourage them to implement a “safe-guard tariff”.<sup>56</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>57</sup>

Ofgem 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 is a £140 discount from the energy bill of customers who meet certain criteria. 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>58</sup>

Now that the default tariff cap has 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>59</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 expires in December 2020, but PPM customers will continue to be protected by the PPM cap level within the Default Tariff Cap.<sup>60</sup>

## 3.2 The Default Tariff Price Cap

A default tariff cap policy first appeared in the 2015 Labour manifesto.<sup>61</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 their party conference in October 2016. The policy was subsequently included in their 2017 manifesto as a “safeguard tariff” for “customers on the poorest value tariffs”<sup>62</sup> and included in the Queen’s Speech 2017.<sup>63</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-

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<sup>56</sup> Gov.uk, [Energy retail market: letter to Ofgem](#), 21 June 2017

<sup>57</sup> Ofgem, [Ofgem reply to letter from Secretary of State](#), 3 July 2017

<sup>58</sup> Natalie Thomas and Jim Pickard, [Ofgem proposes ‘safeguard’ price cap for vulnerable customers](#), 3 July 2017

<sup>59</sup> Ofgem, [About energy price caps](#) (accessed March 2020)

<sup>60</sup> Ofgem, [Prepayment meter cap level](#) (accessed November 2020)

<sup>61</sup> For example, [Ed Milliband’s energy crusade misses target say experts](#), Financial Times, 25 September 2013

<sup>62</sup> Conservative Party, [The Conservative Party Manifesto 2017, Forward Together](#)

<sup>63</sup> Gov.uk, [Queen’s Speech 2017](#), 21 June 2017

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>64</sup>

The then Minister 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 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>65</sup>

Ofgem repeatedly said that a market-wide cap required legislation as it was a change in policy and would otherwise be open to legal disputes.<sup>66</sup> Ofgem’s then Chief Executive Dermot Nolan argued that as Ofgem had referred the energy market to the CMA, they would be implementing the CMA’s suggested remedies, which specifically excluded a market-wide price cap.<sup>67</sup> However, the Government believed that setting a tariff cap was in Ofgem’s power.<sup>68</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>69</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:

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<sup>64</sup> HC Deb 3 July 2017 [c892](#)

<sup>65</sup> HC Deb 3 July 2017 [c891](#)

<sup>66</sup> HC BEIS Committee, [Oral Evidence: CMA’s investigation of the UK Energy Market, HC 982](#), 22 February 2017, Q153

<sup>67</sup> HC BEIS Committee, [Oral Evidence: CMA’s investigation of the UK Energy Market, HC 982](#), 22 February 2017, Q156

<sup>68</sup> PQ 8440 [[On energy prices](#)], 4 September 2017

<sup>69</sup> BBC, [Scores of Tory MPs join energy cap call](#), 29 September 2017

Next week, the Government will publish a Draft Bill to put a price cap on energy bills [...] meeting our manifesto promise and bringing an end to rip-off energy prices once and for all.<sup>70</sup>

The *Draft Domestic Gas and Electricity (Tariff Cap) Bill* was published on 12 October 2017. The Business, Energy and Industrial Strategy Committee undertook pre-legislative scrutiny of the Draft Bill and published their report on 13 February 2018.<sup>71</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.

### Box 3: Absolute vs Relative Caps

There were two main types of price cap the Government could have implemented: absolute and relative. The former imposes a cap on the maximum amount any supplier can charge for electricity and gas, and is the type of tariff used for prepayment meters and vulnerable customers. The latter 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 a number of MPs raised the possibility of a relative cap during Bill scrutiny.

There are 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 have supported the implementation of an absolute price cap to protect customers from overcharging.<sup>72</sup>
- **Supporters of a relative price cap:** Some suppliers and MPs have instead expressed support for a relative price cap. Proponents say 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>73</sup>
- **Opponents of a price cap:** Some MPs and the 'big six' energy suppliers have opposed a price cap. Opponents say a price cap could hurt competition<sup>74</sup> and that consumers who do not engage with the market should expect to pay more for their energy.<sup>75</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 will be lifted by the end of 2020. The Bill provides for the cap to be extended until 2023 if conditions for effective market competition are not met (in October 2020 the [Government announced the extension of the cap](#) to December 2021).

<sup>70</sup> BBC, [In full, Theresa May's Conservative conference speech 2017](#), 4 October 2017

<sup>71</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

<sup>72</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>73</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>74</sup> Adam Vaughan, [E.ON chief: Theresa May's energy price cap will hurt competition](#), *The Guardian*, 20 October 2017

<sup>75</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

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 paper on [The Tariff Cap Act](#).

## 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 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>76</sup>

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>77</sup> Ofgem's press release says this will 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.

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>78</sup>

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

## 3.3 Setting the Caps

The levels of the 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

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<sup>76</sup> Ofgem, [Statutory Consultation – Default tariff cap – Overview document](#), 6 September 2018

<sup>77</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.

<sup>78</sup> Ofgem, [Energy price cap will give 11 million a fairer deal from 1 January](#), 6 November 2018

customers, but high enough to encourage suppliers to offer tariffs below the level of the cap, to maintain competition and incentivise switching.

From August 2019, Ofgem have 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>79</sup> (as in section 3.1 above, the pre-payment meter cap previously had a different methodology). As the caps include network costs, the level of the cap varies between different regions, for example it is higher in some rural areas where the network costs of the bill are higher.<sup>80</sup> The caps are updated twice annually, in April and October (see Section 3.4 below).

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>81</sup>

The pre-payment meter cap will expire at the end of 2020. This date was initially set as it was when the smart meter roll out was due to be complete (see Box 4). In a July 2019 review, the CMA said that due to the projections that the smart meter roll out would be delayed beyond 2020, extending the pre-payment meter cap beyond 2020 should be considered to ensure pre-payment meter customers continue to be protected.<sup>82</sup> Ofgem has included a new prepayment meter cap level within the default tariff cap to ensure prepayment customers continue to be protected after 2020.<sup>83</sup>

The *Tariff Cap Act* provides for the default tariff cap to also be in place until 2020, though if Ofgem reports to the Government that the conditions are not yet in place for “effective competition” in the energy market, then the cap can be extended for a year. These extensions can continue until 2023. The roll out of smart meters must also be considered as part of Ofgem’s report. In October 2020, the Government [announced the tariff cap would be extended](#) to until the end of 2021.

Details of the debate on the setting of the cap, appeals, and the meaning of “effective competition” are available in the Library briefing paper on the [Tariff Cap Act](#).

#### **Box 4: Smart meters**

Energy Smart meters are advanced electricity and gas meters which can offer a range of intelligent functions. The Government plan to roll out more than 50 million energy smart meters to 30 million homes and smaller non-domestic sites in Great Britain.

<sup>79</sup> Ofgem, [Decision – Default tariff cap – Overview document](#), 6 November 2018

<sup>80</sup> For more information on networks, see the Library briefing paper on [Electricity Grids](#), January 2019.

<sup>81</sup> House of Commons Library, [The Domestic Gas and Electricity Tariff Cap Act 2018](#), 17 August 2018

<sup>82</sup> CMA, [Review of the Energy Market Investigation \(Prepayment Charge Restriction\) Order 2016](#), 31 July 2019

<sup>83</sup> Ofgem, [Prepayment meter cap level](#) (accessed November 2020)

Smart meters are intended to have benefits for consumers, suppliers and networks. For consumers, smart meters should provide more accurate bills, easier switching, clearer energy use through an in-home display, and the potential for reduced bills based on reduced consumption. For suppliers, smart meters should mean avoiding site visits (for example to check meters) and reduced customer service overheads due to more accurate billing. For networks, smart meters facilitate a smarter grid, and the real-time data supplied by smart meters should make balancing the grid easier.

Energy suppliers are required to take “all reasonable steps” to install smart meters in their customer’s homes throughout the roll out. The original end target of the smart meter roll out was the end of 2020. However, delays to installations created concern that the target would not be met, and the coronavirus pandemic also impacted installations. In June 2020, [the Government extended](#) the “all reasonable steps” target until 30 June 2021 and announced its decision to introduce a further four year framework to reach “market-wide coverage of smart meters” after this date.

More information is available in the Library briefing paper on [Energy Smart Meters](#) and in the Library insight on [The smart meter roll out: will the 2020 deadline be met?](#)

## 3.4 Adjusting the caps

### February 2019 increase in the cap

The default tariff cap came into force at the beginning of 2019 and Ofgem review the levels of the cap twice a year.

In February 2019, Ofgem announced that the level of the cap would increase from April by £117. They also announced that the pre-payment meter cap would rise by £106. According to Ofgem’s press release, the rise in the caps reflects “the underlying cost of energy increases” with the main change an increase in wholesale prices:

Around £74 of the £117 increase in the default tariff cap is due to higher wholesale energy costs, which makes up over a third (£521) of the overall cap. Higher wholesale energy costs have similarly pushed up the level of the pre-payment meter cap.

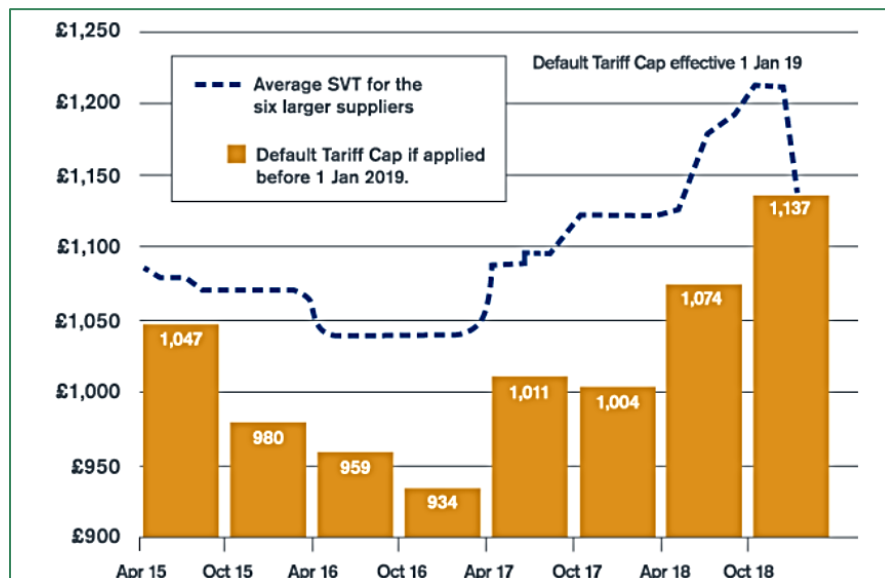
Last year higher oil prices, amongst other factors like the higher demand for gas from the ‘beast from the east’, led to a rise in wholesale gas prices. Because of the importance of gas as a source of electricity generation, this also led to higher wholesale electricity prices.

While the prices of wholesale energy contracts used for calculating the cap have fallen in recent months, overall these costs remain 17% higher than the last cap period.

Other costs, including network costs for transporting electricity and gas to homes and costs associated with environmental and social schemes (policy costs), have also risen and contributed to the increase in the level of the caps.<sup>84</sup>

<sup>84</sup> Ofgem, [Higher wholesale costs push up default and pre-payment price caps from April](#), 7 February 2019

Despite the increase, Ofgem said it was likely that customers would have been paying more if the cap were not in place as the graph below shows.



Source: [Ofgem](#)

Analysis suggests that the default tariff price cap would have reduced the price of the average standard variable tariffs from the six largest suppliers by around £75 to £100 per year since April 2015 had it been in place over this period. The chart below shows these suppliers have consistently charged more than the indicative level of the default tariff cap, which reflects the estimated costs of an efficient supplier. This analysis suggests had the cap not been introduced on 1 January, customers would be paying significantly more even after the increase for the next cap period<sup>85</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 and the latter by £75. Ofgem expect 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>86</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:

<sup>85</sup> Ofgem, [Higher wholesale costs push up default and pre-payment price caps from April](#), 7 February 2019

<sup>86</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>87</sup>

It is important to remember that the cap is on the cost of units of energy, not total bills. As this cap period was over the winter, although the cap level has 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 that the levels of both the pre-payment meter and the default tariff caps would both decrease by 1%. 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>88</sup>

### **August 2020 decrease in the cap**

In August 2020, Ofgem announced the default tariff cap would reduce by 7% from £1,126 to £1,042 for the period of 1 October 2020 – 31 March 2021. The main driver of the reduction was a fall in wholesale costs in part caused by the coronavirus pandemic. For information on the impact of coronavirus on energy bills and Ofgem's response, see Box 2 (in section 1.4)

From 1 October, the default tariff cap also includes a new cap level for prepayment meter customers. This integrated cap replaces the prepayment meter cap which expires on 31 December 2020. The new prepayment meter cap level also decreased from the previous period, to £1,070.<sup>89</sup>

### **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, and £87 for pre-payment meter customers. The main driver was a rise in wholesale prices, but the default tariff cap also includes an additional allowance for suppliers to recover from some of the costs related to Covid-19, including bad debt from customers unable to pay their bills.<sup>90</sup>

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

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<sup>87</sup> Ofgem, [Energy caps to fall this winter due to lower wholesale costs](#), 7 August 2019

<sup>88</sup> Ofgem, [Prepayment meter cap update for 1 April 2020](#) and [Default tariff cap update for 1 April 2020](#), 7 February 2020

<sup>89</sup> Ofgem, [Default tariff cap level: 1 October 2020 to 31 March 2021](#), 7 August 2020

<sup>90</sup> Ofgem, [Energy price cap to increase in April but consumers should switch to save money](#), 5 February 2021



### 3.5 Comment on the caps

According to its proponents, a cap protects consumers who don't switch from tariffs which do not reflect the true cost of energy.<sup>9192</sup>

According to its opponents, a cap damages competition in the market by removing the incentive to switch, and risks underinvestment in infrastructure<sup>9394</sup>.

In response to the 2018 cap announcement, the industry trade body Energy UK's Chief Executive Lawrence Slade said:

The price cap will present a significant challenge for many of the 70+ suppliers in the retail market, who are already facing steeply 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>95</sup>

However, the consumer charity Citizens Advice welcomed the cap, whilst 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>96</sup>

### 3.6 What can domestic customers do to lower their energy bills?

Customers who want to [compare different energy providers' tariffs](#) and [switch providers](#) can use a price comparison website or the [Citizens Advice website](#) for advice. Customers can also check on their energy bills if lower tariffs are available with their current provider. Finally, they may be eligible for energy efficiency measures that could lower the household's energy consumption or bills. These measures are laid out in the House of Commons briefing paper [Help with energy bills](#).

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<sup>91</sup> HL Deb 3 July 2017 [c742](#)

<sup>92</sup> HC Deb 16 March 2017 [c597](#) and [c602](#)

<sup>93</sup> HL Deb 3 July 2017 [c743](#)

<sup>94</sup> Paul Goodman, [If the energy cap doesn't fit](#), Conservative Home, 9 May 2017

<sup>95</sup> Energy UK, [Energy UK responds to Ofgem's price cap announcement](#), 6 November 2018

<sup>96</sup> Citizens Advice, [Energy price cap "offers some much needed protection for loyal households", says Citizens Advice](#), 6 November 2018

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