



BRIEFING PAPER

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Energy bills and the price cap

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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. Many energy suppliers have increased their default electricity and gas tariffs since late 2016, whilst many of their cheaper deals have been withdrawn. The reasons for these changes are complex, with stakeholders citing fluctuating wholesale energy prices, rising operational costs and the impact of levies as reasons for the price increases.

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 their energy supply. 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 report suggested over 30 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.

The Tariff Cap

Despite not being a CMA recommendation, a wider tariff cap has been 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 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*](#).

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

On 6 November 2018, Ofgem announced that a cap of £1,137 will apply to 11 million typical customers paying dual fuel bills by direct debit from 1 January 2019. In February 2019, shortly after the cap came into force, Ofgem announced increases in the levels of the caps, citing an increase in the underlying cost of supplying energy, particularly wholesale 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).¹ The energy market then entered a period of liberalisation with new suppliers emerging and competition between suppliers establishing.

In the years since privatisation there has been considerable restructuring and consolidation of the energy industry, resulting in the existence of the 'big six' energy companies, Centrica plc (British Gas), EDF Energy, E.ON, SSE, Scottish Power and Npower. 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 2015,² rising to 73 in mid-2018 (it has since fallen after a number of small suppliers entered administration, see Box 1).³ However the 'big six' still dominate, supplying about 75% of all British domestic electricity and 75% of all domestic gas in March 2018,⁴ though this has declined since 2012 when they supplied over 95% of the domestic energy market.⁵

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.

However, many consumers don't switch suppliers regularly or at all. These customers tend to be on Standard Variable Tariffs (SVTs)⁶ which is the default tariff offered by companies if consumers have not actively

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

² Ofgem, [Retail Energy Markets in 2015](#), 9 September 2015

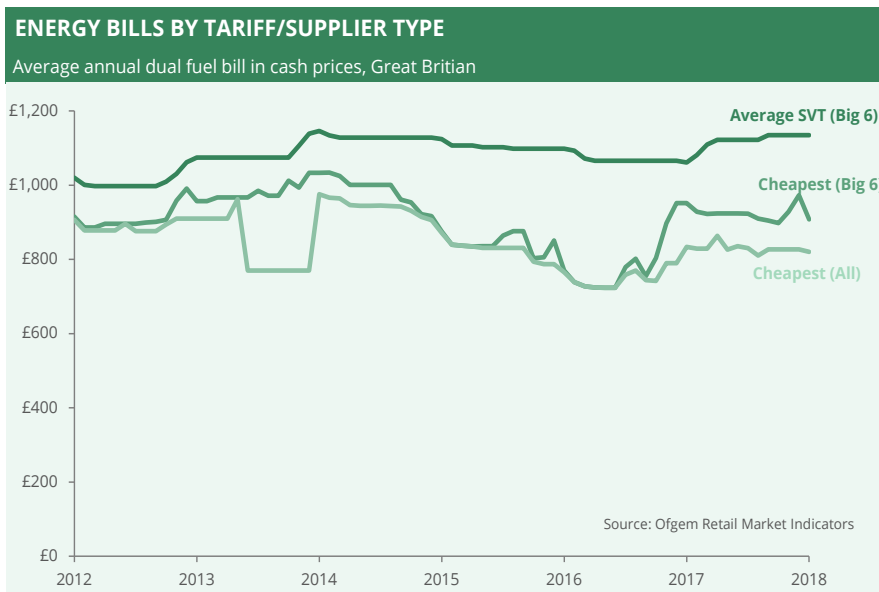
³ Ofgem, [Retail highlights](#), February 2019

⁴ Ofgem, [Retail highlights](#), February 2019

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

⁶ CMA, [Energy market investigation – Summary of final report](#), 24 June 2016

made a choice. It is also the rate consumers default to after fixed price contracts end.



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

There is a price gap between the standard variable tariff (SVT) and the cheapest tariff, even with the same supplier, as the chart above shows. Switching suppliers or tariffs could therefore save consumers money. However, 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.⁷

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.⁸ 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.⁹

There are indications that switching is increasing. Following price rises from all the 'big six' energy suppliers between winter 2016 and summer 2017, Ofgem figures said almost 2.5 million people switched electricity supplier and almost 2 million switched gas supplier between January and June 2017. Having fallen between 2008 and 2012, Ofgem said switching began to increase in 2014. In 2018 the domestic gas and electricity switching rates were up to 19%, the highest rates since 2008.¹⁰

⁷ CMA, [Modernising the Energy Market](#), 24 June 2016

⁸ Ofgem, [Consumer engagement in the energy market since the Retail Market Review 2016 Survey Findings](#), August 2016

⁹ CMA, [Energy market investigation – Summary of final report](#), 24 June 2016 (p. 22)

¹⁰ Ofgem, [Retail highlights](#), February 2019

Box 1: Supplier challenges in the energy retail market

Several small energy suppliers entered administration at the end of 2018 and beginning of 2019.

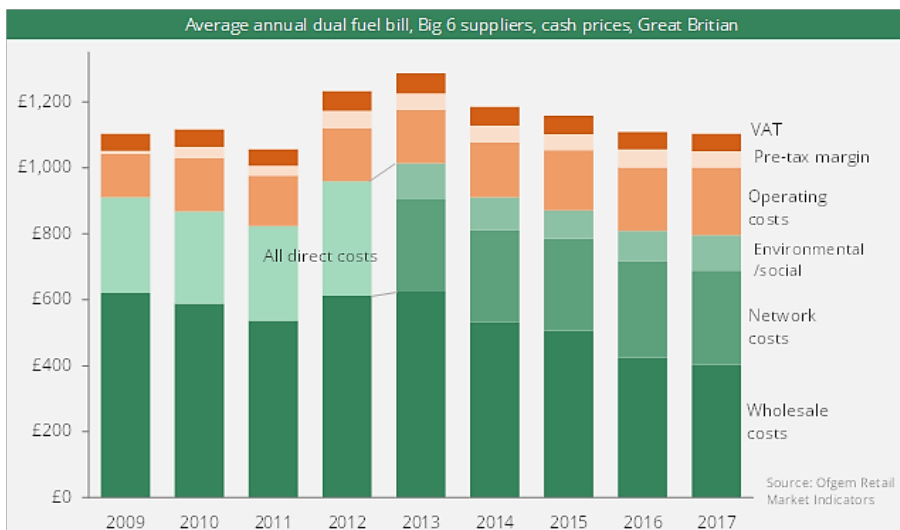
A number of reasons for this have been reported, including small suppliers being more vulnerable to increases in wholesale prices¹¹, and a lack of financial and customer services checks for new suppliers.¹² Ofgem have proposed new tests for licensing energy suppliers, including demonstrating that they have adequate financial resources and can meet their customer service obligations.¹³

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](#).

In addition to small suppliers, some of the 'big six' have faced challenges in the market. In October 2018, Ofgem reported that annual profits for the 'big six' energy suppliers had fallen by 10% due to increased competition.¹⁴ This was before the implementation of the default tariff price cap. Also, at the end of 2018, a proposed merger between npower and SSE, which would have created the UK's second biggest energy supplier, fell through. According to SSE, the deal was no longer going ahead due to "challenging energy market conditions" including the level of the price cap¹⁵ (see section 3).

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 data¹⁶). 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.



Source: Ofgem, [Retail Market Indicators, 2018](#)¹⁷

¹¹ This is Money, Is [ditching the Big Six worth the risk?](#) 12 December 2018

¹² Energy UK, [Energy UK responds to Ofgem's proposed new tests for licensing energy suppliers announcement](#), 21 November 2018

¹³ Ofgem, [Ofgem proposes new tests for licensing energy suppliers](#), November 2018

¹⁴ Ofgem, [Profits and customers fall for six biggest energy suppliers as competition increases](#), 11 October 2018

¹⁵ SSE, [SSE Energy services transaction not proceeding](#), 17 December 2018

¹⁶ Data on bill breakdown from Ofgem, [Breakdown of a dual fuel bill](#), August 2018

¹⁷ Previously network costs were known jointly with environmental and social costs as direct costs.

- **Wholesale costs:** 36.2%. Wholesale costs have historically been the biggest component of energy bills as the graph shows but until recently they have been stable or even falling. There are a number of potential reasons for the increase that started in mid-2016 including the weaker pound after the Brexit vote, French nuclear outages, retirement of old coal power plants, cold weather, and concerns over shortages.¹⁸

Domestic energy suppliers have previously been accused of not cutting bills when wholesale costs fall. Ofgem reported a wholesale cost drop in Quarter 1 of 2017 but this was not reflected in bill reductions.¹⁹ 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.²⁰ Ofgem had earlier written to energy suppliers in June 2014, arguing in a competitive market, prices should be cut as costs fall.²¹

- **Network costs:** 25.4%. 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.²² 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 £284 in 2017. However direct costs in 2009 (when network costs and environmental obligations were combined) were only £290 whereas in 2017 combined they were £392.²³ This shows a rise over time driven by both network and environmental costs.

- **Operating costs:** 18.3%. 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:** 9.7%. Many suppliers account the most recent price rises to "green levies" (environmental and social obligation costs). These include policies such as:²⁴
 - The Renewables Obligation (which closed in March 2017)
 - Feed in tariffs (to close in March 2019)
 - The Energy Company Obligation
 - Carbon price floor

¹⁸ ICIS [Power Index](#) (accessed 15 March 2019)

¹⁹ Ofgem, [Wholesale highlights at January 2019](#), Data portal (accessed 15 March 2019)

²⁰ The Financial Times, [Pressure mounts on UK energy suppliers to cut prices](#), 15 January 2016

²¹ Ofgem, [Letter calling on large energy suppliers to explain wholesale price impact on energy bills](#), 10 June 2014

²² Ofgem, [Energy networks should prepare for tougher price controls](#), 12 July 2017

²³ Ofgem, [Large Suppliers: Domestic dual fuel bill breakdown over time](#), Data Portal, (accessed 15 March 2019)

²⁴ Ofgem, [Energy Companies' Consolidated Segmental Statements](#), 3 July 2017

— 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.²⁵ 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.²⁶

- **Pre-tax profits:** 4.4%. 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.
- **VAT:** 4.8%.
- **Other direct costs:** 1.2%. 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.

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.²⁷

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.²⁸ 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 other European countries, domestic electricity prices in the UK are above average and gas prices in the UK are below average.²⁹

From the end of 2016, energy prices have been rising with all of the 'big six' announcing increases³⁰³¹³²³³ and further rises have been announced

²⁵ Committee on Climate Change, [Energy Prices and Bills – impacts of meeting carbon budgets](#), March 2017 (page 7)

²⁶ Ibid

²⁷ Gov.uk, [Annual domestic energy bills](#), 27 September 2018

²⁸ Committee on Climate Change, [Energy Prices and Bills – impacts of meeting carbon budgets](#), March 2017

²⁹ Ofgem, [Infographic Bills, prices and profits](#), 31 January 2019

³⁰ The Times, [MPs turn up heat as energy firms raise prices](#), 8 March 2017

³¹ Adam Vaughan, [Scottish Power customers to be hit by 7.8% price hike](#), The Guardian, 10 February 2017

³² BBC News, [SSE to raise electricity prices next month](#), 13 March 2017

³³ BBC News, [British Gas to raise electricity prices](#), 1 August 2016

in 2019.³⁴ The reasons for these changes are complex, comprising fluctuating wholesale energy prices, rising operational costs and the impact of green levies, as discussed above.

Ofgem review the level of the price caps twice a year. In February 2019, they announced that the level of both the default and pre-payment meter caps would increase. According to Ofgem's press release, the rise in the caps reflects "the underlying cost of energy increases", especially an increase in wholesale prices.³⁵

³⁴ Adam Williams, [Energy customers brace for further price increases](#), *The Telegraph*, 15 April 2018

³⁵ Ofgem, [Higher wholesale costs push up default and pre-payment price caps from April](#), 7 February 2019

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. Supply price controls were removed in the market in Britain several years after the introduction of competition for domestic consumers in the late 1990's.

Until recently, energy prices were not capped. 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.³⁶

Consumers are faced with a mixture of tariffs that companies have created to attract or retain customers. 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 will be on the default, more expensive, Standard Variable Tariff.

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 report³⁷ criticised the functioning of energy markets, saying the gap between companies' direct debit tariffs, and those for standard credit and 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 probe³⁸ 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

³⁶ Sophie Barker, [Ofgem to end price caps on energy](#), The Telegraph, 27 November 2001

³⁷ Business and Enterprise Committee, [Energy prices, fuel poverty and Ofgem](#), Eleventh report of session 2007-08, Vol. I, 16 July 2008

³⁸ Ofgem, [Energy supply probe](#) (accessed 15 March 2019)

another investigation - the Retail Market Review³⁹ - 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.⁴⁰ 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.

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 report⁴¹ in June 2016.

More information on reform is available in the House of Commons Note 'The Current Energy Market Reforms in Great Britain'.⁴²

Box 2: Dieter Helm Cost of Energy 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."⁴³

In August 2017, The Department for Business, Energy and Industrial Strategy, launched this independent review which will be led by Professor Dieter Helm, an economist specialising in energy based at the University of Oxford.⁴⁴ [The Cost of Energy review](#) was published on 25 October 2017.⁴⁵ 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.⁴⁶

On 15 November 2018, the 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 2019.⁴⁷

³⁹ Ofgem, [Retail Market Review](#), (accessed 15 March 2019)

⁴⁰ OFT, Ofgem, CMA, [State of the Market Assessment](#), 27 March 2014

⁴¹ CMA, [Energy market investigation – Summary of final report](#), 24 June 2016

⁴² House of Commons Library, [The Current Energy Market Reforms in Great Britain](#), 15 March 2017

⁴³ HM Government, [Building our Industrial Strategy](#). Green Paper, January 2017

⁴⁴ Department for Business, Energy and Industrial Strategy Press Release, [Independent review to ensure energy is affordable for households and businesses](#), 6 August 2017

⁴⁵ Dieter Helm, [Cost of Energy Review](#), 25 October 2017

⁴⁶ Gov.uk, [Cost of energy review: call for evidence](#), 7 November 2017

⁴⁷ 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

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 are:

- 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 include:

- 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, so far the following have been achieved:

- A series of Orders based on the recommendations were published on 14 December 2016.⁴⁸
- 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).⁴⁹
- Ofgem have delayed⁵⁰ 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 2018.⁵¹

⁴⁸ Gov.uk, [Energy Market Investigation](#), (accessed 15 March 2019)

⁴⁹ Ofgem, [Prepayment meter price cap](#), (accessed 15 March 2019)

⁵⁰ Ofgem, [Open letter: Update on the timing of the CMA database remedy](#), 7 July 2017

⁵¹ Ofgem, [Results of qualitative research for the 'Check Your Energy Deal' service and digital trial early findings](#), 12 February 2018

- 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 table⁵² to increase transparency on the numbers of people on expensive standard variable tariffs.
- In January 2017, Ofgem launched a Supplier Cost Index⁵³. 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.⁵⁴
- 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.⁵⁵
- 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.⁵⁶
- In November 2017, Ofgem announced its proposals for improving customer data to make switching easier for customers.⁵⁷
- 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.⁵⁸

⁵² Ofgem, [Standard variable tariff comparison](#), 28 November 2016

⁵³ Ofgem, [Supplier Cost Index](#), 19 January 2017

⁵⁴ Ofgem, [Publication of the new Ofgem Confidence Code](#), 1 September 2017

⁵⁵ Gov.uk, [Energy Market Investigation \(Restricted Meters\) Order 2016](#), 14 December 2016

⁵⁶ Ofgem, [Decision: Default tariffs for domestic customers at the end of fixed-term contracts](#), 11 October 2017

⁵⁷ Ofgem, [Open letter: improving customer data and database remedy](#), 13 November 2017

⁵⁸ Ofgem, [Decision on implementing the CMA's recommendation to remove the Whole of Market requirement](#), 16 July 2018

3. Price 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. According to its proponents, a cap protects consumers who don't switch from tariffs which do not reflect the true cost of energy.⁵⁹⁶⁰ According to its opponents, a cap damages competition in the market by removing the incentive to switch, and risks underinvestment in infrastructure⁶¹⁶².

Despite the CMA eventually not recommending a cap on other domestic bills, this idea has reoccurred in political debate.

The UK has three forms of price caps:

- Prepayment price cap – for customers with prepayment meters - in force until 2020
- 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 price cap – for customers on default or SVTs – this came into force from 1 January 2019

Price caps do not apply to all customers; customers who pay with prepayment meters, or are on the Warm Homes Discount scheme, or are on a default or SVT, will be on price capped tariffs. All other customers, for example those 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](#).

Setting the Caps

The levels of the cap are set by the energy regulator Ofgem. The intention of the cap is to set 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.

The methodology for setting the pre-payment meter cap was set out by the CMA as part of their investigation. The methodology includes a reference price for the cost of supplying energy based on existing tariffs and then headroom for suppliers to compete under the cap.⁶³

Ofgem have used a bottom-up assessment approach for the default tariff cap, which will include an estimate of efficient allowances for each

⁵⁹ HL Deb 3 July 2017 [c742](#)

⁶⁰ HC Deb 16 March 2017 [c597](#) and [c602](#)

⁶¹ HL Deb 3 July 2017 [c743](#)

⁶² Paul Goodman, *If the energy cap doesn't fit*, Conservative Home, 9 May 2017

⁶³ Ofgem, [Prepayment price cap](#) (accessed 15 March 2019)

cost category of a bill.⁶⁴ 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. The caps are updated twice annually, in April and October (see 3.3 below).

The *Tariff Cap Act* (discussed below), 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 Business, Energy and Industrial Strategy Committee that appeals would slow the implementation of the cap. Suppliers can dispute the level of the cap through judicial review.⁶⁵

The pre-payment meter cap and safeguard tariff are due to be lifted in 2020 when the smart meter roll out is due to be complete (see Box 2). The *Tariff Cap Act* also provides for the default tariff cap to 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. 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 3: Smart meters

Energy Smart meters are advanced electricity and gas meters which can offer a range of intelligent functions. Between now and the end of 2020, the Government plan to roll out more than 50 million new energy ‘smart meters’ to 30 million homes and smaller non-domestic sites in Great Britain.

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.

There has been concern that the end of 2020 deadline will not be met. [Government data](#) has showed that by the end of September 2018, 12.8 million smart and advanced meters were operating across homes and businesses, leaving the vast majority still to install.

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?](#)

3.1 Pre-payment meter and Safeguard Tariffs

Pre-payment meter cap

The CMA review of the Energy Market recommended a temporary cap for the four million households on pre-payment meters who are less able to benefit from competition as there are fewer tariffs available. This

⁶⁴ Ofgem, [Decision – Default tariff cap – Overview document](#), 6 November 2018

⁶⁵ House of Commons Library, [The Domestic Gas and Electricity Tariff Cap Act 2018](#), 17 August 2018

cap entered into force in April 2017⁶⁶ and is projected to end in 2020 when the smart meter roll-out is due to be completed (see Box 2). The price is recalculated on 1 April and 1 October every year and the methodology used to determine the cap was set by the CMA based on indices of trends and indexes of various costs.⁶⁷

Safeguard Tariff

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 the Secretary of State for Business, Energy and Industrial Strategy (BEIS) wrote to Ofgem to encourage them to implement a “*safe-guard tariff*”.⁶⁸

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”.⁶⁹

Ofgem’s proposals extended price caps to “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 means the pre-payment meter and safeguard caps now cover a total of around 5 million households.⁷⁰

Ofgem have said that customers previously protected by the safeguard tariff because they receive the Warm Home Discount are protected by the new default tariff price cap.⁷¹

3.2 The Default Tariff Price Cap

A default tariff cap policy first appeared in the 2015 Labour manifesto.⁷² By the 2017 General Election a price cap was in both the Labour and Conservative manifestos.

The 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”

⁶⁶ Ofgem, [Ofgem sets prepayment price cap to protect over four million households least able to benefit from competition](#), 7 February 2017

⁶⁷ Gov.uk, [Domestic prepayment meter energy price cap: illustrative model](#), 24 June 2016

⁶⁸ Gov.uk, [Energy retail market: letter to Ofgem](#), 21 June 2017

⁶⁹ Ofgem, [Ofgem reply to letter from Secretary of State](#), 3 July 2017

⁷⁰ Natalie Thomas and Jim Pickard, [Ofgem proposes ‘safeguard’ price cap for vulnerable customers](#), 3 July 2017

⁷¹ Ofgem, [About energy price caps](#) (accessed 15 March 2019)

⁷² For example, [Ed Milliband’s energy crusade misses target say experts](#), Financial Times, 25 September 2013

for “customers on the poorest value tariffs”⁷³ and included in the Queen’s Speech 2017.⁷⁴

Responsibility for the tariff cap - Ofgem or Government?

On the 3 July 2017 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. John Penrose MP 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.⁷⁵

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.⁷⁶

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.⁷⁷ Ofgem’s 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.⁷⁸ However, the Government believed that setting a tariff cap was in Ofgem’s power.⁷⁹

⁷³ Conservative Party, [The Conservative Party Manifesto 2017, Forward Together](#)

⁷⁴ Gov.uk, [Queen’s Speech 2017](#), 21 June 2017

⁷⁵ HC Deb 3 July 2017 [c892](#)

⁷⁶ HC Deb 3 July 2017 [c891](#)

⁷⁷ HC BEIS Committee, [Oral Evidence: CMA’s investigation of the UK Energy Market, HC 982](#), 22 February 2017, Q153

⁷⁸ HC BEIS Committee, [Oral Evidence: CMA’s investigation of the UK Energy Market, HC 982](#), 22 February 2017, Q156

⁷⁹ PQ 8440 [[On energy prices](#)], 4 September 2017

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".⁸⁰

The Tariff Cap Act 2018

During her speech to the Conservative party conference on 4 October 2017, the Prime Minister Theresa May announced:

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.⁸¹

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 2018.⁸² 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 4: 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.⁸³
- **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".⁸⁴
- **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 competition⁸⁵ and that consumers who do not engage with the market should expect to pay more for their energy.⁸⁶

⁸⁰ BBC, [Scores of Tory MPs join energy cap call](#), 29 September 2017

⁸¹ BBC, [In full: Theresa May's Conservative conference speech 2017](#), 4 October 2017

⁸² BEIS Committee, [Pre-legislative scrutiny of the draft Domestic Gas and Electricity \(Tariff Cap\) Bill](#), Fourth Report of Session 2017-19, 13 February 2018

⁸³ 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

⁸⁴ 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

⁸⁵ Adam Vaughan, [E.ON chief: Theresa May's energy price cap will hurt competition](#), *The Guardian*, 20 October 2017

⁸⁶ 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 *Domestic Gas and Electricity (Tariff Cap) Bill* had its First Reading on 26 February 2018. The Bill proposed a temporary, absolute cap on the price of standard variable and default tariffs that will be lifted by the end of 2020, although the Bill provides for it to continue until 2023 if conditions for effective market competition are not met.

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.⁸⁷

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. 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.⁸⁸

The savings for individual customers will depend on how much energy they use, the price of their current tariff, whether they have both gas and electricity and how they pay for their energy. 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](#).

⁸⁷ Ofgem, [Statutory Consultation – Default tariff cap – Overview document](#), 6 September 2018

⁸⁸ Ofgem, [Energy price cap will give 11 million a fairer deal from 1 January](#), 6 November 2018

In response to the cap announcement, Energy UK 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.⁸⁹

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.⁹⁰

3.3 Raising the caps

The default tariff cap came into force at the beginning of 2019. Ofgem review the level of the cap twice a year and in February, 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". The Ofgem press release on the rise states that the main change was 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.⁹¹

⁸⁹ Energy UK, [Energy UK responds to Ofgem's price cap announcement](#), 6 November 2018

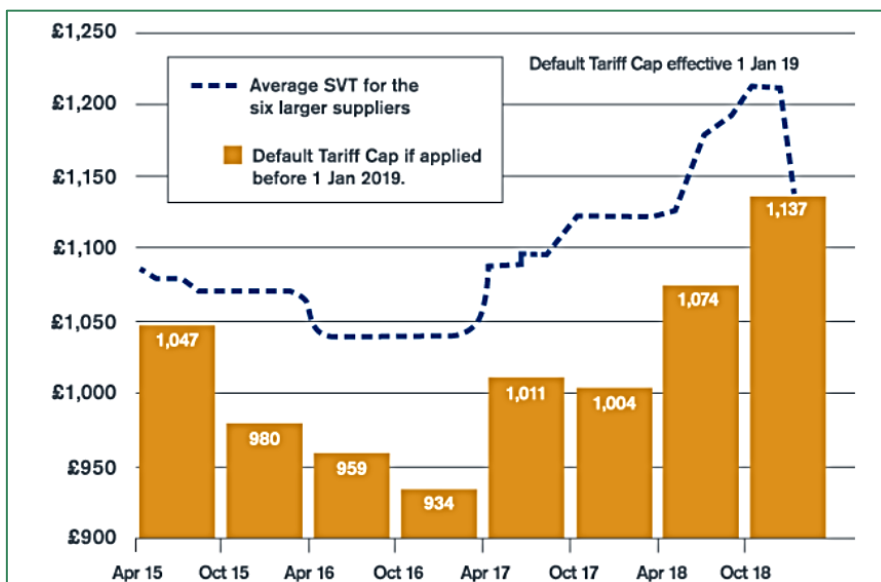
⁹⁰ Citizens Advice, [Energy price cap "offers some much needed protection for loyal households", says Citizens Advice](#), 6 November 2018

⁹¹ Ofgem, [Higher wholesale costs push up default and pre-payment price caps from April](#), 7 February 2019

Following the announcement, a number of suppliers have announced plans to increase their prices.⁹²

However, Ofgem said despite the increase, it is likely that customers would have been paying more if the cap were not in place as the graph below shows:

Analysis suggest 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 period⁹³



Source: [Ofgem](#)

3.4 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](#).

⁹² Sarah Ingrams, [Energy price cap one week on: three firms to raise gas and electricity prices](#), Which, 14 February 2019 (note that other suppliers not mentioned in the article have also announced price rises).

⁹³ Ofgem, [Higher wholesale costs push up default and pre-payment price caps from April](#), 7 February 2019

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