

A Reminder About the Default Tariff Price Cap

Following the privatisation of the energy market, prices for electricity and gas fell. From 2000, prices began to increase in real terms escalating, in 2016 and 2017. In its submission to the Competition and Markets Authority (CMA) investigation of the energy market, Ofgem acknowledged the market is characterised by a significant proportion of “sticky” consumers, unable or unwilling to shop around and switch suppliers to get a better deal. In 2016, in its report on the investigation, the CMA estimated that customers were being overcharged £1.4 billion for their energy. By the 2017 General Election, a form of energy price cap was in both the Labour and Conservative manifestos.¹

The Default Tariff Price Cap was introduced on 1 January 2019 under the Domestic Gas and Electricity (Tariff Cap) Act 2018, and protects around 11 million households on **default energy**,² including **standard variable**³ tariffs. Both Default and standard variable tariffs are a basic tariff from an energy supplier and are typically more expensive than non-default, fixed-term tariffs, typically chosen by to customers who choose to switch.

Licensed gas and electricity suppliers are subject to “tariff cap conditions” (contained in their standard supply licence (SLC) conditions),⁴ which impose a cap on all default energy and standard variable tariffs that may be charged by the supplier to customers for the supply of gas or electricity under domestic supply contracts. Section 2 (1) of the Domestic Gas and Electricity (Tariff Cap) Act 2018 makes provision for “tariff cap conditions” and SLC 28AD in gas and electricity supply licences set out conditions that impose a cap on all standard variable and default rates that may be charged by suppliers under domestic supply contracts. The caps ultimately ensure customers pay a fairer price for gas and electricity and are protected against overcharging.

The caps are based on the costs that Ofgem calculates suppliers need to spend to get energy to customers’ homes and, as such, provide protection to domestic customers by minimising their exposure to paying significantly more than their suppliers’ underlying costs.

Fixed-term energy tariffs⁵ are not protected by the caps, as Ofgem believes these tariffs are chosen by customers who are mobile in the market and who can make their own decisions as to which supplier offers best value.⁶

1 House of Commons website, “The Domestic Gas and Electricity (Tariff Cap) Act 2018” 17 August 2018, available at <https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-8242>, accessed 11 August 2019.

2 This is a rate or amount charged for, or in relation to, the supply of gas or electricity under the contract that applies if the customer under the contract fails to choose an alternate rate.

3 This is a rate or amount charged for, or in relation to, the supply of gas or electricity under the contract that is not fixed for a period specified in the contract. This basic tariff is characterised with variable prices that can go up and down with the market. Customers could be put on a standard variable tariff or a tariff the customer has not chosen (a “default tariff”) if that customer’s fixed-term tariff contract ends and the customer has not chosen a new one. They usually cost more than a fixed-term tariff.

4 These are the standard conditions incorporated in gas and electricity supply licences by virtue of section 8 of the Gas Act 1986 and section 8A of the Electricity Act 1989.

5 A tariff with specific terms applying to the contract conditions. Usually, these lock in a price for a year or more, amongst other services.

6 Ofgem website: Your questions answered: Energy Price Caps, available at <https://www.ofgem.gov.uk/energy-price-caps/about-energy-price-caps/your-questions-answered-energy-price-caps>, accessed 11 August 2019.

The cap will also not apply to customers who:

- **Actively chose to sign up to a renewable energy tariff (standard variable), which Ofgem has exempted from the cap.** On 1 August 2019, Ofgem issued permanent derogations⁷ from the Default Tariff Price Cap (until the cap’s removal in 2023) to clean power suppliers, Good Energy, Ecotricity and Green Energy UK.
- **Have a prepayment meter.** These customers are covered by the **Prepayment Price Caps** (sometimes called a “safeguard tariff”), which limits how much a supplier can charge customers with prepayment meters. This cap was introduced on 1 April 2017.

Over half of all households in Great Britain are estimated to be on default tariffs because they have never switched.⁸ The Default Tariff Price Cap is expected to last until 2023, and the Prepayment Price Cap is expected to last until at least 2020.

How Does Default Tariff Price Cap Protection Work?

Under Section 6 (1) of the Domestic Gas and Electricity (Tariff Cap) Act 2018, the Default Tariff Price Cap must be updated every six months on 1 April and 1 October to reflect changes in the underlying costs of supplying energy. Wholesale energy markets make up around 50% of a customer’s bill. If wholesale prices go down, Ofgem needs to lower the cap to make sure suppliers pass on these reductions to customers by cutting bills. Contrariwise, if prices rise, the amount suppliers are allowed to pass on to customers must also rise, if they are not to be driven into insolvency. The capped energy tariffs are not designed to be the cheapest in the energy market, so customers are likely to save more if they switch, to preserve the incentive of the competitive market to drive down prices for customers who are willing to engage with the market. Of course, the levels of charges paid by customers still vary depending on the amount of energy they actually consume. The actual cap on the rate in pence/kWh at which any individual customer on a standard rate tariff may be charged is calculated by reference to:

- The capped rate of charges for energy, derived from the annualised Default Tariff Price Cap or Prepayment Price Cap
- Payment method: suppliers incur lower costs supplying customers who pay by direct debit
- Location: There are significant regional variations in the cost of transporting energy to customers
- Meter type: The cap is adjusted for customers with multiregister electricity meters benefitting from different rates at different times of day

Ofgem informs stakeholders of the forthcoming cap level in early February and early August each year.

7 Paragraph 25 of the SLC 28AD of the Electricity Supply Licence and paragraph 24 of the SLC 28AD of the Gas Supply Licence provide that Ofgem may issue directions relieving the licensee of its obligations to comply with standard condition 28AD to such extent and subject to such conditions as the Ofgem may direct.

8 Ofgem website: Default Tariff Price Cap, available at <https://www.ofgem.gov.uk/energy-price-caps/about-energy-price-caps/price-my-energy-bill-capped/default-tariff-price-cap>, accessed 11 August 2019.

Historical and Current Default Tariff Price Cap Levels

a) First Charge Restriction Period (1 January 2019 to 31 March 2019)

An initial Default Tariff Price Cap was introduced by Ofgem on 1 January 2019 (when Ofgem modified the SLCs for electricity and gas supply licences).⁹ For the First Charge Restriction Period (1 January to 31 March 2019), the Default Tariff Price Cap was set at **£1,137 per year** for a typical default tariff customer – a dual fuel customer who uses a typical amount of gas and electricity and pays by direct debit using a specified amount of energy in annualised terms intended to reflect the consumption of a “typical” domestic consumer. The typical domestic consumption value for electricity is 3,100 kWh per year and 12,000 kWh per year for gas. The values reflect the various components of a customer’s bill, including (i) wholesale, network and policy costs, (ii) suppliers’ operating costs, (iii) smart metering costs, and (iv) an additional “headroom allowance”.

b) Second Charge Restriction Period (1 April 2019 to 30 September 2019)

For the Second Charge Restriction Period (1 April 2019 to 30 September 2019), the Default Tariff Price Cap for a typical default tariff customer (dual fuel single rate customer paying by direct debit using a typical amount of energy in annualised terms) rose by £117 (10%) to **£1,254 per year** (from £1,137), predominantly driven by a rise in wholesale costs.

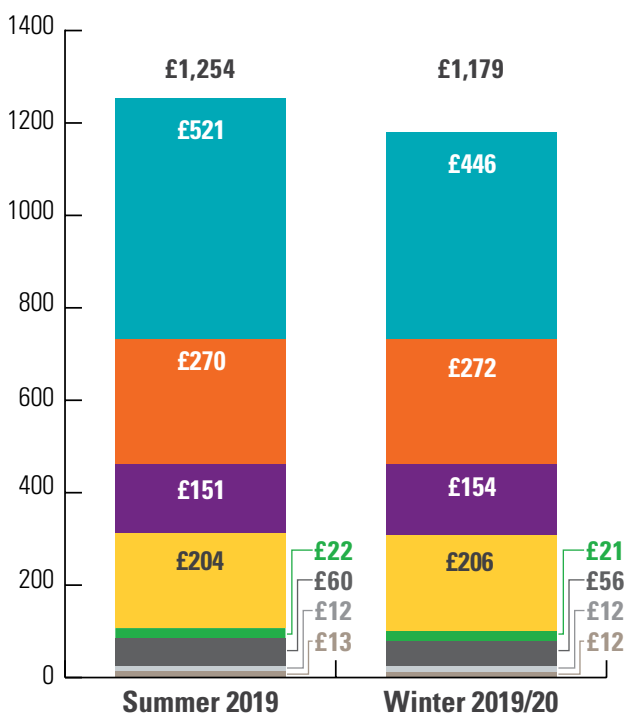
c) Third Charge Restriction Period (1 October 2019 to 31 March 2020)

On 7 August 2019, Ofgem announced the Default Tariff Price Cap would decrease by £75 (6%) to **£1,179 per year** for the six months effective from 1 October 2019, due to lower prices in wholesale energy markets, and the level of the Prepayment Meter Cap falls by £25 for around 4 million customers after its methodology is brought into line with the Default Tariff Price Cap.¹⁰

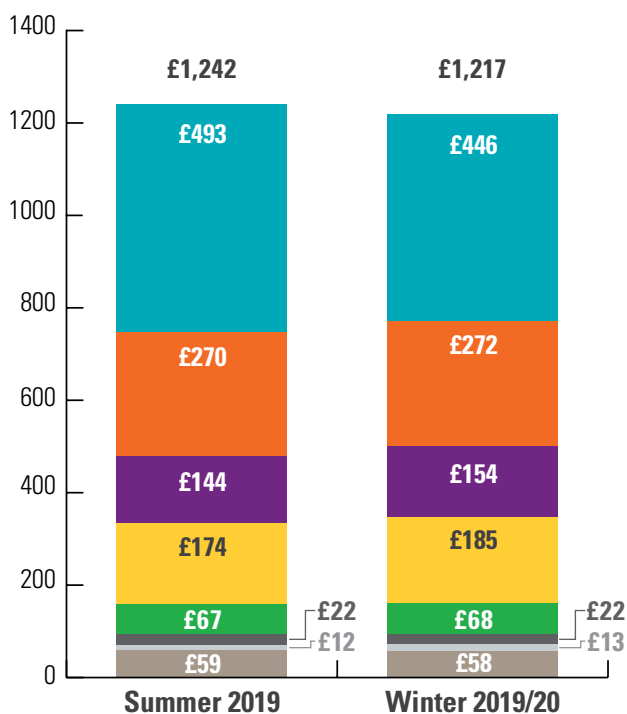
According to Ofgem,¹¹ wholesale energy prices fell significantly between February and June 2019. The reductions of both the Default Tariff Price Cap and Prepayment Meter Cap, it says, have been driven by a combination of low demand during the winter, a high influx of liquid natural gas (LNG) supply and relatively healthy storage levels. Accordingly, the wholesale energy cost element of the Default Tariff Price Cap fell by £75 to £446. Related costs, such as VAT, supplier profits (EBIT) and the headroom allowance, which fell by £7, were offset by comparable increases in the level of environmental levies on end users, network charges and suppliers’ operating costs, resulting in an overall reduction figure in the level of the Default Tariff Price Cap of £75.

Figure: The Default Tariff Price Cap and Prepayment Meter Cap Decrease Levels and Cost Breakdown

Default Tariff Price Cap (GBP£)



Prepayment Meter Price Cap (GBP£)



■ Wholesale costs
 ■ Network costs
 ■ Policy costs
 ■ Operating costs
■ Earnings before interest and taxes (EBIT)
 ■ Headroom allowance
 ■ Payment method uplift allowance
 ■ VAT

Source: Ofgem¹²

Note: Cost breakdowns are not directly comparable for the Prepayment Meter Price Cap due to a change in methodology between the summer 2019 and winter 2019/20 cap periods.

Ofgem will next review the level of the caps in February 2019, for the next six-month summer price cap period, which comes into force on 1 April 2020.

⁹ The enabling legislation for the introduction of these caps is the Domestic Gas and Electricity (Tariff Cap) Act 2018.

¹⁰ Ofgem website, “Energy caps to fall this winter due to lower wholesale costs” 7 August 2019 available at <https://www.ofgem.gov.uk/publications-and-updates/energy-caps-fall-winter-due-lower-wholesale-costs>, accessed 11 August 2019.

¹¹ Ibid 10.

¹² Ibid 10.

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