

DOMESTIC GAS AND ELECTRICITY (TARIFF CAP) ACT 2018

EXPLANATORY NOTES

What these notes do

These Explanatory Notes relate to the Domestic Gas and Electricity (Tariff Cap) Act 2018 (c. 21) which received Royal Assent on 19 July 2018.

- These Explanatory Notes have been prepared by the Department for Business, Energy and Industrial Strategy in order to assist the reader in understanding the Act. They do not form part of the Act and have not been endorsed by Parliament.
- These Explanatory Notes explain what each part of the Act will mean in practice; provide background information on the development of policy; and provide additional information on how the Act will affect existing legislation in this area.
- These Explanatory Notes might best be read alongside the Act. They are not, and are not intended to be, a comprehensive description of the Act.

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Overview of the Act

- 1 This Act has a single purpose, to require Ofgem to put in place a temporary price cap on certain energy tariffs for domestic customers in Great Britain.

Policy background

Energy Market Background

- 2 The term Ofgem is used throughout this document to refer to the Office for Gas and Electricity Markets, which is the regulator of the downstream gas and electricity markets. The Act refers to the Authority which is defined as the Gas and Electricity Markets Authority (GEMA), a group of executive and non-executive members who govern Ofgem, determining strategy, setting priorities and taking decisions on a range of issues. When this document refers to Ofgem and when the Act refers to GEMA, they mean the same thing.
- 3 The supply of electricity and gas is a licensed activity under the Electricity Act 1989 and the Gas Act 1986 respectively. This Act contains stand-alone provisions that will place a duty on Ofgem to modify the standard supply licence conditions to impose a cap on the rates that energy suppliers can charge their domestic customers who are on standard variable tariffs¹ or default² tariffs.³ The provisions also provide Ofgem with a power to modify those conditions to enable Ofgem to implement the cap.
- 4 The process of electricity and gas market liberalisation in Great Britain began with the privatisation and restructuring of the industry in the late 1980s, culminating in the opening of the energy supply markets for domestic and small business consumers in the late 1990s. The freedom for domestic energy consumers to choose their supplier was introduced progressively between 1996 and 1999. In May 1998 the domestic gas market was fully opened to competition, closely followed by the domestic electricity market in May 1999.⁴
- 5 Since 2010, the number of new energy supply companies has grown considerably, with some of these companies growing significantly and establishing a foothold in the market. These new entrants often base their business model on attracting customers through low-cost fixed-priced deals, typically lasting a year. This has resulted in a two tier market in which engaged customers are able to benefit from the most competitive tariffs available while those who are unable or unwilling to switch tariff remain on poorer value standard variable and default tariffs.

¹ A standard variable tariff is a supply contract with an indefinite length that does not have a fixed-term applying to the terms and conditions. It is an energy supplier's basic offer. A customer can also make an active choice to select a standard variable tariff.

² If a customer does not choose a specific energy plan, for example after their fixed tariff ends, they are moved to a default tariff. Ofgem has recently changed the rules around default tariffs. Until October 2017, a supplier had to default a customer onto its standard variable tariff; suppliers can now default customers onto a fixed-term default tariff until they choose a new one.
<https://www.ofgem.gov.uk/publications-and-updates/decision-default-tariffs-domestic-customers-end-fixed-term-contract>

³ There are also fixed tariffs. These are tariffs selected by a customer that remain at a fixed cost for energy for a fixed period of time as defined by the energy supply contract. These are normally the best value tariffs in the retail energy market.

⁴ <https://www.ofgem.gov.uk/ofgem-publications/38437/energy-supply-probe-initial-findings-report.pdf>

- 6 In 2013 the Prime Minister asked Ofgem and the Office of Fair Trading to assess the market. This led directly to Ofgem’s referral of the market for investigation by the Competition and Markets Authority (CMA) in June 2014. The CMA published its final report on 24 June 2016.⁵
- 7 The CMA reported that weak consumer response had given rise to an adverse effect on competition in the domestic retail market and that the Big Six suppliers⁶ had unilateral market power over their standard variable tariff customers. The report set out that customers of the Big Six paid an average total of £1.4bn a year more than they would in a truly competitive market. The CMA reported that this figure was made up of both unjustifiable profits and supplier inefficiencies. The CMA proposed a number of remedies focused on reforming the regulatory framework and enhancing consumer engagement to improve competition, which Ofgem and Government are committed to implementing.
- 8 However, the CMA acknowledged that their remedies would take time to implement. They also identified that the roll-out of smart meters was a necessary element for addressing the issues their report highlighted.
- 9 The CMA also concluded that a price cap should apply to domestic customers on prepayment meters for a transitional period (2017 to the end of 2020, subject to review). This was because prepayment customers were not able to benefit from competitive prices in the same way as other customers due to various additional competition constraints, including the availability of tariffs, and the fact that their bills were particularly high. The temporary price cap for customers with prepayment meters came into force in April 2017 and covers approximately 4 million households.⁷ This cap was extended in February 2018 to include almost a million vulnerable⁸ consumers.
- 10 The difference between a basket of the cheapest tariffs offered to customers who actively switch and the standard variable tariffs of the larger energy companies used by customers who do not switch averaged £263 between 2015-2017. In June 2018, the difference between the cheapest tariff on the market and the most expensive standard variable tariff reached £375⁹. The majority of customers are therefore paying more than they would in a truly competitive market. The majority of people remain on poor value standard variable tariffs and default tariffs, and whilst switching rates are increasing, the annual household switching rate was still only 18% in the twelve months to May 2018, meaning that 4 out of 5 households did not switch. Those who least can afford it are more likely to be affected, such as households with low incomes, people with low qualifications, those in the rented sector and those over 65.¹⁰

⁵ The relevant document, including the final report, can be found [here](#). A summary of the final report can be found [here](#).

⁶ Eon, EDF, Npower, SSE, Scottish Power and British Gas

⁷ The Energy Market Investigation (Prepayment Charge Restriction) Order 2016 can be found [here](#) and the explanatory note [here](#).

⁸

<https://www.ofgem.gov.uk/about-us/how-we-work/working-consumers/protecting-and-empowering-consumers-vulnerable-situations/consumer-vulnerability-strategy/vulnerable-customer-safeguard-tariff>

⁹ Data from the Ofgem data portal, available online at: <https://www.ofgem.gov.uk/data-portal/overview>

¹⁰ For further information on the characteristics of these customers please see CMA Energy Investigation: Final Report (2016), available online at: <https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>.

Government's commitment

- 11 In the Queen's Speech following the 2017 General Election, the Government committed to helping to protect customers until the conditions for effective competition are in place.

Reference: The Gracious Speech, 2017

"My government will ensure fairer markets for consumers; this will include bringing forward measures to help tackle unfair practices in the energy market to help reduce energy bills."

- 12 In February 2018, Ofgem extended the price cap for customers with prepayment meters to a wider group of vulnerable customers. Ofgem also amended licence conditions so that suppliers can roll customers coming to the end of their contracts onto another fixed deal instead of a standard variable tariff, provided that it is the same price or cheaper than the standard variable tariff that the customer would have otherwise have been rolled on to.¹¹
- 13 In October 2017, the Government published a draft Bill to require a temporary price cap on energy prices. The Business, Energy & Industrial Strategy Select Committee in the House of Commons conducted detailed pre-legislative scrutiny on the draft Bill, including taking written and oral evidence from large and smaller suppliers, academics, regulators (including Ofgem), Government and other interested parties. The Committee reported in February, and supported the Bill and the policy but recommended changes to the Bill.
- 14 This Act therefore reflects the Government's policy intention and takes into account the recommendations of the Select Committee. The Act requires Ofgem to modify the standard licence conditions for gas and electricity suppliers, so as to include conditions that impose a price cap for standard variable tariffs and default tariffs offered to domestic customers. There is an exception for those who benefit from protections under the pre-payment meter cap (or a replacement for that cap). Ofgem may also put in place an exception for vulnerable consumers who benefit from another cap. In addition, the Act requires Ofgem to consult on exemptions for green tariffs¹² from the price cap. It also includes a power for Ofgem to exempt green tariffs from the price cap.
- 15 The cap applies until the end of 2020 but it may be extended for a year at a time, until the end of 2023 at the latest, if the conditions for effective competition in the market for supply contracts are not in place. A procedure for extension is set out in the Act.

¹¹

<https://www.ofgem.gov.uk/publications-and-updates/decision-default-tariffs-domestic-customers-end-fixed-term-contract>

¹² Clause 3 defines green tariffs as: standard variable rates which apply only if chosen by domestic customers if, or to the extent that, the rates in question appear to the Authority to support the production of gas, or the generation of electricity, from renewable sources.

Legal background

- 16 The supply of electricity and gas is a licensed activity under the Electricity Act 1989 and the Gas Act 1986. This Act contains stand-alone duties on Ofgem to modify the standard supply licence conditions to impose a cap on the rates that energy suppliers can charge their domestic customers who are on standard variable or default tariffs. The provisions also provide Ofgem with a power to modify those conditions to enable Ofgem to implement the cap.
- 17 This Act follows a review from 2014 to 2016 of the energy market by the Competition and Market's Authority (CMA) and an order made by the CMA to place a restriction on the amount that can be charged to customers on a prepayment meter.¹³
- 18 On 7 December 2017, Ofgem decided to modify the standard supply licence conditions by inserting new standard condition 28AA to regulate charges for a wider group of vulnerable domestic customers. This had the effect of extending the scope of the existing prepayment meter cap to around one million further consumers who were also on their suppliers default tariff.

Territorial extent and application

- 19 Section 13 sets out the territorial extent of the Act; that is the jurisdictions for which the Act forms part of the law. The extent of a Act can be different from its application. Application concerns where an Act produces a practical effect. The Act will extend to England and Wales and Scotland and will apply in those areas.

Commentary on provisions of the Act

Section 1: Cap on standard variable and default rates

- 20 Subsection (1) requires Ofgem to modify the standard licence conditions for gas and electricity suppliers, so as to include conditions ("tariff cap conditions") that impose a cap on the rates that may be charged for certain tariffs offered to domestic customers. Ofgem must do this as soon as practicable after the Act is passed.
- 21 The requirement for tariff cap conditions applies to standard variable and default tariffs, subject to section 3.
- 22 Subsection (2) provides that Ofgem may amend the tariff cap conditions once those conditions are in place. This could be used, for example, if Ofgem need to change the way that the price cap is to be calculated. The tariff cap conditions must be in place until they cease to have effect under section 8.
- 23 Under subsection (6) Ofgem must seek to protect existing and future domestic customers who pay standard variable and default rates, and must take into account the matters listed at subsection (6) when implementing or modifying the tariff cap conditions. It is for Ofgem to balance each of the matters in complying with this duty.

¹³

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/584888/energy-market-prepayment-charge-restriction-order-2016.pdf

- 24 Subsection (7) makes clear that Ofgem will not be required to cap certain charges that are not part of regular bills, such as charges for late payment and charges relating to meters.

Section 2: Tariff cap conditions

- 25 Subsection (1) requires, among other things, that the tariff cap conditions set out how the cap is to be calculated. It also sets out where Ofgem has discretion regarding the content of the tariff cap conditions.
- 26 Subsection (2) sets out restrictions on the content of the tariff cap conditions.
- 27 Subsections (3) requires Ofgem to consult on the methodology for how the cap level is to be calculated before introducing tariff cap conditions and gives Ofgem the discretion to undertake subsequent consultations regarding the methodology.

Section 3: Exemptions from the cap

- 28 Subsection (1) provides that the tariff cap conditions do not apply to domestic customers who benefit from the tariff cap under the Energy Market Investigation (Prepayment Charge Restriction) Order 2016. That Order applies to customers who pay for their energy through prepayment meters, subject to the specified exclusions.¹⁴ Also, the tariff cap conditions do not apply to domestic customers who benefit from a cap that replaces the cap in that Order.
- 29 Subsection (2)(a) enables Ofgem to exempt from the cap any domestic customers who benefit from any other cap that Ofgem chooses to impose for the purpose of providing protections to vulnerable consumers.
- 30 Subsection (2)(b) enables Ofgem to exempt tariffs from the cap if, or to the extent that, Ofgem considers the tariffs support the production of gas, or generation of electricity, from renewable sources. This exemption can only apply to tariffs chosen by the domestic customer.
- 31 Subsection (3) places a duty on Ofgem to consult on whether and, if so, how to exempt such 'green' tariffs. It also clarifies that Ofgem may consult on whether to have a green tariff exemption before or in the course of proposing licence modifications under section 4. Under subsections (4) and (5), Ofgem must conduct the consultation in time to enable it to introduce any exemption at the same time as the tariff cap, or if this is not practicable, to introduce any exemption as soon as practicable after this.

Section 4: Notice of proposed modifications

- 32 Section 4 sets out the steps for the licence modification procedure that must be followed in order to introduce tariff cap conditions. It sets out who Ofgem must notify regarding the proposed modifications and requires Ofgem to consider any representations that are made within the time period specified in the notice. This time period for making representations must not be less than 28 days.

¹⁴ Paragraph 28

<https://assets.publishing.service.gov.uk/media/5847e1fb40f0b60e4c00005b/energy-market-price-cap-explanatory-note.pdf>

Section 5: Publication and effect of modifications

- 33 Section 5 sets out requirements regarding the publication of modifications. In particular, subsection (4) provides that modifications cannot take effect until after the end of the period of 56 days beginning with the day on which they are published.

Section 6: Review of level at which cap is set

- 34 Section 6 places a duty on Ofgem to review the level of the cap at least every six months and publish a statement regarding whether it proposes to change the level of the cap. As a result of that review it would be open to Ofgem to change the level of the cap. This section does not place a duty on Ofgem to review the methodology for setting the cap.

Section 7: Review of competition for domestic supply contracts

- 35 Section 7 requires Ofgem to review the market for domestic electricity and gas supply contracts, to assess whether conditions for effective competition are in place. This review includes, among other things, the roll out of smart meters. It must then produce and publish a report on this, and make a recommendation as to whether or not it considers that the tariff cap conditions should be extended to have effect for the following year. The Secretary of State must consider the report and recommendation and publish a statement regarding whether the conditions for effective competition are in place. This process applies in the year 2020, and in the years 2021 and 2022 if the tariff cap conditions still apply in those years (see section 8).

Section 8: Extension and termination of tariff cap conditions

- 36 Section 8 sets out the procedure for extending or terminating the tariff cap conditions depending on the statement made by the Secretary of State, as per section 7.
- 37 The tariff cap conditions cease to have effect at the end of 2020, if the Secretary of State makes a statement that the conditions for effective competition are in place. If the Secretary of State makes a statement that the conditions for effective competition are not in place, the tariff cap conditions apply for the year 2021.
- 38 If the tariff cap conditions apply in 2021, the same process takes place in the year 2021 to determine if the tariff cap conditions must apply for the year 2022. And if the tariff cap conditions apply in 2022, the same process takes place again to determine if the tariff cap conditions must apply for the year 2023. However, the tariff cap conditions must cease to have effect at the end of the year 2023.
- 39 Once the tariff cap conditions cease to have effect, Ofgem cannot use section 1 to impose further tariff cap conditions.

Section 9: Protection for domestic customers after termination of tariff cap conditions

- 40 Section 9 places a duty on Ofgem to review the pricing practices of energy suppliers and consider if there are categories of consumers who are paying or risk paying in the future excessive charges for standard variable and default rate tariffs, and for whom protection should be provided.
- 41 The review must also consider whether consumers will suffer an excessive tariff price rise by moving to a standard variable or default rate tariff upon the termination their existing fixed-rate tariff. It must also consider whether vulnerable consumers are in need of protection.
- 42 The review must be conducted before the price cap is removed and Ofgem must conduct such a review thereafter as it deems appropriate.
- 43 If the review concludes that the protections are needed, Ofgem must take action using its powers as set out under the Gas Act 1986 and the Electricity Act 1989.

Section 10: Consequential modification of standard supply licence conditions

44 Once the tariff cap conditions cease to have effect, Ofgem may modify the licence to make consequential changes. The procedure for making such modifications is set out in this provision.

Section 11: Amendments of the Utilities Act 2000

45 Section 11 sets out consequential amendments to the Utilities Act 2000.

Section 12: Interpretation

46 Section 12 defines the terms used in this Act.

Section 13: Extent and commencement

47 Section 13 specifies that the Act extends to England and Wales and Scotland and comes into force on the day on which it is passed.

Section 14: Short title

48 Section 14 sets out the short title of the Act.

Commencement

49 Section 13 provides for this Act to come into force on the day that it is passed.

Related documents

50 The following documents are relevant to the Act and can be read at the stated locations:

- The Competition and Markets Authority – Energy Markets investigation – Final report summary.
<https://assets.publishing.service.gov.uk/media/576c23e4ed915d622c000087/Energy-final-report-summary.pdf>
- The Competition and Markets Authority – Energy Markets investigation – Associated documents.
<https://www.gov.uk/cma-cases/energy-market-investigation>
- Draft Domestic Gas and Electricity (Tariff Cap) Bill Command Paper as laid before the House of Commons on 12 October 2017.
<https://www.gov.uk/government/publications/draft-domestic-gas-and-electricity-tariff-cap-Act>
- Evidence to the Business, Energy and Industrial Strategy Select Committee during an inquiry on an Energy Price Cap.
<http://www.parliament.uk/business/committees/committees-a-z/commons-select/business-energy-industrial-strategy/inquiries/parliament-2017/energy-price-cap-17-19/>
- Evidence to the Business, Energy and Industrial Strategy Select Committee during pre-legislative scrutiny of the draft Bill.
<http://www.parliament.uk/business/committees/committees-a-z/commons-select/business-energy-industrial-strategy/inquiries/parliament-2017/pre-legislative-scrutiny-of-draft-tariff-cap-Act-inquiry/>

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- Report of the Business, Energy and Industrial Strategy Select Committee having conducted pre-legislative scrutiny of the draft Bill.
<https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/517/517.pdf>

Annex A – Overview of the Act’s passage through Parliament

51 This table below sets out the dates and Hansard References for each stage of the Act’s passage through Parliament.

Stage	Date	Hansard Reference
House of Commons		
First Reading	26 February 2018	Vol 636 Col 566
Second Reading	06 March 2018	Vol 637 Col 205-276
Public Bill Committee	1st Sitting: 13 March 2018	Col 1-32
	2nd Sitting: 13 March 2018	Col 33-82
	3rd Sitting: 15 March 2018	Col 83-108
Report Stage	30 April 2018	Vol 640 Col 71-104
Third Reading	30 April 2018	Vol 640 Col 105-109
House of Lords		
First Reading	01 May 2018	Vol 790 Col 1994-1995
Second Reading	22 May 2018	Vol 791 Col 991-1022
Grand Committee	1st Sitting: 11 June 2018	Vol 791 Col 177GC-230GC
Report Stage	27 June 2018	Vol 792 Col 202-220
Third Reading	04 July 2018	Vol 792 Col 599-600
Commons Consideration of Lords Amendments (Ping Pong)	18 July 2018	Vol 645 Col 458-470
Lords Consideration of Commons Amendments (Ping Pong)	18 July 2018	Vol 792 Col 1283-1288
Royal Assent	19 July 2018	Vol 792 Col 1396

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Annex B – Progress of Act Table

52 The table below summarises how each Section of the Act was numbered during its passage through Parliament.

Section of the Act	Bill as Introduced in the Commons/Lords	Bill as amended on Report in the Lords	Bill as amended during Commons Ping Pong
Section 1: Cap on standard variable and default rates	Clause 1	Clause 1	Clause 1
Section 2: Tariff cap conditions	Clause 2	Clause 2	Clause 2
Section 3: Exemptions from the cap	Clause 3	Clause 3	Clause 3
Section 4: Notice of proposed modifications	Clause 4	Clause 4	Clause 4
Section 5: Publication and effect of modifications	Clause 5	Clause 5	Clause 5
Section 6: Review of level at which the cap is set	Clause 6	Clause 6	Clause 6
Section 7: Review of competition for domestic supply contracts	Clause 7	Clause 7	Clause 7
Section 8: Extension and termination of tariff cap conditions	Clause 8	Clause 8	Clause 8
Section 9: Ongoing relative tariff differential	N/A	Clause 9 (Non-Government Amendment inserted at Lords Report)	N/A (Removed at Commons consideration of Lords Amendments)
Section 9: Protection of domestic customers after termination of tariff cap conditions	N/A	N/A	Clause 9 (Government Amendment inserted in-lieu of Lords Amendment)
Section 10: Consequential modification of standard supply licence conditions	Clause 9	Clause 10	Clause 10
Section 11: Amendments of the Utilities Act 2000	Clause 10	Clause 11	Clause 11
Section 12: Interpretation	Clause 11	Clause 12	Clause 12
Section 13: Extent and commencement	Clause 12	Clause 13	Clause 13
Section 14: Short title	Clause 13	Clause 14	Clause 14

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