

All stakeholders

Email: retailpriceregulation@ofgem.gov.uk

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Dear stakeholders,

Update on our plans for retail energy price caps

On 26 February, the Government introduced proposals for legislation to Parliament, to introduce a temporary tariff cap for customers on Standard Variable (SVT) and default tariffs ('proposed legislation').¹ This proposed legislation creates a new statutory role for Ofgem to deliver this measure for Government. Ofgem will have a new duty to design and implement the tariff cap (the 'default tariff cap'). This letter sets out our understanding of our proposed new duties and explains how we plan to fulfil these in the coming months.

The proposed legislation places a duty on Ofgem to implement the price cap as soon as practical. Ofgem is committed to protecting energy customers and we are working with Government to ensure we can implement the price cap as soon as possible once the legislation has received Royal Assent. To support this, we will very shortly be publishing a working paper explaining our design principles for a default tariff cap. This will be the first in a series of working papers we will issue (as the legislation passes through Parliament) to explain how our thinking on the price cap design is evolving as we gather views and evidence from stakeholders. In the 'Consultation Process' section of this letter, we have set out information about these papers.

Our proposed new duties under the 'Domestic Gas and Electricity (Tariff Cap) Bill'

The proposed legislation sets out a framework in which Ofgem is required to design the default tariff cap. For instance, this includes who the price cap should be applied to, factors we should have regard to when we are designing it, and the process for reviewing or removing the price cap. Below we have summarised the key requirements in the proposed legislation.

Scope of the SVT/default tariff cap

The proposed legislation places a duty on Ofgem to introduce a price cap for domestic consumers on SVT and default tariffs as soon as reasonably practicable. The price cap will not apply to:

- Consumers on the prepayment meter safeguard tariff (these consumers are exempt from this price cap because they are already receiving price protection) and,
- Domestic consumers on non-default fixed term tariffs.

¹ Domestic Gas and Electricity (Tariff Cap) Bill

<https://services.parliament.uk/bills/2017-19/domesticgasandelectricitytariffcap.html>

This proposed legislation provides some discretion for Ofgem to exempt certain groups from a price cap. This includes:

- Vulnerable consumers that may also be benefiting from a safeguard tariff; or,
- Consumers who have chosen SVT tariffs that support the production of renewable gas or electricity.

On the latter, the proposed legislation requires Ofgem to consult on whether an exemption is necessary.

The legislation also makes it clear that the price cap must be applied in the same way to all domestic suppliers and therefore there cannot be any exceptions for any particular suppliers.

Design of the cap

The proposed legislation gives Ofgem a duty to design the cap in a way that protects existing and future domestic customers on SVT and default tariffs. In complying with that duty, Ofgem must have regard to the following matters:

1. The need to create incentives for holders of supply licences to improve their efficiency;
2. The need to set the cap at a level that enables holders of supply licences to compete effectively for domestic supply contracts;
3. The need to maintain incentives for domestic customers to switch to different domestic supply contracts; and,
4. The need to ensure that holders of supply licences who operate efficiently are able to finance activities authorised by the licence.

The level of the price cap (rather than the methodology) must be reviewed at least every six months and we are required to publish a statement on whether we propose to change the level. This is in line with the existing safeguard tariff, which we update twice a year in April and October to reflect changes in external indices, such as movements in wholesale costs and inflation.

Duration of the price cap

In 2020, we must review whether the conditions are in place for effective competition, and publish a report, including a recommendation on whether the cap should be extended or not. Our review must, among other things, consider the progress of the smart meter rollout. The Secretary of State would then decide whether to remove the cap. If the cap is not removed, we would carry out further reviews in 2021 and 2022. If the cap is extended after each of our reviews, it will cease to have effect at the end of 2023.

We will set our thinking on this process as we design the default tariff cap.

Consultation and licence modifications

There are various requirements for us to consult on the development and implementation of the cap. The proposed legislation provides Ofgem with bespoke powers to modify supply licence conditions to introduce the price cap (including consequential amendments). These powers are based on our existing licence modification powers under the Gas Act 1986 and Electricity Act 1989. Among other things, it requires us to:

- Consult for at least 28 days on proposed changes to licence conditions and their intended effects; and,
- Allow a period of no less than 56 days between publishing our decision and the licence condition changes taking effect.

Consultation process

We have already started work on the design of the tariff cap and will continue refining this with stakeholders. We plan to issue our proposed licence changes in August, assuming Royal Assent is achieved before the summer recess. We are committed to implementing the cap as fast and effectively as possible, to ensure customers on poor value default deals are protected.

To help inform our proposed statutory consultation, we will use a consultation process involving a series of working papers explaining our emerging thinking and seeking views from stakeholders. We will publish the first of these very shortly. This paper will explain some of the key design considerations for how a price cap could be set. This working paper factors in relevant learning and evidence we have gathered from our previous consultation on the vulnerable safeguard tariff.²

We are planning to publish further papers between now and May 2018 covering issues such as:

- The principles we will use to set the level of headroom (ie the amount of room included in the cap above the efficient level of costs, designed to enable competition to co-exist with the cap);
- The approach we take to estimating costs which are to a greater extent outside of suppliers' control and therefore could be used to update the level of the cap over time; including wholesale costs, the costs associated with social and environmental obligations, and network charges;
- The approach we could take to estimating the companies' own operating costs (including smart metering costs);
- The use of market pricing data to set the level of the cap or update it over time; and,
- Our views on an exemption for tariffs which may support the production of renewable gas and electricity.

This series of working papers will be followed by a policy consultation which summarises our thinking.

We expect to publish our second working paper in April. We expect it to cover the use of market pricing data to set the level of the cap or update it over time. We also aim to set out our expectations for when we will publish the different working papers. This will be subject to change, and so we will update this over time as required.

We have already started gathering evidence and requesting information from suppliers. We will continue with this process and will request further information from suppliers later this month.

Providing financial protection for vulnerable customers

We have already acted to put in place price protection for 5 million consumers, following our extension last month of the prepayment safeguard tariff to cover 1 million vulnerable consumers in receipt of the Warm Home Discount.

During summer 2017, we gathered evidence which (also taking into account the CMA energy market investigation findings) led us to conclude that introducing price regulation will better protect the interests of these consumers in the short term. We consider that such intervention is consistent with Ofgem's particular duties to have regard to the interests of certain groups

² Ofgem (2017), Providing financial protection to more vulnerable consumers
<https://www.ofgem.gov.uk/publications-and-updates/providing-financial-protection-more-vulnerable-consumers>

who are vulnerable and to consider protecting the interests of consumers via means other than the promotion of competition.

Last December, we proposed to use our existing statutory powers to extend this protection to cover an additional c.2 million vulnerable customers in winter 2018/19 and consulted on options for identifying vulnerable customers and how we could approach a price cap design for this group. We explained our intention was to introduce such a cap only if a default cap were not to be introduced by winter 2018/19.

In January this year, we hosted workshops with consumer organisations and suppliers to understand their views. Today we have published a summary of responses to the December consultation (alongside the responses we received), including feedback from the workshops.³ This feedback, along with other stakeholder evidence we have received, will be factored into our thinking in relation to the design of both the broader vulnerable safeguard tariff and the default tariff cap.

We will be considering the approach we would use to set the level of both these price caps in parallel to ensure that as a minimum there is price protection in place for 7 million consumers this winter, should the Domestic Gas and Electricity (Tariff Cap) Bill not receive Royal Assent before the summer.

A critical aspect of our work on the broader vulnerable safeguard tariff is how to identify eligible vulnerable consumers. Our preferred option is to use selected means-tested and disability benefits as a proxy to identify eligibility. The Digital Economy Act 2017 introduces new information sharing provisions that allow data sharing between specified public authorities and energy suppliers to assist with alleviating fuel poverty. The Government has recently issued a follow-up consultation to amend this legislation to facilitate data-matching between the Department for Work and Pensions (DWP) and suppliers to identify vulnerable consumers eligible for the price cap.⁴ We are continuing to work closely with DWP and suppliers to explore the practicalities of implementing this option. Alongside this, we are continuing to develop our thinking on other proxies that suppliers could use to identify vulnerable consumers and how they could be implemented in practice. We will provide an update on our latest thinking on this work in due course.

As explained above, we are proposing not to go ahead with the extended vulnerable safeguard tariff if there is a default tariff cap in place by the end of this year.

Any proposals we make – for a default tariff cap or an extended vulnerable safeguard tariff – will need to reflect the underlying legal framework, as well as any policy and other considerations.

Next Steps

As stated above, we will use a consultation process comprising a series of working papers, followed by a summary policy consultation. This will be followed by a statutory consultation on the required licence modifications in the summer. We will look to set the level of the cap over the autumn and bring the cap into effect at the end of this year.

Table 1 summarises the key milestones set out in this letter.

³ <https://www.ofgem.gov.uk/publications-and-updates/providing-financial-protection-more-vulnerable-consumers>

⁴ BEIS (2018), Consultation on data sharing regulations for a safeguard tariff, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/680665/Data_sharing_regulations_for_a_safeguard_energy_tariff.pdf

Table 1: Expected milestones for the design and implementation of a tariff cap

Milestone	Dates
Update on the scope of the vulnerable safeguard tariff	April 2018
Evidence gathering and data requests	March-May 2018
Developing tariff cap design through working papers and consultations. This includes other legislative requirements such as the approach to renewable tariffs and the conditions for competition to remove or extend the tariff cap.	March-July 2018
Publish draft licence conditions for either the vulnerable safeguard tariff or the default tariff cap	August 2018
Decision and set the level of the tariff cap	Autumn 2018
Tariff cap comes into effect	End 2018

Yours faithfully,

Anna Rossington
Associate Partner, Retail Price Protection