

## **Domestic gas and electricity default tariff cap**

### **Department for Business, Energy and Industrial Strategy - Ofgem**

**RPC rating: validated**

#### **Description of measure**

The Domestic Gas and Electricity (Tariff Cap) Act 2018 created a new duty for *Ofgem* to design and implement a temporary cap on domestic standard variable and default gas and electricity tariffs ('the default tariff cap'). A default tariff cap was introduced on 1 January 2019 at around £1,137 per year for typical single rate dual fuel customers paying by direct debit. Around 10.7 million households were expected to benefit from it. A cap will run until at least the end of 2020, at which point *Ofgem* will make a recommendation to the Secretary of State for Business, Energy and Industrial Strategy regarding any possible extension. For the purposes of this business impact target (BIT) assessment, *Ofgem* has assumed the policy duration to be two years.

#### **Impacts of measure**

The main impact of the measure on business is lost revenue to the retail energy suppliers. *Ofgem's* analysis is based on data from the 22 largest suppliers. This is estimated by taking the difference between the cap level and each supplier's default tariff, and then multiplying the result by the number of customers on that tariff. This is summed across all affected suppliers to give a direct cost to business of around £1.2 billion each year. There is also a much smaller administrative cost to suppliers from having to change their prices more frequently, estimated at around £8 million each year.

#### **Quality of submission**

The BIT assessment and supporting *Ofgem* impact assessment (IA) meet a condition in the RPC opinion on the Domestic Gas and Electricity (Tariff Cap) Bill final stage IA.<sup>1</sup> That RPC opinion assessed the Department for Business, Energy and Industrial Strategy (BEIS) IA as fit for purpose on the understanding that BEIS or *Ofgem* will publish a clear estimate of the costs and benefits to business once the level of the cap is known.

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<sup>1</sup> <https://www.gov.uk/government/publications/domestic-gas-and-electricity-tariff-cap-bill-rpc-opinion>

The regulator's assessment is extremely brief for a measure with a very large equivalent annual net direct cost to business (EANDCB) and is sufficient only when combined with the statutory IA, to which the BIT assessment provides a link. This IA explains in detail *Ofgem's* methodology for calculating direct business impacts. The IA also assesses indirect impacts, such as those resulting from possible supplier responses to the measure, and wider impacts, such as on the environment and competition. The latter includes an assessment that price competition will be "...at a reduced level when compared to the baseline scenario." (paragraph 6.30, page 94). The IA provides a good assessment of relative impact of higher and lower caps on consumers and the supply market. The IA also provides a well-balanced assessment of the potential impact of the cap on innovation.

The RPC validation of the regulator's assessment and, in particular, the BIT score is on the basis that the default cap lasts for two years only. Should the cap be extended beyond 2020, the RPC would expect to see a further BIT assessment, supported by an IA as necessary.

The BIT assessment would benefit from addressing the points below.

- *Providing more detail and greater explanation of figures and/or providing clearer cross-referencing to the IA.* In particular, the BIT assessment would benefit from describing more explicitly the regulator's approach to calculating the EANDCB and providing greater indication of where, in the IA, the key information supporting the BIT assessment is presented. The BIT assessment would also benefit from explaining where its figures differ from those in the IA, for example because of different price base years.
- *Revisions to the cap during 2019 and 2020.* In February 2019 it was announced that *Ofgem* was increasing the energy price cap from £1,137 to £1,254 from 1 April 2019. This increase reflects higher wholesale energy prices. The RPC understands that *Ofgem* will set a new price cap on 1 October 2019. The BIT assessment and IA would benefit from explaining how, in its assessments, it treats the review process and any resultant changes to the cap.
- *Wider impacts.* Although not required for validation purposes, it would be helpful if the BIT assessment provided a brief description of wider and indirect impacts, including references to where, in the IA, these detail can be found.
- *Impacts beyond 2020.* The IA helpfully illustrates potential impacts should a cap be extended for the full period to December 2023. This would benefit, however, from greater explanation of the assumptions and calculations involved for the 2021-23 period.

### Regulator assessment

Classification	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£1,202.9 million
Business net present value	-£2,365.1 million

### RPC assessment

Classification	Qualifying regulatory provision (IN)
EANDCB – RPC validated	£1,202.9 million (two year time-limited measure)
Business impact target score	£2,405.8 million (two year time-limited measure)

Regulatory Policy Committee