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**Article**

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Catherine Waddams\*

## The UK Energy Price Guarantee

When energy prices started rising in 2021, the retail energy market in Great Britain<sup>1</sup> was already subject to a regulatory price cap. This had been introduced in 2019 to benefit household consumers who were not shopping around for the cheapest deal in the liberalised retail energy market, and who had been paying higher prices than those who were more active in the market. It merged with an earlier cap, introduced in 2017 for pre-payment meter users, into the Default Tariff Cap from January 2021. Household consumers who were on a “default” (usually indefinite, rolling) tariff with their supplier were automatically protected by the cap, which was set twice a year by the regulator, Ofgem, on a “bottom up” basis of the costs of retailers over the previous few months.

The cap was set to provide head room for active consumers to get a cheaper tariff in the competitive market, which was usually on a fixed basis for one or two years. As wholesale gas prices fell after the first quarter of 2019, there were indeed good fixed deals available below the cap; contrary to many forecasts, switching to alternative suppliers increased initially after the price cap was imposed, as newer entrants were able to obtain cheaper supplies in spot wholesale markets, undercutting established suppliers who had committed to long-term contracts. However, as wholesale prices rose from the first quarter of 2020, gradually at first, but much more steeply from the second quarter of 2021, the situation reversed. Long-term contracts represented lower costs than could be obtained on spot markets, and the new entrants, who often had few financial reserves, could neither compete for new business nor profitably serve the customers they were already committed to supplying.

<sup>1</sup> Ofgem and the price cap do not operate directly in Northern Ireland, which receives equivalent help with energy bills.

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The number of consumers who switched suppliers responded as might be expected, falling back slightly but remaining active until September 2021. After this, switching fell dramatically to lower levels than had been recorded even in the early days of market opening 20 years earlier, reflecting the withdrawal of fixed price offers from September 2021. As wholesale prices rose, the price cap initially provided some price protection for all residential consumers, including both those who had been inactive in the market and those whose fixed terms were ending and transferred to the “rolling” tariffs. This was due to the fact that the cap was based on costs in the previous six months. However, this posed severe profitability issues for retailers, especially those who were paying spot prices for their energy supplies; this was reflected in the high number of company failures in this period (see next section). The respite for consumers was short-lived: wholesale prices rose towards the end of 2021 and both price levels and volatility increased following the invasion of Ukraine. The price cap and retail prices rose inexorably in the wake of increasing wholesale prices, and its historic and publicly calculated basis meant that each six-month increase was widely anticipated and discussed.

In August 2022, Ofgem announced that the cap would be reviewed quarterly, rather than twice a year, to address the volatility of the wholesale market. Later that month, it announced that it would increase the annual bill of a consumer using an average amount of energy by 80% from the previous tariff, to £3,549 (€4,008) from 1 October to 31 December. This would almost triple the prices charged compared with the previous winter, and the announcement caused widespread and understandable concern. At a time when other household costs, especially those of food and housing, were also rising, energy bills would pose a major concern for many consumers, especially for low-income consumers, for whom energy represents a greater share of expenditure than average (Deller et al., 2021). A large proportion of households would struggle to pay their energy bills (Bradshaw, 2022).

Although the Conservative Party has remained in power (since 2010), the UK had three prime ministers (and four Treasury ministers and three energy ministers), with very different economic outlooks, in the last four months of 2022, which meant that policy sometimes seemed almost as erratic as the energy prices to which it was

reacting. The change of leadership also contributed to the slowness of governmental reaction. The package of responses to the crisis in place at the beginning of 2023 owes something to each of these regimes: Boris Johnson in power until 5 September (but having announced his resignation two months earlier); Liz Truss, from 6 September to 25 October; and Rishi Sunak from 25 October. Since Sunak was the chief Treasury minister in Johnson's government, it is not surprising to see more continuity between the Johnson and Sunak governments than with the short-lived Truss administration.

### Exacerbating difficulties for the UK energy market

These pressures on the UK wholesale market have, of course, mirrored those in Europe and the rest of the world, initially because of economic recovery from COVID-19 in the autumn of 2021, and intensified by supply shortages following Russia's invasion of Ukraine. A number of factors, however, have exacerbated the energy crisis in the UK.

On the supply side, British energy is heavily dependent on gas, which heats most homes and generates about 40% of electricity. Since trading is based on marginal cost, tying the electricity market to the gas market transfers volatility in the gas market directly to electricity prices. Consequently, non-gas generation of electricity yields very variable profits, in line with the gas price. The government announced an additional windfall profits tax on such generators in April 2022, and the tax level was increased again in October (discussed below).

A second factor that affects UK energy prices is the background to the retail market described above, which had resulted in the exit of 46 retail suppliers from the market between 2018 and summer 2022, with 28 going bankrupt in 2021-22, leaving the regulator to arrange new suppliers for their customers. To foster confidence in the market and active switching, the regulator had instituted a guarantee that if their supplier exited the market, customers would not lose any credit with the company. Instead, another supplier would be found to supply them at their existing tariff for the time being, and the costs of this arrangement would be socialised amongst all consumers. Moreover, barriers to entry, including financial guarantees, had previously been lowered to encourage the entry of new retailers, many of whom had little experience with or foundation in energy markets. While, as we have seen, exit of retailers at times of rising wholesale prices is expected, meeting the guarantees of so many collapses added considerably to retail costs, estimated at £9.2 billion, or £326 (£370) per customer (Gross et al., 2022). A parliamentary committee has called for

these costs to be recovered through a more equitable means than the uniform rate charged to each household, which is independent of consumption. Following these company collapses, Ofgem has taken a more robust approach to licensing suppliers, requiring more financial resilience, which also adds upward pressure on prices. Thus, current costs include both those already incurred from past firm failures, and those designed to reduce such failures in the future.

Electricity supplies are also affected by the loss of capacity to import from continental Europe through an interconnecting cable, following a fire in September 2021 at a National Grid site in Kent. The facility is not expected to be fully operational until May 2023.

Britain's exit from the European Union contributed to additional uncertainty, as membership of the European common energy policy lapsed at the end of 2020 and was replaced by more ad hoc agreements. Continuing uncertainty over the Northern Ireland protocol overshadows ongoing relationships, but there are more positive indications of future energy trading stability, including the announcement (while Liz Truss was prime minister) of collaboration through UK technical membership of the North Sea Energy Cooperation.

Although heavily dependent on gas, the UK has low levels of gas storage. The partially depleted Rough gas field in the North Sea was used for storage from 1985, but closed in 2017 because of operating expenses. In 2022 it was reopened to help with the energy supply issues, but is operating at only 20% of its previous capacity for winter 2022-23 (Centrica, 2022).

One characteristic of the British residential energy market is that about 17% of consumers, 4.5 million households, pay for gas or electricity or both on a pay-as-you-go system, where energy flows are released only following prepayment. This payment method has traditionally been used to recover debt and to supply those without a good credit record, so prepayment consumers have lower than average income and higher than average financial precarity. Current price pressures see increasing "self disconnections" among these households when they do not pay the necessary upfront fees (Citizens Advice, 2023). Unlike disconnection by a supplier, such rationing is often hidden and results in no energy available at all for heating space or water, for cooking or for lighting. This binary choice, made by some of the most vulnerable households, including elderly people, those with young children and people who are susceptible to potentially adverse health consequences, is a particular concern in the cost of living crisis facing British

households. Some of the traditional benefits of control that prepayment meters have offered in the past (see, for example, Cooke et al., 2001) are now available through smart meters.

### Government support for energy costs and taxation of upstream suppliers

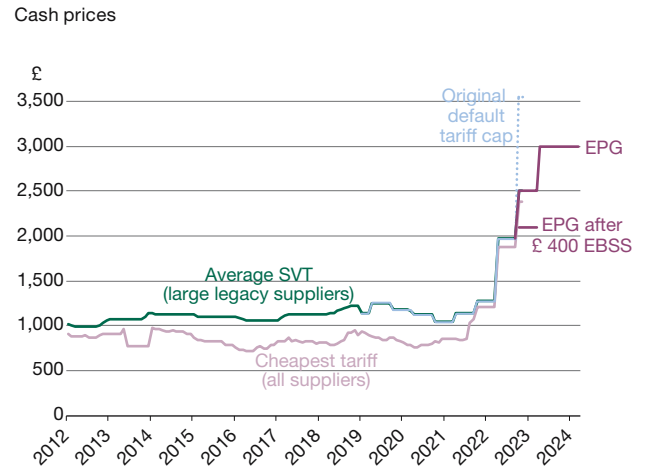
The nature of the Ofgem price cap, outlined above, both anticipated and emphasised the large step changes in household energy costs. When the annual cost for average consumption rose by 60% to almost £2,000 a year in April 2022, the Johnson government announced support, including a £400 grant for each household delivered through discounted bills over winter 2022-23, with further one-off payments for low-income consumers who were receiving means-tested benefits and for all those over retirement age.

However, the announcement in August 2022 of an 80% increase in the price cap from October and predictions of a further increase in January raised widespread concerns. They would require more than three-quarters of households to spend more than one-tenth of their net income on energy, and nearly half to spend more than one-fifth (Bradshaw and Keung, 2022). The concerns raised by these forecasts stimulated additional support measures from the newly elected prime minister, Liz Truss, who rushed to announce additional support and reassure an extremely anxious public before the Queen’s death shut down parliamentary and government business for eleven days. Truss added to her predecessor’s support by announcing a universal additional constraint on energy prices, known as the Energy Price Guarantee, restricting a typical annual bill to £2,500 until April 2024. Together with the £400 discount for winter 2022-23, this imposed an effective cap on prices which would deliver a typical annual bill of £2,100, less than 7% above the Ofgem cap for summer 2022, but a 70% increase on the previous winter. The government would reimburse the difference between this and the Ofgem price cap, a substantial subsidy.

Soon after the hiatus caused by the Queen’s death, Truss’s government announced a raft of additional expenditure plans and tax cuts which led to her resignation. Most of her proposed reforms were repealed and reversed by her second Treasury minister (Hunt) and her successor Rishi Sunak, but the energy package was largely untouched in the short run, though it was curtailed for the year from April 2023, rising then by 20% to £3,000 per year for typical consumption levels.

Ofgem’s initial price cap shifted some of the risk imposed by energy price increases from residential consumers to

**Figure 1**  
**Average annual direct debit dual fuel bill for typical levels of consumption, Great Britain**



Note: SVT stands for Standard Variable Tariff; EPG stands for Energy Price Guarantee; and EBSS stands for Energy Bills Support Scheme.

Source: Ofgem; from Bolton and Stewart (2023).

suppliers, while the energy price guarantee transferred it to the public sector during winter 2022-23; it will continue to apply thereafter if prices remain high. The magnitude of the price changes and guarantees is shown in Figure 1.

The government took on some similar risks for non-residential consumers from autumn 2022, capping the wholesale price that suppliers were allowed to charge (rather than the final price as was the case for the residential market) through the Energy Bill Relief Scheme. However, the risk will shift back to business and third sector users starting in April 2023, since the government will offer a discount on the wholesale price when it is high, rather than capping it. This discount will be greater for energy intensive users. Government has cited the high cost of support (£18.4 billion in the first six months) as a reason for the reforms; they expect support for non-residential consumers to cost around £5.5 billion for the 2023-24 financial year.

One controversial aspect of government policy has been its slow provision of a public information campaign to help households save energy. A publicity campaign was finally launched in December 2022, after being blocked by Prime Minister Truss for being too much like a “nanny state” (Guardian, 2022). However, major suppliers had already reported a significant drop of between 10% and 15% in demand as households responded to higher prices in autumn 2022, though it is too soon to tell if this reduction will be maintained throughout the 2022-23 winter. As part of an international reduction in demand, this may have

contributed to falling wholesale prices since the summer, though lower current prices will not be immediately transmitted to the price cap because of its retrospective calculation.

The spot market price of gas will have a profound effect on the cost of the support to the government finances. In January 2023, wholesale gas prices were below their level a year earlier, and electricity wholesale prices only fractionally above their level at that time. The government estimated that the Energy Price Guarantee would cost £25 billion in its first six months and the Energy Bills Support Scheme would be £12 billion (HM Treasury, 2022). The cost of the higher price level Energy Price Guarantee from April 2023 (which represents a 43% increase in price compared with the Energy Price Guarantee plus the £400 rebate in winter 2022-23) will depend on wholesale prices in that period. As noted above, support to the non-residential sector is expected to add more than £18 billion to the support bill for winter 2022-23 and £5.5 billion for the following financial year.

Despite the government's inaction on energy savings, the National Grid Electricity Service Operator launched a test demand flexibility service to encourage consumers whose meters recorded demand at least half hourly (primarily through rebates on bills) to shift electricity demand away from certain pre-specified peak periods. Over a million customers signed up to the five first events in the last two months of 2022, delivering greater than expected savings (National Grid ESO, 2022). In January 2023, the National Grid activated the scheme during a cold, still period when demand was high and wind generation low.

In May 2022, the Johnson government announced the introduction of a windfall tax on oil and gas companies operating in the North Sea. Sunak extended this both in level and duration in November 2022, so that it currently stands at 35%, similar to the level imposed by the EU, which will last until 2028. The government expects this to raise £40 billion over six years. Such companies are routinely taxed at a higher rate than other UK companies, but also have generous tax allowances for investment. An electricity generator levy of 45% on renewable energy generators in receipt of high prices and above £10 million was also introduced from 2023 to 2028, and is expected to raise a total of £14 billion. This total estimate of £54 billion over six years compares with similar total expected costs of support for the six months of winter 2022-23.

### Assessment and implications for future policy

Government help for the residential sector has clearly been substantial but bluntly targeted during winter 2022-23. The

support provided for households by the Truss government surprised many by its extent and generosity. Benefits were poorly targeted and delivered to households who did not need them. Such universal support also dampened incentives to save energy among those who could afford to do so. Nevertheless their wide-ranging nature alleviated considerable anxiety among a very large number of households, and blanket support may have been the best instrument that was available, given the widespread challenge of rising prices and the need for swift action. The reduction and withdrawal of this support seems appropriate if adequate additional help is provided to households who are unable to adapt to the higher energy prices. As the crisis continues, there is increasing concern for those who are left particularly vulnerable by the large price increases already imposed and those that are forecast as universal protection is reduced. Greater targeting, whether through the welfare system or otherwise, will be needed if households are to be adequately protected at a cost considered acceptable to wider society. The government is exploring new methods of consumer protection, including social tariffs, from 2024 (HM Treasury, 2022). If effective, these are likely to have a profound impact on how the retail market develops.

Reluctance among some households, especially pensioners, to apply for means-tested benefits has led to some universal fixed-sum payments to people of pensionable age, which were increased for 2022-23 to £500 per household. These could be slightly better targeted by making them liable to tax, rather than tax free as they are at present.

The UK is unusual (within Europe) in the separation between general income support and the specific challenges that some households may face, particularly with utility costs. Any difficulty in paying such bills has been largely left to the privatised suppliers, who have been subject to some moral pressure, from governments and more widely, to help those who are struggling to pay. Energy poses a particular challenge because it constitutes a much higher proportion of expenditure among low-income households; and because of payment methods, both the prepayment meters discussed above, and the traditional method of paying three months in arrears, which can result in serious debt issues.

There are restrictions on actions that suppliers can take to recover money owed. For example, it is illegal to disconnect energy supplies from households that are vulnerable because of disability or age or that include children under six. However there is no automatic welfare support system referral scheme for customers in difficulty with outstanding bills; much of the emergency support

available in winter 2022-23 is provided through a privately organised and largely voluntary food bank-based network with a variety of official and unofficial referral mechanisms.

Private suppliers had developed a range of their own social tariffs, but these were phased out between 2011 and 2015, partly to avoid distorting the competitive retail market. They were replaced by the government's warm homes discount, which provides £150 towards energy bills each winter for some consumers in receipt of income-related benefits, and a supplement was announced in May for the 2022-23 winter. Local authorities have received some funding from the central government to provide additional help where needed.

There have been increasing calls for a more substantial and uniform social tariff from charities who deal with issues of fuel poverty, from some parliamentarians and from some of the large suppliers (see, for example, Maule, 2022). At the beginning of 2023, there are no signs that the government will announce plans for a wider social tariff before 2024, though the regulator has called for a 'serious assessment' (Ofgem, 2023). A comprehensive scheme is more likely in the medium term if a Labour government is elected.

All of these challenges have important implications for whether a competitive retail market can be re-established in the wake of the current crisis. There had been increasing dissatisfaction in many quarters over its operation, especially after the widespread entry of retailers when wholesale prices were falling, and their subsequent bankruptcy in recent years; and concerns both about the nature of consumer choice and how it was exercised (Giulietti et al., 2021) and the distributional consequences (Waddams Price and Zhu, 2016). One model would be to auction parts of the market, establishing competition for rather than in the market (Deller et al., 2017), which could incorporate subsidies for some households while retaining some of the benefits of competitive supply. However, identifying and reaching households most in need of support would continue to be challenging whatever the targeting mechanism adopted, and it is difficult to see how errors both of inclusion and exclusion can be avoided in the current interaction (or lack of it) between the energy market and the UK welfare system.

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