Fuelling Fairness:

Five years of the energy price cap

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Executive summary

In January 2019, the energy price cap was introduced. It was a significant intervention for a problem policymakers had struggled with for more than a decade: the 'loyalty penalty'. The problem was that customers who stayed with their energy supplier on a default tariff were paying significantly more than new customers who regularly switched. In 2016, the Competition and Markets Authority (CMA) estimated this costs customers £1-2bn a year.[1] Those who switched to fixed deals saved, and those who stuck to rolling tariffs didn't - creating a two-tier market.

With new research, our review of the five years of the cap finds that the **price cap has decisively protected 'sticky' customers from rising prices, driven operational efficiencies amongst suppliers and adapted well to a period of crisis.** It coincided with a period of rapid challenger growth and consistently high levels of switching. Today, the largest energy suppliers look different from 2019, and customers are increasingly thinking about brand and customer service when switching.

In the wake of the energy crisis, approximately 90% of customers are on default tariffs and protected by the price cap - a much larger group than when the cap was introduced. Wholesale energy prices are stabilising, though still elevated compared to pre-crisis levels, and there's a gradual re-introduction of fixed-price tariffs. The extent to which historically 'sticky' customers will switch remains uncertain. **Our research shows an ongoing tendency for a significant percentage of customers to stay loyal and not switch, trusting their suppliers to offer them a fair deal. As long as the cap remains in place, these loyal customers are protected and are charged fair prices.**

The price cap was a successful intervention in a stable market

From 2019 to 2021, research shows that the cap was effective in addressing its primary goal: mitigating the significant loyalty penalty paid by the disengaged customers of legacy suppliers.

It reduced consumer detriment and protected disengaged customers: the cap successfully protected customers on standard variable tariffs from unfair pricing practices. In line with Ofgem's forecast, our analysis shows that the cap saved these households £1bn a year over 2019-2021. We also find that as a proportion of disposable household income, the poorest 10% benefited from savings 6-7 times that of the wealthiest 10% - the cap has had a distributional benefit as well as protecting all loyal customers.

It drove cost savings by forcing legacy suppliers to become more operationally efficient: in response to a tight allowance on operating costs, the indirect costs for legacy suppliers fell by 17.8% in real terms from 2019-2021. Except for a slight decline in the ease of contacting suppliers, customer satisfaction remained mostly stable during this period.

[1] CMA, *Energy market investigation: Final report*, June 2016

It preserved conditions for competitive pricing and switching: Despite concerns that the cap might stifle competition, suppliers continued to offer competitive fixed tariffs priced under the cap and switching rates sat at between 2% and 9% from 2019-2021. The cap also fostered an environment that allowed challenger firms to compete with legacy suppliers and grow.

The price cap fared well in the energy crisis, but its role changed

Against a backdrop of soaring wholesale energy costs, the cap safeguarded consumers by slowing the pace of price increases. Without this delay, some form of government support would likely have been required much earlier.

It enabled government bill support to be designed and implemented quickly. As a trusted, 'reference price', it helped the Government to confidently pay a fair compensation to suppliers for charging customers the discounted Energy Price Guarantee rate.

The energy market crisis sharply exposed the financial vulnerabilities of some suppliers. The period before the cap had shown that suppliers without sufficient hedges are frequent casualties of wholesale market volatility. The energy crisis involved unprecedented volatility. With the price cap constraining what they could charge their SVT customers, suppliers without prudent hedging and robust financial resilience were more quickly and sharply exposed. To the reverse, it is clear that suppliers with prudent finances and better hedging were able to survive. The adaptation in the cap from 6 months to 3 month caps in October 2022 helped adjust this risk.

Early trends show changes in supplier efficiencies. Initial data points indicate that indirect costs among legacy suppliers rose during the crisis. Customer service levels also suffered with notable declines in satisfaction metrics for some suppliers. With higher volumes of contact throughout the crisis, some of this could be anticipated - and the long-term impacts are unknown.

Post-energy crisis, the need to protect loyal customers persists

As we emerge from the crisis, it's not yet clear what will happen to prices and to switching. Wholesale prices are stabilising, fixed tariffs are emerging, but we do know that an even larger number of customers are protected by the price cap, with ~90% of the market on default tariffs.

We've seen no evidence that the two tier market and the loyalty penalty would not re-emerge if the price cap was removed today. In fact, our research shows that non-switchers exhibit a higher (+6%) level of trust that their suppliers will provide a fair price without any action on their part. Until there is evidence that the threat of the loyalty penalty has gone away, the need for price protection in the market remains. **Furthermore, customers agree that some form of price protection is needed.** Only 7% of the public think energy prices should be left purely to market forces.

Introduction

The energy retail market has been on a journey over the past decade through various reforms, inquiries, regulatory interventions and a wholesale energy price crisis. The market still faces ongoing debates around the fundamental challenges of competition, innovation and price protection. This report examines how one of those interventions - the energy price cap - came to be, its impact in a relatively stable and then volatile market, and key principles for its future.

In January 2019, Ofgem introduced the energy price cap, which sets a legal maximum price that GB energy suppliers can charge consumers on Standard Variable Tariffs. The cap was brought in to protect consumers who did not actively engage in the energy market by ensuring that customers on standard variable tariffs (SVTs) could not be charged 'unfair prices'.

The introduction of the cap in 2019 had cross-party support: Labour proposed the intervention in their 2015 manifesto and the policy was later adopted by Theresa May's Conservative Government after being included in their 2017 manifesto. But this political consensus obscures much more contention within the sector. **This report's opening chapter explores in detail what drove the cap's introduction as well as the policy debate circling at the time.**

In 2021 the price cap was thrust into the political spotlight again with the onset of the energy crisis. As prices rose rapidly in the lead up to and in the wake of Russia's invasion of Ukraine, many energy suppliers exited the market, and their customers were moved onto SVTs with remaining energy suppliers. The price cap became a kind of safe haven tariff for nearly all customers, shielding them from higher bills. **The report's second chapter explores whether the cap achieved its intended effect, and examines whether it had unintended consequences - both prior to and during the crisis.**

The third chapter explores public attitudes on price protection and looks ahead to the future of the energy market. Ultimately, the purpose of this project is to identify whether there is a case for continued price protection in future and key principles to which any intervention should adhere to.

Methodology

Public First was commissioned by Octopus Energy to undertake this research project on the impact of the price cap. The research project consisted of:

- **Expert interviews.** 11 interviews were conducted with a range of experts from energy suppliers, government officials, regulatory representatives, and wider energy market stakeholders to capture first-hand accounts of the price cap's emergence, evolution and implementation.
- **Literature review and data analysis.** To support our analysis on the impact of the price cap, we reviewed existing literature and analysed publicly available data and third-party data on a range of themes related to consumer detriment, competition, supplier efficiencies, and customer satisfaction over the past decade.

- **Public opinion research.** We tested public attitudes towards the state of the market and government intervention in setting energy prices through focus groups and polling. Four focus groups were conducted on 19 and 20 September 2023. The first two groups were made up of undecided 2019 Conservative voters in Red Wall seats of Blyth Valley and Don Valley. The second two groups were made up of East Midlands voters of social class C2 or below, or on prepayment meters. Additionally, we conducted a nationally representative survey of 2,008 UK adults on 13 - 24 October 2023.

Chapter One - History of the price cap: Before 2019

The price cap was introduced on 1 January 2019. It did not come out of the blue but was the result of a series of regulatory studies from 2008 onwards to explore how competition was working in the energy market and whether it was successful in serving the interests of consumers. These culminated in June 2014 when, amidst growing concerns over the state of the energy retail market in Great Britain, Ofgem commissioned the Competition and Markets Authority (CMA) to conduct an investigation (the CMA Market Investigation). The terms of reference specified a focus on "issues connected with the supply or acquisition of gas and electricity in Great Britain, including both retail and wholesale markets, except that, in the case of retail markets, only the retail supply of households and microbusinesses."[2] Notably, the study was to address key concerns that domestic gas and electricity price increases had far outstripped inflation over the previous ten years, and that there was evidence of "deteriorat[ing]" standards of customer service. Ultimately, the referral concluded that there was a two-tier market: "the Six Large Energy Firms enjoy a position of unilateral market power over their inactive customer base and have the ability to exploit such a position through pricing their standard variable tariffs materially above a level that can be justified by cost differences from their non-standard tariffs".[3]

In this chapter we describe the policy and regulatory debates that led to the introduction of the cap. Understanding these debates is crucial to understanding what problems the price cap was designed to solve.

A note on language in this report: Legacy vs non-legacy suppliers

Prior to the late 1980s, energy was a nationalised public utility owned by the state. Under this regime, the UK had 15 natural monopoly suppliers based on geography. Privatisation and further liberalisation of the retail energy market in the 1980s and 90s led to the creation of six major energy and gas suppliers.

These companies are often known as the Big Six - this report refers to them as **'legacy suppliers'**. They included British Gas/Centrica, ScottishPower, E.ON, SSE, npower, and EDF Energy. By 2008, these suppliers still presided over 99% of the overall market share for domestic customers.[4] The 'Big Six' category ceased in 2020 following acquisitions and the emergence of sizeable new entrants into the market.Today, only four of the legacy companies are still in operation for domestic customers - British Gas/Centrica, ScottishPower, EDF and E.ON.

'Non-legacy suppliers' refers to all other energy suppliers that entered the market following liberalisation i.e. not the Big Six. Notable non-legacy suppliers include Shell Energy (no longer operational), Octopus Energy, OVO Energy, Utility Warehouse, and So Energy.

Due to more recent changes in the market, Ofgem now uses a new classification system based on suppliers' size. 'Large' refers to suppliers with 5% or more market share across gas and electricity, 'medium' refers to 1-4.9% share and 'small' refers to less than 1% share. **As this report compares trends in data over time and across changes in classification, where possible, we use legacy and non-legacy suppliers.**

[2] CMA, *Energy market investigation: Final report*, June 2016
[3] Ibid
[4] Ofgem, *Energy Supply Probe*, October 2008

Efforts to increase competition and improve consumer outcomes prior to the CMA Market Investigation

Despite the fact that the energy market had been opened up to competition for nearly 20 years, profits had not been driven down as expected. It was felt at the time that many customers were worse off and, up until 2015, the Big Six held a collective market share of 90%[5]:

> *"[Since 1996] The Government and Parliament expressed ongoing concerns that competition failed to deliver lower costs for customers or drive improvements in customer service and innovation."*[6]

As highlighted in Oxera's 2022 review of Ofgem's regulation of the supplier market: "Up to 2014, the six legacy suppliers accounted for over 90% of market shares before a number of new suppliers emerged."[7] Ofgem had had concerns about failures of competition from 2008 onwards and, as a result took a variety of actions in pursuit of a market that would drive down costs for consumers and facilitate competition between legacy suppliers.

Concerns about the level of consumer engagement, and particularly the outcomes for customers that had never actively switched suppliers, had been bubbling away since the mid-noughties. Ofgem had long been making efforts to improve competition in the market through boosting engagement from 'sticky' customers. In 2008, the then Business and Enterprise Committee launched an inquiry into energy prices, fuel poverty and Ofgem after steep rises in bills.[8] The Committee's report criticised the functioning of energy markets, saying they demonstrated failing competitiveness.[9] Ofgem subsequently launched an Energy Supply Probe in December 2008 to investigate competition in the energy markets. The Probe found that, although there was no evidence of a 'cartel' operating, the market was not working in the best interests of consumers and "competition was not yet fully effective".[10] Even though there was a degree of consumer choice - more so than in some critical other markets - Ofgem acknowledged in 2010 that the barriers to effective consumer engagement remained.

Following the Probe, the 2010 Retail Market Review (RMR) was Ofgem's next attempt to respond to the problem. The RMR proposed "reducing the number of tariffs to just four per provider. In a context in which customers were largely unable to comprehend the multiple offerings, and make informed judgements about which was best for them, this was a step forward."[11]

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[5] BEIS Committee, *Energy pricing and the future of the Energy Market*, July 2022
[6] Ibid
[7] Oxera, *Review of Ofgem's regulation of the energy supply market*, May 2022
[8] House of Commons Library, *Energy Bills and the Price Cap*, September 2022
[9] Business and Enterprise Committee, *Energy prices, fuel poverty, and Ofgem*, July 2008
[10] Ofgem, *Ofgem probe has half a billion pounds in its sights for customers*, December 2008
[11] Dieter Helm, BEIS, *Cost of Energy Review*, October 2017

Following the RMR, Ofgem developed new Standards of Conduct in August 2013, with the intention of engendering a culture change in the way suppliers interacted with consumers. Ofgem also established an independent 'Challenge Panel' of experts to see what progress suppliers had made in embedding the Standards and what impact this was having on customer service levels. The Panel made recommendations intended to support suppliers in managing the culture change required.

In 2014, Ofgem worked with the Office of Fair Trading and the CMA on a State of the Market Assessment. The assessment found weak competition between suppliers, arising from "market segmentation and possible tacit coordination."[12]

Despite these separate studies and efforts, the large number of tariffs, mis-selling scandals and lack of internet access for some customers - many of whom were in the most vulnerable groups of customers such as the digitally excluded - meant that customer engagement and experience had not improved sufficiently by the end of 2015.[13] Moreover, there was a significant degree of pushback from some legacy suppliers as well as economists who challenged the hypothesis that competition was not working in the market. Centrica, for example, rejected Ofgem's conclusions in their assessment, calling the market vibrant and very competitive in 2014.[14] Some took issue with the notion that profits had been excessive and that large price differentiation between tariffs for existing and new customers was evidence of failed competition. Stephen Littlechild's submission to the CMA Market Investigation Panel in February 2015 makes this case:

> *"The claim that a competitive market is characterised by cost convergence is untenable. But as it happens… there was also a marked convergence in costs since 2009… This is a quite different picture from the one painted by the State of the Market Assessment. Even by the proposed (but faulty) criterion, observed cost differences and their change over time do not suggest a lack of retail competition in the retail energy market."* [15]

Others did not agree that a competitive market could involve such large differentials in pricing strategies for those not in a position to engage with the market - and were convinced that major suppliers were exercising market power to set excessive prices and discriminate against less engaged customers.

As Littlechild put it in a report from April 2018: "Price discrimination or differentiation can be a reflection of competition rather than market power. There may be a social or political concern about price differentials, especially involving vulnerable customers, but there is not a competition problem in the

[12] Ofgem, *State of the Market Assessment*, March 2014
[13] Ofgem, *Retail Energy Markets in 2015*, September 2015
[14] ITV News, *Centrica 'refutes totally' idea 'Big Six' are a cartel*, March 2014
[15] House of Commons Library, *Stephen Littlechild submission*, February 2015

generally accepted sense of the term. Hence widespread price controls are not called for, and are likely to make things worse."[16]

The tension between these two views is primarily what led to the CMA Market Investigation. An independent organisation was needed because suppliers and other commentators rejected Ofgem's diagnosis. The CMA also has more extensive powers to address any long-term structural barriers to competition. The CMA published its final report in June 2016.

CMA Market Investigation in 2016: the "Loyalty Penalty" and the idea of a price cap

After a sustained period of real terms reductions in the years following privatisation, prices increased significantly after the turn of the century. Domestic electricity prices rose by around 75% in real terms between 2004 and 2014, and average domestic gas prices by around 125% in real terms over the same period.[17]

Electricity and gas are entirely homogeneous products. It therefore made little sense that domestic customers were paying significantly different prices for energy, and this exacerbated concerns about the market. The CMA found that, from 2012 to 2015, most customers of the legacy suppliers could have made considerable savings from switching suppliers, tariffs and payment methods: for some categories of customer, the average gains from switching were equivalent to more than 20% of their bill over that period. The CMA also found that over the period 2011 to mid-2015, average revenue from the default tariff – applying to approximately 70% of Big Six customers – was around 11% higher for electricity and 15% higher for gas than the average revenue earned from customers on other tariffs.

The CMA's conclusion was that some domestic customers of the Big Six energy companies paid an average of £1.4bn a year more than they would have in a truly competitive market between 2012-2015, forecasting an upward trend of just under £2bn for 2015.[18] This became known as the 'loyalty penalty', and the CMA found that it applied to 70% of customers of legacy companies with 55% of these customers having been on the standard variable tariff with the same supplier for more than three years - up to 10 million customers:

> *"We have estimated that the customer detriment associated with high prices was about £1.4 billion a year on average for the period 2012 to 2015 with an upwards trend. We also found evidence which is indicative of harm to customers from poor quality of service and restrictions on innovation, but by its nature this type of harm is less readily quantifiable."* [19]

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[16] Stephen Littlechild, Energy Policy Research Group, *Competition, Regulation and Price Controls in the GB Retail Energy Market*, April 2018

[17] CMA, *Energy market investigation: Final report*, June 2016

[18] BEIS, *Government response to the Competition & Markets Authority Energy Market Investigation*, February 2018

[19] CMA, *Energy Market Investigation*, June 2016

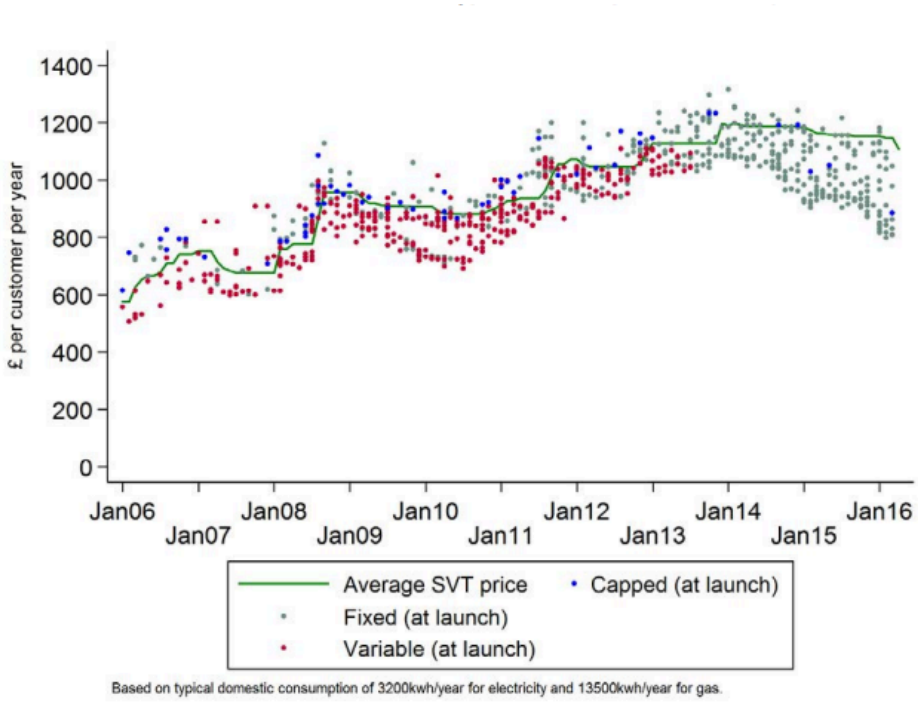
Those who are on default tariffs (and do not engage) are inherently more at risk of their bills going up continuously without noticing. Ofgem had been worried about the emergence of a two-tier market since they launched the Probe in 2009 - one for engaged customers likely to switch to take advantage of the best deals, and another for disengaged customers who were highly unlikely to switch, with the outsized profits made from the latter subsidising cheaper deals for the former. The CMA found that this cross-subsidisation was commonplace:

> *"Several of the Six Large Energy Firms have told us that there is a strong interrelationship between their pricing of the SVT and of their non-standard products. In particular, one of the Six Large Energy Firms told us that to attract customers it had to offer discounts on its SVT and that fixed-term discounted tariffs were therefore priced to attract customers, recognising that a certain proportion of customers would revert to the SVT at the end of the product's term."*[20]

This practice represented a significant lessening of competition, distorting the market and making it harder for other suppliers to get a foothold. Legacy companies were in the position to use these pricing strategies because of the large number of 'loyal' or disengaged customers they inherited after privatisation. In turn, the anti-competitive environment created by this practice pushed many smaller suppliers to adopt unsustainable pricing strategies to compete and gain customers. The experts we spoke to generally accepted that the two-tier market existed, and represented a significant unfairness that needed to be resolved urgently. As a representative from a challenger firm put it: *"It was quite shocking to come in and see that large swathes were paying much more than they needed to."* Figure 1 demonstrates the increase in the discrepancy between SVTs and other tariffs over time.

[20] CMA, *Energy Market Investigation*, June 2016

Figure 1: Average SVTs and non-standard tariffs offered by the Six Large Energy firms



Source: *Ofgem, September 2018*

In spite of the findings of the CMA Market Investigation, the CMA did not recommend a price cap for all domestic customers. Instead, it recommended a range of other measures aimed at making it easier for customers to switch and a cap to protect customers on prepayment meters.[21] These recommendations were highly controversial at the time.

Responses to the CMA Market Investigation

Most of the non-price cap recommendations of the CMA related to retail markets and aimed to enhance competition by encouraging consumers to switch suppliers. Many of these recommendations were intrusive and controversial. For example, following CMA recommendations, Ofgem began a consumer engagement trial designed to find new ways of boosting consumer engagement in the market. Ofgem used new licence powers that allowed them to require energy suppliers to take part. Ofgem ultimately forced Npower to take part in a collective switching trial - enabling consumers to find better deals by clubbing together through a third party - in spite of the company's heavy resistance.

Ofgem also trialled a Cheaper Market Offers Communications (CMOC) scheme for disengaged customers in summer 2018, before the introduction of the default tariff price cap. CMOC was "designed to test whether customers could be prompted to switch to a cheaper tariff by signposting them to three

[21] Ibid

cheaper alternative tariffs".[22] Ultimately these trials did not show enough promise that they would be able to fix the underlying problems in the market. It was accepted by policymakers that persuading loyal customers to engage in the market was extremely difficult. The public opinion research we have done (and described in Chapter 3) indicates that the two-tier market is still around today.

The CMA did, however, put forward a minority opinion (held by one panel member) that a temporary cap on energy prices would provide protection to consumers while its other recommended measures were implemented, until the conditions for effective competition were established. In its response to the CMA, the Government agreed with this position.[23,24]

The persistent difficulties in the market over many years, and the extent of the loyalty penalty highlighted by the CMA, led many in Parliament to agree with this minority view. For some, the only way to prevent disengaged customers from being exploited was to enforce an upper limit on the price that suppliers could charge customers on default tariffs. Tariff caps for customers on prepayment meters had already been introduced by Ofgem (at the recommendation of the CMA) in April 2017 and for vulnerable customers in February 2018 and many wanted the Government to go further.

The CMA's findings also put significant political pressure on Ministers to act - a point that was corroborated in many of our stakeholder interviews. Experts often made the point that the political atmosphere at the time was febrile and Ministers were actively looking for policy measures that would provide tangible benefits to customers (whilst keeping the market as competitive as possible). As one former official involved in establishing the price cap said, Ofgem were under pressure "to deliver a cost of living boon for the PM; and get rid of this loyalty penalty and price walking behaviour for the energy secretary; whilst trying to make sure it didn't choke investment."

Likewise, this political pressure is outlined in an IEA report: "Customer detriment of £2 billion per year, caused by supplier exploitation of weak customer response, was the only message that the media and politicians heard in the run-up to the 2017 general election. The inevitable result was the tariff cap."[25] The strong political appetite for the cap was demonstrated by the inclusion of a commitment in the 2017 Conservative manifesto to "go further" and "extend the price protection currently in place for some vulnerable customers to more customers on the poorest value tariffs." [26]

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[22] Ofgem, *Cheaper Market Offer Communication Trial*, September 2019

[23] BEIS, *Government response to the Competition & Markets Authority Energy Market Investigation*, February 2018

[24] House of Commons Library, *Competition and Markets Authority: "Energy Market Investigation"*, May 2016

[25] Institute ofEconomic Affairs, *The challenge of removing a mistaken price cap*, October 2021

[26] Centre for Policy Studies, *The Case Against the Energy Price Cap*, August 2023

Arguments for the cap: Protecting 'sticky' customers

According to a 2015 GFK study, households found themselves on SVTs for various reasons, including limited access to information, lack of switching awareness, and difficulties in managing finances. Demographics commonly associated with vulnerability to SVTs are: low income households; elderly households; renters; low digital literacy; prepayment users; single person households; households in fuel poverty:

> *"Overall, we find that, excluding prepayment customers, those households who are: in rented accommodation; have incomes below £18,000; or in receipt of a Warm Home Discount rebate have higher gains from switching. By implication, such customers are on average paying a somewhat higher price for their energy than those customers who do not fall into these categories."*[27]

During a BEIS Committee oral evidence session in 2017, then Secretary of State, Greg Clark, accepted that there was a two-tier market. Clark referenced the CMA's conclusions that suppliers have "unilateral market power over their inactive customer base" and can "exploit such a position by pricing their SVTs materially above a level that can be justified". As the CMA found, this practice not only exploits customers but distorts the market more generally. He argued that the prevalence of switching was not due to increase sufficiently enough on its own:

> *"My view is that of the minority panel report, which said that in the next few years it did not expect that there would be such a rapid change as to eradicate that deficit [loyalty penalty], so a price cap was needed."*[28]

At the same time, Clark was eager to differentiate between vulnerable customers and "busy, typical" customers, where the latter are hamstrung by an inability to access the internet or who, "however naively, assume that they will be reasonably well looked after by their supplier." He added, "specifically it is the excessive charging that I want to eradicate…that is the purpose of the price cap, to eradicate that." [29]

Clark's view, along with many others, was that a cap would protect customers who didn't switch from unfairly high tariffs. Citizens Advice welcomed the cap, whilst stressing that customers could still get a better deal by switching or investing in energy efficiency:

> *"This price cap will finally offer some much needed protection for loyal households on default tariffs, who have been exploited for too long. While the cap will mean that people pay a fairer*

[27] GFK, *Consumer Engagement in the Energy Market*, February 2015
[28] BEIS Committee, *Oral evidence: Energy Price Caps*, November 2017
[29] Ibid

price, it will not be the best deal on the market. By shopping around and changing tariff or supplier, people are likely to be able to make much greater savings on their energy bills."[30]

Citizens Advice were effectively arguing that - in spite of the cap - there would still be cause and incentive for customers to shop around, i.e. there would still be competition.

Designing the price cap

In contrast, arguments being made at the time against the price cap were largely that it would hamper competition, innovation and risked underinvestment in retailers. In an oral evidence session the Managing Director of UK Home made the following point:

"In our view, there is an issue with engagement, but the solution is not one of price caps. Price caps will actually hinder competition and innovation in the energy market… prices in the retail energy market have largely moved in recent times—we have seen cuts on gas and increases in electricity—reflecting the changes in the cost of supplying energy to customers." [31]

Professor of Regulation at University of East Anglia, Catherine Waddams, agreed that, even whilst a price cap would prevent overcharging, it would stifle competition and innovation:

"If you are concerned about the process of competition and the opportunities that are available to people, then a price cap is going to work against that. I think it is a political choice, and I am delighted to see that it is a political decision that has been made."[32]

As the above demonstrates, even some of those who agreed with the political necessity of the cap accepted the argument that it would be the lesser of two evils - less competition was seen as an acceptable cost of protecting sticky customers.

At the time, as well as debates over whether or not the cap should be introduced, there were arguments about its design. Some argued that the cap should be 'absolute', in the sense that it would be a fixed 'cost stack' cap which is not designed in referenced to other prices offered in the market, whereas others believed that a relative cap made more sense - i.e. one that is set in relation to other prices in the market, for example as a percentage above the acquisition tariff.

The idea that an absolute cap would hamper competition was given by some as evidence of the need for a relative cap. In 2017, Greg Jackson, CEO of Octopus Energy - then a new supplier in the market - argued: "Competition is important, which is why we believe in a relative price cap, which will make this

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[30] Citizens Advice, *Energy price cap "offers some much needed protection for loyal households", says Citizens Advice*, November 2018

[31] BEIS Committee, *Oral evidence: Energy Price Caps*, October 2017

[32] BEIS Committee, *Oral evidence: Energy Price Caps*, October 2017

market behave far more like supermarkets so that everyone gets a good deal".[33] However, according to a number of experts interviews, it was felt that a relative cap might be more easily gamed and would be less likely to provide sufficient protection for disengaged customers. An absolute cap was announced in 2018.

After the announcement, the notion that competition was steadily growing without the cap was echoed by the industry trade body Energy UK's Chief Executive, Lawrence Slade:

> *"The price cap will present a significant challenge for many of the 70+ suppliers in the retail market, who are already facing steeply rising costs - the vast majority of which are out of their direct control, at a time when the market is more competitive than ever."*[34]

The cap's role going forward was summarised in a letter Clark wrote to legacy suppliers in February 2018: "We have said previously that our intention is to introduce a temporary cap to protect consumers, while the objective of a more competitive market is achieved." [35] Most interviewees accepted that introduction of the price cap was generally resisted by legacy suppliers. Experts we spoke to were clear that its introduction was ultimately driven by political imperatives, in spite of conflict between No.10, HM Treasury and BEIS. The legislation included a sunset in 2020 with a possible annual extension until 2023, subject to achieving effective competition in the market.

[33] Ibid

[34] Business Green, 'Energy industry steps up call for efficiency drive, as Ofgem confirms price cap launch date', November 2018

[35] BEIS, *Letter to Energy Companies*, February 2018

Chapter Two - The impact of the price cap

This chapter evaluates the role and impact of the price cap in the retail energy market from January 2019 to present day. As part of this evaluation, we consider how far the price cap has achieved its intended goals, and the extent to which concerns among the industry have been realised. At the time of its introduction, the primary purpose of the price cap was to remove the loyalty penalty for disengaged customers. It was also expected that energy suppliers, particularly legacy suppliers, would make efficiencies to sustain operations and profitability under the price cap. As highlighted in the previous chapter, critics of the cap warned that it would hamper competition. These are the core criteria by which this chapter evaluates the price cap.

Our analysis evaluates the cap in two distinct time periods: first, during a relatively stable period (January 2019 - July 2021) and, second, during a crisis period (August 2021 - 2023).

Part One - A stable market: January 2019 to July 2021

This section reviews evidence to assess the performance of the price cap against its anticipated benefits and disadvantages during the 'stable' period between its introduction and the beginning of the energy crisis. We look at how the cap fared against the reduction of the 'loyalty penalty' and consumer detriment in the form of fair prices, and the impact of the cap on supplier operational efficiencies. We also assess whether the concerns about the cap (i.e. that it would hamper competition and switching and limit innovation) came to fruition.

Reducing consumer detriment and protecting disengaged customers

Verdict: The price cap's main purpose was to reduce the consumer detriment from suppliers unfairly overcharging SVT and default tariff customers. Both qualitative and quantitative evidence indicate that this was achieved and that the price cap successfully reduced the loyalty penalty between 2019 and 2021. Experts we interviewed from across the retail energy sector were in near-total agreement on this point.

At the time of the price cap's introduction, four of the six legacy suppliers had a greater number of customers on SVTs than fixed tariffs, therefore we would expect that any reduction in the loyalty penalty for SVT customers would negatively impact suppliers' profitability.[36] From 2019, when the wider price cap was introduced, profit margins of the majority of legacy suppliers were negative at an average of -1.5% followed by -1% in 2020 and -2.5% in 2021 (owing in part to the beginning of the energy crisis). British Gas/Centrica was the only supplier to maintain a positive profit margin during this period - however, notably, their domestic gas profits fell from £613 million in 2017 to £172 million in 2019 and £97 million in 2020 (nominal prices), representing a real-terms fall of -84%.

[36] Ofgem, *Standard variable tariff indicators – previous updates*, October 2023

New analysis in this report also analyses the distributional impact of the price cap's bill savings for disengaged customers. In line with Ofgem's own analysis that the cap saved households £1bn a year, we find that households on SVTs paying by direct debit on average saved £100 in 2019/20 and £115 in 2020/21. As a proportion of disposable household income, the poorest 10% benefited from savings 6-7 times that of the wealthiest 10%. A household on minimum wage working part-time in 2019/20 could have saved around £93 a year, equivalent to 1.3% of their disposable annual income.

Evidence: At the time of the retail energy market investigation, the CMA estimated that the detriment totaled an average of £1.4bn a year.[37] In 2018, Ofgem estimated that the price cap would protect 11 million households on standard variable and default tariffs – in addition to the 4 million already covered by the prepayment meter cap introduced in 2017. Ofgem estimated that the cap would deliver the average customer savings of between £75 and £120 a year, totalling an aggregate of £1bn a year.[38]

Experts we interviewed were in near-total agreement with the hypothesis that the price cap successfully reduced the loyalty penalty, and therefore protected disengaged customers from unfair treatment, achieving its primary goal. Likewise, they accepted the notion that disengaged customers were, in effect, subsidising the lower prices of engaged consumers, and that this was a widespread and established practice which itself was leading to two competition issues in the market. It drove suppliers to set unsustainably low prices to acquire customers and awarded unearned competitive advantage to the legacy suppliers who had the majority of 'sticky' disengaged customers on SVTs.

A former No.10 official, for example, argued that the cap did address the loyalty penalty by undermining some suppliers' business models which "exist based on you not paying enough attention." This was echoed by a former senior Ofgem official who agreed, saying that during this particular period the cap "could be considered successful on [a] key measure: reducing the loyalty penalty." A senior employee of a challenger firm said the same: "Once it came in it worked very well – designed based on market conditions that were relatively stable, it served its purpose, it wasn't an affordability measure, it was protection for disengaged customers."

The cap's methodology was spelt out in more detail by a representative from a non-legacy supplier - outlining its effects for disengaged customers: "It worked as designed – each cost allowance was reflective of the cost of supplying energy, suppliers basically could make a fair return and customers were assured of receiving a fair price for their energy, it work very well in terms of design, it put an end to excessive default tariffs."

[37] CMA, *Energy Market Investigation*, June 2016

[38] Ofgem, *Ofgem proposes price cap to give 11 million customers a fairer deal for their energy*, September 2018

A representative of a consumer body highlighted the success of the cap in this area, referencing that the cap returned £1bn in lower prices to consumers - the figure estimated by Ofgem,[39] which we have substantiated in the new research we have done for this report.

Many of the experts we spoke to emphasised that suppliers that were engaged in unfair and exploitative pricing strategies were forced into changing their behaviour and expectations as a result of the cap. One former official working closely on the cap's implementation agreed that the cap sent a strong signal and fundamentally altered the energy market:

> *"It was initially effective in that the Government had provided a concrete steer that a certain type of behaviour was wrong. These customers weren't earned, they were a privatised hand-me-down."*

It was clear from our interviews that experts consider the price cap to have been a success when measured its main objective for this time period. Even those who thought that the cap was the wrong intervention, did not seriously question that it had somewhat protected disengaged customers through lowering their prices immediately after its introduction up until 2021.

Reduced profits of legacy suppliers support the hypothesis of a reduction in unfair pricing for 'sticky' customers

Changes in suppliers' profit margins provide insight into how far the cap offset unfair pricing behaviour. At the time of the price cap's introduction, four of the six legacy suppliers had a greater number of customers on SVTs than fixed tariffs, therefore we would expect that any reduction in the loyalty penalty for SVT customers would negatively impact suppliers' profitability.[40]

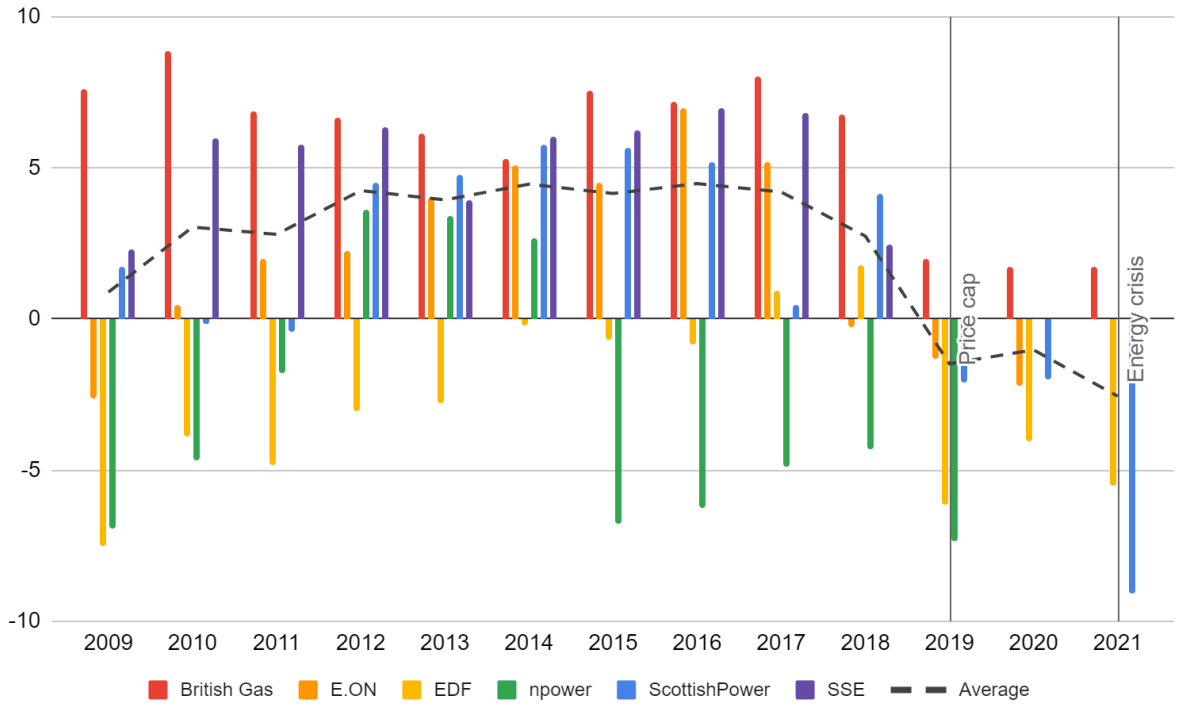
While suppliers' individual margins vary, an aggregate view of legacy suppliers highlights a downward trend in profits following the introduction of the cap. Between 2009 and 2016, the average combined profit margins of legacy suppliers grew from 0.9% to 4.5% before declining - as shown in Figure 2. This broadly coincides with the CMA Market Investigation in 2016 and the introduction of the prepayment meter cap in 2017.

From 2019, when the wider price cap was introduced, profit margins of the majority of legacy suppliers were negative at an average of -1.5% followed by -1% in 2020 and -2.5% in 2021 (owing in part to the beginning of the energy crisis). British Gas/Centrica was the only supplier to maintain a positive profit margin during this period - however, notably, their domestic gas profits fell from £613 million in 2017 to £172 million in 2019 and £97 million in 2020 (nominal prices), representing a real-terms fall of -84%. Such notable losses support the argument that the price cap was effective in reducing unfair and exploitative pricing strategies of legacy suppliers for customers on SVTs.

[39] Ibid

[40] Ofgem, *Standard variable tariff indicators – previous updates*, October 2023

Figure 2: Pre-tax domestic supply margins of large legacy suppliers (combined gas and electricity)



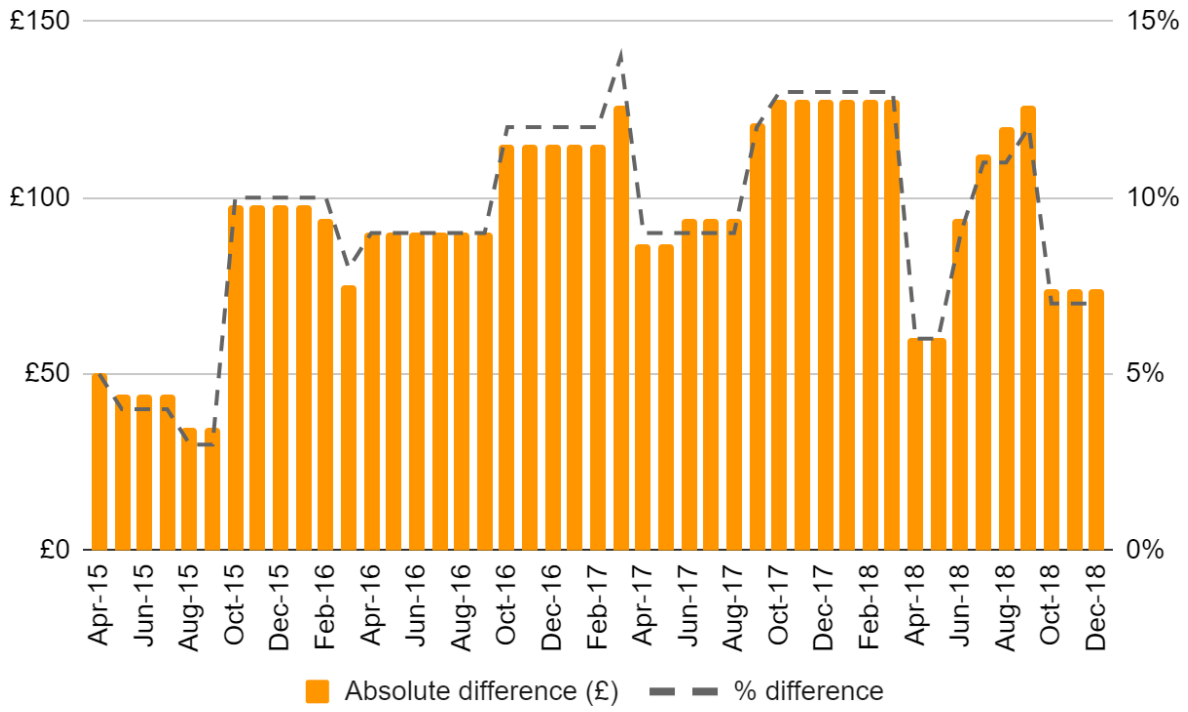
Source: Ofgem, Consolidated Segmental Statements

Bill savings have positive distributional impacts as a proportion of household income

Calculating the bill savings resulting from the price cap is challenging given that it requires knowing how suppliers would have priced their SVTs had the cap not been introduced. This is impossible to know exactly. Ofgem's retrospective analysis provides a useful guide for demonstrating what the average bill savings might have been - shown in Figure 3. Had the price cap been in place between 2015 and 2019, the regulator's analysis suggests that it would have been set £75 to £100 lower than the average legacy supplier's SVT per year in that period.[41] This means that, on average, SVTs were around 9% higher during this period than Ofgem's methodology for a 'fair' price.

[41] Ofgem, *Savings on energy bills for millions as price caps fall*, February 2020

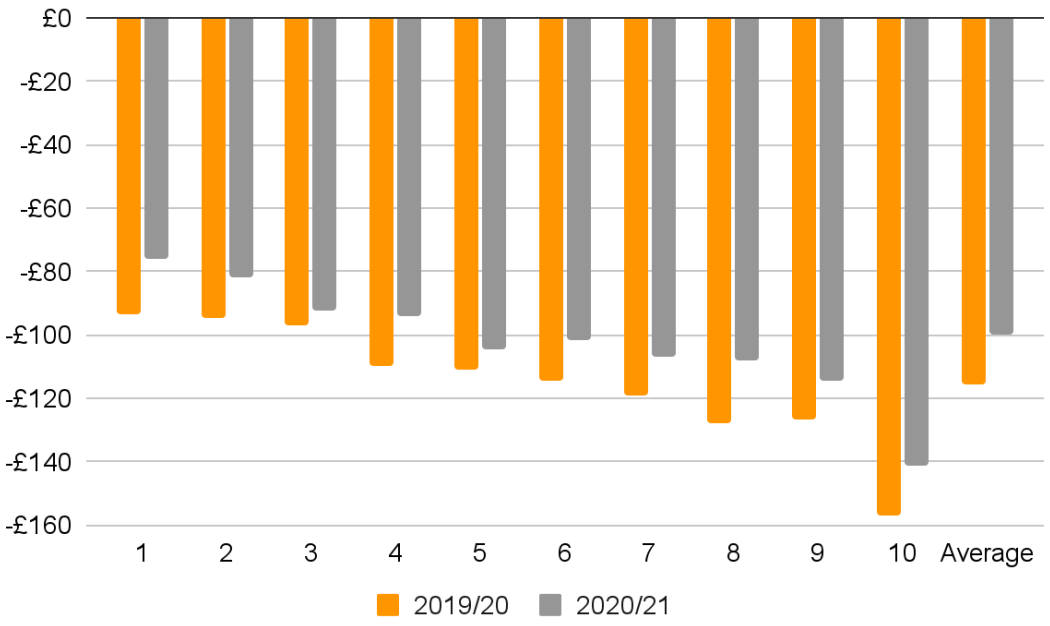
Figure 3: Difference between 12-month standard variable tariff prices and the annual default tariff cap level if applied before 2019, by month



Source: Ofgem

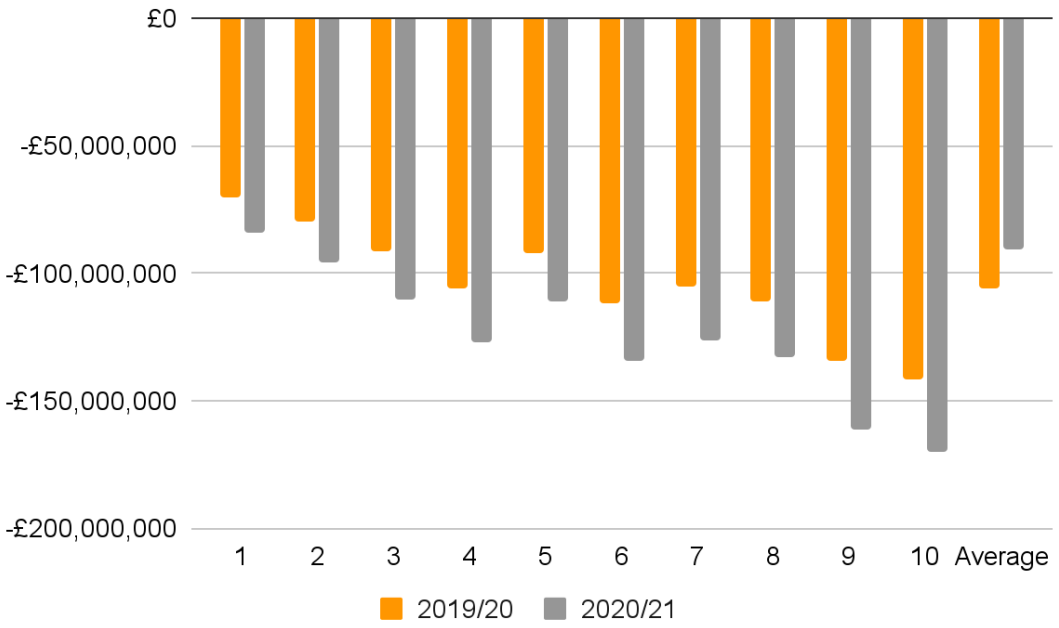
Projecting these assumptions forwards, for direct debit SVT customers only, we estimate the distributional impact of the reduction in consumer detriment in 2019/20 and 2020/21. By this we mean, which households - split by income groups - are likely to have benefited the most from the price cap. As noted, we recognise the limitations to this approach given the complexity of the cap's methodology. We are not modelling the cap nor the exact savings that the cap has delivered and the findings should not be referenced as such. The findings are purely illustrative to show the potential distributional impacts. Using data from the Living Cost and Food Survey and Ofgem's Consumer Survey, Figures 4 and 5 below highlight how potential savings from the price cap vary across income groups.

Figure 4: Estimated average annual savings from the price cap for direct debit SVT customers (£), per income decile



Source: Public First analysis of Living Cost and Food Survey and Ofgem Consumer Survey. April to March financial year.

Figure 5: Estimated aggregate annual savings from the price cap for direct debit SVT customers (£), per income decile



Source: Public First analysis of Living Cost and Food Survey and Ofgem Consumer Survey. April to March financial year.

Our analysis indicates that for an average direct debit SVT customer, household energy bills were reduced by around £115 in 2019/20 and £100 in 2020/21 due to the price cap, which is broadly in line with Ofgem's estimates of £75-120 a year.[42] This ranges from around £90 for poorest households (first income decile) to £155 for the wealthiest in 2019/20, and around £75 to £140 respectively for 2020/21. However, for the lowest income households (bottom 10% of earners), these potential savings represent on average 6-7 times the proportion of disposable household income, compared to those on the highest incomes (top 10% of earners). A household on minimum wage working part-time[43] in 2019/20 could have saved around £93 a year, equivalent to 1.3% of their disposable annual income. For the wealthiest, the savings of £157 were equivalent to 0.2%.

At an aggregate level, the total potential savings are around £1bn in 2019/20 and around £930 million in 2020/21 - again, in line with Ofgem's estimates of £1bn a year. This is to be expected, given the analysis is based on Ofgem's own backcast methodology. The savings range from around £70 million for the

[42] Ofgem, *Ofgem proposes price cap to give 11 million customers a fairer deal for their energy*, September 2018

[43] Minimum wage was £8.21 in 2019/20. Annual disposable household income for a household in the bottom income decile was £7,050. Changes between 2019/20 and 2020/21 reflect lower levels of consumption and prices in the latter year.

poorest decile to around £140 million for the wealthiest decile in 2019/20, and around £58 million to £110 million respectively for 2020/21.

Our analysis indicates that the wealthiest households (in the highest income decile) may have seen the greatest financial benefit from the price cap, both in terms of average household savings and aggregate savings for the decile. This is despite the fact that lower income households are proportionally much more likely to be on SVTs than higher income households. Even so, the findings likely reflect the general, aggregate trend that energy consumption is correlated with income, therefore the potential for savings is higher.

Any policy should take its distributional impact into account. The purpose of the price cap in reducing consumer detriment was critically about fairness, rather than affordability. As a result, the progressiveness of the policy should be considered in its evaluation but is not a core tenet for measuring whether the price cap achieved its intended purpose. On balance, the evidence presented in this section supports a clear argument that during the stable period from 2019 to autumn 2021, the price cap achieved its core objective to reduce consumer detriment (the 'loyalty penalty') by delivering bill savings and, that as a proportion of income, the poorest households gained the most.

Enabling supplier efficiencies through reduced operational costs

Verdict: An aim of the cap was to drive less efficient suppliers to reduce costs for the benefit of customers. This was expected to enable the adoption of more permanent efficiencies that would also benefit future customers. Our research indicates that efficiencies were achieved, as seen in the reduction in operating costs per customer for most of the legacy suppliers between 2019 and 2021. Expert interviewees also supported this view, highlighting the uptake of new software because of the cost pressures imposed by the cap. One stakeholder went as far as saying that these more efficient business models could now be here to stay, even in a market without the price cap. This view is explored further in Part Two of this chapter with data on efficiencies during the crisis.

Some interviewees raised concerns that efficiencies led to cost-cutting practices across customer services, however, data to support this is mixed. For the most part, overall customer satisfaction remained stable following the introduction of the cap until autumn 2021. This was also true in relation to billing and the switching process. Although, it is likely that price cap-forced efficiencies help explain an increase in those who found it difficult to contact their supplier during this period.

Evidence: Ofgem set the operating costs element of the price cap methodology at a tight level with the expectation that this would drive efficiencies while allowing for a small profitability margin for suppliers[44]. It was Ofgem's express intention that the cap should be "a tough cap that ensures loyal

[44] The allowance for the core operating costs is benchmarked at the lower quartile minus £5. The EBIT margin was set at 1.9% by Ofgem until October 2023 when it increased to 2.4%.

consumers pay a fair price that reflects efficient costs".[45] While some interviewees saw this as overly punitive on legacy suppliers, it was acknowledged that it incentivised greater efficiency which was reflected in lower operating costs across the market. In the words of one representative from a non-legacy supplier: "It has to have driven a more efficient mindset across the market."

This argument was repeated by a former representative of a legacy supplier company, who argued that the price cap's introduction had significant consequences for legacy suppliers whose operating costs were higher than their competitors. They argued that the market prior to the cap involved a "clear demonstration of market power" and that after the cap was introduced "there was a big resetting of shareholder expectations… which was factored into the share price".

A representative from a consumer body said that they were right when they predicted that the cap, "would lead to an efficiency drive, forcing the Big Six to modernise and find efficiencies". They tempered this positivity by suggesting that some efficiencies were found in cost-cutting necessary services: "suppliers have cut a hell of a lot from their business models." Similarly, a senior representative from Ofgem said plainly that the price cap could, alongside its success in reducing the loyalty penalty, be considered successful at "making suppliers more efficient."

One stakeholder went as far as saying that these more efficient business models could now be here to stay, even in a market without the price cap. For example, a senior Government official said: "Given that the cap has achieved this efficiency gain, arguably the consumer would now be better served by it being removed." However, this view is based on many unknowns about the future of the retail market and suppliers' behaviour.

A few experts agreed with this point that the legacy suppliers were forced to find efficiencies, but were divided on whether this was 'punitive' or not. When speaking about this trade-off, a former No.10 official said that, either way, the cap "achieved an efficiency gain" for the market : "The cap calculations [gave] costs for 'an efficient' supplier and those costs were lower than most of the legacy suppliers so it really did drive operational change." This official put much of this change down to suppliers adopting new software because of the pressures imposed by the cap. A similar view was expressed by a former HM Treasury official, although in less positive terms:

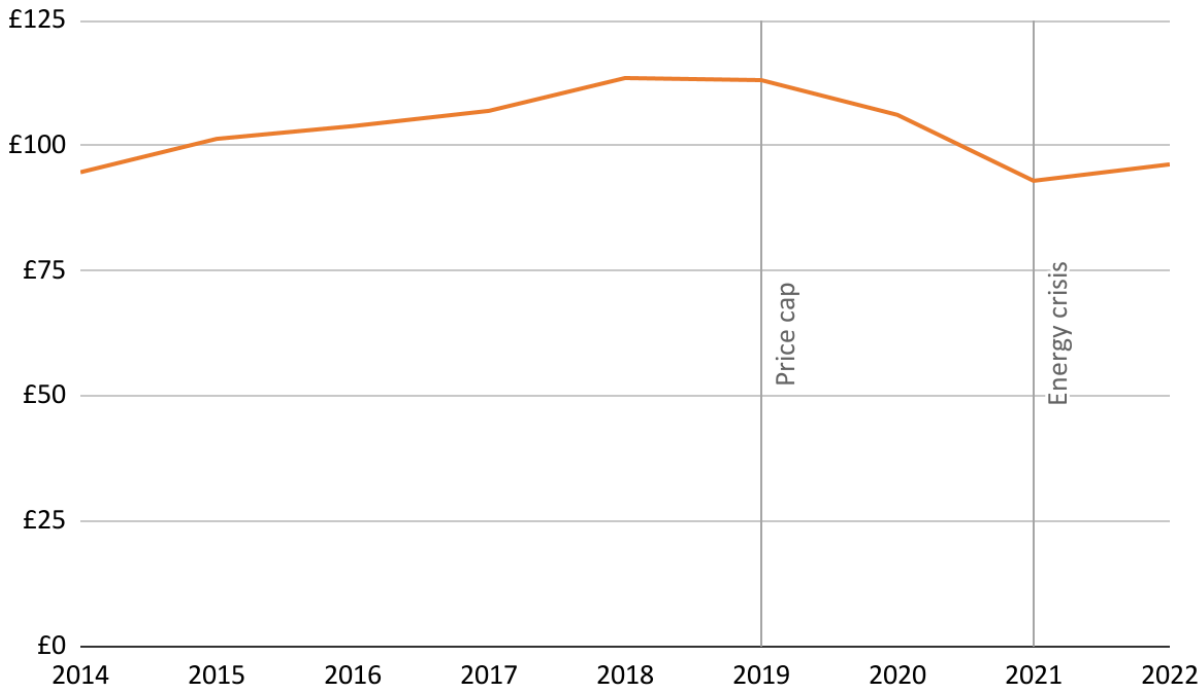
> *"The initial cap was really pernicious. Ofgem ascribed a couple of challenger suppliers as 'efficient' and said [every company] has to meet their standards and cost base, then added a wedge for profit. It obliterated the profit margins of all the major energy suppliers because they weren't making any money on the supply market for a few years."*

Public First's analysis of the Consolidated Segmental Statements submitted to Ofgem by legacy suppliers indicate that, at an aggregate level across the legacy suppliers, operational efficiencies were made following the introduction of the price cap in 2019. Figure 6 below demonstrates how, on average,

[45] Ofgem , Ofgem strategic narrative: 2019-23, July 2019

indirect costs[46] for domestic gas and electricity supply increased year on year per customer between 2014 and 2018 from £95 to £114 per customer respectively (2022 prices). Efficiencies began to take effect from 2019 and continued throughout the 'stable market' period, with the cost per customer declining by -0.4%, -6.1% and -12.4% year on year until 2021. This represents a fall in real terms of -17.8% (£20.10 per customer) from 2019 to 2021.

Figure 6: Average indirect costs per customer for legacy suppliers, domestic gas and electricity supply (£, 2022 prices), weighted by supplier market share



Source: Public First analysis of Ofgem, Energy companies' Consolidated Segmental Statements
Note: Weighted average of British Gas/Centrica, E.ON, EDF, npower, ScottishPower and SSE. Average gas to electricity ratio for customer numbers is 1:1.2. SSE's financial year runs April-March therefore estimates are calculated on a January-December basis for comparability. Missing data for 2021 and 2022 for E.ON and npower – E.ON no longer had to provide Ofgem with consolidated accounts after ceasing to hold a generation licence in 2021. npower was sold from RWE to E.ON in 2020 where the same limitations from licensing apply. Missing data for SSE from 2020 - SSE sold domestic customers to OVO in 2020.

There are limitations to taking an aggregate view across legacy suppliers, not least because it masks the way in which different suppliers behaved – as seen in Figure 7. Following the introduction of the price cap, efficiencies were largely driven by SSE in 2019; npower, British Gas/Centrica, and E.ON in 2020; and EDF and British Gas/Centrica in 2021. This is supported by announcements made at the time that,

[46] Indirect costs refers to operating costs such as sales and marketing, bad debt costs, costs to serve, IT, HR, finance, property, staffing and billing.

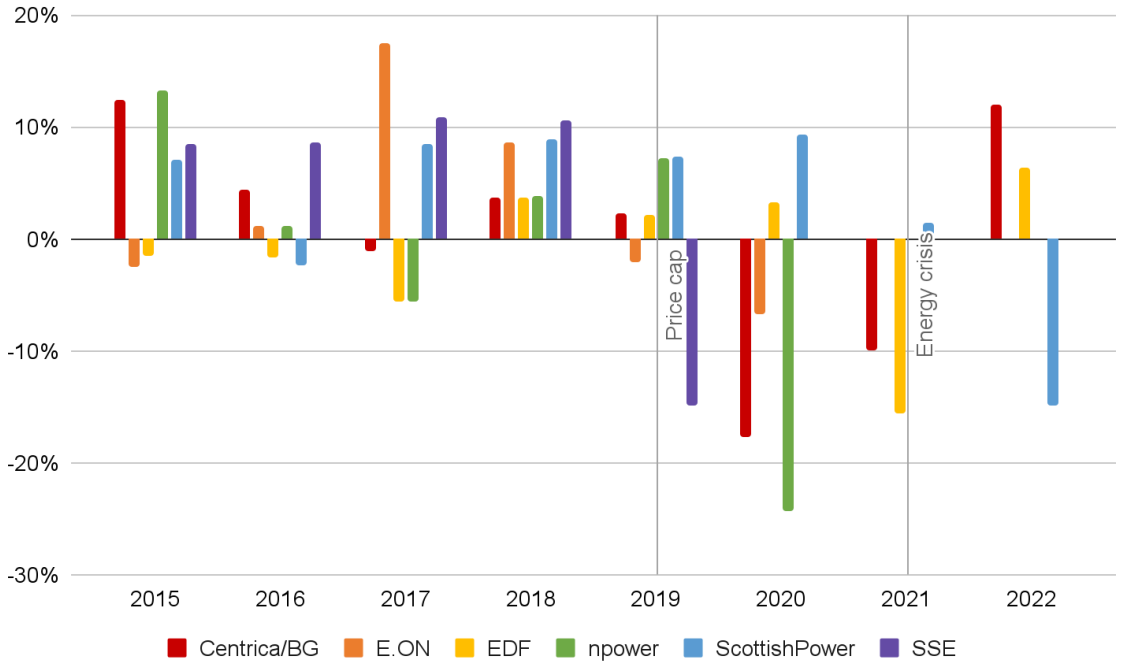
for example, British Gas/Centrica would reduce its headcount by 5,500 by 2020.[47] Since the introduction of the cap, most legacy suppliers have undergone technology replatforming which will have driven efficiencies.[48] Additionally, some of these cost reductions may reflect a streamlining of SSE and npower's business models ahead of their sale to OVO and E.ON respectively. By comparison, ScottishPower continued to increase their indirect costs per customer year on year throughout this 'stable market' period.

Additionally, changes in the market from 2020 onwards impacts data availability. SSE sold their domestic customers to OVO and npower was sold to E.ON in 2020. From 2021, E.ON was no longer required to submit consolidated segmental statements as they ceased to hold a generating license. As a result, from 2021 onwards, the analysis reflects the business models of British Gas/Centrica, ScottishPower and EDF only.

[47] The Guardian, *British Gas owner to cut 4,000 jobs blaming price cap and competition*, February 2018

[48] E.ON and Kraken Technologies form strategic partnership for E.ON's UK residential and commercial customer business, 23 March 2020; EDF strikes deal to move its 5 million customers to Octopus Energy Group's Kraken platform, 4 November 2021; Centrica signs strategic partnership with ENSEK to accelerate digital transformation and help position the company for growth, 18 August 2021.

Figure 7: Year on year change in indirect costs per customer for legacy suppliers, domestic gas and electricity supply (£, 2022 prices), per supplier



Source: Public First analysis of Ofgem, Energy companies' Consolidated Segmental Statements
Note: Weighted average of British Gas/Centrica, E.ON, EDF, npower, ScottishPower and SSE. Average gas to electricity ratio for customer numbers is 1:1.2. SSE's financial year runs April-March therefore estimates are calculated on a January-December basis for comparability. Missing data for 2021 and 2022 for E.ON and npower – E.ON no longer had to provide Ofgem with consolidated accounts after ceasing to hold a generation licence in 2021. npower was sold from RWE to E.ON in 2020 where the same limitations from licensing apply. Missing data for SSE from 2020 - SSE sold domestic customers to OVO in 2020.

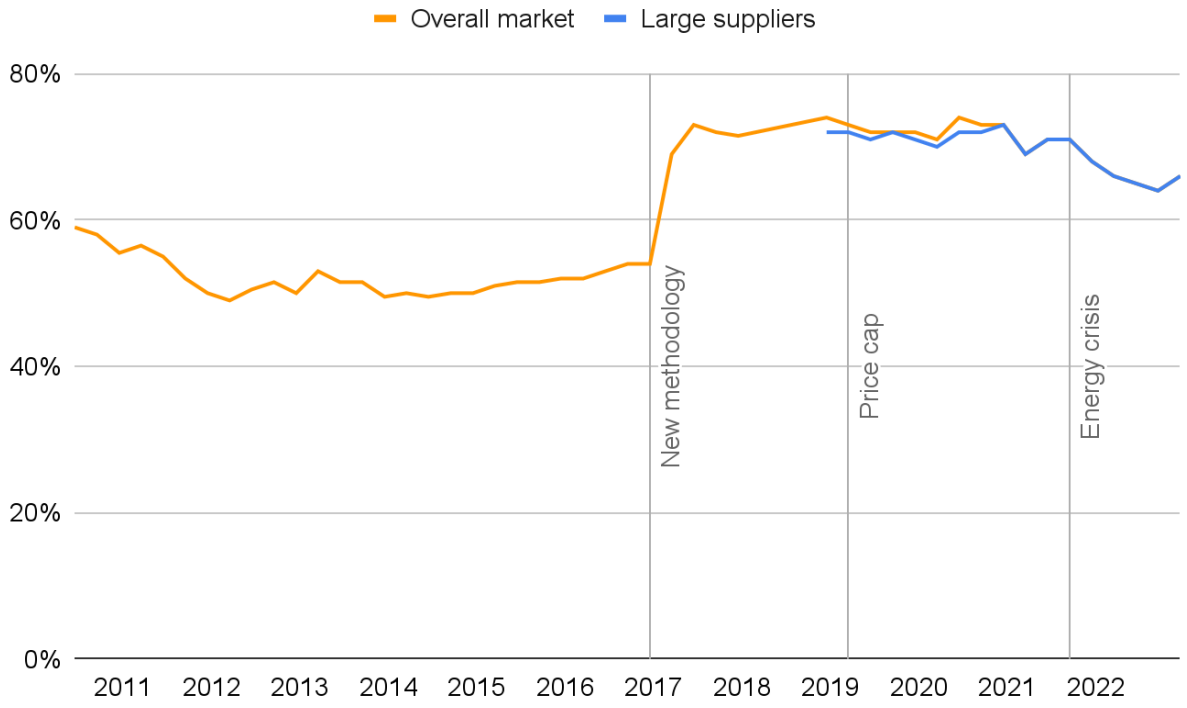
Customer service levels largely remained stable except for ease of contacting supplier

While supplier efficiencies can generally be considered as a positive externality, as suggested above, some of the experts we interviewed raised concerns about falling customer service standards resulting from suppliers cutting services to lower costs. Data on customers' satisfaction levels with their supplier indicates that, at least in aggregate, standards remained relatively stable until the end of 2020.

Customer satisfaction levels were fairly stable from 2014 to 2017 with a marginal increase of 4 percentage points by the end of the three years from 50% to 54%. Under the newer methodology, customer satisfaction was again relatively stable in the run up to and immediately after the introduction of the price cap at an average of 72% from mid-2017 to the end of 2020.[49] Large suppliers (including the legacy suppliers) generally follow the same trend as the overall market during this time period - as seen in Figure 8.

[49] While satisfaction levels dropped to 69% in Q1 2021, they returned to 71% until Q3 of that year.

Figure 8: Percentage of customers satisfied with energy supplier's overall customer service, by supplier size, 2010-2022

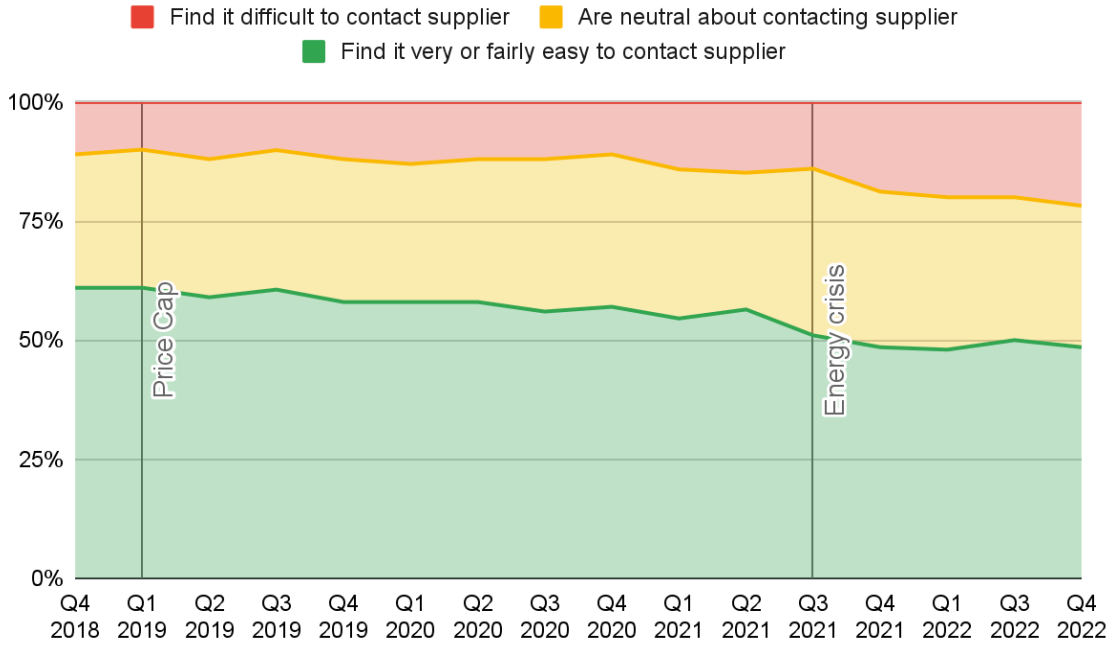


Source: Ofgem

Note: Overall market trend line is eclipsed from Q4 2020 because it is identical to large suppliers. Data on size of supplier is only available from Q4 2018. Large suppliers include British Gas (including all white label brands), E.ON/E.ON Next, EDF Energy, Scottish Power, OVO (including SSE and other white labels), Octopus Energy (including Co-operative Energy and other white labels), and Bulb.

On more specific measures, customer satisfaction with billing (both understanding and accuracy) and switching processes also remain stable until declining from Q3 2021. This differs slightly for how easily customers say they can contact their supplier. Comparisons against the pre-price cap period are limited given that Ofgem's survey data only commenced in Q4 2018. However, Figure 9 indicates an overall gradual decline in those finding it easy to contact their supplier from 61% in Q1 2019 and 57% in Q2 2021. Those finding it difficult increased by 50% from 10% to 15% in this same period.

Figure 9: Percentage of customers by ease of contacting their supplier, 2018-2022



Source: Ofgem

Limited drop in competitive pricing and switching under the price cap

Verdict: A key concern from some industry voices was that the price cap would hinder competition in the energy retail market. In 2018, Ofgem also anticipated that overall the chosen cap level would enable some level of competition, albeit at a reduced level.[50] Although, it's important to note that prior to the cap, the ability of legacy companies to exploit sticky customers through unilateral market power also distorted competition, as concluded by the CMA in its investigation. Evidence from between 2019 and 2021 indicate that competitive pricing of tariffs and competitive switching rates existed under the price cap. Attractive offers remained in the market. After accounting for significant falls in wholesale prices from 2019 to 2020, we find that suppliers still priced their acquisition tariffs very keenly, but stably, during this period. Additionally, switching rates continued at a plateaued rate of 2%-9%, from 2019 until the energy crisis, despite Ofgem estimating that rates would fall by -30%.

Evidence: Energy suppliers compete on a range of factors - price, customer service, digital offers, smart home/decarbonisation solutions, renewable credentials, and more - to incentivise customers to switch from one supplier to another. This section explores to what extent competition - in the form of pricing and switching rates - occurred under the price cap.

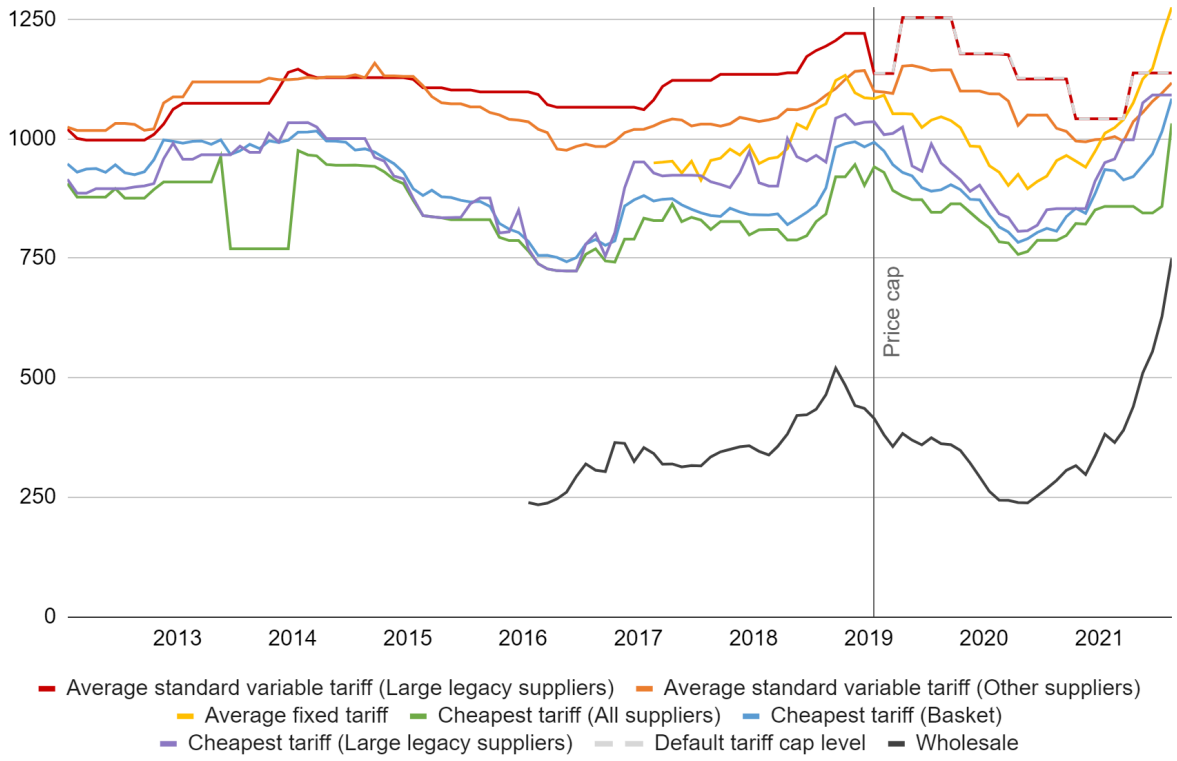
[50] Ofgem, *Default Tariff Cap: Decision, Final Impact Assessment*, 2018

Before the price cap was introduced, Ofgem expected the cap would decrease the number and type of low-priced acquisition tariffs on the market that would sit under the cap level. This was expected to dent the number of 'tease and squeeze' growth strategies – whereby suppliers 'tease' new customers with low prices on the basis that those customers will then roll onto higher-priced SVTs.[51] As a result, suppliers that were more heavily reliant on cross-subsidised or negative-margin tariffs to acquire new customers were expected to be most impacted.

Expert interviewees largely reported that during the stable market period prior to the crisis, competitive pricing continued. A senior employee of a legacy supplier conceded that "competition was happening under the price cap" with fixed tariffs being offered at prices well below the cap between 2019-2021 – as shown in Figure 10. Similarly, a Government official working closely on the cap's implementation at the time agreed, saying that the cap ultimately fostered greater competition in the market: "It allowed challenger organisations to make inroads of those markets, bigger companies had less power to price out challengers offering tariffs that make it impossible to compete."

[51] Ibid

Figure 10: Comparison of retail prices by tariff (£, annual for average consumption), January 2012-August 2021



Source: Ofgem and Public First analysis of third party wholesale data (only available from 2016). Wholesale data reflects the 12 month average price for a dual fuel household with average consumption. From 2019, the default tariff cap level and average SVT level of large legacy suppliers is exactly the same, therefore the lines on the chart are overlaid.

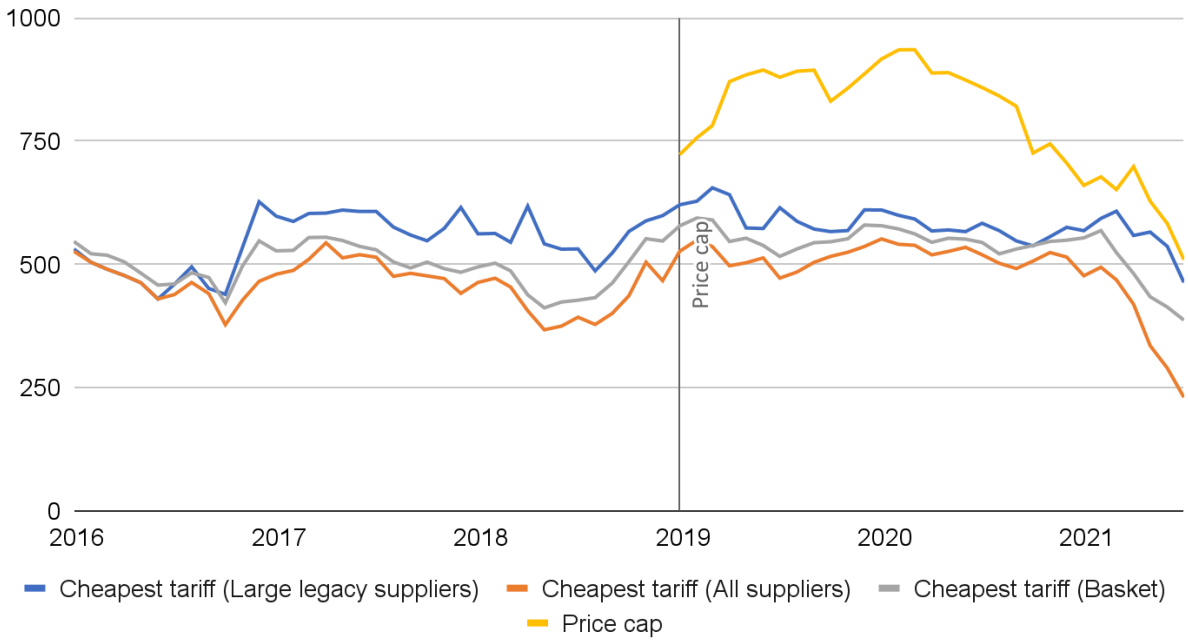
Pricing strategies are informed by a range of factors such as wholesale, policy, and operational costs as well as profit margins. The markup between suppliers' cheapest tariff (which tend to be fixed deals) from the wholesale market prices serves as a useful proxy for how competitive the tariffs are. In times of softer competition, we would expect the markup from wholesale prices to increase. This is because, while wholesale costs can vary based on suppliers' hedging strategy, they are generally similar across all suppliers and influenced by a global market unlike supplier costs such as operational costs.

Much of the decline in the cheapest fixed tariffs in 2019 and 2020 can be explained by falling wholesale prices. Figure 11 shows how the markup between these tariffs and the wholesale costs remained relatively stable during this period, with suppliers still pricing their acquisition tariffs very keenly after the introduction of the price cap.

From January 2019, the mark-up between wholesale and the cheapest tariffs fell for the first 6 months of the price cap but increased again until 2020. This represents an average increase from £525 in January

2019 to £550 in January 2020 for all suppliers. Prices then became gradually more competitive through 2020 with a gradual decline to around £480 on average across all supplier types by January 2021. This shows that while the cheapest tariffs did not achieve the level of competitiveness seen in August 2018 (with a markup of £380), they equally did not rise significantly either from previous peaks in June 2017 (with a mark-up of £520).

Figure 11: Mark-up between wholesale costs for a 12-month period and the cheapest tariffs on the market (£)



Source: Ofgem and Public First analysis of third party wholesale data (only available from 2016). Wholesale data reflects the 12 month average price for a dual fuel household with average consumption.

Switching rates plateaued

Ofgem's own impact assessment of the price cap in 2018 estimated that the chosen cap level might reduce customer switching rates between 10% and 40%, with a central estimate of 30%.[52] However, our research shows that this was not borne out in practice - both empirical and anecdotal evidence from expert interviewees indicates that widespread switching continued, although at a plateaued rate of 2%-9%, from 2019 until the energy crisis.

Most experts accepted that in the period before the crisis, the cap fostered a market in which switching levels remained stable after years of growth from 2014 to 2018, whilst at the same time preventing anti-competitive practices from legacy suppliers. One representative from a company that helped consumers compare and find the best energy tariff said that, in the years after the introduction of the

[52] Ofgem, *Default Tariff Cap: Decision, Final Impact Assessment*, 2018

cap but prior to the crisis, many people continued to move tariffs and suppliers because money could be saved. They said:

> *"There were deals to save hundreds of pounds. Our benchmark was always against the price gap in terms of - when you look at a saving - here's what you're going to pay if you don't do anything on a standard tariff… but the fixed deals out there are plentiful. That used to be our big message…you can save 200 pounds a year now, so it's worth switching."*

Another interviewee from an auto-switching site also evidenced this point by noting how their business remained profitable under the cap, signifying that switching continued.

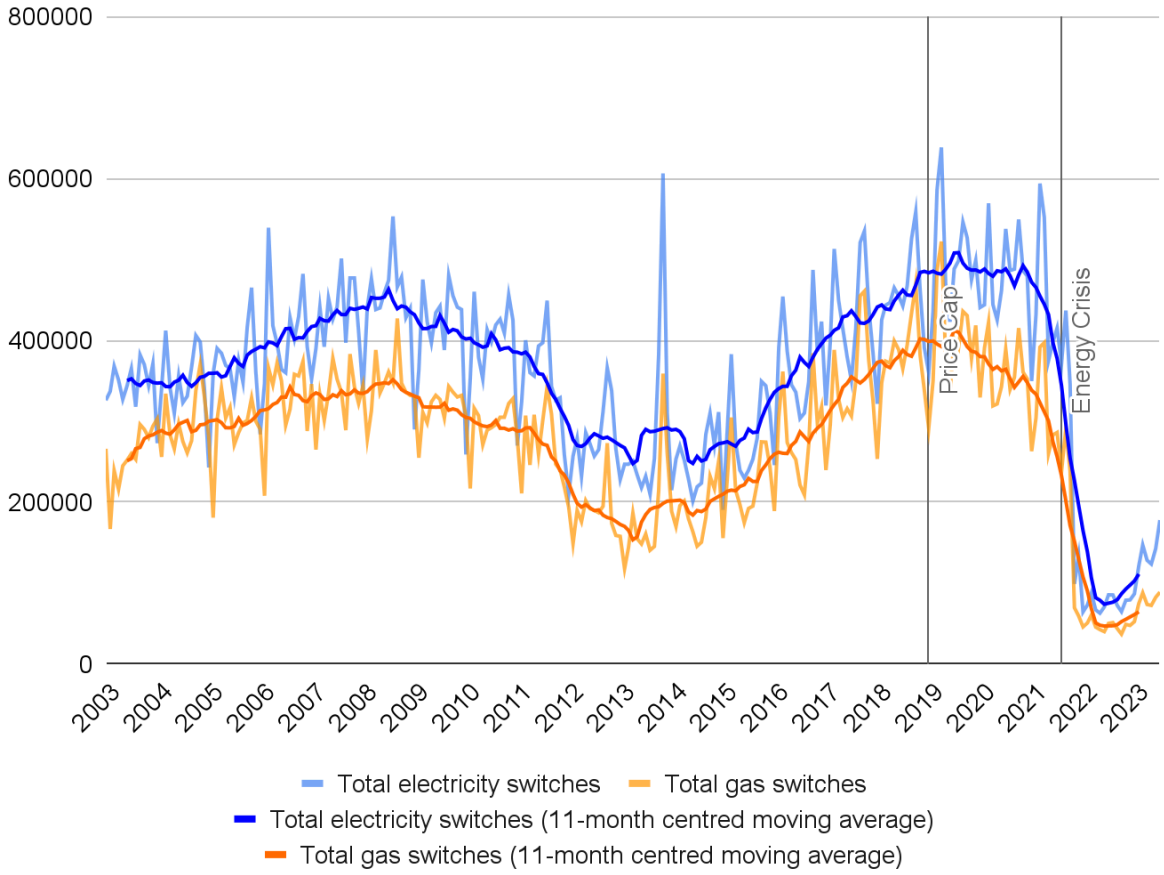
Data from Ofgem, visualised below in Figure 12, broadly supports this story, with the caveat that switching from one supplier to another somewhat plateaued after the introduction of the price cap for electricity switches and fell only slightly for gas. This was after a steady increase prior to the introduction of the cap. During the period from January 2015 to December 2018, switching increased at an average year-on-year rate of 14.7% and 18.2% for electricity and gas respectively. By comparison, in the period from January 2019 to January 2021, after the price cap, these average year-on-year increases had fallen to 2.83 % and -2.77% for electricity and gas respectively.[53]

Taking electricity and gas together, this meant that total switches in fact increased by 8.6% from the year prior to the cap to the first year of the cap; and they increased by 2.3% in its second year, again as measured from 2018 (the year prior to the cap). This stands in stark contrast to Ofgem's initial central estimate of a 30% decrease.

Ofgem also expected there to be a total of 8.5 million switches in 2019, for both gas and electricity. In actuality, more than 10.7 million switches occurred in that year - over 25% higher than predicted. Clearly, Ofgem underestimated the extent of switching after the price cap's introduction.

[53] All these figures are calculated from the 11-month moving average, which, for each month, is the mean of that month plus the five months before and the five months after.

Figure 12: Total external electricity and gas switches per month (i.e. from one supplier to another)



Source: Ofgem

Note: It was necessary to include a moving average due to high month-to-month variation and seasonality in the data in order to understand trends over time. This is an 11-month centred moving average, which includes the mean of the month in question plus the five months after and the five months before. Hence, in the moving average, the effects of the energy crisis, for example, appear to begin a few months earlier than in reality. External switching refers to switches from one supplier to another, not between different tariffs offered by the same supplier. Data does not include customers transferring from corporate transactions or Supply of Last Resort events.

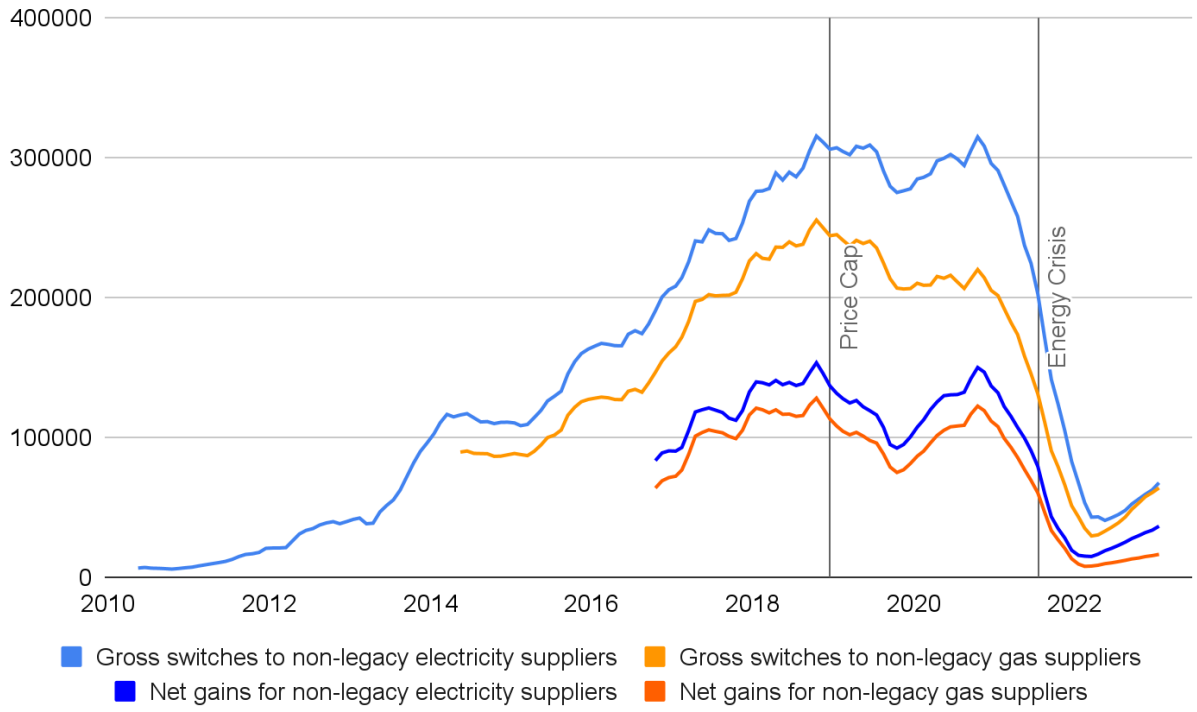
External switching, from one supplier to another, is one measure of consumer engagement and competition in the market. But, the number of switches from large legacy suppliers to non-legacy suppliers is also of interest for where that competition is taking place. Interestingly, the trend in switching differs slightly from the aggregate trend here.

Both gross and net switches from legacy suppliers to non-legacy suppliers increased significantly across the available data until the introduction of the price cap, as shown in Figure 13. For net electricity switches, for which we have the most data, this was by an average of 10.5% month-on-month between

January 2010 and December 2018. This coincides with fierce competition from new entrants in the market at the time, which led to a rapid increase in non-legacy market share of +16% and 17% during the period 2015-2018, for electricity and gas respectively, as shown in Figure 13.

Following the introduction of the cap, switches to non-legacy suppliers continued and peaked in April 2019 at 440,804 net accounts. Although, after April 2019, the monthly level of switching from legacy suppliers to non-legacy suppliers falls by November 2019 to 105,631 and then is almost fully recovered by March 2021, to 366,609. It's difficult to explain what exactly causes this initial downturn given there are likely multiple factors at play including seasonality of switching, overall plateauing of switching rates, and, crucially, the fact that the data excludes corporate transactions or Supply of Last Resort events. This means that the 3.5 million customers that were acquired from SSE (a legacy supplier) by OVO (a non-legacy supplier) in 2020 would have been omitted from switching data, artificially depressing the trend.

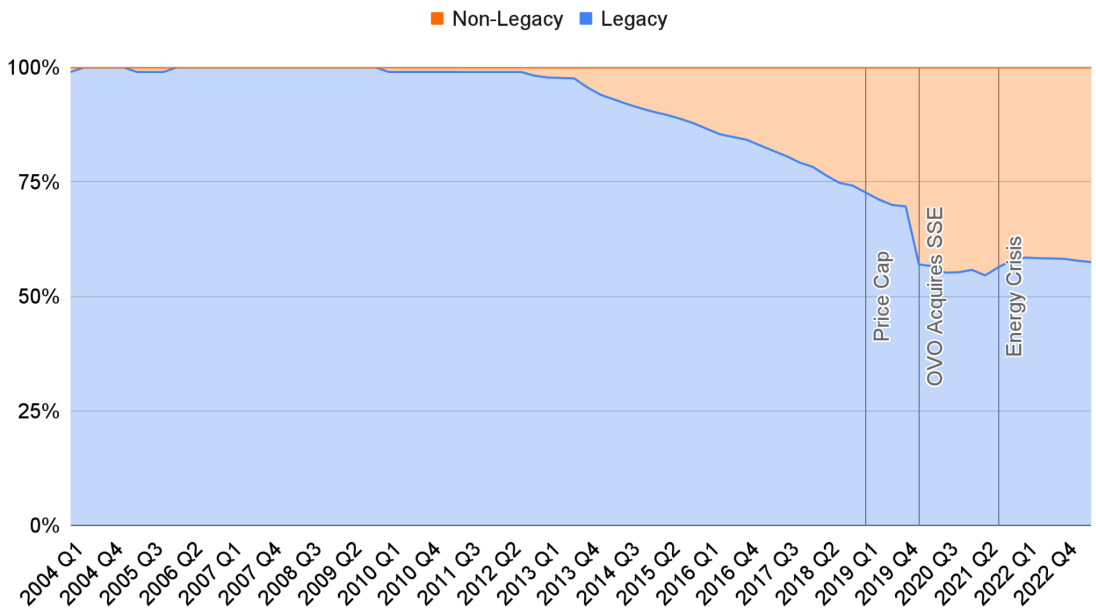
Figure 13: *Gross* and *net* switches from legacy suppliers to non-legacy suppliers (11-month, centred moving averages)



Source: Ofgem

Note: 'Gross' in this context means any external switch to a non-legacy supplier, bearing in mind that this could be from another non-legacy supplier, not just a legacy supplier. The net figure is calculated by taking the total gross number of meter point gains for non-legacy suppliers and removing the total number of such losses. Data does not include customers transferring from corporate transactions or Supply of Last Resort events

Figure 14: Total electricity market share of domestic customers by supplier type



Source: Ofgem

Note: The graph for gas is not included but shows an extremely similar pattern. Legacy suppliers comprise British Gas/Centrica, npower, Scottish Power, SSE (until its domestic customers were acquired by OVO in 2020), EON and EDF

Impact of the price cap on supplier hedging strategies

Verdict: In the years prior to the cap, there was an explosion of challenger energy suppliers entering the market. However, with fierce competition and a price cap looming, the number of suppliers peaked at 70 in 2018 and then began to fall with 10 firms exiting the market that year. Following the introduction of the cap until Q3 2021, 30 suppliers exited the market bringing the number of active suppliers to 49. For SVT customers, the price cap incentivised standardised hedging (i.e. in line with the price cap wholesale methodology), but inadequate hedging from suppliers remained an issue which was exposed in the energy crisis..

Evidence: Prior to the introduction of the cap a number of experts pointed out that many supplier hedging strategies were unsustainable. A former No.10 official, for example, spoke of the 'chaos' in the energy market prior to the cap: "You could set up an energy company standing in a shopping aisle on your phone." This, he said, was enabling poor hedging strategies, and business models that were "bad for consumers and stupid for investors."

Another employee from a challenger company echoed this, highlighting how the cap tempered some of the risky behaviour from a race to the bottom: "It didn't fall away altogether, many suppliers were still taking undue risks but it incentivised standardised hedging."

A number of our expert interviewees noted that the cap incentivised better hedging strategies from some suppliers, especially for SVT customers. This was because the best way to manage the risk of a mismatch between the cap and a suppliers' own costs was to hedge in line with the cap's methodology. Additionally, one expert who previously worked for a legacy supplier argued that the cap enabled greater trust and transparency between suppliers and the regulator on different hedging strategies. This was based on a belief that the process of setting the price cap methodology forced clearer communication on the cost base of suppliers.

However, while some suppliers improved their hedging during this time, Oxera research in 2022 found that the hedging approach among others was less than adequate between June 2020 and November 2021.

> *"A number of suppliers that went on to fail shared several common characteristics: negative equity balances in the years leading up their failure; poor liquidity and low levels of working capital; over-reliance on customer credit balances; and, either unhedged, or not substantively hedged, positions."*[54]

This was corroborated by the BEIS Committee report which said that, in the lead up to the 2021 crisis, many suppliers: "operate[d] with inadequate hedging, leaving the market ill-equipped to absorb wholesale price increases."[55]

[54] Oxera, *Review of Ofgem's regulation of the energy supply market*, May 2022
[55] BEIS Committee, *Energy Pricing and the Future of the Energy Market*, July 2022

Part Two - The energy crisis: August 2021 to 2023

The energy retail market changed significantly with the onset of the energy crisis from August 2021. Due to a range of global factors, the wholesale gas price began to rise significantly, which was then exacerbated by Russia's invasion of Ukraine in February 2022. The wholesale allowance in the price cap was not designed for an energy market with this degree of volatility and, as such, resulted in a number of unintended consequences.

This section explores how the price cap's effects altered in this new context, and impacted the functioning of the energy market during the energy crisis from 2021 up until the present day.

The price cap as mass-market affordability measure and benchmark

During the crisis, the price cap acted as a benchmark for a government funded mass-market affordability measure. As set out in Chapter 1, this was not the original purpose of the cap, but it was a role it played.

As wholesale energy prices rose and there was increasing volatility in the wholesale market, it was impossible for suppliers to offer fixed rate offers that were cheaper than the cap. This meant that as fixed tariffs expired, with no other offers available, customers increasingly defaulted onto SVTs. The number of customers on SVTs grew substantially from 15 million customers in August 2021[56] to 29 million in April 2023.[57] This represents over 90% of the market.

It is difficult to predict how record wholesale energy prices would have fed through onto bills in the absence of a mechanism such as the price cap, although it is likely that SVT prices would have risen much faster, exacerbating the hardship faced by millions of people. Our analysis of wholesale prices highlights the unprecedented levels that energy prices reached during the crisis. Based on time series data for gas and electricity prices, we estimate that the wholesale element of an average annual energy bill increased from around £250-300 in 2020 to around £1,400 in 2021, rising as high as £4,000 in September 2022. It is clear that, until October 2022 when the Government funded Energy Price Guarantee (EPG) was introduced, the cap acted as a constraint on energy bills.

Experts we spoke to broadly agreed that the price cap served as a default form of price protection, slowing the speed with which wholesale prices were passed onto customers. Many pointed out that, without the cap, some form of Government support would have been needed prior to October 2022. In the words of one former No.10 official this was a good thing: "grateful that there was a mechanism that stopped the immediate transfer of high energy prices onto bills". It is likely that without the cap already

[56] Ofgem, *Record gas prices drive up price cap by £139 - customers encouraged to contact supplier for support and switch to better deal if possible*, August 2021

[57] Ofgem, *Customers to pay less for energy bills from summer*, May 2023

in place, the Government would have had to step in much earlier than October, though not until after many consumers had been forced to take the hit in the interim.

The second unintended but highly significant consequence of the cap was to act as a reliable benchmark of efficient revenues for suppliers, which then supported the design of government bill support. Ofgem's price cap calculation gave an impartial view of the revenue suppliers should receive for their SVT customers, and therefore the money Government had to pass to suppliers to cover the difference between the Energy Price Guarantee and the price cap. Without the cap in place, it would have been incredibly difficult for the Government to have a clear sense of a fair level of compensation required by suppliers once an acceptable price ceiling for customers had been established. In this way the cap undoubtedly saved taxpayer money by improving the efficiency of the Government intervention.

Obviously these were good things. But the cap's existence was not without its costs. The delay in the ability of suppliers to pass through wholesale costs exposed a general lack of resilience in the market.

In the crisis, the price cap sharply exposed weaknesses in the financial resilience of suppliers

Between the beginning of the crisis (Q3 2021) and Q2 2022, 28 energy suppliers exited the market. Most prominent of these was Bulb with 1.5 million customers who were ultimately moved onto Octopus Energy following the first ever use of the Special Administration Regime for retailers. Clearly, the crisis exposed a fundamental lack of financial resilience in the energy market.

As highlighted at the end of Part One, Oxera research suggested that many of the suppliers that went on to fail were associated with poor risk management practices. Although all firms were exposed to a certain degree, some were less able to manage instability than others. Whilst it is true that many suppliers engaging in these practices may have failed in the absence of a price cap, it is unlikely they would have failed so quickly and in such close proximity to one another, since they would have been able to pass their costs onto their consumers. As Oxera observed in its review of Ofgem's regulation of the supply market, Ofgem had no easy trade-offs to make in designing the cap - and this was borne out in the crisis:

> *"Ofgem could have shortened the period of time between updates to the price cap—i.e. it could have updated the cap more frequently. This would have allowed suppliers to charge a price that would have been closer to the actual costs incurred for unhedged customers… [but] in seeking to reduce the costs of supplier failure with the design of the price cap, potential trade-offs could have had a negative impact on customers in the form of higher bills, especially for loyal consumers who did not switch (if more headroom had been built into the cap), or more volatile bills (if more frequent updating of the cap had been implemented)."*[58]

[58] Oxera, Review of Ofgem's regulation of the energy supply market, May 2022

Instead, the existence of a six-monthly reviewed cap meant suppliers were unable to meet costs for long periods at a time. In August 2022, Ofgem announced that it was moving to a quarterly review of the price cap, with the changes to come into force from 1 October of that year.[59] This change was considered necessary by existing suppliers in the market to reflect the volatile market and secure the resilience of remaining suppliers. The cap continues to be quarterly, although this is an area Ofgem has suggested it will review in future.

Many of the experts we spoke to considered that the cap was not to blame for the supplier failures but in a crisis context, it revealed a set of poorly run and managed firms, which then folded. A former HM Treasury official stressed the importance of looking at the bigger picture:

> *"It's difficult to separate the price cap from the more general retail policy… All the focus on competition meant that you had loads of fledgling suppliers that were terrible, [Government] thought "as long as you have the cap and switching, you're fine" but it was not the case."*

A former No.10 official said something similar, pointing out that 'worst' suppliers were weeded out in this period: "The cost curve of energy meant that a lot of these companies were being dragged out of the market anyway." Similarly, an expert working for a consumer group was forceful in this view:

> *"The supplier failures were not due to the price cap. We always knew there was a risk of chickens coming home to roost because of the industry make up. One company went under because their backers sold their hedge."*

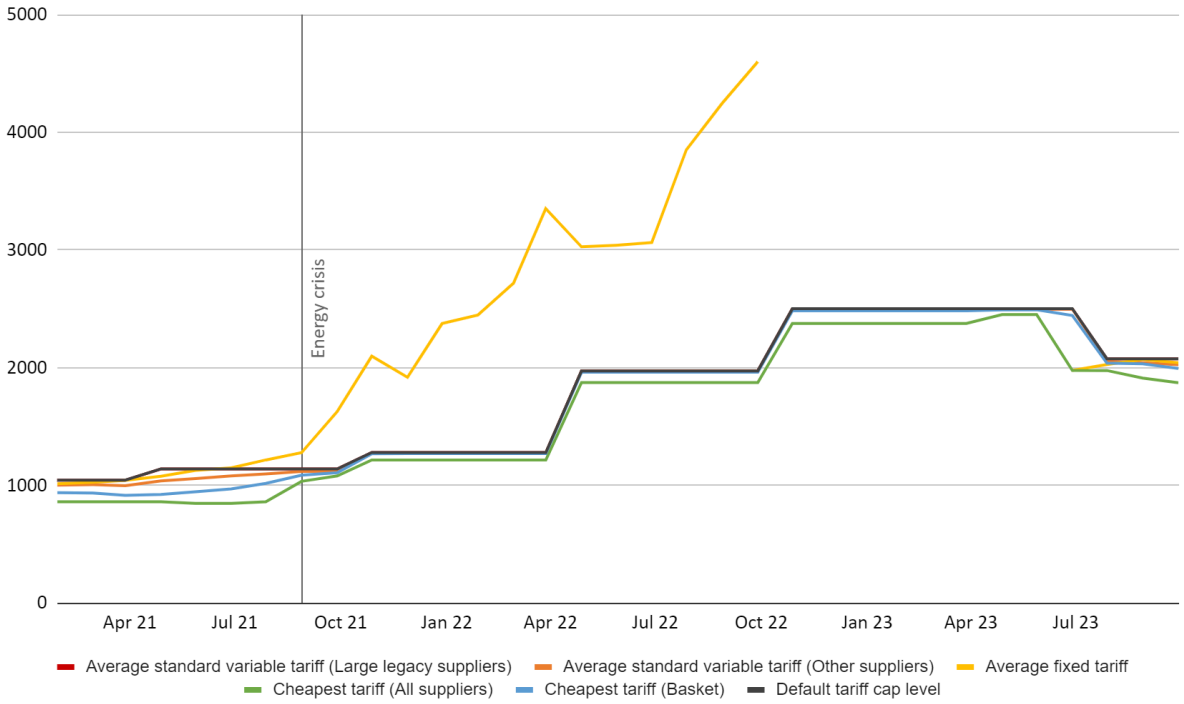
This stakeholder said that this was reason to "veer away from any simplistic takes to say that price cap caused the meltdown". They acknowledged that the cap had issues with inflexibility, saying that "at crunch points, it didn't help. Was a six month price cap right, probably not" but fundamentally, they said, this was not a healthy market.

Diminished price competition and an increased focus on brand? How the price cap evolved from a safeguard tariff to the only tariff

The combination of rising wholesale prices and the price cap played a significant role in diminishing competition in the market during the crisis. Factors that enable competitive pricing and switching were blunted. Cheaper fixed tariffs came off the market while some were increased above the price cap. Consumer protection experts then advised customers not to switch, meanwhile customers from failed suppliers were moved collectively to other suppliers. Over the course of the crisis, the majority of tariffs have been priced at or just below the price cap - as seen in Figure 15. Of the fixed deals currently available on the market, the cheapest is priced at just 3.5% below the price cap, a relatively new phenomenon post-crisis.[60]

[59] House of Commons Library, *Energy Bills and the Price Cap*, September 2022
[60] MoneySavingExpert, *Should I fix my energy or stay on the Price Cap?*, January 2024

Figure 15: Comparison of retail prices 2021-2023



Source: Ofgem

Switching rates plummeted during the crisis. Total switching from one supplier to another, shown above in Figure 15, decreased year-on-year by over 80%. This represents a fall from 609,166 switches at the beginning of the crisis during August 2021 to a minimum of 102,024 during October 2022. Following this, switching has rebounded slightly: latest data shows that switching levels climbed over 3.5 times to 362,226 in the 12 months to November 2023. This is still around two-fifths of the average level of switching that occurred (845,657) between the price cap being introduced and the start of the energy crisis.

While much of the trend in switching can be explained by market and cap forces detailed above, there were two additional regulatory mechanisms that were triggered by the crisis, disincentivising suppliers from seeking out new customers through the standard switching routes. One was a Ban on Acquisition-Only Tariffs (BAT), requiring suppliers to make their tariffs available to both new and existing customers. The other was the Market Stabilisation Charge (MSC), activated when wholesale prices exceed 10% more than the price cap level. While this is in place, for any customer who switches supplier, the acquiring supplier has to reimburse the losing supplier at a rate set weekly by Ofgem. This is to offset the risks associated with hedging during such price volatility, where losing customers could mean incurring significant losses on the hedged supply. Ofgem has recognised how this mechanism will have impacted competition:

> *"We acknowledge that the MSC in its current form is likely to have some impact on market competition. At a time of such price volatility, this needs to be balanced against the much reduced risk of expensive, disorderly or unplanned exits from the market in the absence of any stabilising measures which can result in consumer detriment through increased bills."*[61]

A representative from a switching site gave a firsthand account of the dramatic change in approach they took after the crisis:

> *"And then essentially the energy crisis hit. And we then moved into how to help people through the crisis. So it wasn't switching, it was giving you information of the support that you can get. It was very much a refocus on rather than switching to save, it's actually now: okay, what can you do around your home to save energy, turn off your heating etc."*

They noted that this was not a unique approach, but one that every similar organisation was taking across the market at the time.

This echoes a broader trend now becoming more salient in the market for non-price competition. A separate former switching site interviewee described how, due to the lack of price competition currently available in the market, both energy suppliers and comparison websites will likely place more focus on competing on brand, customer service, and innovative products for customers now and in future.

Are supplier efficiencies here to stay?

Although there's not enough data to suggest a new trend, modest initial findings pose the question as to whether the efficiencies gained during the stable period of the cap are here to stay. Between 2021 and 2022, the aggregate indirect cost per customer rose year-on-year by 3.5% from £93 to £96 (2022 prices) - as shown in Figure 6. While this may appear to be a marginal increase, it was the first year-on-year increase since 2017-2018. Due to changes in the market from acquisitions and licensing, by 2022, this aggregate figure only reflects three of the former legacy suppliers - British Gas/Centrica, EDF and ScottishPower. Figure 7 highlights how the growth in indirect costs per customer is mostly driven by British Gas/Centrica, who saw a 12% year-on-year increase from £85 to £95 (2022 prices), compared to 6.34% for EDF (£90 to £95, 2022 prices). Notably, ScottishPower decreased their indirect costs per customer by -14.96% from £119 to £100 (2022 prices) between 2021 and 2022, which could in part reflect redundancies made by the company in 2022.[62]

A few experts we spoke to believed that, in the period since the onset of the crisis, some of the efficiencies that were won in the period prior fell away. As a former representative of a legacy supplier put it:

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[61] Ofgem, *Decision to extend the MSC and the BAT beyond 31 March 2023*, February 2023
[62] Holyrood, *ScottishPower plans 300 redundancies amid 'unprecedented challenges*, June 2022

> *"[Legacy suppliers] are happy with their market shares, and they can argue pretty successfully with Ofgem about their profits… Ofgem aren't too concerned because they see this as a period of stabilisation… there's a real risk of the world going back to what it was like before the price cap."*

A similar point was raised by an official closely involved in establishing the price cap:

> *"Ofgem then basically lurched massively in the other direction after 2021 into overly protecting suppliers, allowing them to recoup money if they got things wrong. It went too far the other way at the detriment of consumers, and the government because the government was subsidising the entire market."*

Whilst this point was made by a few experts, others argued that the cap methodology was contributing to issues and ultimately driving up operational costs by being too ad hoc. A representative from a challenger company said the following:

> *"The price cap methodology hasn't kept pace with that change, it has a lack of agility and a lack of robustness, especially with increased volatility in the wholesale market… there are countless adjustments, ad hoc, iterative and uncertain in their nature… It is not supporting suppliers to operate at a profit."*

Ultimately, there is no way to predict how this will play out in future. Centrica, for example, explicitly expects its opex to decline further in the future years. In their 2023 H1 results Centrica noted that:

> *"We have driven an average 8% reduction per year in cost per customer since 2019, and we see the possibility for this to reduce by a further 10-15% over time as our processes continue to improve and all customers migrate onto the new platform."*[63]

Time will tell whether these predictions will materialise or whether there will be a reversal of at least some of the improvements made to supplier efficiencies and consumer detriment in the period after 2021 until the onset of the gas crisis. It is worth noting that Ofgem is conducting a review of opex which is expected to conclude in 2024.

Customer service levels hit all-time lows

Following the onset of the crisis, suppliers' customer service levels saw notable decline relative to its previous stable trend. From June 2021 to September 2022, the percentage of customers that were satisfied with their supplier's overall customer service fell from 71% to 64% - its lowest since the new metric was introduced in 2018. Latest available data shows a slight improvement to 66% by year-end of 2022. This overall trend of decline in service was consistent across more granular levels of customer

[63] Centrica, *2023 Interim Results*, July 2023.

satisfaction, such as ease of contacting suppliers, understanding and accuracy of billing, and switching. For example, at the end of 2022, less than half (49%) of customers found it easy to contact their supplier while 22% said they found it difficult - both the lowest and highest respectively since records began in 2018.

Aggregate figures can hide differences between suppliers. Longitudinal data on individual suppliers is limited, but snapshot rankings can be of use for demonstrating differences. For example, the latest iteration of Citizens Advice's Star Rating of energy suppliers finds a near 2-star difference on a five-star scale between the highest-rated and lowest-rated energy suppliers for customer service.[64] Generally speaking, companies with the lowest opex tend to also be the best performing in terms of customer service.

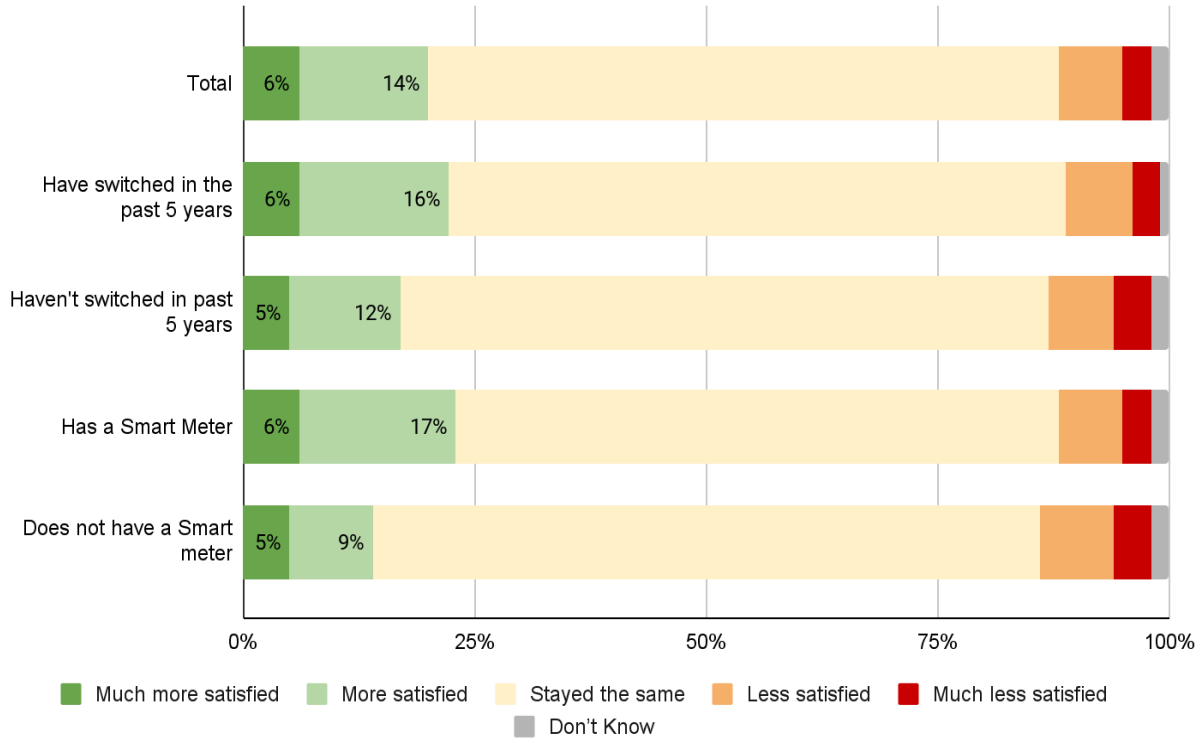
It is difficult to disentangle how far poor customer service is the result of the crisis or the price cap *in* the crisis. That being said, in a counterfactual situation where the price cap did not exist, could the crisis still have led to customer service challenges for suppliers? Being free from 'operational cost allowances' would some suppliers have made the necessary investments to ensure customer services remained satisfactory? What implications would this have had on bills? It is impossible to know, but these are worthy questions that should be taken into account by anyone considering the future of the price cap. Ofgem will also be examining much of this in its opex review.

To understand where customer satisfaction is today, we tested attitudes to energy suppliers in four focus groups and an online poll of 2,008 UK adults conducted in October 2023. Our poll found that customers are broadly happy with the service levels given by their energy suppliers. Generally speaking, we found limited differences between the two groups of engaged and disengaged customers in terms of their satisfaction.

Two-thirds of customers said they were satisfied with the customer service levels provided by their supplier - with a net satisfaction score of 54%. We also asked customers how their attitudes have changed over the past 18 months. The majority of customers said that their views have not changed, although generally speaking, as Figure 16 illustrates, below, customers who switched in the past five years and those with smart meters reported improvements of between 25% and 30% more than those who hadn't showing that engagement in the market, at least recently, has been more likely to lead to improvements in customers' satisfaction with their supplier.

[64] Citizens Advice, *Compare energy suppliers' customer service*, September 2023

Figure 16: Net change in satisfaction with the level of customer service of energy suppliers by whether customers have a smart meter and whether they have switched tariff or supplier in the past five years



Source: Public First. Survey question: 'Are you more or less satisfied with the level of customer service provided by your energy supplier than you were 18 months ago?'

Chapter Three - Looking ahead: What do customers want?

In this chapter, we set out the findings of our public opinion research[65] to help understand how the public are thinking about their energy bills, with a view to understanding what this means for the future of price protection.

We found that:

- **The two-tier market - engaged and disengaged customers - is still very much in existence.** The engaged tier are hungry for deals and more competition, but there are others that regard switching as too much hassle (see Figure 22).
- **Customers accept that some form of price protection is needed.** While the cap is not widely understood, there is an intuitive acceptance among the public that certain groups of customers are not equipped to shop around, and only 7% of the public think energy prices should be left purely to market forces (see Figure 24).
- **Customers want more deals and are more prepared to shop around in a cost of living crisis.** Our polling found that nearly two thirds of the public are either much more or more concerned about their energy bills compared to a year ago. Now, the majority of customers say that, because of the cost of living crisis, they are more likely to actively search for better deals in the market, including 40% of those customers who haven't switched in the last five years (see Figures 19, 20 and 21).
- **But there are still significant behavioural differences between switchers and non-switchers** Those who had not switched tariff or supplier in the past five years were slightly more likely to trust their energy suppliers to charge them a fair price (68%) than those who had switched (62%). In some ways, this highlights the key need for price protection, as non-switchers were most at risk of being charged an unfair price prior to the cap's introduction (see Figure 23).
- **For those who do want to switch, price is still the main consideration, but they are also thinking about brand and customer service.** In a world of limited price differentiation, brand awareness and customer service are increasingly important in determining whether or not they will switch (see Figure 18).

In this context, whether or not we see the anticipated level of switching play out or not, it is clear customers see a role for government intervention in prices when market rates are too high. Policymakers should be prepared for scenarios of high or low switching - especially given expectations on them to protect customers from bills that are too high.

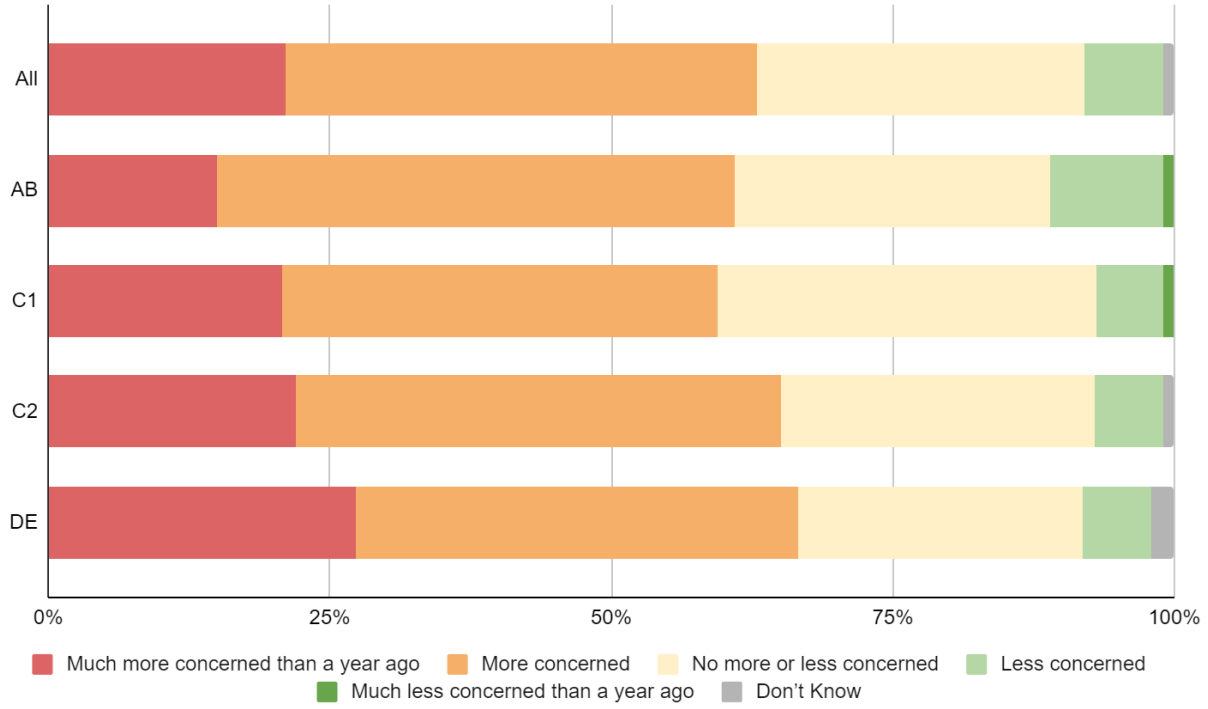
[65] We tested attitudes towards the energy industry and the Government's interventions into the market over the past 18 months in four focus groups and an online nationally representative poll of 2,008 UK adults conducted in October 2023. We focussed our questions around three broad themes: (i) engagement with the energy market; (ii) trust in the market; and (iii) understanding of energy policy.

Engagement with the energy market: concerns about bills and propensity to switch

Our research found that public concern over bills is much higher than a year ago, and that there was a particular concern about more bill increases in winter. In our focus groups we heard this anxiety expressed frequently, in spite of the fact that household energy bills had (at the time) been stable for a number of months. In the words of a participant in the East Midlands: "I had an email the other day that [my energy bill] is coming down again but I don't know what it will be like when everyone starts putting the heating on again" (Female, 45-49 years old, East Midlands).

Our polling found three quarters of the public expect their monthly outgoings to increase over the next year and nearly two thirds of respondents said they are much more or more concerned about their energy bills compared to a year ago.

Figure 17: Concern over current household energy bills compared to a year ago



Source: Public First Survey. Survey question: 'Thinking about how you felt about your energy bills a year ago, are you more or less concerned about the cost of your energy bills now?'

We then asked the public about their levels of engagement in the market - appetite for deals and likeliness to switch, as well as their motivations for these attitudes. Our research found that the market does indeed still have similar characteristics to before the crisis in the sense that there is a large group

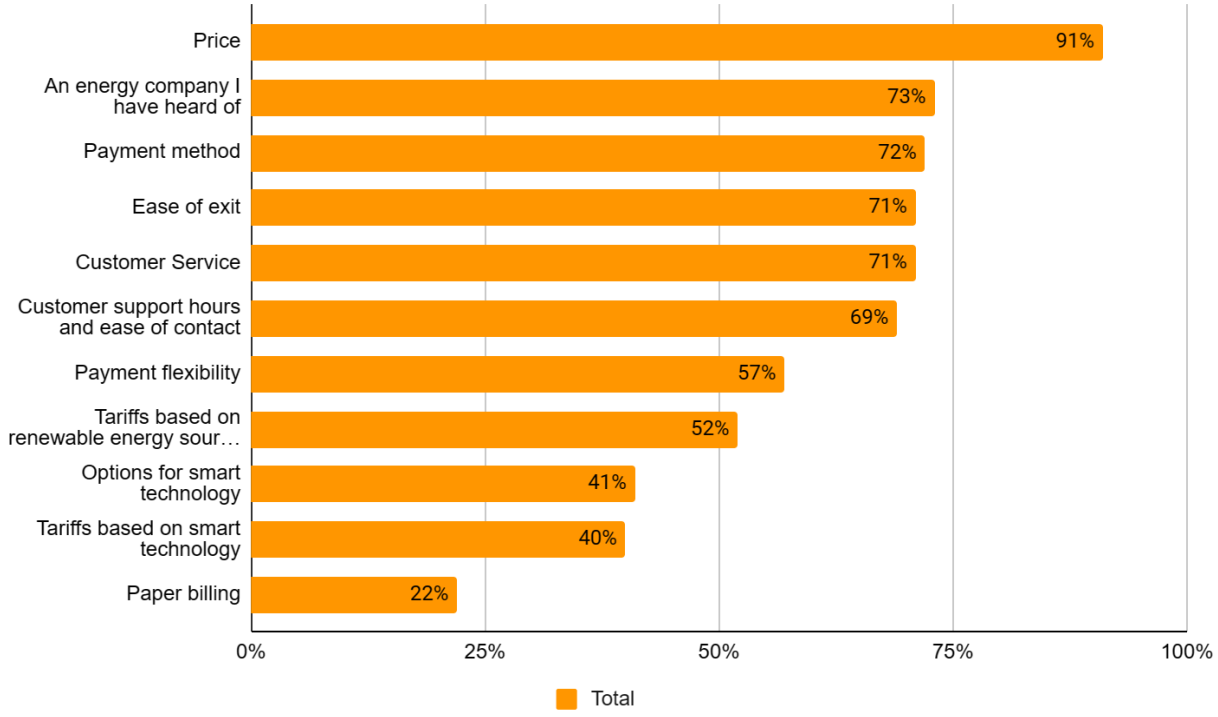
of customers with an interest in switching and a second group of customers who regard switching as 'too much hassle'.

In our focus groups we heard these differing attitudes expressed frequently; in the words of a participant in Don Valley: "When you're looking around, most of the numbers are more or less the same.... And by the time you go through all the rigmarole of sorting it out, it's not worth the hassle half the time." (Female, 50-54 years old, Blyth Valley).

This contrasted with the perspective of a participant in a focus group from the East Midlands: "I've certainly got plans to have a look and see if we can get a better deal now" (Male, 35-39 years old, East Midlands).

These differing views are exemplified by our poll, where close to half of respondents said they had not switched tariff or supplier in the last five years compared to 50% that had. In terms of reasons for switching, price is the most important factor for customers when comparing energy deals for 9 of 10 people. After price, customers felt having a company they've heard of (73%), payment method (72%), and customer service (70%) were the most important factors for switching.

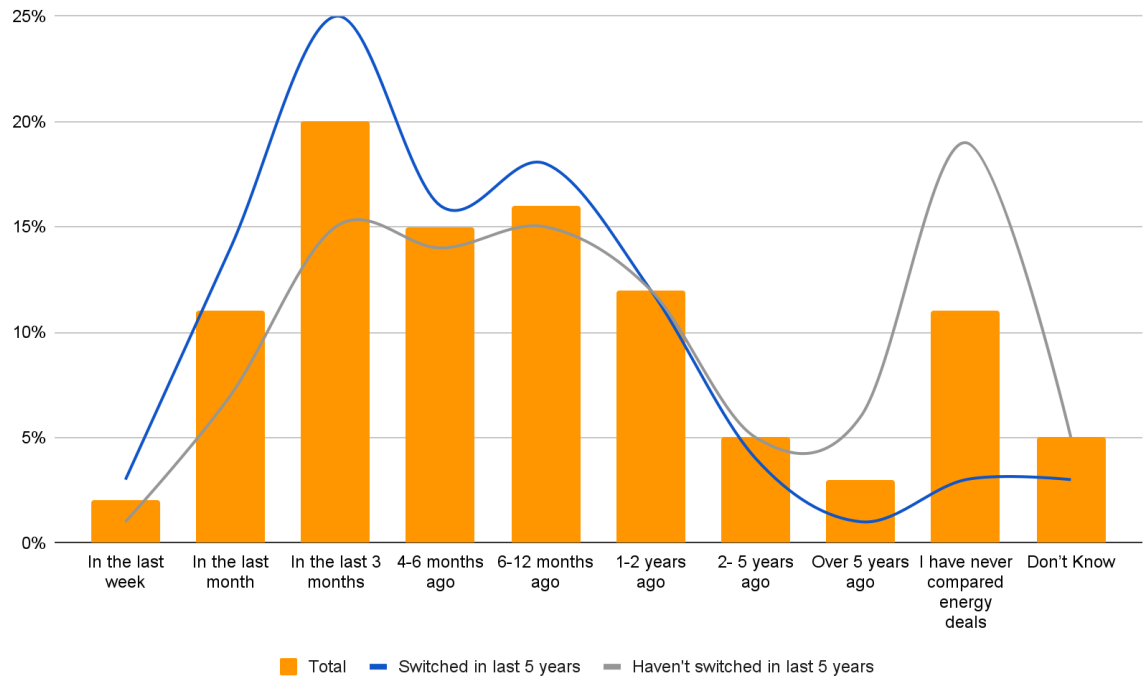
Figure 18: Importance of different factors when comparing deals from different suppliers



Survey question: 'Thinking about the last time you compared energy deals from different suppliers and/or tariffs for your home, how important were the following factors, if at all?'

There are still significant behavioural differences between switchers and non-switchers. One in three customers say they have looked for deals in the last three months, this rises to 43% for customers who have switched in the last five years, and falls to 23% for those that haven't. Figure 19 demonstrates the disparity in engagement between those who have switched in the past five years and those customers who haven't. In the current context, though there is more concern over bills than before, people who have switched in the last five years are still much more likely to engage in the market than those who haven't.

Figure 19: Last time customers compared energy deals to see if they wanted to switch to a different supplier or tariff, by whether customers have switched supplier or tariff in the last 5 years

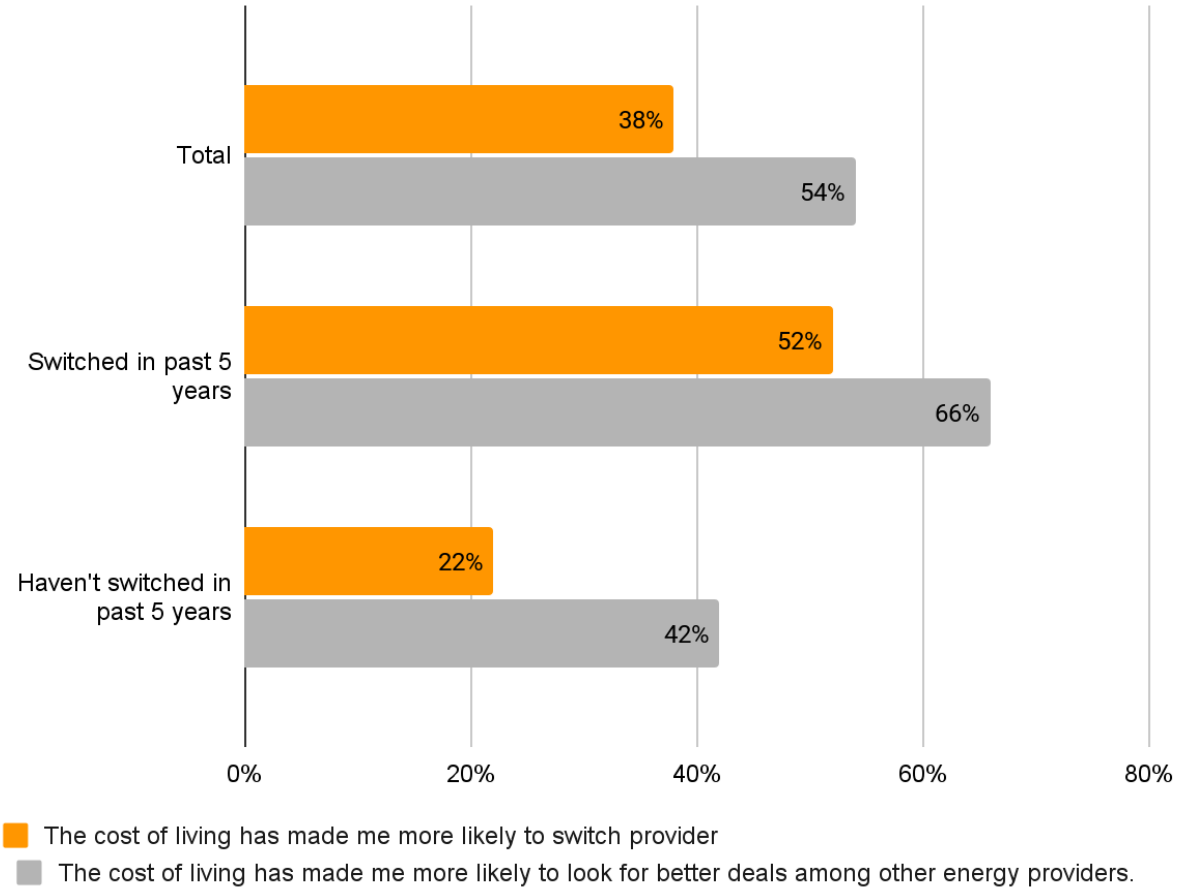


Survey question: 'When was the last time you compared energy deals to see if you wanted to switch to a different supplier or tariff?'

But this is not to say the energy market hasn't changed in the last two years; the cost of living crisis has had a dramatic impact on consumers' willingness to try and save money even in small amounts. As Figure 20 shows, the majority of customers now say that, because of the cost of living crisis, they are more likely to actively search for better deals in the market, including two fifths of those customers who haven't switched in the last five years. However, far fewer are likely to convert this comparison into an act of switching. Just over one in five customers who haven't switched in the last five years say they are now more likely to switch their provider.

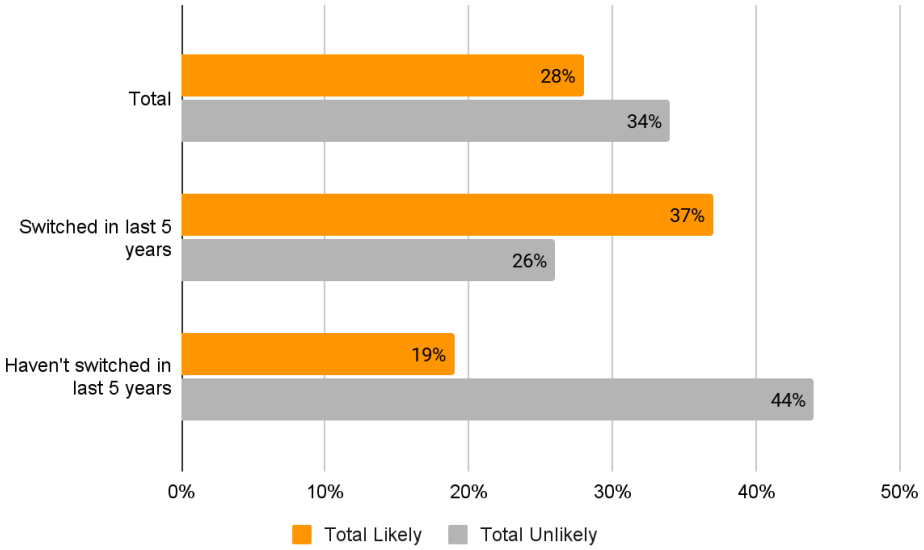
This suggests that, in a world of high energy prices and inflation, engagement in the market could soon be higher than in previous years when energy bills were more affordable for the average consumer. This is a positive sign - however, as highlighted above, there are both persistent and new barriers to converting this potential engagement into direct action (switching).

Figure 20: Net agreement with statement that cost of living crisis has improved attitudes switching provider and looking for better deals, by whether customers have switched supplier or tariff in the last 5 years



Survey question: 'To what extent do you agree or disagree with the following statements'

Figure 21: Likelihood of switching in the next 12 months, by whether customers have switched supplier or tariff in the last 5 years

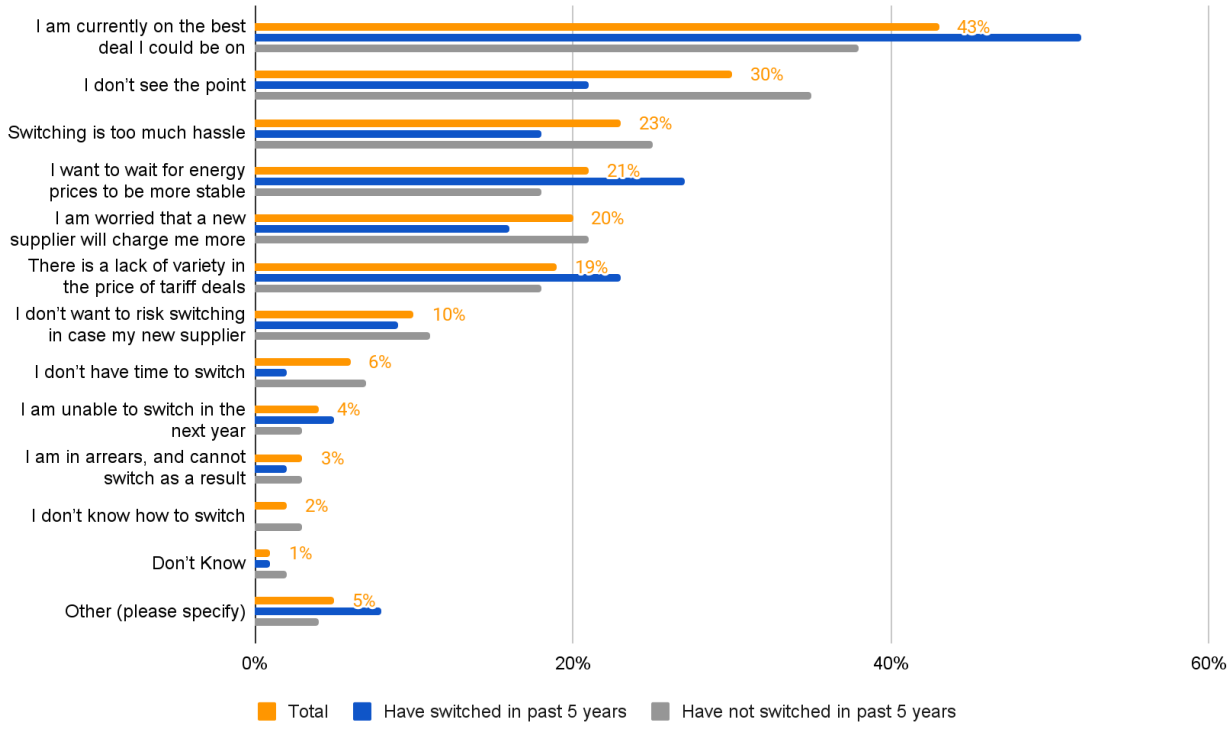


Survey question: ' How likely or unlikely are you to switch energy suppliers or tariffs in the next year for either your gas or electricity?'

Even though the cost of living crisis could be a catalyst for further engagement in the market going forwards, it's important to note that whether people actually end up switching is dependent on several factors. When simply asked whether they were likely to switch tariffs or suppliers in the next year, one in three customers said they were unlikely to do so. A greater proportion than those who said they were likely to (28%) - as seen in Figure 21. Interestingly, this is not easily attributable to previous levels of engagement. For those who have not switched in five years, one in five are now more likely to switch. Meanwhile one in four of the switchers are unlikely to switch again in the next year. This may indicate a slight shift in the overall make-up of who the sector typically considers more or less engaged.

The reasons for this are varied, though fundamentally the idea that customers are 'already on the best deal' is the largest single driver for this sentiment. As Figure 22 shows below, 43% of total customers share this view. Customers who have switched in the past five years are waiting for prices to be more stable and see a lack of variety currently in tariff deals. Meanwhile those who haven't switched in this time are still likely to report that they don't see the point or it is too much hassle.

Figure 22: Respondents reasons for saying they were unlikely to switch tariff or supplier in the next year, by whether customers have switched supplier or tariff in the last 5 years



Survey question: 'You said you were unlikely to switch energy suppliers or tariffs in the next year. Which of the following reasons, if any, explain why? Select up to three.'

Again, this came through heavily in our focus groups, with one woman from the East Midlands voicing concerns about the value of switching tariff or supplier: "You don't want to end up paying more than you pay now. So it's like, stick with what you know'" (Female, 45-49 years old, East Midlands)

Likewise, a woman from the Don Valley constituency echoed the view:

> "At the moment, it's almost not worth it because it's not the easiest thing to switch, is it? So I think unless there was a massive price difference, I just don't think it's worth it at the moment" (Female, 30-34 years old, Don Valley)

In contrast, it was equally clear from our focus groups that, for customers who were engaged, the lack of available deals was frustrating: "I wish there was more choice available with regards to suppliers. I think nowadays it seems to be very few and the rates… They're all pretty high and I don't think you have the variety anymore" (Male, 35-39 years old, East Midlands).

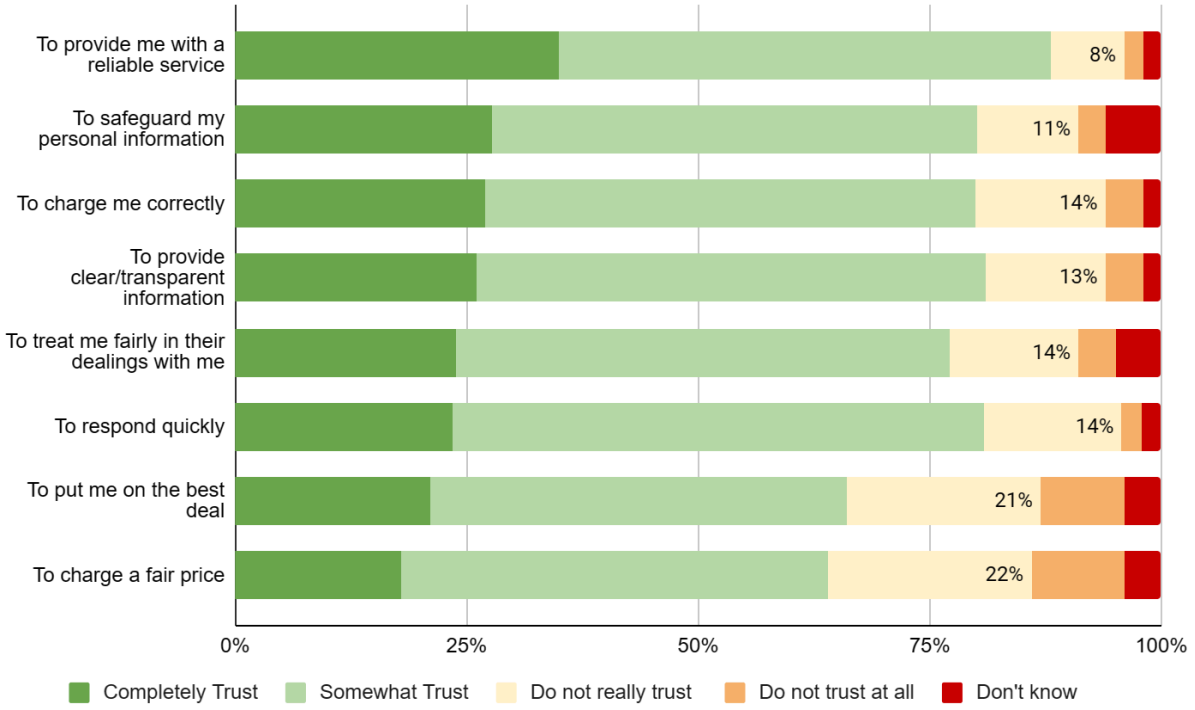
Trust in energy suppliers

The question about whether customers' intentions to switch will materialise is partly down to trust. The picture of trust in energy suppliers is mixed, especially when it comes to fair prices. Fundamentally, there is still a large proportion of customers who don't switch because they trust their supplier will put them on the best deal.

Participants in both of our focus groups expressed a view that switching suppliers would lead to them being overcharged in the long run. In other words, the risk of 'tease-and-squeeze' seemed to be at the forefront of participants' minds. This risk was often used as a justification for the futility of switching or searching for better deals. In other words, those participants who believed that the 'tease-and-squeeze' risk was real, often used this as a reason to stick with their supplier. The distrust of suppliers in this respect is clearly a barrier for engagement amongst those less inclined to search for new tariffs or better deals. In the words of a man (30-34 years old) from the East Midlands: "You never know do you? You might find yourself paying more in the long run." Others in the group did not trust that their supplier would act fairly or that price increases were reflective of the increased costs suppliers were facing: "We just seem to be charged more and you just can't see where it's being spent. It just seems to be for the shareholders" (Male, 50-54 years old, Blyth Valley)

Much of this sentiment is highly dependent on a customer's particular supplier, although our poll findings did suggest generally high levels of trust in suppliers.

Figure 23:Trust in energy suppliers to carry out a variety of actions



Survey question: 'Thinking about your own energy supplier, to what extent do you trust them to take the following actions?"

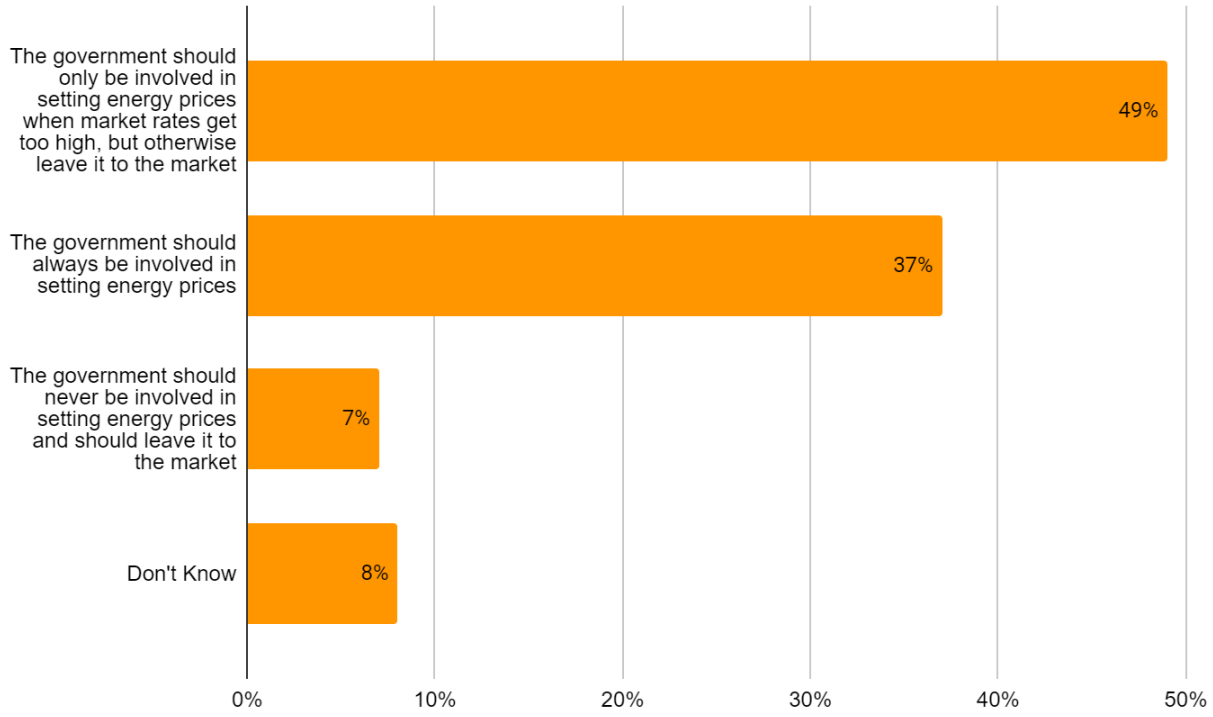
Areas of least relative trust amongst customers were to do with charging a fair price (32%) and putting customers on the best deal (30%). Still, twice the number of customers trusted their supplier to carry out these actions than those who didn't trust them. Notably, those who had not switched tariff or supplier in the past five years were more likely to trust their energy suppliers to charge them a fair price (68%) than those who had switched (62%). In many ways, this outsized trust in the non-switcher group is a key driver of the need for price protection - as this is the group that is most at risk of being charged an unfair price. Findings from our focus groups aligned with this.

Attitudes to and understanding of government involvement in energy prices

We also asked the public about government interventions in the market to gauge their understanding and perspectives on the principles of both price protection and financial support schemes for customers, such as the Energy Price Guarantee. As set out in Figure 24, we found that the public are open to Government involvement in circumstances of high prices, but also that neither of these

interventions are well understood. A representative from a large legacy supplier echoed this finding in an interview, saying: "the price cap is now misunderstood by the public as an affordability measure".

Figure 24: Public attitudes on when the government should be involved in energy prices



Survey question: 'Which of the following comes closest to your view?'

Many participants in our focus groups recognised that there is a limit to the reach of government in energy prices.

> *"I think you've got to be careful how much you expect the government to do with all of it […] but I think ultimately, as much as your car insurance, or your phone deals, TV deals… we've got to accept a bit of responsibility for making sure that we don't just turn off to it and expect somebody to make sure we're getting the best deal that we can."* (Male, 35-39 years old, East Midlands).

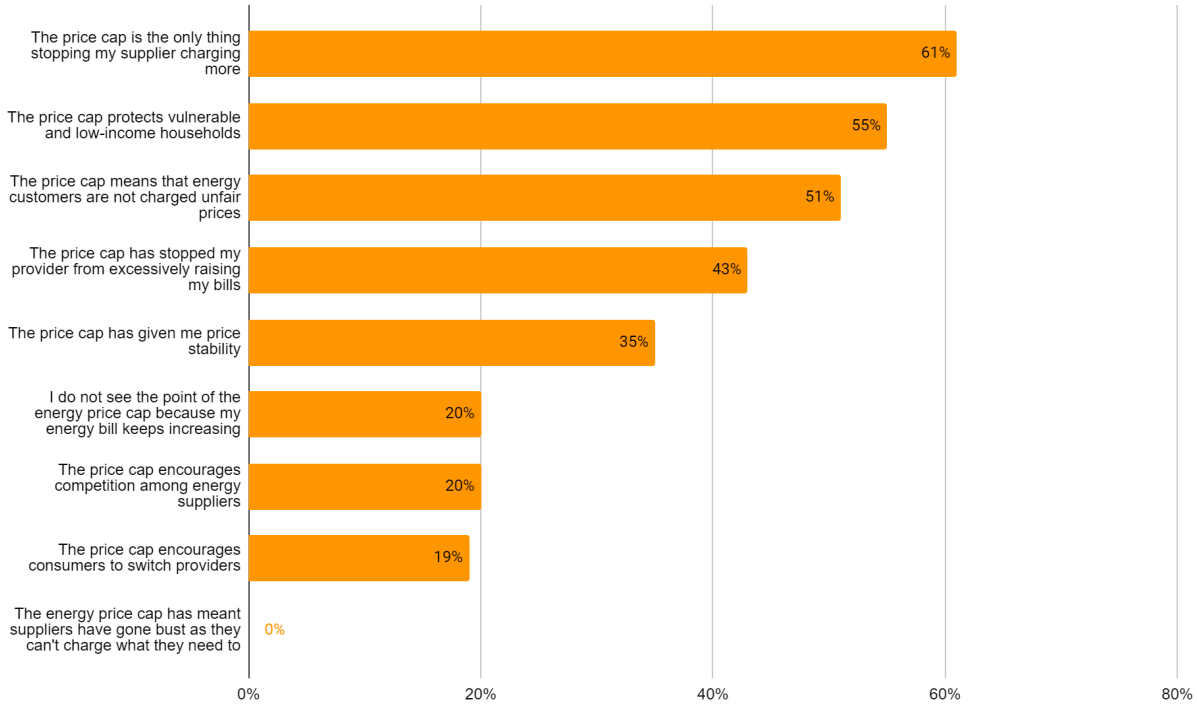
Or likewise, in the words of a participant from Blyth Valley:

> *"I want [Government] to be involved if they're safeguarding the people, other than that as long as it's a reasonable price, and it's amicable for people to pay, fair enough. But when it gets ridiculous, that's when I think the government [should] step in".* (Female, 40-44 years old, Blyth Valley).

There were a number of participants who, whilst accepting that there should be some onus on customers to find better deals, intuitively saw the case for price protection and often referenced people in their own lives who would benefit from some form of price protection mechanism: "You need some personal responsibility for changing [tariffs] but older people like my grandad, if he was on his own, he wouldn't know how to do anything." (Female, 45-49 years old, East Midlands).

In terms of their actual understanding of the cap itself, participants in our groups had some knowledge but were unlikely to be able to explain how it worked in detail and some conflated the cap with the Energy Price Guarantee. As one woman (25-29 years old) from the East Midlands said: "I feel like I have heard of it but I don't know what that means for me." When asked specific questions about the cap, participants in our poll were split on how much they said they understood about the policy. As the below shows, a third of respondents said they had heard of the price cap and could explain it to a friend compared to over half (54%) who had just heard of it but didn't know details. Nearly one in eight had not heard the cap at all prior to the poll.

Figure 25: Public attitudes on the impact of the price cap (net %)



Survey question: *'To what extent do you agree or disagree with the following statements?'*

In the context of mixed levels of understanding, attitudes towards the necessity of the cap are also mixed, and several different views are held by the public. As Figure 25 shows, the public view the price cap as primarily curbing suppliers' from charging higher prices. This came through in our groups, where one participant from Don Valley said the following: "It could go either way [without the price cap]. And

you could be cynical and say, yeah, they're all gonna get together and raise the prices even higher" (Male, 30-34 years old, Don Valley).

Although a majority believe it also exists to protect low income households - as emphasised throughout this report, this is not the explicit purpose of the cap, it exists to protect all customers who do not switch. In practice, this includes low-income households who were more likely than wealthier households to be on SVTs.[66]

[66] GFK, *Consumer Engagement in the Energy Market*, February 2015