House of Commons

Business, Energy and Industrial Strategy Committee

Oral evidence: Energy pricing and the future of the energy market, HC 236

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Watch the meeting

Members present: Darren Jones (Chair); Tonia Antoniazzi; Alan Brown; Richard Fuller; Ms Nusrat Ghani; Paul Howell; Andy McDonald; Charlotte Nichols; Alexander Stafford.

Questions 408 - 483

Witnesses

I: Dermot Nolan, former CEO, Ofgem.

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Examination of witness

Witness: Dermot Nolan.

Chair: Welcome to this morning's session of the Business, Energy and Industrial Strategy Select Committee for our final hearing in our inquiry on energy bills and the future of the energy market. We have three panels this morning. In our first panel, we are delighted to welcome Dermot Nolan, who is the former CEO of the energy regulator, Ofgem. Good morning, Mr Nolan.

Dermot Nolan: Good morning, Chair.

Q408 **Chair:** It is becoming increasingly clear, to me at least, that the failure in the energy market is only really comparable, from a regulatory perspective, to failing in the financial market during the banking crisis in 2008. It is a very significant structural failure of supervision of an important market. Most of the problems appear to have occurred during the time when you were CEO of the energy regulator, Ofgem. It is really important for this Committee to therefore understand how that happened, so that we can make recommendations about how we avoid this in the future. Were you naïve as an organisation to the problems, or were you wilfully negligent?

Dermot Nolan: That is giving me two not very appealing choices.

Chair: What is the third?

Dermot Nolan: The third is if I might try to explain some of the thinking behind it. I will obviously try to answer the question directly. I do not want to start going back to when I first started, but I will slightly. The sense at the time was that Ofgem was in an environment where it needed to foster new entry. There was a very strong belief from Government, from the body politic, if you will, that the big six, which is a term I will use—it is perhaps not a fair term, but it was certainly a common term used then—had an enduring share of the retail market, 99% or 98% for many years. This was inefficient, not very innovative, not good for competition and costing customers money.

I would stress that the dynamic in which Ofgem operated around that time was a sense that we needed to be seen to bring more competition and more innovation to the market. That was very much the milieu in which we operated. Certainly in my opening Select Committees, when I was here, I was continually asked about why there had not been more competition brought to the market. There was very much a goal, shared, I think, by the Ofgem board, to bring such competition. There were a variety of ways of doing that and changes from about 2015, 2016 and 2017 onwards.

Those kinds of changes saw many new firms entering the market, some of which have survived, some of which obviously have not. I would describe the regime at the time as permissive. I would also describe the permissiveness of the regime as something that was, if anything, encouraged by Government, but also a conscious decision by the Ofgem board. We then saw competition come in. We saw the price cap come in, which interacted quite strongly with the whole process. I can explicate details of that as I see it if you wish me to.

I think there was a realisation within Ofgem in 2017 and 2018 that, in certain cases, firms had entered the market in a speculative manner, in a manner that was probably not reasonable, not fair, and that we needed to do something about it. Steps were being taken to do something about it and I can discuss specifically how and when to do that. Obviously in the last year we hit an enormously difficult event, where we saw literally a quintupling, in some sense a 10-fold—I am not even sure what the verb is for that—increase in prices. The regime was not fit for purpose at that point. I do not think any regime would have been entirely fit for purpose, but I accept that, if we had moved more quickly, we would have stopped some of the failures that have happened.

Q409 **Chair:** There has since been an independent review by Oxera, commissioned by the Ofgem board, which has highlighted a whole host of risks that were accepted by Ofgem when you were CEO. Have you read the Oxera report?

Dermot Nolan: I have. I cannot say I have read every single nugget of it, but I have broadly read it, yes. I read it over the weekend.

Q410 **Chair:** What I am struggling with is that Ofgem is an independent regulator that hires expertise and should have a close working relationship with the companies that you regulate. You have said that the body politic wanted you to prioritise competition over regulatory supervision. Is it not your job as an independent regulator to say to Ministers and Select Committees, "There are risks and these are the consequences of that"? Did you raise those risks with Ministers, that you felt the pro-competition approach was actually undermining the resilience of the energy market?

Dermot Nolan: I have a couple of comments. We did raise risks with Ministers at various times, and with civil servants.

Q411 **Chair:** When did you first raise those issues?

Dermot Nolan: If I may finish, I will come back to that. We raised risks, but I also want to make clear that, by and large—you will, I am doubtless, ask me further questions about this—the risks that were taken in the regime up to around 2018 and 2019 were manageable and, indeed, were managed. In that sense, we always knew there were risks of failure. In fact, we thought that failure of new entrants and firms was a process that was inevitably going to happen. I would suggest that, up until about 2018, any firm that failed was dealt with, and there were many failures in 2018. The system coped very well with that, without any costs being imposed on consumers. You are looking quizzical. Would you like me to discuss that further?

Q412 **Chair:** Maybe you could just stop and I will ask you some more questions. We are going to get into some of these things in more detail. You are talking about 2018-19, but that is six years after Citizens Advice wrote to you in 2013, expressing concerns about the good management of energy companies. Why did it take you so long?

Dermot Nolan: I must confess that I was not there in 2013 and I do not recall such a letter, but I am sure it was there. I am not questioning that. I would regularly meet with Citizens Advice, including the CEO, more than once a year from the time I started. Citizens Advice throughout had said to us a number of things. One is that it felt that service quality in the energy sector could be improved somewhat. We talked to them continually about that over time.

It then expressed concerns again, two or three years later, that a lot of the new entrants were not providing as high quality service as perhaps they could have been. There was a variety. Some of the new entrants around 2017-18 provided the highest levels of quality service, but on average they were probably not great. Throughout that period of time, there were consistent questions from Citizens Advice about what we were doing about quality of service, which we did our best to respond to. In various cases, we took enforcement action and other kinds of action against the firms. I suppose I would call it compliance action.

I do not recall and I am honestly scrutinising my memory as closely as I can. Certainly around 2015-16, I do not recall Citizens Advice saying, "This market is unstable". If anything Citizens Advice was saying, "You need more competition and you need some higher quality of service", as indeed it would say, I think, in many sectors.

Q413 **Chair:** The Oxera report makes it clear that lots of risks were accepted by the Ofgem board on the use of customers' money to grow energy companies. Energy company founders did not need to source their own capital to start the business. Companies were not being required to hedge properly against future prices. There was not adequate supervision of financial accounts at energy companies; you just were not checking whether they were managing their businesses properly. The fit and proper person test did not come in until many years later and we know that that was not adequate in itself. Are you just telling this Committee that that was all okay?

Dermot Nolan: No, I do not think I said that.

Q414 **Chair:** You said it was an accepted risk, so, presumably, you thought it was okay.

Dermot Nolan: Many of the risks were accepted, yes.

Q415 **Chair:** By whom?

Dermot Nolan: The Ofgem board.

Q416 **Chair:** And you, presumably.

Dermot Nolan: Yes, I was part of the Ofgem board.

Q417 **Chair:** It has now cost taxpayers billions of pounds. Do you wish to apologise to the public, Mr Nolan?

Dermot Nolan: I will get to the idea of what I did or did not do and my regrets on that, if I may, a little later.

Q418 **Chair:** I am asking you the question now. Do you wish to apologise?

Dermot Nolan: I regret that, during my time at Ofgem, we did not take actions more quickly that I think would have protected consumers, yes.

Q419 **Chair:** It was your failing, was it not, Mr Nolan?

Dermot Nolan: I do not think that I would concur with that.

Chair: We are going to come back to some of these issues in more detail.

Q420 **Paul Howell:** The Chair has just touched on the area that I am going to talk about anyway, which is the fact that you had all these new companies coming in without risking their own capital, misusing credit balances, with inappropriate hedging etc. In November 2016, GB Energy failed and it took two years and seven more failures before you even started to consult on what was going on there. Can you explain why there was that lag?

Dermot Nolan: I can, I think. In 2016 that was the first failure. I think that it was the first failure for 10 or 11 years. My recollection is not perfect, but it was a company that appeared to have been poorly managed and probably not taken on great hedging. I think that it was poorly managed. That was dealt with, in the sense that the company failed. We then transferred its customers to another company that was happy to take them on. All credit balances were protected and it cost the energy customer nothing.

In that sense, we viewed that failure as, at the time, an unlikely event, but we did not view it as necessarily problematic to the market. As I said, if you are trying to encourage a degree of competition, companies will fail. I do not believe that that one failure by itself was indicative that there was some huge problem.

Q421 **Paul Howell:** There were another seven failures before you then decided that it was worth consulting to see what was going on.

Dermot Nolan: There were another seven failures. Actually, I do not recall the precise number, but I am sure you are correct. There were other failures, mainly, I think, in late 2017 and 2018. By and large, those failures, again, were all dealt with, in the sense that the companies failed, the customers were moved on, all the credit balances were protected and there was, intrinsically, no cost to either the taxpayer or the energy customer.

By that stage, if I am talking 2017 to 2018, we saw a situation where firms that had failed were failing, but the consequences had been dealt with in a satisfactory manner. By that period of time, it became clear to Ofgem that there were a number of firms that were entering in what I can only describe as a speculative manner. I think that that was the Oxera report as well. They were entering in almost a "heads I win, tails you lose" kind of manner. They were entering the market and hoping prices moved a particular way.

It was at that point when we realised, "Okay, there have been failures. They have not cost anybody anything, because the system has worked well on that". At that point, we realised, "We need to take action to make entry more difficult and make companies better capitalised", so it was then we did the review.

Q422 **Paul Howell:** Once the changes had been implemented in 2019, nearly half the suppliers that entered the market after that point in time subsequently failed. Did the new entry requirements fail to ensure that companies were financially robust? Is that not what they were there for anyway?

Dermot Nolan: My recollection may not be perfect, but my sense was that, when the supplier review concluded, there were two outcomes of it. The first was in early 2019, which said that any new entrant into the market had to meet further, more stringent tests. To the best of my knowledge, and I am certainly open to correction, I think that none of those firms actually failed afterwards. I would also stress that that is quite a small sample. Only a number of firms entered after that point, maybe only four or five. To the best of my knowledge, and I am sorry if I am wrong, none of those failed.

The second and more difficult aspect was the firms that had already entered the market. How did we put changes into firms that were already in? That was work we were undergoing and it was not finished when I left, but it was due to come in 2020.

Q423 **Paul Howell:** Is it fair to say that that was, under your tenure, consistently delayed? It took a long time for the introduction of new rules to these suppliers.

Dermot Nolan: It did take some time.

Paul Howell: You could see the market changing and you were consulting, but you were not making any difference.

Dermot Nolan: On new firms, we stopped. We increased our monitoring on that, but we found it difficult, I freely admit, to find the right set of rules, and I am talking late 2019, for existing firms. The older firms all said, "There should be exactly the same kind of set of rules as in the financial sector". The newer firms said, "If you put any rules like that in, you will drive us all out of business". We were struggling with what was the right formulation. As I said, I left at the start of 2020, but that piece of work was supposed to be finished shortly afterwards.

Q424 **Paul Howell:** Is that not your role? You are saying you are struggling with it and you have to find a balance between the existing suppliers and the new suppliers. Was it the competence of Ofgem, or was it the resources in Ofgem? What was stopping you from getting to a conclusion at a timely point whereby the difference could be made to the market?

Dermot Nolan: I suppose that I will give three points in response to that. One would be that resources were somewhat limited. Over 2018 in particular, much of Ofgem's resources had been deployed to the price cap, preparing for the price cap and putting the price cap in place, which had taken, frankly, immense amounts of resources and time. After that, Ofgem does other activities. There were limited resources, but there was a desire to at least try to find a way.

I accept that it was our role and I wish we had done that more quickly and perhaps more efficiently. I certainly accept that. It was our role. It was a difficult role, because the market had very different things. We could have ended up taking actions that would have driven firms out of the market, including potentially efficient firms.

The third point I would say generally, and you may or may not accept this, is that, looking back, the idea at Ofgem so far had been that we had tried to bring in and facilitate competition, which, in many ways, we were asked to do. There are risks of failure in any firm in any market. Firms will always fail in a market and that is certainly a situation where it does not seem reasonable to me that the energy sector said, "No firm can fail". We had facilitated increased competition and innovation, I would argue, and so far failures had not cost anything. There had been significant failures so far. We had failed to realise—and I regret this—what might happen in the kind of shock that we have seen over the last six or eight months.

Q425 **Paul Howell:** I have one other point. You have talked about the failures not costing anything. From what I understand, you are quite right, but a failure should cost the people who are investing. It seems that the businesses that have come in got out without any consequences to them. Yes, it has not cost the consumer, but, to use your phrase, it is a "heads you win, tails I lose" game. Surely something should have been done to address that side of things, in terms of making sure that, if people were going to play in the market and look for the high-risk, high-reward games, something was there to make sure there was consequences.

Dermot Nolan: That is fair enough and I accept that. Certainly in the market of 2014 to 2015, when there had been literally no entry for years and, after the CMA report, a sense that there was huge amounts of detriment in the market, due to a lack of competition, we felt we needed to facilitate entry. At that point in time, and you may disagree, but this was a conscious decision, we did not feel that we could have a situation whereby we said that only big firms can enter, or only firms that have lots of equity can enter. At that point in time, we said, "We are trying to encourage entry, where possible. For anybody who enters, there is a long supply licence condition. They will have to adhere to all those standards. If they do not deliver good quality of service, we will pursue them".

I certainly agree that, at that time, we did not have something that penalised firms that failed. There was probably reputational loss, but I accept that. Firms could leave in a way that was not harmful to the consumer, certainly not at that point, but that was also not harmful to the owner.

Paul Howell: Your phrase was about not wanting to only allow the big companies to come in with massive equity. There is still a proportionate equity that should have been appropriate to the smaller entries.

Q426 **Chair:** Can I check something, Mr Nolan? I think you said that, while you were preparing for the price cap, you did not have adequate resource at Ofgem to supervise the energy companies that were trading. Was that correct?

Dermot Nolan: I apologise if I misspoke. I think I said that the resources of Ofgem in general, particularly in the retail space, were devoted to preparing for the price cap at that point in time. To some extent, the price cap was a massive prioritisation. I sat in, I think, the Bill Committee, where people said, "You must have this in in five months". We had to devote massive amounts of resources to do that.

Q427 **Chair:** I am struggling to understand. Is it not your core purpose to supervise energy companies? You did not have enough people doing that. Did you express that concern to Ministers and ask for more resource?

Dermot Nolan: No, we did not—not in that period of time.

Q428 **Chair:** Why not?

Dermot Nolan: I do not think that we did not supervise firms at that point in time. We continued to supervise firms over that period, not perhaps as much as you want, and I am certainly happy to discuss that. Because we were doing the price cap, which was subsuming vast amounts of resources of the organisation, we did not commence the supply licensing review around that point in time. We were devoted to finishing the price cap, which we had been told, by Parliament etc, was absolutely the first priority.

Q429 **Chair:** I understand that, Mr Nolan, but you were an independent regulator whose job it is to supervise these companies. You keep blaming Ministers and Parliament for the fact that you did not do these things on time.

Dermot Nolan: I am not blaming Ministers or Parliament. I am saying that there was huge pressure to do the price cap. Given the resources we had at that time, we continued to supervise the industry, perhaps inadequately, and I am very happy to discuss that. We did not commence this review and that was a conscious choice within the board: "We have to do the price cap first and the review will follow".

Chair: There was not adequate supervision. That was the problem, Mr Nolan.

Q430 **Richard Fuller:** Following up on your point, Mr Nolan, I have here the 2018-19 annual report and accounts, which has a line item under DEL of £3.1 million for energy market investigation remedies and £1.9 million for GEMA great working environment. What was the £1.9 million of great working environment money for?

Dermot Nolan: It was designed to try to ensure that the organisation was working more effectively as an organisation, as many independent public bodies will do.

Q431 **Richard Fuller:** What was the £3.1 million for energy market investigation remedies for?

Dermot Nolan: My memory is that that was dealing with the CMA, which had concluded its investigation in 2016, put in place various remedies and asked us to implement them. My memory is that it was dealing with those.

Q432 **Richard Fuller:** Do you not think that it would strike the public as a bit odd, when you are complaining about adequate resources, that you were spending £1.9 million that year on making it a great place to work?

Dermot Nolan: I do not think that I am complaining about adequate resources. I am saying that there was a fixed level of resources that we had at the peak, as anybody has within a given year. I do not know if it was reasonable or unreasonable, but trying to make the organisation more effective and efficient is something that you see the head of the FCA has spent vast amounts of time and resources doing recently. I do not think that it is that unusual to have that.

Q433 **Chair:** You said that, when GB Energy collapsed in 2016, you were not particularly worried, because it did not cost the consumer anything. Actually, there was £50 million of credit balances and £173 million of renewable obligations that had to be mutualised. That is a pretty big cost, is it not?

Dermot Nolan: It is not in the greater scheme of things.

Q434 **Chair:** You were not worried about £173 million plus £50 million being mutualised.

Dermot Nolan: We were not worried in the context of trying to bring more competition and innovation into the market. We were not worried about the mutualised bill. In 2018—again, I am reasonably sure of these figures but I will, of course, check them afterwards—there were eight to nine failures. The total cost to the consumer of that was, I think, 50p for the entire year. That was something that the board genuinely thought was not great but an acceptable cost to foster the kind of competition and innovation that, at the time, we were seeing.

Q435 **Chair:** In 2014, there were 27 suppliers. By 2018, there were 70 suppliers, so a rapid increase in the number of companies and an assumption therefore of an increase in the amount of failure. If one company had cost you £223 million, when you extrapolate that to the increased number of companies and therefore the increased risk of failure, which you accepted was okay, surely that cost should have worried you.

Dermot Nolan: I do not recall the £223 million. I am sure that you are correct. It was some time ago, but I do not recall it. I am reasonably clear—this was two years later—that, over a period of significant failure in 2018, the mutualised cost was extremely small compared with the bill.

Q436 **Chair:** The thing that troubles me is the amount of delay, which Mr Howell has been asking about. I understand that you had other priorities, like the price cap. In my view, you should have been worried about supervising the companies you are supposed to supervise. There is constant delay. From what you are telling me, I can only conclude that that is because you genuinely were not worried about it.

Dermot Nolan: I do not think we were not worried about it.

Q437 **Chair:** Why did you not prioritise it?

Dermot Nolan: We did not prioritise it to the extent we should have and I regret that. I accept that that was a mistake on Ofgem's part.

Q438 **Chair:** Whose decision was that? You have to go to your board and make recommendations about how you prioritise the use of your resources. You would have had to make a recommendation to the board. Was it your decision or did the board tell you, "No, we do not want you, Mr Nolan, to prioritise supervising the companies; we want you to prioritise other things"?

Dermot Nolan: As far as I recall, certainly with regard to the price cap and the supplier licensing review, that was my recommendation to the board, yes.

Q439 **Chair:** It was your fault.

Dermot Nolan: The board made a decision.

Chair: On your recommendation.

Dermot Nolan: Yes, it did.

Chair: We are going round in circles.

Q440 **Alexander Stafford:** I wanted to pick up on what I believe you said earlier on. You said that the risks up until 2018 were manageable. I believe that you said that. We have had a few of these energy companies that failed speak to us. Avro, for instance, came to speak to us. It had always been a loss-making business. In 2019, so just after 2018, it had loaned almost £150,000 to directors and almost £1 million to companies it controlled. The risk there had not changed. Did you think that was manageable, that a loss-making company is giving the best part of £1 million to companies it owns?

Dermot Nolan: Personally, I was not aware of that.

Alexander Stafford: That was the time it made £28 million of losses.

Dermot Nolan: Most of these companies made losses. We did not view that in itself as inherently problematic. Most new entrants will frequently not be profitable. As far as I can remember, Amazon never made profits until about five years ago.

Q441 **Chair:** Amazon is not providing electricity and gas to people's houses. This is different, is it not?

Dermot Nolan: I accept that it is different, but we had managed continuity of supply. In fact, continuity of supply has always been managed. I would put it this way. I do not think that the idea of a new entrant being automatically required to make profits from the start was reasonable. The board made a choice that that was not something we were going to have. Some companies would make profits. Some would not. Some would fail. If they were relatively well capitalised, which, as it turns out, as I am sure you will say, some were not, there would be ways to deal with that. No, they were not making profits.

Q442 **Alexander Stafford:** You say, "If they are well capitalised". Avro had no external capital whatsoever. This is 2019 numbers I am talking about, so six years after it had been founded by, frankly, a student in his bedroom, with no capital, relying on customer credit balances. They were siphoning off £1 million to other entities they owned and that did not raise a red flag. In no way in the risk assessment was that seen as a concern. I am confused. If you are a company making such losses, owned by someone who has no capital, and you give £1 million to a company you control and that does not raise a red flag, surely that is a serious failure.

Dermot Nolan: The failing there, which I accept, was that we did not fully understand the structures of the companies. It is not so much the fact that Avro was not making money. Yes, we should have done more and been better in noticing that it was actually siphoning money off.

Q443 **Alexander Stafford:** I am still struggling. If you cannot understand the structures of the company, six years after it was founded, making huge losses, what is the point of Ofgem in that sense? Surely the idea is to look at those companies, keep an eye on them. If you want to increase competition, which clearly is your stated purpose, you should then keep a close eye on this new competition and see how it is being done. I do not see how this could have happened.

Dermot Nolan: We did not do enough in terms of monitoring all the very detailed financial information of the firms. All the 70 firms were, if you like, person-marked. There were people assessing what was happening with them, in particular their viability or otherwise. This was not, perhaps, as much as it should have been and I would admit that, but every firm in the industry was marked to some extent. There was always someone seeing what was happening.

For instance, none of the potential failures came as a surprise. If a company was potentially in a difficult situation, that was generally known. It was known within Ofgem. It was generally communicated to BEIS. There were weekly calls between BEIS and Ofgem in that regard. In that sense, if a company was going bust, it was managed and the failure was managed.

Q444 **Alexander Stafford:** You just said that you did not think that any of the companies that failed came as a surprise. I think that it came as a surprise to the millions of customers though. Bulb, for instance, is another one that came to speak to us. It was a huge company, relatively, for small entrants. I think that that came as a surprise to the market. If these companies collapsing did not come as a surprise, surely you should be sending out help or speaking to the Government to say, "We are very worried about these companies. It is going to cost the taxpayer a lot of money. We are going to need to do something". Did you send those? You said that it was not a surprise. Did you tell the Government that you were thinking these people were going to the wall?

Dermot Nolan: We did. I can only speak to the point of my time, but, when I say that the failures in 2018 did not come as a surprise, we knew over time that the company was struggling financially. It was looking for more capital. This was generally the pattern that occurred. It was looking for more capital, but it might not succeed. If it did not succeed in raising more capital and went into financial distress, we would have to manage its exit. That was the process that we used. As I said, there were regular calls to the Department, saying, "This company is in difficulty. This company is in difficulty. This is how we propose to deal with it".

Q445 **Alexander Stafford:** You have been quoted in *The Times* as saying that Bulb has no one to blame but itself and it was predictable and clear what was going to happen, but then Bulb expanded exponentially during this time. It was loss making and had inadequate hedging practices. Why did Ofgem not do something about it?

Dermot Nolan: There are a couple of points on that. On the Bulb quote, yes, that was a quote I made. I would certainly stand by it. I can certainly accept that one of the reasons I am here today is that you could say, "Whether Bulb was Bulb's fault or not, you, as Ofgem, should have done something about it". I assume that that is why I am here, so I completely accept that.

Bulb grew. Certainly by the time I left, and I am not saying this in a negative or excuse way, there were no indicators that I knew of that Bulb was potentially in a distressed situation.

Q446 **Alexander Stafford:** When you look back on your time as chief executive of Ofgem, how do you rate yourself and the performance of Ofgem? Did you succeed in what you wanted to do?

Dermot Nolan: No, not entirely.

Q447 **Alexander Stafford:** What did you achieve that you are proud of?

Dermot Nolan: We achieved significant amounts of competition in the retail sector, but some of that, whether that was an achievement, has been taken away by some of the failures now. We achieved significant amounts in retail stuff, in network stuff and on various other points. I do regret and certainly on my performance in the last year or two I should have done more. I feel that.

Q448 **Alexander Stafford:** Do you accept that the success of your performance is merely a mirage? It looked great, competition, so you could say to people that you did well on competition, but that was built on sand. Nothing happened. It all was fake.

Dermot Nolan: I do not think that that is true, if I may say why. I accept that the crisis of the last eight months has been hugely damaging. I accept that. Looking back on the decisions that were made, I have indicated that we should have moved more quickly. I would look back and say that, with the competition that had been brought, the innovation was not, in many cases, fake. There had been many failures before. They had been managed in a non-costly fashion.

It was subject, ultimately, to a price shock that is possibly one in 100 years, certainly more than one in 50. I am just old enough to remember the oil price shock in the early 70s. It was not as severe as this. In my view, no system would have survived this fully. If we had made more changes, it would have survived better. I would stress that the kind of event we have seen is literally a one-in-100-year event. I do not think we can reasonably be expected to be prepared for that.

Repeating what I said to the Chair earlier, we could have moved more quickly in either of two ways around 2018 and 2019. One would be to introduce stricter controls on existing firms, which would have certainly helped in avoiding some of the mutualisation of cost that we have seen.

Two would have been if we had—and I regret not doing this too, though it would have been very difficult to predict—changed the price cap instead of every six months to every two months or one month. That would have had its own costs, I have to say, and its own problems. If we had done that, I think that some of the mutualisation and some of the failures would also have been avoided. Given a framework where the price cap was set every six months because the CMA had suggested that, whether we could have predicted that I do not know, but I regret not taking both of those actions.

As I said, I do not think that any system would have survived the degree of shock that has come to it. Even systems with very strong financial controls—if you look at, say, aviation and the travel industry—have had big failures at times, such as Monarch and whatever. We did not expect this event, so there was a failure of imagination on my part in that regard.

Q449 **Alexander Stafford:** I have one further question. It is once in 100 years. I accept that things are difficult. How do you think Ofgem performance and the energy market in the UK fare against comparable countries in Europe, for instance? My impression was that they are not doing as badly.

Dermot Nolan: It depends what you mean by not doing as badly. Let me give the most obvious contrast, which is France. EDF has 90% of the residential market share. The French Government reacted to this by telling EDF that it was not to raise its price and to suffer an €8 billion impairment loss. That was a political choice. I do not know if it is good or bad. The electricity prices in France have not risen to the extent that British electricity prices have, because they are 80% nuclear and thus the rise in gas prices does not affect them that much.

You have seen very direct action in Germany, Spain and Italy, where Governments have directly intervened. I am not saying that that is right or wrong. If you look at, say, the Italian market, it is just as dependent on gas as we are. The Government have directly interacted. France is a very different example. If you look at Scandinavia, you find that there has been almost no effect. Looking at Norway, 100% of its electricity is hydroelectric. All its heating is electric heating as well. It has literally had no effect. It has hit countries very differently and the countries have different systems underlying it.

Q450 **Chair:** Mr Nolan, can I check something for the record? You said that Ofgem had a contact person with each energy company. I think you said that you maybe did not have the depth of understanding that you wish you had had about each company. We heard that Avro Energy, for example, had a very weird structure. There were no direct employees at senior level. It was a management consultancy. There was a huge amount of money that was coming directly from customers' direct debits into these convoluted corporate structures. The founder could not even remember if he did the fit and proper person test. Did Ofgem know any of that?

Dermot Nolan: I did not know. I may well be criticised for that. Personally, I did not know the specific details of Avro. I read the testimony Avro did and, yes, I was shocked and disturbed by it.

Q451 **Chair:** You should have known, should you not?

Dermot Nolan: I am not sure if I should personally have known, but we should have known more about the structure certainly, yes. As I have already said, we should have had a better understanding of the structures of the companies that Avro had and, in particular, the idea of someone taking money out of it.

Q452 **Andy McDonald:** Mr Nolan, can I take you back to the Oxera report? There are some specifics that I want to share with you and invite your comment on. It found that, under your leadership, the board did not properly discuss some key decisions related to tackling risky supplier behaviours and some were delegated. Ofgem's board effectiveness review paper showed that it was unable to dedicate sufficient time to critical issues and did not always have access to the necessary information required to make decisions.

You have been asked how you would rate the board's performance on tackling risky behaviours under your leadership and you have said that you wished things were done differently. Given those findings, how would you conclude? If we look at schools, they are rated as "outstanding", "good", "requires improvement" or "inadequate". Where do you think you would fit in that?

Dermot Nolan: It is hard for me to say. I would certainly not claim to be outstanding. I did read those sections of the Oxera report. It is hard for me to evaluate them. I certainly do not have access to any of the board documentation anymore. I can say, from memory, and I am very happy if you wish to test me on this, that there were formal board documents, but there were also other documents.

The board meetings were traditionally, I think, usually on a Tuesday, but the board met the night before and discussed issues in an informal session for an hour first and then over dinner. I do not believe any of those were minuted or kept as formal board records. I am not necessarily disagreeing with them, but, in my view, by and large, the board was generally kept very much up to date with the situation.

Q453 **Andy McDonald:** How do you respond to the challenge that, because of the lack of adequate time, you delegated critical issues away from the board? Is that a reasonable and fair assessment by Oxera?

Dermot Nolan: I do not think that it is that fair, no, in the sense that policy decisions were discussed with the board. In terms of the individual failures that took place, and I am referring, I suppose, to 2018, when most of the failures occurred, generally speaking we would inform the board about them, but we would not ask the board for permission, as it were, to do anything on that. We would say to the board, "There is an environment whereby maybe company X or company Y is in a risky position. We may have to manage their exit in the most positive way possible and we will do so". I feel that the general patterns were discussed quite extensively with the board.

Q454 **Andy McDonald:** Can I press you on that? The report also found that there were no proper frameworks for assessing what consumer interests are, or what effective competition means. There was also no evidence of quantitative impact analysis being undertaken to inform the supplier licensing review. It was not until after you left that Ofgem collected comprehensive, industry-wide data on financial resilience. Why did Ofgem fail to establish those proper frameworks, collect the necessary data and provide the rigorous impact analysis that was needed to make informed decisions? Why did those things not happen?

Dermot Nolan: I will try to answer each of those. On the impact assessments, I do not know whether I fully agree with the Oxera report. There were impact assessments on all the decisions. There was an impact assessment on, certainly, the supplier licensing review. This is my view, and maybe it is not entirely consistent with Oxera, but most of the decisions we made about timing—I spoke to the Chair earlier and he questioned me about resources—were based on a reasonably comprehensive discussion and idea about what the risks and trade-offs were in a particular situation.

When I spoke earlier I was asked whether there should be concern about the fact that eight companies had failed and whether we should have done something on it. That is a very fair question. As I said, I wish we had done things more quickly afterwards. We were in an environment whereby the eight companies had failed, the risk of significant consumer damage seemed very low, unless we saw a certain level of wholesale price changes. If someone was doing a quantitative assessment, you would have said that there was literally a 1.5% chance that we would see that level of volatility. There were decisions made, some of which were wrong, because we did in fact see that level of volatility. There were conscious decisions made about prioritising in that regard.

Q455 **Andy McDonald:** If I am summarising Oxera correctly, it is saying that there is no evidence of those quantitative impact analyses having been carried out, but you are saying that that is not right.

Dermot Nolan: I do not think that it is right. I was interviewed for the Oxera report back in—I do not know—February or March. I cannot remember the precise date, but I was interviewed. I am not sure if I am supposed to have said that, but I was interviewed.

Q456 **Andy McDonald:** That is interesting, because obviously there were very diametrically opposed accounts of what actually transpired.

Dermot Nolan: I would argue that there were impact assessments done on many of the things. I can come back to you if you like on that. I am very happy to do so.

Andy McDonald: I would be grateful. Thank you.

Q457 **Richard Fuller:** Very quickly, I wanted to pick up some points you made in response to Mr McDonald. You were taking about 2018 and said that was when most mistakes happened. You said the board was informed. It is really interesting me about whether the efforts you were taking failed only because it was a once-in-a-lifetime price change, or whether essentially it was preordained because the policy was mistaken. In that year, you were given a bonus, I think for the first time, of £20,000. What was that bonus paid to you for? It would indicate that the board at that time had full confidence in everything you were doing or that you had hit some specific targets.

Dermot Nolan: I was six years at Ofgem and I received bonuses for the first three and not for the last three. The 2018 was probably to do with 2017 and I think it was in a general sense that the senior civil servants, or the certain set of civil servants at my grade, were rated and evaluated by the board or the remuneration committee. I do not recall specifically but I think it would have been for 2017 rather than 2018.

Q458 **Richard Fuller:** Just to refresh your memory, you also received a bonus the following year and the year that you left. It was about £5,000 rather than £20,000, according to the accounts.

Dermot Nolan: I did not receive a bonus in my last year.

Q459 **Richard Fuller:** Well, I will check, Chair, but I think in the annual report—

Dermot Nolan: It comes as a slight shock to me, but anyway.

Richard Fuller: No, you may be right, my apologies.

Dermot Nolan: I certainly would not have recommended myself for a bonus in the last two years.

Q460 **Richard Fuller:** Without tying myself up on that too much, it is evident to you, is it, that the board at that time were satisfied with your performance and that the issues about competition at that time, in the full discussion, were not seen as being a harbinger of failure to come.

Dermot Nolan: That is correct.

Q461 **Chair:** Just to check, I think you said to Andy McDonald that you did not share the criticism that the board was not fully kept up to date with everything because you had informal dinners the night before a board meeting.

Dermot Nolan: We had two hours of informal meetings and then discussion over dinner, during which we discussed most of the issues, including supplier failure. That was a consistent pattern in board meetings, in addition to the regular papers that went to the board.

Q462 **Chair:** Do you not think supplier failure should have been formally added to the agenda and minuted in your formal board meeting, not at dinner the night before?

Dermot Nolan: It was at times. I cannot remember all the specifics of the board meetings. I will try to check, but I think there certainly were times when supplier failure and supplier issues came up within formal board meetings and were minuted.

Chair: It just paints this very relaxed culture about failure of energy companies, which I find quite amazing, but there we are.

Q463 **Tonia Antoniazzi:** Ofgem has significant powers to enforce its rules, but, at the expense of its customers, Ofgem has consistently failed to take any significant compliance or enforcement action in response to bad practices that were reported to you. Examples are the cases of ExtraEnergy, Cardiff Energy and Pure Planet, of which I had been a customer. Where there were potential breaches of licence conditions relating to customer service standards, you took no regulatory action. All of these suppliers later failed. How can you explain Ofgem's poor performance on enforcement and compliance while you were its leader?

Dermot Nolan: I disagree with that characterisation, in the sense that Ofgem took significant enforcement action throughout my time there. In 2014, 2015, 2016 and 2017, we fined companies £20 million or £30 million a go frequently. In terms of the specific companies you mention, I do not recall all the specific actions. I recall significant compliance work on Avro. I think that we took one enforcement order against it. Whether that was sufficient, I do not know, but I would generally reject the idea that we were not active in enforcement during my time there.

Q464 **Tonia Antoniazzi:** In its evidence to the Committee, Citizens Advice expressed its concern that Ofgem was not effectively enforcing the rules. It had its *Market Meltdown* report that found that you had allowed a culture of rule breaking at the expense of consumers. One thing that it found, which I find amazing, is that the number of Ofgem staff who were working on enforcement fell by 25% between 2017-18 and 2020-2021. Why was this the case and were you on the board actually aware of that?

Dermot Nolan: I do not recall. I am sure Citizens Advice is relatively accurate. I do not recall that. I will have to come back to you on it. I do not recall the enforcement number. It was certainly not a conscious choice that was made, but maybe I am incorrect. I do not know.

Q465 **Tonia Antoniazzi:** There would need to be a trigger for why there was such a drop in staff.

Dermot Nolan: I do not recall the number of staff dropping by that much. I am terribly sorry. I genuinely do not remember, but I will try to find out and revert to you.

Q466 **Chair:** It was a freedom of information request and it had been therefore confirmed by Ofgem that staff fell by 25%.

Dermot Nolan: I am sure then that it is correct. I do not recall why that happened. I would suspect that it should not have happened. If it did, I will come back to you as to why it happened. I just do not recall it.

Q467 **Chair:** People leave all the time, but presumably you have a HR director that says to you, as the CEO, "FYI, we are losing quite a lot of staff in our enforcement unit. We should make some effort to recruit and get our numbers back up". Did that discussion happen?

Dermot Nolan: I do not know. I am really not being disingenuous. I literally cannot remember, but I will try to come back to you. Sorry about that.

Q468 **Richard Fuller:** For the record, and perhaps not surprisingly, Mr Nolan remembers his remuneration package better than I did, so he was right and I was incorrect. In traditional George W Bush fashion, I misremembered that.

I would like to talk about the relationship between you, the board, and the Government in the implementation of this competition policy. Did you find yourself, or did your colleagues find themselves, under pressure from the Government on specific policies at any time?

Dermot Nolan: There was one situation of intense pressure about the price cap and how the price cap should be put in place. Should it be done by Government or the regulator? That was probably the most intense thing. If I was characterising my time there, my first couple of years, I would not say there was intense pressure about specific issues. There was relatively strong pressure about, certainly in the first two or three years, "Why is more not happening in competition? Why do the big six have the share they have and what is Ofgem doing about it?"

There was also pressure, particularly in the first few years to say, "The industry is saying that you are putting quite a lot of burdens on it. It is quite burdensome". This was in 2014-15. "Should you not be trying to remove regulations, rather than put them in place?" That was the early type of pressure that was there.

Q469 **Richard Fuller:** The first of those that you mentioned was about competition. How did you think that the Government perceived at the time you delivering on increased competition? Was it simply number of entrants? Was it market share?

Dermot Nolan: It was allied to the idea that the big six—again, I will use the phrase—were characterised as expensive and inefficient, which was not good for consumers. One sign of this changing would be the big six market share radically reducing.

Q470 **Richard Fuller:** Earlier on, you mentioned that there was an acceptance by the board that some new entrants would make profit, some would not and there would be some failure. Did the board ever come to a view about the use of forward payments by customers who are prepaying to fund the growth of businesses? What were your general principles on that point?

Dermot Nolan: As I recall, I think that that was there in 2015-16. Again, my recollection is slightly blurred, but I think that Ofgem suggested that this was not appropriate and took actions against it in 2016. I cannot recall that precisely. I will have to revert.

Q471 **Richard Fuller:** Ofgem took action. What action?

Dermot Nolan: I cannot remember if we took enforcement action or rang up a company and said, "Do not do this", but I think some action took place in that regard.

Q472 **Richard Fuller:** As a general policy, facing competition, as you said—six competitors, 96% market share, persistent difficulty in creating competition, an acceptance that there may be losses—there was a very risky potential strategy of using customers' cash to fund the operating costs. Was there a general principle established that that was not a good way to stimulate competition? If so, did Ofgem at any time conduct a review of competitors to see if they were doing that, comprehensively?

Dermot Nolan: There was a principle established that we should not do that, that that should not be done. I do not recall a specific review where we consulted on something.

Q473 **Richard Fuller:** You made a principle but there was no analytical—

Dermot Nolan: That is, again, my recollection. This was six or seven years ago. That is broadly my recollection.

Q474 **Richard Fuller:** Was there any comment from the Government about whether that was a good idea, or was that never raised by the Government in your recollection?

Dermot Nolan: Civil servants said that this was potentially a problematic issue that we should try to deal with. That was my slightly vague memory.

Q475 **Richard Fuller:** Your memory is that civil servants raised this as a potential concern.

Dermot Nolan: I think so.

Q476 **Richard Fuller:** Ofgem's board response was to establish therefore a general principle, but there was then no interrogation of the companies to understand whether they were doing that.

Dermot Nolan: That might be a fair recollection. I do not recall a certain conscious "we consult on this" type of thing.

Q477 **Chair:** You said you just called up a company and said, "Please stop using credit balances". That is a pretty informal way for a regulator to engage with a company, is it not? You have formal mechanisms.

Dermot Nolan: To be blunt, I think that, if you ask any regulators, they will say that, if they want something done, the first thing they will do is to ring the company up and say, "Stop doing this", simply because otherwise you have to consult legal processes. Being blunt, I would have thought that any regulator does that.

Q478 **Chair:** I would understand that if it was an individual company behaving in a way that you felt was unacceptable, but it was a structural problem across lots of companies. You said you rang up one company. Which one was it?

Dermot Nolan: My recollection was that it was OVO. This was about 2015 or 2016.

Q479 **Chair:** That was you, was it? You just rang up.

Dermot Nolan: No, I do not think that it was me.

Q480 **Chair:** I will read some of the Oxera report out to you: Avro Energy was "highly reliant on customer credit balances", at around 80% of assets in 2020. Utility Point was "highly reliant on customer credit balances", at around 90% of total assets in 2020. Pure Planet was "moderately reliant on customer credit balances". People's Energy was "reliant on customer credit". PFP Energy was "reliant on customer credit". CNG Energy was "reliant on customer credit". Green Supplier was "highly reliant on customer credit". All these companies have failed, to the cost of the taxpayer, but all you recall is one conversation that somebody else had with one company. This was a structural problem.

Dermot Nolan: I broadly agree with what you are saying, in the sense that companies used credit balances a lot. Certainly in the last few years I was there they were starting to do that more. My recollection is slightly blurred, but they were starting to do that more. When such companies failed, the cost of mutualisation on that was generally very low. It was, I accept, a non-perfect world, but the credit balance issues were protected under the supplier of last resort regime and did not seem to lead to any socialised cost.

Q481 **Charlotte Nichols:** Under your leadership, Ofgem designed the energy price cap mechanism. We have heard evidence throughout this inquiry that the price cap left suppliers with insufficient headroom to deal with the increase in wholesale prices and stopped them from recovering these costs for an extended period. Why was the potential risk of shocks to the wholesale market not accounted for in the design of the mechanism?

Dermot Nolan: There was a lot of discussion on that and a lot of choice. Being blunt, and I must confess that I do not regret this, there was a conscious choice to make a tougher price cap. Yes, there were immense amounts of discussion within the board about that particular issue. We were conscious that we were going to reduce profitability in the industry. The board took the view that that was the right thing to do. It took that view because the alternative would have been, frankly, higher prices almost indefinitely.

One thing we found within our analysis of the bigger companies during the price cap was how inefficient they were compared to some of the smaller companies. We made a conscious decision to reduce the profitability of the sector. That brought the consequence that, in fact, there was less profitability within the sector. Being blunt, though, I still think that that was the right decision. Otherwise, prices would have been higher for a significant period of time.

Q482 **Charlotte Nichols:** Further to that, in the price cap there is no mechanism or provision for contracts for difference savings to return value to customers. Why was this decision taken? As a result, are you confident that the benefits of renewables are being passed through to consumers?

Dermot Nolan: I have no memory of that. The fraction of renewables through contracts for difference was very small at that time. The point you are referring to now is that the renewable generators are giving money back, those on contracts for difference, which is the one small positive effect, if you will, of higher prices. They are giving money back. Sorry, I would assume that that is happening. This is news to me that the price cap did not do that. I cannot explain that. I will have to come back to you.

Q483 **Chair:** Mr Nolan, that is the end of this first panel. My observations from the evidence you have given this morning is that there was a sense of intense relaxation at Ofgem over many years about these issues. There were informal discussions with the board at dinners, as opposed to minuting them. There was an acceptance of failure and cost to consumer, an inability to really understand what was going on in the companies you were regulating and insufficient resource allocated to the supervision of the companies you were tasked with regulating.

The crisis that we are in now seems to have three key points of failure. Yes, there is the wholesale cost of gas. Yes, there is bad behaviour by some businesses, which we have brought to task in this Committee. Also, as far as I can see, there was a fundamental failure of Ofgem, as the regulator, to supervise the companies that you are asked to supervise. Do you accept that summary?

Dermot Nolan: I do not think that I do. I accept the idea that Ofgem should have been more proactive, certainly during the last couple of years of my tenure, to make changes. I do not think that the phrase that we were intensely relaxed about failure is valid. We saw failure as something that would happen from time to time and that was not necessarily the worst thing in the world. Any company will fail and we felt we had a system in place that would deal well with failure, did deal well with failure and was robust, in my view, until the most recent eight months, in dealing with failure. We had a system of monitoring firms. I accept that it was not enough.

I do not believe, however, that the choice to try to bring more competition to the market was necessarily the wrong choice. It was something that has brought considerable benefits to consumers over time, in terms of some competition and innovation. I believe that many of the firms that have entered will make a genuine contribution to ensuring that we certainly help consumers move towards our net-zero goals. I accept that we should have moved more quickly in the last year or two to deal with the shocks. I deeply regret that, but I probably do not accept the overall characterisation. I wish we had moved more quickly and I apologise to you for that.

Chair: Thank you for your time and contributions this morning.