HOUSE OF COMMONS

Public Accounts Committee

Oral evidence: Regulation of energy suppliers, HC 41

Monday 11 July 2022

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Watch the meeting

Members present: Dame Meg Hillier (Chair); Olivia Blake; Dan Carden; Mr Louie French; Sarah Olney; Nick Smith; James Wild.

Gareth Davies, Comptroller and Auditor General and David Fairbrother, Treasury Officer of Accounts, were in attendance.

Questions 1 - 103

Witnesses

I: Sarah Munby, Permanent Secretary, Department for Business, Energy and Industrial Strategy; Joanna Whittington, Director General, Department for Business, Energy and Industrial Strategy; Jonathan Brearley, Chief Executive, Ofgem; Neil Lawrence, Director of Retail, Ofgem.

Report by the Comptroller and Auditor General

The energy supplier market (HC 68)

Examination of witnesses

Witnesses: Sarah Munby, Joanna Whittington, Jonathan Brearley and Neil Lawrence.

Q1 **Chair:** Welcome to the Public Accounts Committee on Monday 11 July 2022. Today, we are talking to senior officials in BEIS and Ofgem about the regulation of energy suppliers, something that is obviously very pertinent at the moment, with 30 suppliers leaving the market as the energy crisis hit earlier this year, then compounded by the Russian invasion of Ukraine, meaning that around 4 million customers had to move to other suppliers. One company, Bulb, was so large that the Government could not divest those customers to other suppliers and had to put it into a special administration regime to protect the interests of customers.

We have in front of us, as our witnesses, Sarah Munby, the Permanent Secretary at the Department for Business, Energy and Industrial Strategy, Joanna Whittington, the director-general from the same Department responsible for this area of work, Jonathan Brearley, the chief executive of Ofgem, the regulator for the energy industry, and Neil Lawrence, the director of retail at Ofgem.

Before we go into the main session, starting with you, Sarah Munby, there is a lot of talk about power outages, us boiling our kettles, charging our cars or whatever it may be at different times of the day. What is the latest thinking in the Department about this? Is it likely to happen and how are you going to manage it?

Sarah Munby: No, we do not think that it is likely to happen. We are confident in our security of supply for winter. Having said that, I hope we are, in all things, responsible. Given the volatility in energy markets, we are making sure that we are belt and braces, frankly, prepared. That includes, as you will have seen, the recent contracts that we have signed with coal-fired generators to ensure that they are generating this winter. We are exploring any other options we can to make sure that we are in the strongest position going into winter.

The reason that we are ultimately confident is that we have a very varied source of gas itself and of electricity generation, including access to the international markets. Of course, any individual source of supply can come into trouble and the same happens, by the way, every winter. We always experience small-scale threats. It is that diversity of response that enables us to be in a strong position. For example, for gas that includes direct pipeline connections to Norway, our own continental shelf of course, LNG imports from the rest of the world et cetera, as opposed to—we have talked about this in this group before—having a direct and large-scale reliance on pipeline gas from Russia.

Q2 **Chair:** We have the target to reach net zero by 2050. Using coal-generated power is going to dent that. Has there been any thought about encouraging customers to use energy at off peak times in order to reduce the reliance on fossil fuels to plug the gap?

Sarah Munby: It is worth saying on the first point around coal that of course, yes, that is true. This is a one-year extension of life, so it is not something that we are expecting to impact our long-run trajectory towards net zero in any way.

There is the separate question on whether we are looking at other ways of reducing demand this winter. Of course those discussions are always happening. It is worth saying, particularly on usage, time of day and tariffs, that Ofgem is doing work with some of the suppliers, which Jonathan could talk to, about rewarding consumers for shifting when they use electricity. We think that that is a productive route to go down.

It is worth also recognising that we will, particularly in industrial sectors, doubtless see some decline in usage because of high prices. We should be honest about that.

Q3 **Chair:** It is the carrot, Mr Brearley, to encourage people to use it. A lot of customers, who are committed to tackling climate change, would be quite happy if they knew what was a good option to move their energy use to different times. You are offering some carrots. Can you explain what those might be?

Jonathan Brearley: To explain, right now, the National Grid, the part that runs the system, is trialling paying people to use their energy at different times. There are plenty of suppliers out there that are beginning to develop the model that says, "If you can reduce system costs or system risks, we can share the benefit of that and give that benefit back to you".

I know that we will probably come on to this later on in this session, but, when you think about the world we are entering, that world of millions of electric vehicles and far more renewables than we have today, the ability to do that is going to get stronger. When we think about the future of the retail market, in my mind, that is going to become a fundamental part of it.

Q4 **Chair:** How far away is this from reality, if we are looking at the winter, for example? Will there be preferential pricing for people using energy off peak at that point?

Jonathan Brearley: There are tariffs that are available already. The smart technology you need to make that comfortable for people is still some way away. It is part of the strategy but, as Sarah says, it is as much the supply side as well as the demand side we are going to need to look to.

Q5 **Chair:** If someone wants to both be green and help the grid, what should they do?

Jonathan Brearley: I would look at your supplier's tariffs. There are special tariffs that are based on the time of day. If you can offer to be able to shift your demand, you will benefit from that.

Chair: That is an enticement.

Q6 **Nick Smith:** Mr Brearley, how many suppliers offer off-time tariffs?

Jonathan Brearley: There are a few. Neil, you may want to comment, but there are early tariffs in the market.

Neil Lawrence: I do not have an exact number. We will have to write to you, but it is becoming more prevalent.

Q7 **Nick Smith:** Is it 10% or 20%?

Neil Lawrence: I will come back to you. Off the top of my head, I know of four that definitely do it and are looking at scale. I will have to come back to you in writing with the exact number.

Q8 **Chair:** Some of those companies may not be taking switches at this point, because they will have absorbed the other companies, so it may not be an option.

Jonathan Brearley: Those are usually outside of the standard variable market, so it is possible to get that. There are some big, well-established companies. I probably do not want to sponsor it in this session. It is still a small sector, though. It is still a small part of the retail sector. It is something that we think needs to grow over the next 10 years.

Q9 **Chair:** One of the other concerns, of course, is the more vulnerable customers. This is moving on to more generally the cost of energy. If you have a prepaid meter, which many of my constituents have, because it is a much easier way to budget than having the risk of a quarterly or monthly bill or direct debits, they still pay more. What is Ofgem doing to support more vulnerable customers at this time? We have had energy company directors come out and say that it is not fair. A number of us have known that for a long while from our constituency perspective. What are you doing about that?

Jonathan Brearley: There are two dimensions to this. There is what we can do within the regulatory framework that we have. One really strong representation we have had from consumer groups is around the standing charge. We will come on and talk about how we spread the cost of the existing supplier failures. The original decision we made was to split that between the standing charge, which everyone pays and is fixed day by day, and the volumetric charge.

I need to emphasise that trade-offs in this area are not simple. I talk to a lot of different vulnerable customers and there are many vulnerable customers who use a lot of energy. For example, if you have a disabled child or you are an elderly person in a larger house, you have a large energy bill. If we move from a standing charge to a volumetric charge, we need to be aware of the secondary consequences. We are examining that and consulting on basically taking all of that charge off the standing charge and putting it into the volume-based charge.

In terms of the rest of it, we have been working closely with Government on the package of support for everyone in the market. Perhaps Sarah will want to say more on that. That, to me, is key to offsetting what is a huge change for customers at the moment.

Sarah Munby: This probably comes down to the question of applying the £400 payment this winter to prepayment meters. It is worth saying that, for a large fraction of prepayment meters, you can apply that as an automatic reduction. We will obviously do that where possible. We have worked through what the right ways are, including vouchers. Those are used in a lot of the schemes that are already run to provide benefit to customers on prepayment meters. We think that we have a range of solutions that should allow prepayment customers to access the same benefit as others.

Chair: We are going to get into some of the other stuff around customer service in the main session.

Q10 **James Wild:** I have been contacted by a number of park homes residents in my North West Norfolk constituency who are pleased, of course, that the previous Chancellor put in place the £400 energy grant. Their concern is that they are not the direct billpayer, they will not receive the benefit of that and it will be taken by someone else. How are you going to make sure that that actually gets to the intended people?

Sarah Munby: It is an excellent question and park homes are one of the difficult cases for the £400. The other obvious difficult case is people who pay for energy as part of a fixed rent, as opposed to a separate payment. This is not to suggest that we do not need to think about the problem, but, to give you a sense of scale, you are talking about less than 1% of the market here. We have a solution for the 99%. We need to come up with a sensible answer on the 1%.

We have put out some suggestions about the right ways to do this as part of our technical consultation on the scheme. It is worth saying that we may reach a point where there are some groups for whom this scheme is not the solution, if that makes sense. At that point, you have to start looking at the broader package of Government support and how you direct it to the most difficult-to-access groups, like park homes owners.

I am not saying this is the full answer, but as an example of that the Government have committed an extra £500,000 million to extending the household support fund, which is a much more discretionary kind of package. The answer probably will be at the end that we will push our 99% up as high as we can get it—99.5%, 99.6%—and there may be a very small group of customers at the end who need a solution that goes broader, outside of just running this scheme, in making sure that other sources of Government support are directed in the right way. We do not have all the detail on that worked out to give you today, but we are acutely aware of the challenge and the problem.

Q11 **James Wild:** In the scenario where you encourage people to go to the discretionary support fund, it would not then make sense to have given all the landlords the £400, would it? They would not be paying energy costs.

Sarah Munby: Clearly, wherever we have the ability to make it happen, our preference is for landlords to pass on the reduction. In many cases, the market will help make that happen too. You can be sure that we will use all the levers of Government to encourage that to happen. We have to be realistic: we may not be able to guarantee that in every single case. Certainly, I do not have an answer today that means I can guarantee it in every single case. That is why we are thinking ahead. If we cannot make that happen in every case, we need to make sure that we have an answer from the broader set of Government support.

Q12 **James Wild:** At what point would we need to have the answer, the solution, in order for it to be able to be paid in a timescale that the Ministers and Government have already committed to?

Sarah Munby: We would need to have it soon, clearly.

James Wild: Hence why I asked the question.

Sarah Munby: As you can imagine, we have just put the technical consultation through. This is all subject to very live discussion, literally as we speak.

Q13 **Mr French:** I have a quick follow-up on the point you have just made about prepayment meters. I appreciate what you are saying around working through how you help that 1% of potentially more vulnerable customers who are being left out from the scheme. I think that most people would overwhelmingly support that. You mentioned vouchers. In my area, in Old Bexley and Sidcup, I am aware of a number of blocks of flats that use prepayment meters. I am aware that a number of shops have stopped selling the fob that they take the key for. How are we going to reach these people with vouchers? Will it be through the local council? What is the thinking of the Department at the moment?

Sarah Munby: I do not know the answer to the specific question that you are asking. I am very happy to write, by the way, because it is a perfectly sensible question. It is worth saying that we have to run other schemes that also involve getting additional funds to prepayment customers, so this is not a new problem. That is not to suggest that it is easy, but it is well worked through, so I have reasonably high confidence in this.

Chair: It looks like Mr Brearley can give some information.

Jonathan Brearley: One other thing we do is run some of those schemes. There are different ways in which you can do it. Some suppliers can automatically wind on credit to customers. Others, for example, when they are sent vouchers, are sent barcodes that are scannable when they go to the same place they go to charge their prepayment meter. We have other schemes that have the same issue. In essence, we will benchmark that and use that as experience for doing the same with this scheme.

Mr French: That is really helpful. Thank you. I would like to flag that point about the reduction in places where people can top up. That is a particular issue, like I said, in my constituency. I am sure that, across a number of constituencies, that lack of places to do it is a particular problem.

Q14 **Olivia Blake:** Can I ask for a bit of clarity about the household support fund, if that is used as an alternative? Where does the discretion and the decision-making around the discretion sit?

Sarah Munby: I do not own the household support fund, if you see what I mean, so I am not going to answer detailed questions on it. I am happy to ask the relevant Department to follow up.

Chair: It is part of the Department for Levelling Up, Housing and Communities.

Olivia Blake: It could be different in different places.

Chair: It is a bit like some of the business support during Covid and some of the other discretionary funds that are down to local authorities to decide. We keep a close eye on postcode lottery or local decision-making, depending on which way you look at it. Is there anyone else on this issue? We are going to pick up most of the issues in the main session.

Q15 **Dan Carden:** Can I pick up on the issue of prepayment meters? It is something I have written to the Secretary of State about over the last year. I represent a very deprived community in Liverpool Walton. It is often the most deprived people who rely on prepayment meters. They are, essentially, cut off from their energy supply when they are no longer able to top up their meters. That is the reality for them. The Secretary of State has said in the House of Commons to me that he is speaking to energy companies about how to encourage the most vulnerable on to direct debits. What is the Department doing to ensure that people are not cut off this winter, when energy bills will simply become unaffordable?

Jonathan Brearley: Perhaps I ought to pick that up and explain how the regulatory framework works. I talk to a lot of customers on prepayment meters and I know that, for many people, when you are trying to budget and control your spend, this is a preferred metric. There are two dimensions to this. The systems behind it cost more and the regulations we need to apply have to reflect the cost of supplying energy.

After we had the Covid crisis, we introduced new conditions on the companies as to how they treat different groups of customers. For a prepayment meter customer, if you run out of funding, the company needs to put on emergency credit for you. There are two versions of that. One is emergency credit for your general energy use. The other is that, if you lose your energy, for example, during the weekend and you cannot get out to top up your meter, they need to provide you with credit to last until then.

That is not unending. They cannot provide credit forever, because, unfortunately, that is not financially sustainable, but at least it provides a bridge for people, particularly when they are trying to manage their finances. We work closely with BEIS and we recognise, particularly for this group, given the sorts of changes we are seeing in the market and the price rises we have seen already, that this is going to be a focus for us over the next six months.

Q16 **Dan Carden:** It is also the case that people on prepayment meters can end up paying higher rates for energy than people on direct debits. What are the Secretary of State and the Department doing to reverse that, to make sure the companies are not putting the highest rates on the most vulnerable customers?

Jonathan Brearley: The pricing regulation means we have to reflect cost—so the cost to serve, to get you your energy. That is why there is a differential between prepayment meters and direct debit payments. We work with companies to try to get people on to direct debits, but, ultimately, we need to reflect those costs. The thing we do is to make sure that companies, not just with prepayment meters but across the board, are treating their vulnerable customers fairly. That means a whole set of measures, including the emergency credit I described before.

Q17 **Nick Smith:** Mr Brearley, how well does the credit bridge you talked about work?

Jonathan Brearley: Do you mean the emergency credit?

Nick Smith: Yes.

Jonathan Brearley: I have sat with people putting this on meters. I have talked through in a triangular conversation between an adviser and a customer who had self-disconnected their gas. I have seen companies really proactively use this option for their customers. It works quite well. The problem is that these amounts of money are of a different order of magnitude, compared to the rises we have seen. That is simply because we need wider intervention, which is why I come back to what Government are doing overall for customers, which is aimed to help.

Q18 **Nick Smith:** Is that credit bridge sufficient for your anticipated difficulty this winter for those customers?

Jonathan Brearley: It is sufficient to manage an ongoing problem, as in a problem that occurs if you are two or three days away from your benefits payment, for example. It is not sufficient to offset the price rise we have seen, which is why we have worked closely with Government on other measures to do that.

Sarah Munby: It is perhaps worth noting, building on what Jonathan is saying, that, as well as the £400 measure that we talked about earlier, which is a universal measure, there are a range of measures that are not universal and are not run through the energy system. They are not BEIS measures but they are Government measures, including specific payments for those on means-tested benefits, pensioners and people with disabilities.

It is also worth perhaps a quick mention of the warm home discount, which is designed exactly to help people manage their energy costs. We need to look at that whole set of measures in the round to make sure that support is targeted at those who need it most. As you rightly say, Jonathan and the suppliers then have a job to do to make sure that, operationally, the system enables people to use that support to heat their homes.

Q19 **Nick Smith:** How will you monitor that this bridge works, come the autumn, when people are expecting really high bills? How will you ensure, should you detect a problem, that you take extra measures that will support people?

Jonathan Brearley: Neil may come in on our monitoring. We have a self-disconnection monitoring system.

Neil Lawrence: That is exactly it. We monitor all suppliers on a range of customer service metrics. The self-disconnection is absolutely one of those. Rates are up since last year. We will continue to monitor that and work with suppliers.

Q20 **Nick Smith:** How much up are they?

Neil Lawrence: They are up just marginally at the moment, because the full price spike impact has not been seen as much through the summer period, due to lower consumption. We are aware and it is a big worry for the industry overall. We will continue to work with suppliers to make sure that they fulfil their licence obligations and that, when these things happen, they are proactively tracked. Suppliers have to reach out to customers on this issue. It is very dangerous if we have high levels of self-disconnection, especially as we go into the winter months.

Q21 **Chair:** We are going to move into the main session. We skirted around that already. We are going to cover the challenges of what has happened, with so many suppliers failing in such a short space of time. Mr Brearley, you are the regulator. You oversaw the expansion of the market. How was it ever allowed to develop to such a situation where so many, 30, suppliers failed within weeks?

Jonathan Brearley: As you know, we carried out our own independent review. We have worked closely with the NAO team. The drivers are clear. This is a once-in-a-generation change in wholesale prices, which we have seen internationally. I need to emphasise that those changes have not finished yet. They are ongoing in the market. Prices were six times their normal level in winter and they are 10 times their normal level today. The impact of the supply situation we saw in winter, plus Russia-Ukraine, has put the market under absolutely unprecedented strain.

However, there were two factors, with hindsight, that we think could have made a difference. The first was that the level of financial resilience in the market clearly was not strong enough. Although we know that there would have been costs under any circumstances, that would have mitigated the number of failures and, indeed, the time they failed, and so therefore the cost.

The second was the design of the price cap. Again, I spend a great deal of time talking to customers about what they do and do not care about. The price cap has done a lot for customers over the last six months. It cannot stop a rise, but it has mitigated that somewhat. Certainly, comparing customers in Britain to customers elsewhere, there are lots of things that are good about the price cap. The price cap simply was not adaptable to this kind of market. Being designed to change once every six months in a market that changed as dramatically as it did over such a short space of time were the two regulatory factors that contributed to that cost, although, as I say, under any circumstances, in any competitive market, we would have seen failures and therefore cost.

Q22 **Chair:** Sarah Munby, your Department oversaw this increase in suppliers. We were all moaning about the big six. Then everybody wanted to see more competition. Some of this was predictable, was it not? What would you do differently now? Did you not think that maybe your Department would see some of this coming?

Sarah Munby: It is worth saying that, ultimately, there is a trade-off between having a market that is very open to entry and, therefore, maximum levels of competition, and having a market that has lots of resilience requirements and, therefore, is maximally resilient. Managing that trade-off for the benefit of customers is exactly Ofgem's role.

The Department legislated, with broad support in the House—cross-party support, I think—for the introduction of the price cap. There was a good reason for that. Immediately prior to that, the CMA had done a full investigation into the market and found, I think, £1.4 billion worth of consumer detriment annually because of lack of competition in the market.

Exactly as Jonathan has said, the drawing of that balance needs to be thought about really carefully. Hindsight suggests that it could have been drawn in a different place, but the impulse to increase competition in this market was right. I do not think that any of us would apologise for thinking that competition is an important force here. It just needs to be balanced carefully with resilience.

Q23 **Chair:** There is a different between competition and the unsustainability of some of the companies. Ofgem realised that there was a problem in 2018.

It was not until the quite late summer of 2019 that you began to look at—what was it?—certain requirements for entrants to the market. Why did it take until 2018 to realise and then a year or so to act?

Jonathan Brearley: It might be worth just stepping back to the world we had in 2015 and 2016. To come on to this point about why the market was opened up, we had a small number of companies that were taking advantage of—

Chair: Yes, we all know. Describe it, but I think we all know. Give a brief description, because we might as well have it on record.

Jonathan Brearley: A small number of companies took advantage of their customers who did not move. We saw margins of those customers and companies in general up to 8%. In today's money, that would be nearly £250 on top of the cost of energy, so we knew there was a problem. In 2018, we saw a lot of representations around the financial resilience of some of those entrants. We prioritised, first, shutting the gates to make sure nobody else could come in who did not have a resilient business model and then designing the ongoing requirements.

In terms of the ongoing requirements, it was and is incredibly controversial within the sector. You have to balance the need to make sure you keep companies financially resilient with the need to make sure you have enough diversity in the market in the first place. We have been through all the decision-making that was made, right the way back to 2016.

Particularly in 2019, because that was so controversial, we opened up the question in two forms. We decided to implement what is called a financial responsibility principle, so a broad principle about making sure that you are responsible, and then began to take forward a set of more detailed licence conditions, such as what you do about the funding you take from customers through credit balances and what you do with Government funds. The time it took really reflected the complexity of the negotiation and discussion across the sector.

Q24 **Chair:** You have said again, or you said it earlier, that the financial resilience of the market was not strong enough, putting it slightly more baldly than the chief executive of Octopus Energy, Greg Jackson, who wrote to us and to the Chair of the BEIS Select Committee, and companies also submitted evidence. He says, "The regulator failed to recognise the difference between fly-by-night chancers and serious challenger retailers. It allowed the former to thrive, creating an unsustainable market". I think that we would all say that is a fair comment, is it not?

Jonathan Brearley: Without a doubt, we allowed companies into the market expecting that the normal processes of competition would force them to exit if they were unable to run themselves, but they were not resilient enough. They were not resilient enough to survive a shock of lesser magnitude than the one we have seen.

Q25 **Chair:** Could you not have foreseen that? You must have been looking at the make-up of them and where they had emerged from. They were new companies. When he calls them "fly-by-night chancers", that is his language, but, from what has happened, it sounds like there is some truth in that.

Jonathan Brearley: If you go through the timeline of our decision-making, in 2016 we first looked at the issue of financial resilience. It was decided at that time that we should prioritise opening up the market. It was actually in 2020 when we began to see the resilience of the sector come under threat and, indeed, we wrote to the Department to express some of the concerns. We increased our monitoring and then we introduced the more stringent rules and regulations in January 2021.

Q26 **Chair:** It is not quite an either/or, is it—have competition or have strong suppliers? You can do both. You could have set some slightly higher bars for entrants to prove that they had some resilience or stronger financial backing.

Jonathan Brearley: The entry requirements that we put in in 2019 worked, so we made sure that nobody else came into the market.

Q27 **Chair:** That is rather like closing the door after the horse has bolted, is it not?

Jonathan Brearley: The problem was the ongoing requirements for the suppliers themselves. We accept, with hindsight, that those should have been tighter. When we looked at supplier failure, prior to September of this year, although there had been costs, they were not anywhere near the order of magnitude of what we have seen.

The fact is that we had this huge rise in wholesale prices, which did two things. It increased the number of suppliers that failed, but also increased the costs of their failure. We accept that, looking back, financial resilience controls could and should have been stronger. Equally, the design of the price cap should have allowed the market to adapt more freely.

Q28 **Chair:** In terms of making the decisions, obviously the policy decision falls to your Department, Ms Munby, on whether to open up the market.

Sarah Munby: No, I do not think so.

Q29 **Chair:** You do not think so, okay. It was very much politically driven at the time.

Sarah Munby: Yes, but it is Ofgem's responsibility to look after both current and future consumer interests in the market. Competition is one of the forces that drive that.

Q30 **Chair:** Who thinks they are responsible for what? Let us be clear.

Jonathan Brearley: I will put it in really simple terms. We all had a shared objective to open up the market. I was in the market in 2015. I was not in Ofgem, but I saw the state of the market then and that was the right decision. The trade-off between that and financial resilience, as Sarah says, is a matter for the regulator. As we have said, looking back, that should have been tighter.

Q31 **Chair:** What would you do? We have obviously seen a lot of exit from the market. The market has shrunk dramatically. What plans do you have going forward to look at future competition? How are you going to make sure you do not get fly-by-nights in?

Jonathan Brearley: In terms of how we do not get fly-by-nights in, I am going to ask Neil to give you the detail. We have significantly strengthened all our financial requirements on the suppliers. We have very detailed and very close monitoring of all their finances.

There are three things. First, you will not get in this market unless you have a robust business plan and backing behind you. We turned down a licence last week to say no.

Secondly, if you are in the market and we think you are taking too much risk, given the changes we are seeing elsewhere, we will do three things. We put you in a compliance process. We then apply restrictions to what you can and cannot do. We say, "You cannot take on new customers. You cannot pay any dividends to your shareholders. Ultimately, if you cannot change, we will take your licence away and exit you from the market".

Finally, we have a fit and proper test that we are applying that says, "If you were involved in a failure previously, that is an important factor as to whether you should be a director in a company in the future". There are all those things. Not only have we changed the rules but we are enforcing those at the same time.

Neil Lawrence: To add a little more colour to what Jonathan has articulated, it is my job to assess those new licence applications. We have a team in place to do that. We take those three tests very seriously.

You would only see one public licence refusal because, when we get to the stage in the process where we are saying, "We do not think you are meeting the bar", applicants generally withdraw, so it is not in the public eye. I want the Committee to absolutely know that we take that job really seriously. Since July 2019, I think that there have been 41 "withdrawals" from licence applications. That is our process working and we have tightened up those rules this year as well.

Q32 **Chair:** There were 41 companies that tried to get into the business but did not meet your bar.

Neil Lawrence: Yes.

Chair: They still tried.

Jonathan Brearley: Chair, it may be worth reflecting on the change in approach here. I would characterise Ofgem's approach in the past as being reactive, so trying to identify companies that are under stress and deal with them, but seeing that as the tail end of the market. This crisis has shown us that we need regulation that looks and feels much more like banking regulation, so that everybody is put under a test, everybody is assessed and we then respond accordingly to each company differently. That is a very big shift from the type of retail regulation we had in the energy sector previously. It is quite unique to the situation we are in now.

Q33 **Mr French:** My mind was thinking about banking regulation before you made that point. Banking legislation and how the FCA has had to operate over the years have changed depending on crises that we have been through. For example, you pointed to the growth in wholesale prices being a big driver of the issues that have come under pressure. What would your estimates be of the number of companies that would have gone out of business if the price had gone up by, say, half what it did?

Jonathan Brearley: We have done a whole set of work on almost the converse: what if we had tighter financial regulations? What would that mean? We do not have an exact number for that, but I will describe the picture of the failures. We saw quite a group fail early in September. That was the very start of the crisis; that was the very start of the price rises. In my mind, those simply were not financially resilient enough to survive a shock of half that, as you mentioned.

As you go through the winter, unfortunately there are some companies that ran reasonable business models that you would have thought, in late 2020 or early 2021, were making reasonable choices, but they were caught under a specific set of circumstances brought about by the gas crisis. We still see companies that are under financial strain today. There is a range of responses. In my mind, particularly the early cases were not resilient enough. Those are the sorts of things that we are intervening to stop now.

Q34 **Mr French:** I assume and hope you will be doing this, but, if I can use the phrase, are you war gaming situations, in terms of the knock-on effects of being too tight on regulation?

Jonathan Brearley: Yes, absolutely. The one thing our review said, and I think that the NAO report said to us, which we absolutely agree with, is that, without doubt, this should have been tougher. There should have been firmer financial regulation in the first place. Everyone we have spoken to who has advised us has said, "Do not swing to the other end of the spectrum and make such a high bar you do not let people come into this market and challenge the incumbents".

Chair: We have certainly had evidence to that effect.

Jonathan Brearley: We talked about that net-zero world. We need new approaches, new technology and new kinds of companies coming into this market. The way I see it, as we implement these regulations, it is not an Ofgem decision and then we leave it to be enforced against. It will be a balance that we strike over time and change over time.

Q35 **Chair:** That brings us to the protection of consumers. Obviously, there is the impact on the consumers who shifted over. We had some quite detailed evidence from Citizens Advice about some of the poor service that they have had as they have shifted over. What did you do to regulate as people were moved from one energy supplier to another? I am not talking about Bulb at this stage. This is the ones who were changed to a new company overnight.

Jonathan Brearley: Neil ran the process for us last year. In a sense, both the SoLR and SAR processes were our key mitigations to a situation like this.

Q36 **Chair:** We should probably spell that out for those who are listening. The special administration regime was for Bulb. There was SoLR for the other 30. Do you want to spell it out?

Jonathan Brearley: When you have a company, if you have a small enough customer book that you can move it to another supplier, and that can be done administratively, without risking anyone's security of supply, and is manageable financially, the preference is to use what we call supplier of last resort. That is to go into the market and ask someone to take on these new customers and to make sure that their energy is bought and sold to them at the level of the price cap.

When a company gets too big, it becomes too hard administratively to be confident that you can move all its customers. Financially, it usually becomes a challenge, certainly for many in the market. At that point, you begin to consider what we call a special administration regime, which is where Government appoints the administrator and then, in a sense, the administrator makes the decisions for those companies.

Q37 **Chair:** You had a lot in that former category of moving them over. That was a lot in one go and there has been a lot of concern about how some of those customers got little information, were worried about the prices, did not know what was going on. Looking at what happened then, what would you do differently and what do you think went wrong for consumers?

Neil Lawrence: The process held up really well. The SoLR process was not designed to run 29 companies through in that short space of time, so it held up to very high levels of resilience. Absolutely, there are some things that went wrong for individual customers. Throughout the process, we worked with the suppliers, the administrators and the outgoing supplier to try to minimise the disruption for customers.

When we work with administrators, at that point, we do not regulate them. All the work that we do is on a best will basis. It is involving negotiation, our soft power, to persuade administrators to do what they can for customers at that point, but they are outside the scope of our regulation.

Q38 **Chair:** Is that something you think needs to change?

Neil Lawrence: We think it needs to change. We can continue to work constructively and we can continue to try to help, but a tighter regulation of administrators at that point would help.

Q39 **Chair:** It seems extraordinary that there is a gap. Once you go into administration, you are off the hook for the regulator at that point, completely.

Jonathan Brearley: This is a matter of ongoing discussion. We think that some influence needs to be put over the administrators of the residual customers. We do our best with them and many of them are quite good, but we would like to work with the insolvency agency and others to make sure that we get the best service we can. There are some things we are doing around terms and conditions in the contracts that allow that to happen. Ultimately, one lesson learned for me is that we really need to think about the management of the residual customers, particularly those who are in debt to the company that has failed.

Q40 **Chair:** If you fail, there is the issue for your shareholders, your reputation, possibly your career and maybe your immediate salary, but your customers are at the bottom of the heap if they no longer can rely on Ofgem to give them support. In the end, some support did happen through soft powers.

Jonathan Brearley: To step back from this, when you run the supplier of last resort regime, you have three big priorities. First, everyone is kept on supply. Secondly, their credit balances are transferred over time. Thirdly, the disruption to those customers is minimised. There are lots of very good examples, but we need to continue to work on that process in order to make sure, particularly in that third category around disruption, that things happen. By and large, people were kept on supply and credit balances have been transferred.

You then get to another issue. The residual company, so the one that has failed, has a lot of customers who are still in debt to it. There is more work that we need to do collectively to make sure that those customers are treated fairly and reasonably. That is an area that we should all focus on. There are some things Ofgem can do. We can regulate to change the terms and conditions for those customers. There are some things the insolvency agency can do, because it has control of administrators, but we would like to come back to this, if we feel like those two levers would not be enough, as to whether we need to do something more to change the law.

Q41 **Chair:** You want to see a change in law. Is that something that the Department is going to look at? You do not have many Ministers now to look at this, do you?

Sarah Munby: Indeed. As Jonathan said, there are quite some levers that do not require legislation that can be pulled first, which would definitely make a difference in this situation. If the residual problem, as it were, that is left after we have done those things needs legislation, of course that is something we would look at.

It is perhaps worth the caveat that what you are talking about here is getting into insolvency law, which, in itself, is a complex beast that spans sectors. That is why it would be fair to say, without speaking for Ministers, that one would not necessarily rush to do that if there are regulatory levers specific to this market that can solve the problem. Of course, we should be open-minded to it if it is required.

Q42 **Chair:** I can see, from your dancing on a Whitehall pinhead—I do not mean it in a rude way—about who is responsible for what, that it is not your area of responsibility. Insolvency is true, but it is actually the customer who is trying to get their energy who is the focus of an energy company. That should probably trump some of the other things, from what Mr Brearley is saying.

Jonathan Brearley: As both Sarah and I are saying, there are some things that we ought to be putting in place. We will be looking at the terms and conditions. We will be making sure we can try to find a way that the insolvency agency can give guidance and controls to administrators. At the end of that, if there is a problem, we would be coming to the Department and asking to look at changing the law. This comes to a more generic point that the interaction between insolvency law and the supplier of last resort regime in general is something that we need to continue to look at.

Q43 **Chair:** It sounds like a huge bit of work for you at Ofgem there. We have now a shrunken market. Is it closing the door after the horse has bolted, or do you think that you will need these things in future?

Jonathan Brearley: We are in, as I say, a once-in-a-generation change. Even in September, when we began to see suppliers fail, none of us imagined that we would have 10 times the price in summer.

Chair: We have had a wave of things coming through Government that no one predicted and that were unprecedented.

Jonathan Brearley: I know. I understand.

Q44 **Chair:** That brings us back to our discussion on risk. I know that others are going to be coming in on some of the regulatory stuff and looking forward. I wanted to touch on Bulb. Bulb was too big to fail and had to go into special administration. That is costing the taxpayer pretty dear—£900 million so far, so just shy of £1 billion. How do you feel that has gone from your perspective, Mr Brearley?

Jonathan Brearley: Coming back to what we are trying to do when we have a supplier that fails, criteria one is that everyone is kept on supply. That is most important. Remember, Bulb has between 150,000 and 200,000 prepayment meter customers, for example. Number two is that disruption is minimised and number three is that credit balances are protected. From the perspective of the customer, the special administration regime has done the things it was intended to do.

The reason we made that recommendation to the Secretary of State was that we simply did not think putting 1.7 million customers on top of those that had been transferred already, in the middle of winter, was a risk that we should allow customers to take. In terms of the financials behind that, our job as a regulator, once that has happened, is to step back from the administrator and treat that company like every other company in the market. From that perspective, we are comfortable with what has happened. That does not mean that we are comfortable with the cost, but that is ultimately a decision and a matter for the administrator and for Treasury and Government.

Q45 **Chair:** It is probably worth reminding people of the figures: 2.4 million customers have moved suppliers. That does not include the Bulb customers, who have had a special vehicle, basically, running them. The cost is £2.7 million, not including Bulb, which is £900 million so far, so it is significant. Bulb had 1.6 million customers, so that was a lot of customers affected.

I would be interested in your thinking on this. One other issue around Bulb is that all consumers have had to pay in their bills for the cost of these changes. According to the NAO, it is £66 on each bill, covering the period from, I think, April to October. Is that fair that, at a time when customers are really hit hard with their higher energy bills and other cost of living crises, they are having to pay £66 for the failure of the market?

Jonathan Brearley: It is worth reflecting what that money paid for. In September/October, the price of energy was much higher than the price-capped price was for customers in the market. The principal cost, 85% to 90% of that cost, was around buying that energy and giving it to customers at the price that everybody else was paying. It was something that absolutely needed to happen.

The second part of that cost was making sure that people got their credit balances returned to them. The third part, which was very small, was the administrative and wider cost you would see in the system, so it was necessary to spend that money. We spent a great deal of time with the industry looking at whether we could delay the impact on customer bills. Ultimately, that became part of the conversation with Government about how we mitigate the impacts against this. We have £66 this year. I think, Neil, next year it is the rest of £94, is it not?

Neil Lawrence: Yes, so we will see an increase. The difference between the £94 and this £66—

Q46 **Chair:** Let us be clear. Is there another £94 or is it £94 in total?

Neil Lawrence: No, £94 in total, sorry. That is all dependent on the true-up process. We receive a second batch of SoLR claims for all the SoLRs that went through last winter. That will true up costs. Again, our role as regulator is to challenge those costs and make sure they are fair, on behalf of consumers. We will go through that process again and challenge hard. The SoLRs that happened at the beginning of this winter were not included in last year's costs, so we will add those in from next April as well.

Q47 **Chair:** I wonder what the cost to those companies is of failure, if the customer and the taxpayer are picking up the bill. I know that there has been some discussion about ringfencing credit for customers, so it is protected. Our sister committee has looked at this with you, I think, as witnesses. I know that there are challenges both ways on that. It is not as simple as it sounds. On the other hand, it seems to me that the poor consumer and energy user has been rather squeezed in this and is having to cough up.

Jonathan Brearley: One change we are making is looking at ringfencing customer credit balances. We are in discussion with the industry now. There is a trade-off. We believe that we should be protecting customer money but, equally, we do not want the bar to be so high that new entrants or independents are unable to function in the market. That is something under active discussion with the industry at the moment.

Secondly, and equally importantly, is capital adequacy. It is saying to a company in the future, "Either you hedge, so you buy your energy forward at a fixed price, or you show us how you have access to capital to cover changes in the markets". Those are two of the fundamental parts of the financial resilience that we need to see in this.

One area we are looking at, again with BEIS, modelling ourselves on banking regulation, is what we do about shareholders and directors who have made money in the past. A conversation we would like to have is to think about the incentives on them. We would certainly be open to doing that.

Q48 **Chair:** That is a very important area to look at. You are looking at how customers are better supported. In terms of supporting customers as consumers making a choice about which company they buy from, most of us would not have known, when we were switching, which companies had a stronger financial model and which had a weaker. Even with a bit of work, it might have been quite hard to find out. Is there anything Ofgem is doing to protect customers at that point, when they are making an active choice to switch?

Jonathan Brearley: I will give a perspective and Neil may want to come in on this. I do not think that asking a customer to understand how financially resilient a company is will allow many customers to make different choices from the ones that they make. We need to put in place a series of standards that allow the customers to look across the market and know, not always, but by and large, that this company is resilient to a series of future shocks, a bit like banking. For me, it is about getting that balance right. I know from all the conversations I have had with customers, from consumer research we do, that it is a market that is still quite complex for many people to look at anyway.

Neil Lawrence: We have acknowledged that the supervisory regime we had in place, at the time that the market was opening up, could have been better. Since then, we have upped our game. We monitor a range of metrics of all suppliers in the market on a weekly basis. That includes their financials and the commercial offerings they are making to the customer. We look at hedging and a whole range of customer service metrics. As a regulator, we want to build confidence in the market, so that, when customers go to a new supplier, they are confident that that deal is going to be there and is going to last.

Q49 **Chair:** Are you looking at a dashboard, a traffic light system or something?

Neil Lawrence: It is more complex than a traffic light system because there is a lot of data.

Q50 **Chair:** Yes, for you, but what about if I am a customer, I am trying to switch and I want to see if this has resilience? Do I pay a cheaper price but get a riskier deal, or do I pay a higher price?

Neil Lawrence: There are no plans for a traffic light system to customers. That is not what we are proposing. I am saying that, internally at Ofgem, by monitoring all the suppliers and improving that supervisory regime, customers should have confidence that, when they switch in the future, they know that the supplier is bona fide and we know that the market is in good health. I must stress what Jonathan said earlier. We are in a very interesting situation this winter, with very high and volatile prices that we are trying to manage.

Jonathan Brearley: Thinking about the experience of the customer and the various things we are doing around that, this goes beyond the gas crisis and financial resilience. There are a series of kitemarks out there. There are a series of rating systems that already exist in the market.

We are clear that suppliers need to do everything they can to support their customers through this. We are running a series of compliance reviews that, basically, will look at aspects of the following things. We are currently running a review on direct debit setting, because that was raised as a concern to us in advance of the price cap being increased before. We are looking next at the way vulnerable customers are treated and to make sure that suppliers are doing everything they can to support vulnerable customers. Equally, we will be looking at a wider set of reviews that Neil can expand on.

Out of each of those, there will be three things. There will be enforcement action if we think that a company is too far away from where it should be. There will be compliance action, where we are asking for improvements, but those improvements are things we are confident can be put into train by companies that we are happy to see act in the way that they are acting. We will be making that sort of information public, so customers can make some choices around it.

Q51 **Chair:** This is all a lot of work for Ofgem.

Jonathan Brearley: It is a lot of work for Ofgem.

Q52 **Chair:** You have how many extra strands of work? You have just rattled some off then. You have the 29 suppliers that you have helped transfer. You have the deeper regulation of companies that you are looking at. You are looking exhausted, Mr Lawrence, at the thought. How are you going to do that with your current resources? The Treasury Officer of Accounts is in the room. Is this a bid for money from the Treasury or from BEIS, as the Permanent Secretary is next to you? Are you actually resourced to do this?

Jonathan Brearley: This may be the moment to mention that Neil was recruited and joined Ofgem in July 2021, so this was a different kind of job than he was anticipating at the time. We have put in a bid to Treasury. We think that we need more resources. It is worth outlining not just the financial parts of that but also the skills we need. It is a massive shift for a regulator to move from one where you have reactive monitoring of the market and you are responding to edge cases, to one where you are introducing something like the prudential regime in banking.

We spent a lot of time with the Bank of England and others to see the sorts of changes we need to make. We will need to bring in more financial oversight and financial oversight skills. We need to begin to build better systems to monitor so we are not doing this in the same way we are doing it right now. Equally, we need to increase our compliance teams, so we can handle the new sets of questions we are asking ourselves and our companies. Yes, there is a bid in Treasury. That is pending at the moment.

Q53 **Chair:** That was a good bid there. The final question from me is on district heating systems. A lot of us, including me, represent constituents who live in blocks of flats with district heating systems. I understand that there has been one breakthrough, where one housing landlord has gone and persuaded the energy supplier that, as it goes to individual flats and people have individual bills, they count as domestic customers. I do not know if you know about that one. There is a group of London MPs now working on this, so we will be writing to you separately about that.

They have had a really rough deal. I should declare an interest, because I have such a district heating system, but it is not about me at all. It is about many people with bills that have gone up 700% and really high prices. What is Ofgem doing to support them?

Jonathan Brearley: We do not have a price cap in that part of the market. In the energy Bill that BEIS has recently introduced into the House, we are building a new regulatory regime for district heating. Part of that will be looking at regulation of price, as well as service standards and other aspects. I am happy to expand on our thinking, but it is a regime we need to build for a growing customer segment.

Q54 **Chair:** Sarah Munby, when the Minister responded to this in a recent debate, there was a lot of talk about what is going to happen, which I think we would all acknowledge is a good thing, as beginning to tackle it. There is no support for now for some of those customers caught in a really difficult situation, especially if it is on top of things like cladding issues and so on that some of them will be facing as well. There are a lot of costs at the moment for some of those people. Is there any hint or prospect of a short-term solution to support them?

Sarah Munby: I would have to go back to what I said earlier about the broader picture of Government support. There is not going to be a quick solve through the energy market.

Chair: I will let you off the hook on that one, because we had a detailed debate about it only recently with whichever Minister it was. I cannot remember whether they are still there—probably not. We will lobby the new Minister when they are appointed.

Q55 **Sarah Olney:** I want to explore the price cap a little further. In relation to these supplier exits that we have been talking about, Mr Brearley, when you were in front of the BEIS Select Committee in February, you said that the price cap was a factor—not the only factor, but a factor—in the large number of supplier exits we have seen this year. Can you explain that a little more? What impact did the price cap have?

Jonathan Brearley: If you imagine yourself as a company in any market, with the huge change in input costs that you have seen, your natural response would be to increase your prices. By definition, the price cap prevents you from doing that. I need to emphasise what I said earlier. That is a huge benefit for customers and has made a massive difference over the last six months, in terms of being able to manage and stagger the rises you have seen. If you are a company in financial distress, that has been a factor in your insolvency.

In terms of the design behind the price cap, the issue was that our ability to update it, with that new market change, only happens once every six months. That, in itself, meant that some of those countries that were under stress were unable to adapt their pricing and therefore unable to survive.

Coming back to the main drivers of this, though, when you look at those early cases, quite often those were not companies with contracts at the price cap. Those were companies issuing fixed price contracts and then being unhedged if the market turned dramatically against them. Go on later into winter and you see that the price cap was a factor in some of the later insolvencies.

Since then, we have made some changes to the price cap to allow us to adapt it more frequently. There is a really hard judgment we still have to make, but we have set out a minded-to position that says, rather than change it every six months, we will change it every three months. That allows the price cap to adapt to the market. That means it changes more frequently, but that means more changes in prices for customers, which some customers welcome and some customers really do not like.

Q56 **Sarah Olney:** Am I right in thinking that the price cap that is going to come in in October is going to be £3,200? Is that right?

Jonathan Brearley: The last estimate we gave was to the BEIS Committee. That was £2,800. Given the pricing dynamics we are seeing and the ongoing impact of the Russian invasion of Ukraine, it is clear that there is the positive pricing pressure there, so prices are looking higher than they did when we made that estimate. We do not give ongoing commentary until we make our formal announcement.

Q57 **Sarah Olney:** When will that formal announcement be?

Jonathan Brearley: We will announce the level of the price cap towards the end of August.

Q58 **Sarah Olney:** Imagine that it is in the region of £3,200. It may or may not be, but it is going to be higher. We know that it is going to be higher than now. What more can be done to help individuals and households keep their bills low, do you think?

Jonathan Brearley: I will talk about regulation in the industry and perhaps Sarah can talk from a Government perspective. All of us recognise that we are going to have to do everything we possibly can. With the industry, that means making sure that it goes above and beyond the rules we set for vulnerable customers. That means understanding your customer group, knowing when there are other stressors that your customers show when there are signs of financial vulnerability and making sure your systems and processes are working, you are setting your direct debits at the right level and you are managing this on behalf of the customers that we all serve. We have ongoing conversations with the retailers about that.

The scale of this is genuinely beyond anything that we have seen and beyond anything that the industry on its own and the regulator on its own can address. That is why Government have taken the action that they have taken. Ultimately, it is a question that I think Sarah might pick up from there.

Sarah Munby: The Government have already shown that the cost of living package has been adjusted in response to learning more about what the movement of the price cap is likely to be. It is clearly going to be a matter for Ministers whether they continue with that process.

The thing that makes this so challenging is that there is not really a solution to the rising cost of energy that is not one that asks for further funding, either generally across the customer base or targeted at vulnerable people in the customer base. This is a problem that is fundamentally caused by a really significant increase in global energy prices. We should absolutely optimise things like the price cap and the details of the regulatory approach in the way that works best, but none of them is going to, at heart, address the challenge. That is why we have a £37 billion cost of living package already in play.

As we see what happens to further evolution of prices, I can well imagine that Ministers will want to keep a close eye on the question of whether any of that goes any further. That is the primary lever, because there is not a quick fix to make the energy cheaper. You have to help people be able to pay for it.

Q59 **Sarah Olney:** On that, is there anything further than can be done for businesses, which of course do not benefit from a price cap and are also facing rising bills, and local authorities? I am speaking to a number that are saying that they will not be able to afford to heat swimming pools this year. Beyond households, is there anything more that can be done for other types of customer?

Sarah Munby: As you can imagine, that is true right across the public and private sectors. Every business or organisation that uses energy is subject to these price increases. It is probably fair and appropriate to say that you need to be a little bit careful about compensating everybody from the public purse. We are just moving money around the economy here, if you see what I mean.

On businesses, the group that we pay most attention to, although it is clearly an issue for everybody, is those that have particularly high levels of energy use—what we tend to describe as the energy-intensive industries—where energy is a really significant component of their input cost. They are typically internationally competitive, so there is a risk of companies leaving the UK if others go further than us. We have made really quite significant commitments, including extending the energy intensive industries support scheme for several more years and looking more closely at what we can do to try to bring industrial energy prices in line with international competition.

Sarah Olney: This is a slightly provocative question, but what currently is the point of the price cap? It is not managing down bills for consumers at a price that most can afford, as we know. It is also not promoting competition. Everyone is charging at the level of the cap. There is no price competition in the market. What is the point of the price cap?

Jonathan Brearley: Let me take you back to the situation in 2015-16. The price cap has an in-built margin of around 2%. It is designed to reflect fair costs but to reflect no more than those fair costs. In the market we had before, we had some companies charging up to 8% margins on top of the costs. Think about what would happen to customers' confidence right now if they were being charged an 8% margin over and above the costs that we see in the market today. Many people do not switch even in a fully liberalised and free market. Those customers would pay much more for their energy than they are doing now.

I am strongly of the view that we need some form of pricing regulation. We need to continue to adapt the price cap to the changing market. When we get to a net-zero world, we may need to think again about how it is structured. Ultimately, that has given a huge amount of reassurance to customers that, although we cannot offset the change in the price of gas or the price of electricity, they are not being charged unfair profits over and above that. Indeed, the sector is still in a position where a lot of the margins are zero.

Q60 **Sarah Olney:** When you were designing the price cap, did you consider this scenario where very high wholesale prices would effectively squeeze out competition and increase household bills beyond what many people would be able to afford?

Jonathan Brearley: We did envisage there would be changes in wholesale costs and we did put in place what we thought were a set of mitigations. Particularly, we thought that in extreme circumstances we might be able to reduce the enforcement of the price cap. Those mitigations did not think about two things: the scale of the change that we have seen and, indeed, the situation we were in last winter.

The idea of the regulator not enforcing pricing regulations simply was not credible when faced with the winter that we had, but it is one that we looked at. We looked at the design of the price cap in the first place.

We have now done two things to address this. First of all, we have more frequent updates to the price cap. Secondly, we also have a procedure you can follow that says, "If the price cap is too far away from the market, we have a structured process to reassess what the price should be in the future". In absolute extremis, we can adapt the price cap even if the market is more volatile than we envisage.

Q61 **Sarah Olney:** Going forward, my understanding is that the price cap was intended to be temporary and was due to finish next year or the year after. Are you in favour of keeping it or extending the life of the price cap? If so, what changes do we need to make?

Jonathan Brearley: For me, pricing regulation is incredibly important. I have been in this market for 15 years, and I have seen the reduction in consumer confidence you get when there is nothing there to protect customers, particularly at a time like this. I look across at markets in other countries, and I see real concern from customers there around the changes they have seen and whether they are getting value for money. We have already adapted the price cap to adapt to the market circumstances that we have. It is not going to be perfect as we go through such extreme changes as we are seeing.

It really, then, comes to a question about future retail market design, which I am sure Joanna will want to pick up in a moment. At that point you may want to think again not only about the need for pricing regulation—you may well need it—but about what forms of it you might need in that new world where we are relying on much more flexible tariffs, the use of electric cars and the use of heat pumps, all of which point to a different way of charging and using our energy. Perhaps Joanna wants to pick that up.

Joanna Whittington: As part of the energy White Paper a couple of years ago, we set out our overall thinking about a strategy for the retail market and then we published a more detailed document in July 2021. We are looking again at that retail market strategy with a view to refreshing it and publishing it after the markets have stabilised.

The sorts of things you would probably expect to see in that would be an aspiration for a stable and resilient market. That is very much building on the lessons that have been learned through the last couple of months. I very much support the work that Ofgem has done already, but I would question whether we should go further.

Sarah was referring earlier to the tension about making sure that "stable and resilient" does not crowd out the consumer protection effect that competition can have not just on price but on service. The quality of service has historically been a really big issue.

The third thing that is really important is bringing in innovation. The energy supply businesses sit at that interface between the energy system and the consumer. When we look at the delivery of net zero, we want a system that is prepared to innovate, to bring forward new products, potentially to invest in those products and to offer new services so that overall we end up with a system that is secure and resilient but also flexible and least cost.

Our intention is to say something before the October price cap on the plans for developing that strategy, with a view to publishing something once we are clear that we are in a confident and stable position.

Sarah Munby: Just while we are on the slightly longer term, it is worth giving a brief plug for the real underlying solution to the challenge we are talking about today, which is the longer-term transformation of our energy generation system away from gas and, therefore, a dependence on global price volatility towards domestic and renewable sources of electricity. If you are asking what the deep solution to the problem is, it is what we have laid out in the British energy security strategy and so on about transforming the generation system into one that is less vulnerable to shifts in the global price of gas.

Q62 **Sarah Olney:** Since you mention it, I am aware that in the Chamber right now they are talking about the windfall tax, as we are not calling it, or the profits levy Bill. You say you are able to offset profits that otherwise would be liable to the windfall tax by investing in oil and gas, in fossil fuels. Is that right? I am assuming this is a Treasury thing rather than a BEIS thing, but does that not slightly contradict what you have said there?

Sarah Munby: Yes, it is a Treasury question, I am afraid.

Jonathan Brearley: Can I build on what Sarah was saying about how we get out of this? Strategically, the reason why our consumers are in the situation that they are in is principally our dependence on gas and the international gas markets that we have.

I just want to put some numbers around what Sarah is describing. The Department auctioned offshore wind last week. We pay roughly £40 per megawatt hour for electricity from offshore wind. It is over £200 in the market today, because of the reliance on gas. When we think about the future of retail and we build that strategy, we want a retail market that can cope in a world where we have more renewables and more storage, and we really are asking customers to buy and sell their energy in a different way. In Ofgem's view, that is the way in which we will build ourselves out of the situation we are in.

Q63 **James Wild:** I just want to talk a little more about the lessons learned from the supplier exits and how we move forward from here. Citizens Advice has said that Ofgem allowed unfit and unsustainable energy companies to trade with little penalty, which we have covered a little here. How are you going to ensure that the reforms you have talked about—and it would be good to clarify which are in force and which are proposals you are consulting on—will make a difference to how you regulate suppliers?

Jonathan Brearley: I will ask Neil to come in on the detail, but the central part of it for me is, first, capital adequacy. Do you have enough money or enough risk management in your business to make sure you can survive a much wider range of scenarios?

Secondly, we are applying a fit and proper test so that people who have been involved in the market and who did run some of those business models that were not responsible are not able to come into the market again. Thirdly, we have a series of compliance reviews that make sure that companies are treating their customers fairly according to the rules in a number of areas. In terms of where we are, we are enforcing against those rules already.

On the rules that are being developed and under consultation, I made the points about moving to the prudential regime and ring-fencing customer credit balances, customer money, as well as the renewables money. Those are things that we are discussing with the industry at the moment.

Neil Lawrence: To add a few examples of things we are already doing while we wait for consultations to finish and to enact that, we have issued the first version of a stress test. Version 2 of the stress test will come out before this winter, so we can be confident about the level of resilience that all suppliers in the market have.

We mentioned the compliance reviews. There is a market-wide review of "fit and proper", to make sure we are absolutely certain that everybody in this industry has passed that test and, indeed, that suppliers are following the rules. There are also further market-wide compliance reviews on things like risk management. Those reviews are really invasive; they are a really good tool, because they are aiming to drive standards up across the industry, which is what we want to do on behalf of consumers.

Q64 **James Wild:** How does that capital adequacy approach compare to other European markets and the requirements that exist there?

Jonathan Brearley: Most European markets do not have the same sort of retail market that we do. A lot of companies are vertically integrated. Indeed, a lot of companies are either state-owned or price-regulated from the top. They do not have the distinction between the two markets that we do. The best benchmark I can find is the banking sector that we have here. That has the same kind of structure and some similar risks.

There is one thing I need to emphasise, though. We have talked a lot about the things we are doing both to enforce and to redesign the regulations. We are still in the middle of this massive change in costs that we have seen. It is going to be a balancing act for the industry to recapitalise at a time when costs are going up and customers are under a great deal of pressure. We are going to need to adapt to make sure that we do not inadvertently push companies out of the market and therefore cause customers more cost while, equally, keeping a tough and resilient regime in which we move the market, as best we can, from where it is today to one that could survive shocks more broadly.

There are some big trade-offs there. For example, we issued a provisional order to a company to say, "You cannot take on new customers and you cannot pay your shareholders until you change". If they do not change, the only option for us is to take their licence away, which will cost customers some money but less money than leaving them to trade in the market.

Q65 **James Wild:** On the trade-offs, you have resilience, competition, innovation and different things. Is Ofgem geared up to do this? Looking at the Oxera report, it raised concerns about silos and frictions within the organisation on information flows to look at the trade-offs. What changes have you made in response to that report to do that work?

Jonathan Brearley: There are three areas. Chair, you mentioned risk management, for example. We are looking not only in retail but across the board at what are the more extreme edge scenarios, and we are wargaming those much more intensively than we used to.

Although we were doing cost-benefit analysis policy-by-policy, Oxera did not feel we had a robust enough framework to draw out the trade-off, for example, between competition and innovation. Last week, as part of a piece on market reform, we set out our view of what those trade-offs should be and how we were going to assess them. That becomes one framework across our regulatory piece that allows us not to look at an individual policy but the policies as they aggregate together.

We are designing a different operating model that reduces the silos and makes sure that, in a sense, we build in collaborative working as part of the way we run ourselves. That is ongoing.

Q66 **James Wild:** In the face of the number of failed companies, inevitably there are calls for massive new regulation to come in. How are you going to guard against that kneejerk call for regulation that may well be over the top? We have had this black swan event in terms of energy prices going up. Do we need to completely change the thing? Moving to the financial services regulation you are talking about sounds to me like quite a heavy-handed approach to regulation. Is that actually justified? How are you balancing that out?

Jonathan Brearley: This is an ongoing conversation we have with our board. What I say to them is that this is not something you design and leave. You need to put the limits in place that you think you need for the market today and see what impact that has. Is that addressing the financial resilience problems that we have seen? Equally, if we find that nobody enters the market or that the independents are not able to survive in this market, we will need to change and adapt the regulation over time.

That is why the wider framework, this thing we published last week that sets out our goals and objectives, becomes a really important tool to make sure we are testing ourselves and to make sure we are not only delivering on one objective but looking at all the objectives across the piece. In that way, I expect us to develop what we can see. To emphasise, I, my board and the industry do not want a sector that is so regulated we do not see change. We cannot afford that.

Q67 **James Wild:** One of the companies that came into the market as a challenger, Octopus, has given evidence to us on your approach on ring-fencing. It is very critical about what you are proposing to do. It estimates that, if you took an arrangement similar to ATOL or the Financial Services Compensation Scheme, the cost to consumers of putting such a system in place would be seven to 15 times less than what you are proposing. How do you respond to that?

Jonathan Brearley: It is probably known to this Committee that this is a matter of huge controversy across the industry. There are others who are saying that we should be doing this immediately.

In a sense, the way we are thinking about this is twofold. One is to protect customer money and make sure it is not disappearing and having to be replaced by those of us who pay our bills in the future. The second, which is equally important, is to look at the moral hazard in the market and make sure that, if you are a small supplier coming into the market today, you do not have this incentive to keep growing. By keeping growing and offering low tariffs, you can survive as long as you grow long enough.

Oxera said to us that this was one of the factors or one of the models that contributed to the failures we saw last year. We have published our analysis that says that, by and large, we think this is a cost-effective measure. We have asked the industry for what the alternatives could be, but this is a really good example where we are going to have to get that balance right. That is why we are consulting rather than simply putting the rules in place.

Q68 **James Wild:** When would you expect to take decisions on that?

Jonathan Brearley: I would expect to do that early in autumn this year.

Q69 **Chair:** How long will it take to kick in when you make a decision on that?

Jonathan Brearley: We have statutory timetables. You need to consult statutorily and then the decision has a 51-day standstill period. It would be early next year.

Q70 **Chair:** In the evidence that Mr James Wild referred to, Octopus says that it estimates that the impact of implementing this policy—that is, ring-fencing on credit—will drive up the annual customer bill by around £15. That is on your mind.

Jonathan Brearley: Yes, absolutely. Just to step back out of that example, we need companies to hold more capital. That does mean there will be a pressure on bills, but the counterfactual is the cost of failure that we have seen. We need to get the balance right between the two things. I should emphasise that one of the things we asked the industry about was transition. This may not be introduced fully on day one; this may be a transition over time.

Q71 **James Wild:** Another one of the proposals you put forward is the market stabilisation charge. Again, Martin Lewis, the MoneySuperMarket expert, has been highly critical about that. We are looking forward to that hopeful time where wholesale costs drop a lot so that this would actually kick into play. Are you worried that you are overreacting to a scenario in a way that in the current circumstance seems reasonable but in the longer run could act against competition incentives?

Jonathan Brearley: No, I am not worried in this case, because of the situation we are seeing before ourselves. We talked about a rise of six times the normal price last year and 10 times the normal price today. We are seeing prices in the winter market that we have never seen before in the industry. That is already baked in.

In those circumstances, you broadly plan against three different scenarios: first, where prices get even higher, where the market gets tighter; secondly, where you stay roughly where you are today but you have volatile prices; and, thirdly, where prices drop dramatically and go back to the level they were before. It may feel unlikely, but let us say there were an outbreak of peace in Russia-Ukraine and the trading circumstances unwound.

The best thing we think companies can do for their customers is to forward hedge now, locking in the prices in the market so we do not expose customers to huge increases later on. If they do that and you enter that third scenario of prices falling, that is going to be a huge challenge to their financial resilience. To say to companies today, "You need to hedge", which is what we are doing, we had to put in the market stabilisation charge. That says that we are going to allow this market to transition back to normality over time, knowing that it will not put them at risk of failure.

Although I know we have had criticism from Martin Lewis—some quite direct criticism to Ofgem—Martin has not looked at the whole piece. The trade-off here is not between a world where you have the stabilisation charge and a world where you do not; it is a world where you have more failures than you need and, therefore, more cost.

Q72 **James Wild:** You mentioned hedging. At the moment, when companies go into insolvency, administrators can monetise the hedging contracts that companies might have, but none of that flows beyond the creditors. What changes are you looking at to prevent the shareholders of those businesses benefiting from that when it is the taxpayer who is picking up the costs of a lot of this?

Jonathan Brearley: This is a matter of concern for us. We have put forward as part of our package of measures two regulatory proposals that would potentially require companies to put in place trust arrangements that would allow the money from those hedges to transfer over to a supplier of last resort.

I have to say—we have made this point clear publicly—that we are testing those out, and they may not work. If they do not work, we may need to look towards legislation to resolve this. I would like to see any asset left in a residual company having a call against it, if customers are paying somewhere else for the residual cost of that failure. Ultimately, we would like the supplier of last resort, the company that picks up those customers, to be a creditor to the administrator and to be able to challenge other creditors for those assets.

Q73 **James Wild:** Could you do that within your existing powers? As that goes into insolvency, would it require legislative change?

Jonathan Brearley: We are testing our existing powers. If they do not work, we do think we need legislation. We think this needs to be fixed.

Q74 **James Wild:** Mr Lawrence, from your perspective, what does healthy competition look like in this market? How many suppliers would you like to see? What rate of return would you like to see them earning?

Neil Lawrence: That is such an open question. What we really want is competition for consumers. The number of suppliers really is not the metric. It is about the outcomes that are being driven for consumers. If we look at the framework we have outlined, are customers getting fair prices? Are we driving that transition to net zero, whatever the market looks like in the future, from where we are now? Are the quality and standards right in the industry?

Those are the metrics we need to look at. It is not a numbers question. It is difficult to comment on or guess at the number, given the situation we are in today and where we may transition to.

Jonathan Brearley: Something that Oxera said to us, which has changed our approach, is that there was a focus on switching as the metric for energy to see how healthy the market was. We need to be broader in the way we assess our market arrangements, including the financial resilience of the market, and to think not only about price but about service standards and other things for those customers who do not move very often.

Part of that is this transition we are in and the work we are doing to change the price cap and run the compliance reviews, and part of it is the retail strategy that Joanna outlined earlier.

Q75 **James Wild:** How are you going to ensure that you continue to get innovation into the market? How is that going to be factored into your trade-offs of wanting to encourage new models and net-zero-related business models?

Jonathan Brearley: It all comes back to the adaptive nature of the framework we put in place. We have to make sure that we continue to get entry, that we are seeing competition between incumbents, and that we are allowing a market to develop new and changing tariffs, coming back to where we started, that allow people to get the rewards for using their energy at different times.

We want to set up a set of monitoring arrangements that not only looks at the financial resilience of the companies but allows us to test those other things as well. We are not talking about setting up a system and leaving it rigid. It is one that needs to change and adapt over time. As we get to that future world, given the sorts of tariffs we have and the sorts of things we are going to need from this new market, yes, I believe there will be pricing regulation, but it may look quite different.

Q76 **James Wild:** What steps and what action have you taken against businesses that have been holding excessively high direct debit levels and requiring excessively high direct debit amounts from customers? Have you taken enforcement action against them?

Neil Lawrence: Yes, absolutely. We had a market-wide compliance review off the back of our own data that showed there was concern on direct debits earlier this year. It was an invasive review. We looked at the arrangements that every supplier had in place across their management control framework to make sure they drove the outcome for customers as well, looking at the data underneath direct debits.

We have completed that review. We will do an announcement shortly in the public eye, but all suppliers have been contacted. We have a range of suppliers that are in what we would call the enforcement zone. There are two that we are going to take through to enforcement action off the back of it. We have a range of suppliers in an amber zone. They have to give us improvement plans. They have to go and check all the direct debits and the increases that are excessive, and show that they are really within the bounds. We will keep monitoring that.

That shows the power of this review. It has caused a lot of angst with suppliers, but we believe it is the right thing to do on behalf of customers to push the standards up in the industry. It has been a really successful exercise at this point.

Jonathan Brearley: We will be making an announcement in the next few days.

Q77 **James Wild:** Protecting consumers is at the top of your statutory objectives, so it is a bit concerning to read the advice from Citizens Advice where it says that Ofgem has repeatedly failed to act on information provided by Citizens Advice on consumer experience and evidence of potential licence breaches by suppliers, particularly around telephone support and billing. Am I wrong to be surprised that less than 40% of Ofgem's compliance and enforcement cases over the last three years focused on consumer experience?

Jonathan Brearley: The *Market Meltdown* report that was released last year highlighted a set of things that we think are really important. We have made a set of changes as a result of Citizens Advice's evidence and, indeed, the evidence we have seen in the market. We talked about that around financial resilience.

There are some areas where I do not agree with them, and one area is the number that you quoted. The other area is the success or otherwise of Ofgem's compliance and enforcement regime. There are two metrics that I would look at. The first is the level of fines we have issued across the industry over the last 10 years, which is significantly higher today than it used to be. Secondly, we need to remember that the retail market is one part of this market. We also need to enforce against network companies—I will come on to some examples around that—and generators that are taking money unfairly out of the market.

Yes, we have a range of compliance and enforcement cases. When you have the residual impact of Storm Arwen, when you have customers left off power for nine days, that in my mind is as important as some of the retail issues we have seen. There is more to do, particularly if we are going to monitor supplier financial resilience, but it is an area where Ofgem has to focus across the market rather than on one particular part.

Q78 **James Wild:** Mr Lawrence, you talked a bit about the enhanced monitoring that is now in place. What is that telling you about the current state of the market? Should we be prepared for further companies to go bust?

Neil Lawrence: It would not be right for me to speculate in this forum on who is going to exit the market. Jonathan has already said that we are still facing a period of high and volatile prices, way in excess of things we have seen before. We will utilise our monitoring to monitor companies, but we know the risk is high.

Q79 **Chair:** Can you just remind us how many are left in the market?

Neil Lawrence: There are 26 domestic suppliers left in the market. That is the total number.

Chair: That is including the big ones.

Neil Lawrence: Yes, a small number have a significant market share.

Jonathan Brearley: It is worth making that point. We are not out of this yet. On a retrospective look at last winter, we are still in this change. We have all our enforcement and procedures ready and in place, but it is still a challenging market. It is quite possible that we see further exits.

Q80 **James Wild:** What can you do if you discover there is another Bulb out there or another business that has an excessively risky approach? What can you do to prevent their demise? Can you do nothing?

Jonathan Brearley: There is a series of things you can do. First, we talked about the monitoring and compliance reviews that we run and the stress tests that we run. Secondly, you limit the activity of that company when you find out it has a problem. We have issued orders that do that. Thirdly, you can work with that company to understand the impact our wider regulations are having on its finances. There may be things you can do, such as looking at the time it takes to transition to the new regime.

Fourthly—this is really difficult—if we do not think they could survive, if we do not think they are going to stop taking unnecessary risk with customers' money, ultimately we have to take their licence away.

Q81 **James Wild:** How many of those 26 have a customer continuity plan in place?

Neil Lawrence: I will have to give you the exact number on customer continuity plans. We are doing the customer service market compliance review to look in detail at those plans. The binary, whether they have one or not, is not the issue here. It is about how good it is and whether it will stand up to scrutiny.

Chair: You are making sure it is not just a tick-box exercise.

Neil Lawrence: Yes, exactly.

Q82 **James Wild:** Clearly, the number of companies that have failed has created problems for the existing suppliers around transferring. What are you going to do if there are further failures and other suppliers are not prepared to take on customers?

Jonathan Brearley: As was mentioned in an earlier part of the session, we have the powers to compel companies to take on customers. Part of the criteria for that is about being mindful of the situation both operationally and financially for that supplier. In a sense, we have found during the SoLR process that suppliers have come forward. We have had a very constructive relationship with the industry about sharing the operational burdens of some of the failures we have seen. We have a good relationship with the main suppliers. We are working closely with them. Ultimately, we do have powers to mandate if we think we need them.

Q83 **Chair:** Presumably it is the biggest suppliers that can absorb people more quicky.

Jonathan Brearley: Yes, operationally they are much more capable of absorbing people.

Q84 **James Wild:** You have powers to compel, but you may decide you cannot do that because they cannot financially take it. Ms Munby, what provisions do you have in place and what agreements do you have with the Treasury for additional funding, if they have to use the administration regime?

Sarah Munby: Ultimately, exactly as you say, just to be clear, if it was not possible to make the supplier of last resort process work, exactly in the way we have done for Bulb, we would be into the world of a special administration regime. We are not currently expecting to stand up that process.

Jonathan Brearley: It is worth saying that the close working between Ofgem and BEIS over the last six months has meant that we both make sure risks are highlighted and understood. We have been working to make sure that, if there is an event, we are ready for it. That is what we did with Bulb.

Q85 **James Wild:** Just to clarify, Ms Munby, you said you were not expecting it, but are you preparing for it?

Sarah Munby: We have just had an excellent drill, so we are feeling pretty prepared.

Q86 **James Wild:** That is confidence. To finish up on the funding points that were raised earlier, figures provided from your annual reports by the NAO highlight that the budget has gone up from £59 million in 2016-17 to £76 million in 2020-21. You talked about putting in a higher bid. You are funded by the companies you regulate, so ultimately that is a cost that will go on to consumers. Could I just clarify that you were talking about increasing the costs to those businesses rather than asking for a separate funding pot from the Treasury?

Jonathan Brearley: The funding for the financial resilience measures that we would ask for is regulatory funding, so it would come from the levy that we charge across the industry. It is worth noting that a large part of our budget is directly funded from Treasury. That is around administering Government schemes.

Q87 **Dan Carden:** Could I just return to the issue of the price cap? Mr Brearley, you explained very well that it was originally brought in to regulate the energy suppliers and make sure they were not topping up their profits unfairly. It was not brought in to cap energy bills. If it had been brought in for that, it certainly would have failed. The cap for the average bill would have gone up 78% since the winter of 2018-19. Has anyone in the Department thought about a price cap that is a cap on the bills that families pay in this country? Has such a cap been examined by officials?

Joanna Whittington: Ofgem put in the price cap following the decision to legislate. At that time we looked at what was the best way of creating something that was effective and sustainable in the market. What has happened is the global price of gas has increased tenfold. If we were to just introduce a price cap, we would create a crisis elsewhere in the system. We would be able to afford to buy the gas on the global market that is necessary to heat our homes and keep the lights on.

Q88 **Dan Carden:** I am interested in a price cap on the amount families pay for their gas and electricity. Today we are debating a windfall tax in the House of Commons. It does seem that there is a disconnect. While the wholesale price of energy is affected by geopolitical events, it is also affected by the enormous profits of the oil and gas giants. Shell made £7 billion profits in three months; BP made £5 billion profits in three months this year. The price cap, as it is currently designed, has no linkage to that. Could there be a price cap that factors in and links to the profits that are made in that part of the process?

Jonathan Brearley: Right now, with the legislation we have, that is not practicable. We need to reflect the cost paid by the company that buys the energy. That is the cost it gets from the wholesale market, which is set by that international price.

Q89 **Dan Carden:** Ofgem regulates the suppliers, but have Government looked at this? It seems so disconnected. We are considering a windfall tax in the House of Commons right now so we can pay back some money to families who are paying extortionate amounts on their bills. We have an energy price cap that rises with the cost of energy. Either we should stop calling it an energy price cap, because it is nothing of the sort, or we should redesign a proper energy price cap.

Sarah Munby: The specific proposal that you are describing, which would essentially mean that people only needed to pay up to a certain level, would be an almost complete reinvention of the way our energy market works, including a massive step back for the role of competition in driving service improvement and innovation. We have not done any work on that.

As you can imagine, we are looking at a whole series of different possibilities for how we move forward with the energy market to work on what you are talking about, but not that specifically.

Q90 **Dan Carden:** I am not sure I buy the argument about the market. Perhaps this is a question that would be more suitable for Ministers. As you have already outlined, there is a £30 billion package of welfare support to help people pay their bills and to sustain themselves through this cost of living crisis. There is no market. It is utterly broken. People cannot afford £3,000 energy bills each year. Is it not time to redesign the cap and make it cap energy prices?

Jonathan Brearley: Perhaps it is worth just explaining how we are thinking about this in general. We have the price cap; it reflects the cost. We work with the Government on the measures that we have, including the £400 discount, because we recognise that ultimately the market prices out there have risen in a way that is unprecedented.

In a sense, we have separated the two things. We have to run the price cap we have, but the Government have put in place a series of measures that offset that cost for families directly through their energy bill, which is a way of making sure we mitigate those rises as best we can.

Joanna Whittington: There are two sources of potential revenue. There is the billpayer and the taxpayer. Traditionally the energy system has—

Q91 **Dan Carden:** There is another source that is being looked at in the House of Commons right now, which is the profits of the energy giants.

Joanna Whittington: Those would go into a taxpayer source of income. Traditionally, the energy system has been paid for by the billpayer. That provides the right incentives at the margin for people to use less energy et cetera, but in the current environment, where prices have increased so radically, there are lots of things that we would want to look at again.

We are looking at how we can take ourselves off a system where we are dependent on global gas prices through the investment in renewables that we have talked about. Some of the other things we talked about are the short-term measures around intervening this winter. The energy system is part of a broader system and Government have made a number of decisions—

Q92 **Dan Carden:** The Government are failing on that as well. As was already pointed out by my colleague, companies can avoid paying the windfall tax if they are investing in oil and gas projects.

Sarah Munby: That is correct or at least they can offset—

Q93 **Dan Carden:** It goes against what the Government say their proposal is, which is that they should be investing in solar and green energy.

Joanna Whittington: In parallel, we are investing in carbon capture and storage. Investment in domestic oil and gas is a transition to carbon capture and storage. That is another technology that would generate jobs and opportunities in the UK and potentially internationally.

That then creates the opportunity for other new markets around blue hydrogen and from blue hydrogen potentially to green hydrogen, which is going to be such a critical part of the future energy system we have been talking about, one where homegrown energy, the use of renewable technology in particular and perhaps green hydrogen, will have such an important role to play in taking us off the global gas price.

Dan Carden: It is a long way off.

Q94 **Chair:** That is the thing. There is a strategy, but waiting for gas prices to go down is—

Joanna Whittington: That is why I said that the Government have also made a choice to intervene today with the £400 payment. It is a combination of measures. Changing an energy system in response to this crisis is a long-term problem.

Q95 **Dan Carden:** It is right that the design of the price cap is not what people think it is. Perhaps it might be worth, at this point in time, renaming it something that is not a "price cap", because it is nothing of the sort.

Joanna Whittington: Yes.

Chair: It was always predictable that people would charge up to the cap.

Q96 **Olivia Blake:** I have two brief questions slightly related to what we were just discussing. When do both of you envisage that there will be an uncoupling between the cost of electricity and wholesale gas prices? You mentioned that we could move away from that, but how likely is that in the next 10 years, for example?

Joanna Whittington: We are looking at the appropriate market arrangements for electricity, in particular as we invest in technologies that have high fixed costs and low variable costs, which is renewables and nuclear compared to gas CCGTs. Our intention is to publish a consultation shortly to raise some of these issues.

We have in place a set of market arrangements. We introduced in 2013 a capacity market and the contracts for difference. As we move to a system that is incredibly renewables-centric, the question is about how those arrangements evolve so that consumers are paying properly the cost of production but the system is also operable. One thing that I am sure we will talk about at some point in the future is how you operate a system that is 70% renewables, or thereabouts, and how you get the right additional market signals around flexibility and balancing to make sure it is secure.

Q97 **Olivia Blake:** Just to follow up, given its scarcity and the cost to create it, could hydrogen fall into a very similar trap as gas prices? Could you have the same situation, perhaps?

Joanna Whittington: It is definitely early days with hydrogen. There are a lot of opportunities domestically to build on the infrastructure we already have and to reuse and re-purpose assets offshore to pipe, transport and store hydrogen. The next piece is to make the transition from blue hydrogen to green hydrogen. Our huge opportunity in terms of renewables provides the chance for us to be exporters of hydrogen in due course, so perhaps a beneficiary rather than an unhappy recipient of global prices.

Jonathan Brearley: Joanna has summarised it exactly right. The only thing I would add is that those contracts for difference, those renewable contracts, have already delinked the price of electricity from gas. One of the remarkable things is that renewables that seemed expensive five years ago are now paying back to customers and reducing the price cap.

Q98 **Olivia Blake:** Is it a problem that contracts for difference have not utilised the full availability of already approved projects?

Jonathan Brearley: That is really a matter for the Department.

Sarah Munby: Do you want to take that one, Joanna?

Joanna Whittington: A contract for difference is a private contract. We are very keen to make sure customers feel the benefit of the low prices of renewables as soon as possible. We have spoken to companies to make sure they understand how important we think that is.

Q99 **Mr French:** I will follow on a similar theme. I am going to ask the same question to both Ofgem and the Department, if I may. There is this shift in the power price market from the US dollar gas price to more of a renewable focus. We can see we are in a transitionary period, and this is not going to be an easy transition. How are you going to manage that shift?

I will go to the Department first. When I ask about managing, I mean not just monitoring but managing the interests of investors, on one hand, who have signed up for a 15 or 20-year contract on a feed-in tariff or a CfD, and moving it forward to something that is not just going to be linked to the gas price. How are you going to manage that and maintain investment in the UK energy market?

I would put a second question to Ofgem on that. How are you going to monitor that from a regulatory perspective?

Joanna Whittington: You are absolutely right. We do not want to disrupt the high levels of investment that we are already seeing, recognising that we have mechanisms that we know have worked really well and have been adopted internationally.

The most important thing is to do consultation so we properly understand the needs of future investors and they can see the opportunity to make money by creating a stable environment, which we have been successful in doing previously. That is why speaking to the industry and speaking to investors is a critical part of any development to revised electricity market arrangements.

Jonathan Brearley: With BEIS, we will monitor the supply base in the market. As Joanna said, the regime that is in place has been very successful to date at getting investment in. There are three other things that we need to do. First of all, Ofgem needs to make sure the network is developed fast enough so those projects are able to connect in quickly. We are working particularly with the transmission companies to do that based on a national plan.

Secondly, we need to create and build this world of intermediaries—people who can make the most of the fact that, if you give them a smart charger, they will get a certain discount on their bill and offset the cost of the charger against that.

Thirdly, I come back to the design of the retail market. If you think about the transition as a whole, a lot of what we have done has been what I would call supply side or producer-related. We have offered contract incentives to change the supply base. We now have to think hard about a retail market that changes customer behaviour.

Coming back to your question about the future, Chair, we will need to reward people if they are willing to charge their cars at different times, for example when the wind is blowing or when demand is low. That is a big change that we will work with the Department on.

Q100 **Mr French:** That is really helpful. We are very much in a transitionary period, so this is a very interesting discussion that I am sure is going to go on and on. From the Ofgem point of view, my colleague Mr Wild mentioned budgets. What are your headcount projections? How much headcount are you going to need? How many staff are you going to need to manage the change in role for Ofgem, given that the energy market is changing?

Jonathan Brearley: Our headcount is roughly 1,400 right now. There were three drivers of the bid that we put in place for Treasury. I am afraid that until we get that I will not be able to give you the exact figures.

First, we are running more Government schemes. The boiler upgrade scheme came to us, and we are implementing that at the moment. Secondly, we are increasing our role on the wider regulatory and supply side. For example, we are developing the regulatory regimes for carbon capture and storage, as Joanna mentioned, and new nuclear. Thirdly, in the retail space we do need more resources, if we are going to play this more proactive role, to make sure that we understand the situations of the retailers and we can respond to those properly. Those three things are the basis for asking for differential headcount compared to what we have today.

Q101 **Mr French:** How would that projection on headcount have increased over the last five years?

Jonathan Brearley: If I go through the list of those, it is the third that is new since the gas crisis. The others were planned in and we have been having ongoing conversations with BEIS about the functions and Treasury about the funding. That third one is substantial. In order to do this and to play the role we want to play, we do need different resources and different skills.

Q102 **Mr French:** I suspect all of us want a stabler and cheaper UK energy market—that goes without saying—but, as a regulator, what do you see as success in being able to regulate energy suppliers going forward?

Jonathan Brearley: I come back to the work we are doing about that broader framework. In straightforward terms, first, we want customers to pay a fair price for their energy. Secondly, we want to have a market that is resilient in terms of both the financial integrity of the companies that are in it and the security of supply. Thirdly, we want a low-cost transition to the new low-carbon world. Fourthly, we want standards around the way customers are treated, service standards et cetera, to be improved compared to where they are today.

That is the sort of framework we set out last week. We are now working on making sure we monitor that across the piece not only at the micro level of each decision but at the macro level as a regulator. That is all up for discussion, so we would like to reflect on that.

Chair: There is a lot of change ahead.

Q103 **Olivia Blake:** I just have one question for the Department. Maybe Sarah will be able to answer this. Should the Department spend more of its energy thinking about support for energy efficiency for customers and working with other Departments in Government on retrofit schemes? Whatever happened to smart meters and that programme of work? How interoperable are they going to be between these crashing markets?

Sarah Munby: We have not talked about it very much today, but it is probably useful to start by saying that we spend a very great deal of time talking about those issues. We have probably well over 1,000 people working on energy efficiency issues. The Government have put well over £6 billion of funding into that issue in this Parliament. You will have seen that we just extended our ECO scheme, which is the scheme that operates through the energy market where energy suppliers also support people in improving the energy performance of their homes. That is going to be a £1 billion a year scheme. There is an awful lot happening in that space.

Clearly, the business case, in the broadest sense, for energy efficiency improvements is going up and up all the time because of the cost of energy. Yes, absolutely, we are always in discussions with colleagues around Government about how we can do more and go further, but we are fully signed up to the energy efficiency agenda.

Chair: Thank you very much, everybody. Thank you to our witnesses, Neil Lawrence and Jonathan Brearley from Ofgem, and Sarah Munby and Joanna Whittington from the Department for Business, Energy and Industrial Strategy. Thank you for the previous briefing we held in private on more details about the arrangements around Bulb, which are commercially confidential.

Thank you for your time. The transcript of this session will be put up on our website uncorrected in the next couple of days. Thank you to our good colleagues at Hansard for that. We will be producing a report on this in the autumn.