



Energy and Climate Change Committee

Oral evidence: [Energy prices](#), HC 773

Tuesday 29 October 2013

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Members present: Sir Robert Smith (Chair); Dan Byles; Ian Lavery; Dr Phillip Lee; Mr Peter Lilley; Albert Owen; Christopher Pincher; John Robertson; Dr Alan Whitehead

Questions 1-192

Witnesses: **Tony Cocker**, Chief Executive Officer, E.ON, **William Morris**, Managing Director, SSE, **Guy Johnson**, External Affairs Director, RWE npower, **Stephen Fitzpatrick**, Managing Director, Ovo Energy, **Neil Clitheroe**, Chief Executive Officer, Retail and Generation, ScottishPower, **Ian Peters**, Managing Director, Energy, British Gas, **Martin Lawrence**, Managing Director, Energy Sourcing and Customer Supply, EDF Energy, and **Ramsay Dunning**, Group General Manager, Co-operative Energy, **Andrew Wright**, Interim Chief Executive Officer, Ofgem, gave evidence.

Q1 Chair: First, I must remind the Committee of my entry in the Register of Members' Financial Interests to do with the oil and gas industry as a shareholder in Shell.

I normally thank witnesses for being here. The courtesy is to thank you, but it is disappointing that, having just finished the inquiry into energy prices, profits and poverty, we are already back into the cycle of prices going up again. Christmas and winter are approaching, and people are worrying about their bills.

Could you introduce yourselves, starting on the left, with your name and company?

Tony Cocker: I am Tony Cocker, CEO of E.ON UK.

William Morris: I am Will Morris, the managing director of retail for SSE.

Guy Johnson: I am Guy Johnson, director of external affairs, of npower.

Stephen Fitzpatrick: I am Stephen Fitzpatrick, founder and managing director of Ovo Energy.

Q2 Chair: Those of you who have put prices up talked about the wholesale market going up, yet Ofgem has done a calculation suggesting that wholesale prices have risen by only 1.7%. I wonder what you, as witnesses, would say about the state of the wholesale market.

Guy Johnson: We are one of the companies that have put prices up. We have done so because of the external cost pressures that are now on us. We held an event just across the road—in Church House—in July, where we explained the increasing proportion of the bill that was made up by external costs, by which I mean policy costs, network costs and wholesale costs.

In our instance, we said that that element of our price increase that related to the increase in wholesale costs assumed a 3% increase in wholesale costs. I do not think that that is hugely out of line with Ofgem's assumptions. To some extent we are talking here about apples and pears, in that Ofgem's assumptions are backward looking, whereas we were forward looking in our assessment of prices.

William Morris: The most useful thing to start with is to clarify that Ofgem put out another announcement this morning on the very subject, which I think adds some useful light to the matter. I am not sure whether the Committee has had sight of it. In that, Ofgem said, "We have also published actual market data which shows that the wholesale price of gas for use this winter is 8% higher than the price of gas for use last winter." For electricity it is 13%. It seems to have revised its position as per the interpretation that we saw 24 hours earlier.

From our point of view, we obviously regret profoundly having to put prices up at any point, particularly when our customers are struggling to manage their difficult and tight budgets. We made that increase a few weeks ago. The wholesale part of that was a 4% increase, which is somewhat lower than the Ofgem numbers coming out today. We are hopeful that we will manage to that.

Luckily, we buy ahead on a 24-month curve—the way we buy our wholesale gas, which enables us to insulate our customers from those peaks and troughs that we see in the market. It is regrettable that it increased at all. Of course, none of us wants prices to rise, but I am optimistic that my business will remain within that 4% figure.

Q3 Albert Owen: Mr Morris, are you saying that the revised figures from Ofgem mean that you have not put your prices up enough?

William Morris: Not at all. I am saying that because of the way we forward-buy to insulate ourselves against these fluctuations—we estimated it to be 4%—the number we quoted at the time of our price announcement will be what we deliver.

Q4 Albert Owen: Mr Johnson said that 3% is what they factored in. How much did you factor in that gas prices would be going up when you announced your 8.2% rise?

William Morris: Four per cent.

Q5 Albert Owen: So the rest of it was green levies and others?

William Morris: Yes. If you want to take the drivers behind that increase—

Chair: We will come on to green levies in a minute. I want to pursue more on the costs.

Q6 Mr Lilley: Mr Morris, you have announced an 8.2% increase in your tariffs. By how much over the same period until your last price increase have your unit costs in the supply business risen? What percentage?

William Morris: In terms of unit costs, are you referring to the costs that we directly control in my business?

Mr Lilley: No, I am talking about the costs you are passing on.

William Morris: Our costs have increased by 4% from a wholesale point of view—

Mr Lilley: No, in total. Has it gone up by 8%, 5% or 12%?

William Morris: It has gone up by a total of 8%.

Q7 Mr Lilley: So this reflects an aggregate increase in your costs?

William Morris: Yes. It reflects both an aggregate increase of costs over the first half of the year and our projection for what will happen to those over the next half of the year.

Q8 Mr Lilley: You say that your wholesale costs when you buy in electricity and gas have risen by 4%. Is that what you are saying, that they have contributed 4% of the total? If half your costs are your raw materials, and they rise by 4%, that contributes 2% to the total.

William Morris: I am with you. The wholesale energy proportion of the bill is roughly about half, so it is by far the largest part of the costs. So, yes, in absolute terms, 4% of that would be a larger sum than a higher percentage of a smaller amount. The other large proportion is the cost of transporting energy from the power station to customers' homes which is a regulated cost. It is going up by 10%.

Q9 Mr Lilley: That is 10% in a year? The regulator has allowed it to go up by 10% in a year?

William Morris: That is effectively the pass-through. We have to pass through from the regulator. Regulated costs are not subject to our definition. The final piece, which is a smaller part of the bill, to your point, Mr Lilley, is the Government environmental and social schemes which have gone up by 13% and currently account for about 10% of the bill. Our

concern, as you are probably aware, is that that will increase significantly. We would like to see those costs off customer bills and into general taxation, which we believe to be a far fairer means of recuperating those important investments. Right now I am effectively paying the same proportion of my income towards the cost of those schemes as someone who is just above the fuel poverty line, which clearly is not even morally defensible. Hence we have been very keen and we welcome the Government's decision to review that.

Q10 Mr Lilley: I am still not sure that your figures add up. If half your costs have risen by 4%, that contributes 2% to your final tariff rise. If 10% has risen by 13%, that contributes 1.3%. So we are still a long way off 8%.

William Morris: If you look at the different proportions—I could submit this to you in detail—you have a gap at the half year between what the 8.2% rise would do and the overall increase. But that is driven by the fact that we run the business on an annual basis. The key metric that we have to project out—at the moment we will be announcing a loss for our retail business in the first half of the year—will be seen at the end of the financial year to be at a 5% margin of 5p in the pound. Within that announcement is the attempt to recoup that, to deliver that 5p in the pound profit.

Q11 Mr Lilley: Could we quickly ask Mr Johnson the same figures? What percentage increase in your total costs is there?

Guy Johnson: If you break down the bill—

Q12 Mr Lilley: What is the total?

Guy Johnson: If I can attempt to answer it by giving a percentage breakdown of the bill, I may well have answered your question. If not, I am happy to come back. So, 45% of the bill for us is wholesale costs, which have gone up by 3%; 23% is transport costs and network costs, which have gone up by 10%; and 15% are what we have called policy, or policy and regulation costs. Those have gone up by 31%. So in terms of external costs, those are the three main external costs driving our price increase.

Q13 Mr Lilley: Thank you very much. That is pretty interesting. The regulatory costs are up by nearly a third, and the transmission costs, which are also regulated, are up by 10%. To what extent does the rise in transmission costs reflect the increased costs of transmission network to link up with windmills and offshore wind farms and things like that?

Guy Johnson: There is certainly an extent of that. Obviously we do not know what our network costs are going to be for next year. We do not know that until February. They can then change within year. I think in 2011 they changed four times within year. So there is an element of estimation here. But clearly there is an extent to which the increase in network cost is being driven by the connection costs and the user system costs of the remote north of Britain: for example, intermittent generation, renewable generation. In terms of what I have

called the policy costs, the largest driver of that is the cost of the energy company obligation. I suspect we may well come back to that later.

Q14 Mr Lilley: And you are not, to any extent, simply raising your prices ahead of and to pre-empt a threatened freeze in the prices or ahead of anticipated rises in green tariffs?

Guy Johnson: We are not raising them in anticipation of a price freeze, no. The point to make about the energy company obligation, which is the largest driver of those policy costs, is that that is an uncapped cost. It is almost an uncapped fine in the event that one does not comply with the obligation. That obligation runs to March 2015, so the window within which we have to comply with that obligation is beginning to close. What we have found in relation, for example, to the previous energy efficiency schemes, CERT and CESP, was that the costs in the last year were very high. In the instance of CERT, they were 20% higher, and in the instance of CESP, 120% higher in that last year as the window closed. Clearly, therefore, one of the issues that we have to address and manage—because we were compliant, although not all suppliers were, with CERT and CESP and fully intend to be compliant with our obligations under the energy company obligation—is the extent to which we are going to need to fulfil a large part of that obligation as the window closes in March 2015—in other words, a large part of that obligation in 2014. That was obviously a concern when we were considering prices for next year.

Q15 Mr Lilley: My constituents think it is all very wonky and that you are buying electricity from yourself or other people at a wholesale price and trading it through an arm held, possibly, abroad. They fear that you can simply sell electricity cheaply to your German trading company, buy it back from your German company at a high price, show that there has been a price increase in your wholesale costs of electricity—and possibly the same applies in gas as well—and you have simply taken a lot of profit offshore.

Guy Johnson: In our instance, we sell supply, or if you like, we net off—which I think is what is behind your question—less than 10% of the requirement for our business. The rest of it we buy in the market or, in the instance of our generation business, we sell in the market. We effectively run our generation and retail business as separate business units. One of the things that the Labour party has been talking about is ring-fencing generation and retail. That is something that we effectively do and we would support.

In relation to your question about gas, we have very little upstream gas business, so we buy in the wholesale market. What I would say to you is that effectively our supply business buys gas, for reasons that I have explained, but also buys electricity in the wholesale market in the same way as anybody else could. Indeed, our trading operation sells to Ovo, Ecotricity and other small suppliers in the same way as we can buy wholesale electricity. So it is open and transparent.

Chair: That brings in Mr Fitzpatrick.

Stephen Fitzpatrick: I will try to give you a briefer answer. I am delighted to say that we do not buy any electricity from npower. It may be one of the reasons why we are so much cheaper. We buy all of our power and gas on the wholesale market and the easiest way that I

can explain to you what has happened in the wholesale market in terms of pricing is that the most expensive price we have paid for wholesale gas in the last four years was, I think, in May 2011, for that following winter of 2011. It was 74p a therm. Since then, it has been below 72p a therm for this winter, last winter and next winter. We are buying gas for next winter at the current price of 69p a therm. So I cannot explain any of these price rises, other than they are not the prices that we see in the liquid wholesale market. We do not have any self-supply to adulterate that.

The other thing that I want to pick up on, if I may, is the idea that it is okay to look at forward-looking prices instead of backward-looking prices. A forward-looking price reflects your anticipation of the risk of prices rising in the future. But I do not think that British consumers care very much if you have traded inefficiently. When you look back and see what the actual price on the day was and say, “That was the wholesale price for that winter, for that day”, that should be the reference price, not what any individual energy company predicts the energy price might get to and reflects that in their retail pricing. Like some Committee members, I have been somewhat confused by looking at the explanations for the price rises in the past three or four weeks from some of our competitors, because we do not see nearly the same impact, especially on wholesale commodity costs.

Q16 Ian Lavery: First off, reports yesterday suggested that more than 3 million elderly people fear that they will not be able to keep themselves warm during the winter. The report also said that 24,000 people could die because of the hikes in energy prices from your companies. It is an absolute outrage that that is being allowed to happen in one of the richest economies in the world. It is an absolute abuse from the big six energy companies.

I would like to clarify, Mr Fitzpatrick, whether you said that the big six companies are selling gas and electricity and then buying it from themselves at above the market rate. I think you said that on 21 October to the BBC. I am perplexed by that, but, for the record, can it be right that one of the reasons why everybody in this room is paying more for their bills is that some companies are buying off themselves at above the market rate?

Stephen Fitzpatrick: Just to clarify, in the interview with the BBC I think I was asked why some other companies were talking about rises in wholesale commodity costs. I gave a possible reason that they may face increased costs from their wholesale trading arms. I did not suggest that that was the case in any individual company, nor did I say that that was the reason behind the price rises.

If you were to ask me why prices are going up, I would say that, as I have been saying for a long time, in the example of npower, their standard tariff is 16% more expensive than they are willing to sell on their cheapest tariff basis, so it looks to me like a lot of energy companies—a significant number of the big six—are charging the maximum price they feel they can get away with to the customers they feel will not switch under any circumstances, and then maintain an illusion of competitive pricing with tariffs targeted towards a very small number of relatively well-engaged customers. If you look at that differential between the price that most people pay and the headline rate—the cheapest deal on the market—in the case of npower, which is the worst offender historically and today, the price differential is 16%, which is about £200. That is more than the increase that we have seen—

Q17 Ian Lavery: Can I ask a similar question to the other three members of the panel? Are your companies buying electricity and gas from your companies at above the wholesale price?

Tony Cocker: Absolutely not. We buy our electricity and gas for our retail business—I think we discussed this at our last meeting—from the market via our trading business. We operate our businesses on a stand-alone basis, so on the one hand we have our retail business and, on the other hand, our generation business. Our generation business sells its generation in the market, at market prices, through the trading business. There is absolutely no cross-subsidy between the two businesses. We operate them on a separate basis. In fact, this is one of the things on which we agree with Ed Miliband: there should be virtual separation between generation and retail. We already do that and we believe that that would be a good proposition to improve transparency and clarity in the overall marketplace.

William Morris: I would say in addition to that that we are, as you know, a wholly UK-owned business operating only in the UK and Ireland. As such, we are completely transparent in the way that we operate our separate businesses.

The specific answer to your question is: that is absolutely not the way that we do business. We do not subsidise our retail business by selling energy to it at a favourable rate from the generation side; indeed, we routinely trade 100% of our generation capacity in the independent, day-ahead market.

Q18 Ian Lavery: I am not saying that you subsidise it, but that you are inflating it.

William Morris: Indeed. We are not doing anything to it at all of any negative nature. In fact, for me it is really important in running this business—as you probably know, I am a relatively recent arrival into the energy sector, so I understand the frustrations of customers and members of the Committee about opaqueness—that we have that level of transparency. If we cannot get a level of transparency, clarity and trust, I cannot operate a sustainable business. On the question you are asking, Mr Lavery, it is plain to see that the day-ahead market operates in that way. We can give that reassurance, but there is a wider issue that surrounds so much of our debate.

Guy Johnson: To answer that from npower, again the answer is no, we do not. We do not buy at an inflated price. I would answer to Mr Lilley that there is a very small percentage, less than 10%, that you could say is netted off, but the balance we buy in the market. I am talking about electricity. We have a very small upstream gas business, so we buy pretty well all our gas in the market.

In response to Mr Fitzpatrick's point, in broad terms we have what we call a standard product and two fixed-price products. We have a fixed price until April 2015 and a fixed price until December 2017. I do not know where the idea that we have some undercutting products has come from.

Stephen Fitzpatrick: I hope you don't mind me glancing over and seeing that you have the rankings of all the different tariffs that are available in the market. You have got one

highlighted right at the top of the table, and another one highlighted, which is another of your tariffs, right at the bottom.

The point that I made earlier is that you have a fixed-price tariff in the market right now that is fixed for the next two winters, so your standard tariff is 16% more expensive than the fixed tariff. No doubt in 12 months' time we will be talking about the increase in wholesale prices over next winter. I do not see how you can have a two-winter fixed tariff that is so significantly cheaper than the price that your standard customers—and therefore, I would argue, your more passive customers—are currently paying.

I would also add that I think it is common practice among several of our competitors that they load the environmental and social obligation costs on to those customers who are less likely to leave, and offer much more attractive fixed or promotional tariffs—probably without the social and environmental costs that we hear so much about—for those customers who are more actively engaged in the market. It is difficult to explain.

Q19 Dr Lee: What level of profit do the trading arms of your companies make? We hear about the retail arms making 4%, 5% or 6%. How much do your trading arms make and where are they located geographically?

William Morris: In our case, I have two points in response to your question. First, none of the profits made from trading stand within trading. They are either pushed into the retail business or the generation business—we have three businesses.

Q20 Dr Lee: So you declare no profit whatsoever for your trading arm?

William Morris: No, trading provides a service to the businesses that is accounted for transparently and publicly and they sit within the other businesses: my business, the retail supply business; or the generation business.

Q21 Dr Lee: Does that apply to all the others as well?

William Morris: Well, the other point is that it is easier for us to answer that because we are obviously doing it here in the UK and it is transparent and visible.

Q22 Dr Lee: Okay. So?

Tony Cocker: Our trading business is based in Dusseldorf in Germany. It operates across Europe and, indeed, globally, so it manages all the trading operations for E.ON across the whole of continental Europe and also outside of Europe, in electricity, gas, coal and freight and so on. It is very transparent. You can look at our published accounts and you will see the annual profits of the trading and optimisation business. It is now called E.ON global commodities. I am happy to take you over to have a look. There are 1,000 people running a very professional business, managing on a global basis.

Guy Johnson: In terms of our trading operation and the way in which we show its numbers, as I have said before, we publish what we call financial statements, consolidated segmental statements. Those segmental statements show the profits and the revenue of each of our generation businesses and our supply businesses. Within those numbers are the numbers that include trading in relation to our generation and supply businesses. So the numbers in relation to our generation assets, the numbers in relation to our supply assets are included within the published statements within the numbers that you see on our website.

Q23 Dr Lee: So your trading company does not make any profits.

Guy Johnson: It is exactly the same as Mr Morris has said in our instance. The numbers that are in our financial statements include our trading numbers in relation to—

Q24 Dr Lee: What I am trying to pare down to is, is this old-fashioned transfer pricing going on?

Guy Johnson: No, there is no old-fashioned transfer pricing going on.

Q25 Dr Lee: Clearly, if you are a company that is predominantly, say, state owned, there is some sense in the profits being made in the home country, because the tax would be extracted—the corporation tax or whatever—and it would be fed back into that country's tax bills, so that customers in that country would benefit. I am not suggesting that is happening; I am just talking about what would happen if it were happening.

Guy Johnson: One of the points I would make is that there is clearly an element of concern or suspicion that, whether because of this argument that we trade with ourselves or because of similar comments, there are excess profits, and we have seen comments about windfall taxes and so on. As far as npower is concerned—maybe we are different from some of our competitors—when I looked at a 2012 report by Bloomberg, it said that, in the last five years, we were one of the smallest of the major energy suppliers, but had the largest ratio of capital expenditure to income. In other words, we have invested £2.9 billion in the UK over the last five years, and that is 1.8 times our operating profit. So, each year, we have invested £260 million more in the UK than our profit. One hears about windfall taxes and similar comments, but, at least as far as we are concerned, it is a little incongruous, because the reality is that we are massive net investors in the UK, as those numbers show.

Q26 Dr Lee: Do you have any comments on that?

Stephen Fitzpatrick: With £2.9 billion of investment and only 10% self-supply, I do not know where all the money is going if it is not invested in energy generation. If it is, I would not recognise the 10% self-supply figure I heard earlier. It is one of the questions I am interested in finding out more about.

Q27 Albert Owen: Can I ask you something, then, Mr Fitzpatrick? You said the highest price you saw on the gas market was in 2011 for the following winter.

Stephen Fitzpatrick: Yes.

Q28 Albert Owen: Did you raise your prices this year? Have you been putting them down because you have been getting cheaper gas from the commodity market?

Stephen Fitzpatrick: As we have heard, the gas price—the power price—is about 45% to 50% of the overall bill. I would say that our prices have risen in line with network costs.

Q29 Albert Owen: How much did they go up last year?

Stephen Fitzpatrick: We did not raise our price last winter. We raised our price in April this year, so we held off throughout the whole of last winter. We saw that there was a warm start to last winter, in October and November, and we saw wholesale prices falling, so we pushed back.

Q30 Albert Owen: So as the prices fell, you actually reduced your bills?

Stephen Fitzpatrick: Yes. In fact, in January 2012, we were the first energy company to announce a price cut. Subsequently, in the next seven days, all six of the other energy companies cut either their gas or their electricity prices.

Q31 Albert Owen: So, Mr Morris, why don't you have a word with Mr Fitzpatrick? You might get your power 4% cheaper.

Stephen Fitzpatrick: We would be happy to sell wholesale electricity and gas to these guys, if they thought it might be cheaper.

Q32 Dr Whitehead: The companies that generate had an aggregate profit margin of 24% in 2011, 21% in 2010 and 22% in 2009. Those generating companies, of which the big six own about 70%, sell to somebody. That is how they make their profit: they generate the energy and sell it. However, the supply side, as you say, does not make a very high profit. So where does the money go in between?

Tony Cocker: We have a generation business; we operate coal and gas-fired power stations here in the UK. That business, over the last few years, has made a profit. As we look at it this year, I would say it is struggling. My colleagues who run those stations are working really hard to ensure that they are available to generate and that they are available at sufficiently low cost to keep them open. In aggregate, in our generation and upstream areas of the business, we have invested around £7 billion in the past five years, so there is a roll call. There is some misinformation that investment has stalled in the past three years. I have heard

that said recently by certain spokesmen. That is not what I hear. We opened London Array last year. We opened Tween Bridge with the shadow Secretary of State. We opened Grain with the Secretary of State. Those are very substantial investments. In fact, in preparing for the meeting, I looked at some of the independent generators and said, “Okay, how much did they invest?” In aggregate, we have invested basically 100% of what we have earned in the past five years.

Q33 Dr Whitehead: From generation?

Tony Cocker: From generation. One of the larger independent generators has invested 30%. I speak for a company with employees who are proudly operating power stations and that is proudly investing in new power stations to help to keep the lights on in this country.

Q34 Dr Whitehead: Can I return quickly to the netting-off issues. Mr Johnson, you mentioned that 10% of your trades are netted off.

Guy Johnson: Less than 10%.

Q35 Dr Whitehead: Is that volume, number of trades or value?

Guy Johnson: That is volume.

Q36 Dr Whitehead: What about the value and the number of trades? Does it come to the same figure?

Guy Johnson: I do not have those numbers with me today, but of course I will send them to you if you wish. I stress that it is less than 10%, it is electricity only and the whole point about—

Q37 Dr Whitehead: Is it 10% of the total number of trades, for example?

Guy Johnson: It is 10% of the volume, I believe, but I will write to you to confirm.

Dr Whitehead: Of the number of trades?

Guy Johnson: No, of the volume.

Dr Whitehead: Of the volume of trades?

Guy Johnson: Sorry, of the volume of electricity, but I will write to you to confirm.

Dr Whitehead: Of the volume of electricity?

Guy Johnson: Yes.

Q38 Dr Whitehead: Those are the netted-off figures that appear nowhere on anybody's information sheets, because they are netted off.

Guy Johnson: Again, I would like to write to you about that specifically. The point I would make is that this is a very small percentage of either our generation or our supply. Of course, we supply in electricity more than we generate, so clearly there cannot be a balance in any event. We run those two businesses separately. One of the things on which we pride ourselves is that we run a model in which our retail and our generation businesses are run separately and they trade in the market, they do not—

Q39 Dr Whitehead: Clearly, netting off suggests that it is not all run separately.

Guy Johnson: As I say, it is less than 10% and the rest of our electricity, whether generation or supply, and all our gas is traded openly in the market. We operate separate businesses.

Q40 Dr Whitehead: Do you have the same figures for netting off for E.ON and SSE? What sort of netting off do you have in your companies?

Tony Cocker: Off the top of my head, I do not have those figures, but in very simple terms, we net off very, very little. As I said earlier, we sell what we generate and we buy what we need. We do not net off. That is the business model with which we operate.

William Morris: I will provide a written response to your question, Dr Whitehead, but to the best of my knowledge, it is exactly the same. As I said before, we do not net off; we put them into the two businesses. I think that it is important perhaps to return to your point about the generation business and the margins there, but from SSE's point of view, it is a stand-alone business and also a very capital-intense business.

We are not that dissimilar, although with bigger numbers, being a British company. We have invested £7 billion—£2 billion more than we made in profit over the past five years—so, as Mr Cocker was saying, it is by no means stalling. It remains a hugely important part of the group's business. Obviously, it is not my part to run, but it is massively important to us.

The bit that we fail to get across, and what coming from the outside is quite curious, is that this is massively important for Britain, for your electors and our people. It is not only the staff we employ—20,000 in our case, and thousands more indirectly—but the prosperity and the recovery of our country. We are often doing this not in rich London, but in remoter parts of the country, where employment levels are much lower. A challenge for us that we need to take on is about how we articulate that more effectively, because it is a massively important part of our economy.

Q41 Dr Whitehead: I appreciate that. You have given rather different answers on netting off and hedging strategies, and yet, for the past two years, there have been almost

exactly the same price rises from each of the big six at roughly the same time—and, incidentally, in exactly the same order of announcement.

I appreciate that E.ON has not yet announced a price rise; one would hope that there will not be one, but that would seem counter-intuitive. If those strategies are so different and if you are operating in the market in such different ways, you would not expect the price rises to be exactly the same for all the companies and to be announced at the same time.

William Morris: Certainly, as you have rightly said, we have taken the decision to go first in the last two years, at the last possible moment. By being very rigorous about the way we did that, I am pleased that we have made the lowest increase of those that have increased thus far.

The reality is that 85% of the ingredients behind that bill are outside of the energy companies' direct control. By definition, there will be a certain amount of similarity. As we all face into the winter, we are all under similar pressures. The critical thing for us is to look at how we can get those bills down. I imagine that the Chair will move on shortly to the subject of the green schemes. There is an opportunity where we can start to take away the pain from consumers. What concerns me, as head of the retail business, is that.

Guy Johnson: If I could just pick up briefly, Dr Whitehead, in response to your question. I agree with what Mr Morris has said. It is a competitive market, but, to some extent, we are all subject to the same cost pressures. Those cost pressures might make up 83% of the bill.

There is one other point that I would like to make. You talk about the profit in generation, and there is no doubt that, over recent years, profit in generation has been higher than profit in retail, although the numbers that I gave you come from the fact that we have invested 1.8 times more than we have made in the UK, our generation and retail combined numbers, and we have built Pembroke and Staythorpe, which are two of the largest and most efficient power stations in Europe, with substantially reduced emissions compared with a coal-fired power station.

There is something to which it is worth drawing the Committee's attention—Mr Cocker referred to it: things are changing. We have invested in very efficient gas-fired power stations. We made a loss of £21 million in our generation business in the first half of 2013. On some of those gas-fired power stations, including some of the newer ones, we have concerns as to their profitability into 2014. Things have definitely changed, particularly in relation to gas stations.

Tony Cocker: Can I move back to retail prices and profit in generation? As you said, Dr Whitehead, we have not yet made any announcement on price changes, and we have not yet made a final decision. We constantly monitor it, as you would expect. I want our customers to know that we will hold our prices for as long as we can.

Q42 John Robertson: What does that mean?

Tony Cocker: It means what I said. We will hold our prices for as long as we can.

Q43 John Robertson: It means nothing—unless you can tell us a date, it means nothing. You have already decided that you are going to have a rise, you just do not want to say it.

Tony Cocker: I have said that we will hold for as long as we can, and then I was going to explain the drivers. The drivers, as each of the guys on my left have said in differing degrees, are similar for the different companies. There is the wholesale price, the network cost and the social and environmental obligations. At the end of the day, they are the same drivers, and they are largely out of our control, but you can get different answers by managing them differently.

On ECO, for example, we have delivered, on the basis of DECC's announcement the other week, 30% of the ECO delivery to date, and we are at the bottom end of the cost on that. Therefore, although this obligation is not entirely in our control, we can manage it and be more cost-effective. Our aspiration is to manage it and to be more cost-effective than our competitors.

That is not to say that I disagree with Mr Morris that it should be out of the bill completely and put into general taxation. I actually agree with that. It is a regressive poll tax—stealth poll tax, essentially—and it would be much more progressive to put it into general taxation. The way it is at the moment, we can manage it to a certain degree, and that is why we are able to hold our position at present.

Q44 Christopher Pincher: You have all said very clearly that a large proportion of your costs is driven by external factors. One of those factors is the Government, as well as the so-called social and environmental obligations, which Mr Morris said comprises something like 10% of the bill. An average dual-fuel bill is something like £1,260—it knocks a hole in thirteen hundred quid—which suggests that the so-called green levies account for something like £126 per year in people's bills. Are we agreed on that sort of figure?

William Morris: Yes. Well, slightly less, but broadly—absolutely.

Q45 Christopher Pincher: Say between £112 and £126 or something like that.

Why is it that the proportion of the green levy total accounted for by ECO is so different in each of your estimates? May we start with you, Mr Cocker? What do you think the proportion of that green levy total is accounted for by ECO?

Tony Cocker: I think that it is based on each of our experiences to date both in CERT and CESP—the predecessor to ECO—and in ECO. I believe that we did well in CERT and CESP. We were the first supplier to announce that it had completed that scheme. By completing early, we were then able to start on ECO early. When you start early, it means you start to implement the lower-cost measures earlier than your competitors, so by the time your competitors get round to doing it, to a certain extent you are on to the higher-cost measures that are the ones in the marketplace.

Q46 Christopher Pincher: What do you estimate ECO to be in pounds, shillings and pence?

Tony Cocker: I do not have that number off the top of my head.

Q47 Christopher Pincher: Okay. We will come back to that. Mr Morris?

William Morris: The challenges with ECO and the fact that you have different figures coming at you from companies, as you rightly point out, is in part because it is a new scheme and quite a complex scheme. We commissioned an independent report by PA Consulting to help us work out what we thought the figure should be. In fact, the number that we have come up with is £60 for the period of the rest of this winter.

It goes back to Mr Lavery's question, which was an enormously important question that we did not really answer earlier, on the concern about fuel poverty and people choosing not to eat, or choosing to heat rather than to eat, which is a massive concern for, I am sure, all of us in the room. It is absolutely the right thing to do, but we once again come back to the point that that £60 represents virtually half the cost of those Government schemes. It is a large number on the bill, and it would be back to where it should be—not the use of it, because it can generally help people to have warmer houses and save money, but it should not be spread across everybody's bill whether you earn what I do or you are just above fuel poverty.

Tony Cocker: Mr Pincher, you may recall that I responded to and wrote a letter to Ed Miliband, and I said that, at a stroke, politicians could reduce energy prices by moving these costs—and we can also make them more cost-effective—

Q48 Christopher Pincher: We will come on to that, I assure you.

Mr Cocker, you say that you do not know how much ECO will cost. Mr Morris, you say that it is about £60. Mr Johnson?

Guy Johnson: When we did the *Energy Explained* report that I talked about in July, we estimated that ECO costs were of the order of 6% of the bill. To try to give a little bit of context for all this—

Q49 Christopher Pincher: That is just over £60.

Guy Johnson: Yes. When we did the *Energy Explained* analysis, we did it on the basis of a 2013 bill of £1,247 in total.

Just to put a little bit of colour on ECO, ECO is an extraordinarily complex scheme. There are three elements to it. One is what is known as affordable warmth, and then there are two others: one called the carbon emissions reduction obligation and one called the carbon saving communities obligation. What has happened is that elements of the affordable

warmth obligation have been delivered and, as Mr Cocker said, some of the cheaper measures are being delivered, but less of the two other measures. The carbon emissions reduction obligation is difficult in terms of the measures—the focus on solid wall or hard-to-treat cavity walls.

If I can just give you a little bit of a feel, what happens is that an energy performance certificate assessment is carried out. We then consider, in the light of that, whether ECO measures are appropriate. Somebody then goes, in order to assess those measures, to assess what can be done in the house, what else needs to be done; and then the measures are put in. So we are talking about three visits to a household.

We are talking about a reasonably long lead time, here. It is not a simple, straightforward thing, where we can ensure that it is all done, for example, in the first 12 months of the scheme.

Q50 Christopher Pincher: But you are saying £60. British Gas, I think, who will be in the next session, say £40. DECC says that £40 is rather a large estimate. Why are your figures so much bigger in terms of ECO cost than DECC estimates?

William Morris: I think I tried to answer the question before, Mr Pincher. It is the fact that it is a new scheme; it is complicated to administer and we are trying to make our best endeavours to get an accurate figure—hence us using an independent firm to help us get to that level.

What we do know, which is perhaps even more significant, is not necessarily the fact that we are all slightly different, but the fact that it is going to go up. When we look ahead into the following year's ECO costs, to meet that overall obligation, we are going to see the figure. The figure that we are currently forecasting at is even taking it into the region of over £100, which is of course a yet bigger burden. That is one of the reasons why we have said two things: one is to get it off customer bills, so it is fair and on the taxation scheme; and also, perhaps, to look at delaying the speed of this drive for decarbonisation, because it is by the speed of it that the impact is coming so quickly.

Q51 Christopher Pincher: Do you estimate that any of this cost will be as a result of poor delivery of these policies—that you could implement them much more efficiently and thereby reduce the cost yourselves, which you would not then have to pass on to your customers?

William Morris: That is a very good question. We will do absolutely everything in our interest to deliver those as efficiently as possible. The problem is, however much we try and articulate the reason why the bill is going up, customers understandably look to us as the guys doing it.

I want all these schemes to be administered as efficiently as possible—indeed, I am very keen to get back to this issue of fuel poverty, which worries me profoundly. When we look at these other parts of efforts to be more efficient and green, we find that people are still concerned that they need to turn off their heating to be able to eat. We know that in our

country today with the schemes that we have in place there is nobody who should be in that position of worry.

We have a common obligation to try and get that message across. All we try to do is talk to as many customers as possible, to reassure them that we have got not only the Government statute, £135 support with affordable warmth, but also our own range of all kinds of other measures to help customers who are perhaps struggling to pay their bills or struggling to cope. We don't want anybody to be in that situation, and, if nothing else comes out of our session this afternoon, we are clear that we don't want to fuel these fears further, because the system is set up to prevent that.

Q52 Christopher Pincher: That is admirable. You heard the Prime Minister in the House of Commons last week say that he wants to roll back the green levies. If they are lifted, will you pass on the saving that you incur, in total, to your customers?

William Morris: Yes. Unquestionably yes.

Q53 Christopher Pincher: Mr Cocker?

Tony Cocker: Your question is “if they are lifted”. I think we need to reflect on that, because I profoundly believe that these measures, in and of themselves, done in the right way at the right pace, are the right things to do. They do help many people. At the same time, smearing it across everybody's bill is putting up the cost for everybody, and therefore is regressive.

Q54 Christopher Pincher: That is the question about whether you impose a levy or find money through general taxation.

Tony Cocker: I am not sure about the phrase “rolling back green levies”. We can refocus ECO in a measured way, although we are halfway through it. When we changed the rules on the feed-in tariff, we made sure the supply chain and suppliers were not disrupted and so on, but I agree that fundamentally we should ensure that we review it and that it is as cost-effective as possible.

Q55 Christopher Pincher: Fundamentally—I hope you can answer this question with a yes or no—if levies are lifted, is a cost is lifted from you?

Tony Cocker: Absolutely

Q56 Christopher Pincher: And that saving would pass in total to your customers.

Tony Cocker: Yes.

Guy Johnson: Yes.

Q57 Christopher Pincher: And how quickly could that be done?

Tony Cocker: How quickly can it be changed—

William Morris: My answer is that we could do it in a matter of weeks, as soon as we can physically administer it. We need to be black and white with this. It is important. If the Government respond to our request to put this into general taxation, pound for pound and penny for penny it should come straight off the customer's bill.

If we are ever going to achieve our goal of being transparent and trustworthy, that would be an example of how willing we would be. We would do it as fast as possible, and I would suggest that Ofgem oversees the process. Let us hope and pray it happens as soon as possible.

Q58 Albert Owen: Could you answer this question? When the Prime Minister made that statement, did you interpret what he said about green policies to include ECO's social tariffs? Were you as surprised as I was that ECO came in this April, and here we are in October talking of getting rid of it? Do you see the carbon price floor, which has just been introduced, being scrapped as well? The warm home discount and a number of others have just been introduced, and they will be taken away. Do you see green levies as being something different from some of the social policies, and do you think the Prime Minister was a little mixed up and needs to explain?

Tony Cocker: I could not comment on what the Prime Minister—

Albert Owen: Your interpretation.

Tony Cocker: Our interpretation was a review of all the green and social obligations, but I think the line of questioning from your colleague was around ECO. You raised the issue of the carbon price floor; you know what my view is on that. It is a tax and it should be stopped. It has no benefit in supporting investment. It gives a windfall subsidy to the people who built nuclear power stations at the time of our fathers and has been paid for many times over. That should simply be taken away. That would be a pretty immediate reduction of the bill, although because it is factored into the wholesale prices at the moment, it would take a bit of time to take it through. Those two things are general taxation and can be addressed in the case of the carbon price floor by moving it.

Q59 Albert Owen: I have to push you on general taxation. You give discounts to your customers for having dual fuel. Many of my constituents do not have the luxury of those discounts because they do not have dual fuel. They pay a lot more for oil, LPG and many other things. You are saying they should pay extra tax while others benefit from a reduction on dual fuel. You talk about fairness, but I don't think that is fair.

Tony Cocker: I understand what you are saying. At the same time, I am sure you would agree that if ECO is in, let's say, DECC's range of £45 to £60 per household across all

households, that is simply a poll tax. I am sure you railed against the poll tax when Mrs Thatcher was Prime Minister.

Q60 Albert Owen: I am against ECO and the carbon price floor, so I haven't changed my opinion.

I am interested in this and I am sorry to press it, but it is important because the policy was announced in the House of Commons only last week—six days ago—and we had already arranged this meeting. I want to hear whether the rest of you interpreted the Prime Minister as meaning certain green levies or also social tariffs.

William Morris: I think my interpretation was that the Prime Minister and the Government wanted a review of all constituent parts that fall under that banner.

Q61 Albert Owen: Even though they have just introduced them.

William Morris: Yes—quite likely. I think there is a new reality out there, which is that if you look at our energy policy as a country, it is inherently contradictory. We wish to decarbonise apace and to have security of supply at a time when supplies are decreasing, and we want to make bills lower, but you cannot deliver all three. The good news from the high level of media coverage and the challenge from people like you on this Committee is that we are having the debate.

On your point, Mr Owen, nobody wants to see people suffer as a consequence—certainly, we at SSE do not want that. Some have said that the affordable warmth scheme, for example, would vanish as a consequence of moving it into taxation. We have said all along that we do not challenge the validity of these schemes and their objectives. But I hope the Government's intention is to review fully the way they are administered and come to the right conclusion.

Chair: I think we have gone around this subject now. John, you wanted to talk about transparency.

Q62 John Robertson: Yes. Gentlemen, you mentioned transparency right at the beginning. Mr Johnson, you said you need a level of trust and transparency or you can't work in the market, and Mr Morris agreed. It is funny, Mr Morris, Mr Johnson and Mr Cocker, that you have pretty well agreed on everything. Perhaps when you answer this question just one of you can answer it, because it would be like asking the three of you anyway. That way, we can get more questions asked. Mr Fitzpatrick can obviously speak for himself and the smaller companies.

Do you understand that people in this country do not trust you? I was on a radio programme earlier today, and time and again they said to me, "Go and tell those people that we don't trust them." The first thing you mentioned was trust. How do you expect to gain that trust back?

William Morris: I think that is a really important question. I absolutely understand it because 15 months ago I was one of the people sitting on the outside looking in. I came into this role and this sector with low expectations, but I have to tell you in all sincerity that the quality of the people I have encountered in this British company and their passion for doing the right thing and keeping the lights on—be it yesterday in the storms or in my retail business—is second to none. Although I have been in much fluffier brands and businesses in other parts of the service sector, I would say that their quality and integrity are second to none.

However, on your point, Mr Robertson, we have a profound problem on our hands because we are not getting the message across. We would support—there are a number of plans afoot to do this—more and more transparency. Equally—I made the request to you earlier on the issue of fuel poverty—you must help us.

Q63 John Robertson: We will look at fuel poverty separately, so leave that issue for now. Accountants have tried to look at how you run your companies and whether things are done correctly, but university degrees are obviously not enough to understand how the big six work and what they do with our money. Mr Cocker talked about how his is a global industry. I would be interested to know, Mr Cocker, as yours is a global company in a global industry, whereabouts do you pay your taxes these days?

Tony Cocker: We pay a significant amount of tax in this country.

John Robertson: That is not what I asked. In which country does your headquarters pay its tax?

Tony Cocker: Our headquarters is in Germany, and I assume therefore that the German company pays German taxes and the British company pays British taxes.

John Robertson: I expect a CEO to know, not to guess.

Tony Cocker: The company for which I am responsible is E.ON UK plc. We are headquartered in the UK. Our parent company is E.ON SE, which is headquartered in Düsseldorf in Germany. We pay taxes here in the UK, and we are proud to do so. We also invest significantly in the UK, as I have said before.

I completely agree with your earlier point on trust. I have said to the Committee before that I was really struck when I first came back to the UK two years ago by the level of distrust of this industry. We have worked very hard in E.ON—my colleagues have worked very hard—to improve our business, simplify our tariffs, simplify our bills and those sorts of things.

John Robertson: You are not trying hard enough. Let me move on.

Albert Owen: They might put the prices up this winter. They have not done that yet.

Q64 John Robertson: I am still waiting to hear when you are going to put your prices up. Maybe you will tell us before you leave today.

You have talked about how much money you have invested. In your case, Mr Cocker, you have invested £7 billion. How much of that do you get as a subsidy from the Government to help you invest? You get money for renewables.

Tony Cocker: That splits down into fossil generation, so coal and gas-fired power stations, renewables—onshore and offshore wind—investment in gas storage at Holford, and investment in exploration and production in the North sea. Each of those is a stand-alone business. Of course, we all know that the renewables obligation provides a subsidy to enable renewables to be built, but we have a Government policy—

Q65 John Robertson: So you do get money from the Government?

Tony Cocker: No, that—

Q66 John Robertson: Okay; fine. The answer is that all that money you have got, even though you are investing in renewables and different kinds of technology—you get nothing from the Government to help you. Let me ask you, Mr Johnson, what about your company? You said that you had £2.9 billion invested. Do you get any money from the Government to help you with what you are doing?

Guy Johnson: We do not get subsidies in relation to the moneys that I talked about. Those are moneys that relate to the investment that we make in what, for want of a better term, you could call our conventional power generation and our retail business. If you add in the investment that we have made across our renewables business—that has invested in the order of £2.3 billion in the UK over the past five years—then, yes, we do receive some subsidy in relation to that. In the past three years, those total in the order of £170 million. They are vastly dwarfed by the £2.3 billion that we have invested, for example, as you know, in building Gwynt y Môr off the north Wales coast, and in operating and building jointly with SSE Greater Gabbard, a 500 MW offshore wind farm which opened last year.

Q67 John Robertson: Transparency is important. There is a distinct lack of transparency between the generation side of your business and the retail side that you give to the customer at the other end. I know that there is a middle person who buys off one and sells to the other. I appreciate that, but my problem is this. According to Ofgem, you make roughly 23% profit on generation, and according to your own figures it is anywhere between 17% and 21%, depending on the company. And yet all we ever hear about is how much money you make on the retail side, or how much money you lose on the retail side. When you were in last time, I asked you whether, when you pay money in a dividend to shareholders, you include generation and retail, and you said yes. Why are you still not putting these two things together when you are trying to work out a price rise for people?

Tony Cocker: We don't put those things together.

John Robertson: I know that. I want to know why.

Tony Cocker: We don't put those things together for exactly the reason that Stephen Fitzpatrick explained. We run these businesses as separate, stand-alone businesses.

Q68 John Robertson: They are not stand-alone when you are paying your shareholders.

Tony Cocker: They are stand-alone businesses and each has to survive on its own two feet. We agree with that, which is why we have been calling for virtual separation of generation and retail, which is what the Labour party leader is now also calling for.

Q69 Chair: Why not have real separation? Why just virtual?

Tony Cocker: It depends on what you mean by real separation.

Chair: Well, run them as separate companies.

Tony Cocker: We do run them as separate companies.

Q70 Mr Lilley: Require them to be sold off. If they are run entirely separately, would there be any loss from requiring you to sell off your supply businesses and just run generators, or vice versa, or are there any economies of vertical integration?

Tony Cocker: From my perspective, there are no economies of vertical integration, but that is a different question from the one you asked about being forced to sell off an asset as a forced sale.

Q71 John Robertson: Let me clarify. It is okay for everything to count for shareholders who get dividends, yet it is also okay for an ordinary member of the public to get a big 9% or 11% rise while you are making some 20% profit on the generation side. A simple yes or no answer will do, because it is about transparency gentlemen, not about clouding the issue.

Tony Cocker: You are probably also looking historically, John. I think Mr Johnson highlighted that at least some of their gas stations were not making very much money this year. Our gas stations are not making very much money. When you see the results at the end of this year, you will see that profits have come down. They have to stand on their own two feet. That enables a competitive market. For Stephen Fitzpatrick to—

Q72 John Robertson: Not for the people who count. I have a few more questions for you. A simple one: will you promise not to cut off elderly and disabled people in the winter, even if they cannot pay their bills?

William Morris: Yes. We have that as a policy. In fact, we cut nobody off during the winter period.

Guy Johnson: Yes. We do not cut anybody off during the winter period.

Q73 John Robertson: We will hold you to that. The next question is, how do you know that you are not cutting off somebody who is elderly or disabled? What are you doing to find out?

Tony Cocker: Obviously, we work very hard to make sure that we find out and understand details of our customers where we possibly can. In fact, we have agreed that we will not cut off anybody between 1 November and the end of February—no residential customers.

Q74 John Robertson: We are not here to give you a hard time for nothing. Fear is very important, and I am frightened that we will put you guys in such a position that people out there are even more scared about whether they want to put on their electricity or gas. Whether we like it or not, some people in my constituency have to worry about whether they are going to eat or heat. I need you to ensure that they are going to have both.

William Morris: Absolutely. I return to my earlier point in answer to Mr Lavery's question: we need you to help us to get the message across. There is no reason for anybody in our country to be facing that dilemma.

Q75 John Robertson: Hopefully we will get there. May I ask you a question, Mr Fitzpatrick? I asked you this before, but I am going to change the company this time. If I were to give you half of RWE's business, could you do it cheaper and make it better for the customer?

Stephen Fitzpatrick: I am glad you asked. When we looked at last year's Ofgem segmental accounts, which is the total top-down due of all the retail business—all the big six and small suppliers—we found that if each of the big six were to charge the same unit rates that we charged in 2012, I think I am right in remembering that the total saving would be £1.4 billion for the year in gas and £2.3 billion for the year in electricity. That is £3.7 billion less, which is about 10%. Interestingly, RWE's prices after the recent rise are the most expensive on a standard basis, so I would be delighted to take half their business.

All the questions I have heard today are about trying to track down where the money is going. As I said the last time I was here, and I think the time before that, you will never find it. These guys are among the best filibusterers in the business. I have not followed very much of what has been said, but we need more competition.

Q76 John Robertson: Would you then agree that it is time that we looked at these companies, broke them up into generation, and retail and business, and then didn't allow

them to do both? We make them be on either one side or the other, and if they will not, we will have to do a proper investigation into it. *[Interruption.]*

Stephen Fitzpatrick: I would like to answer that and I am afraid that I disagree with you. I am sorry to say it, but I do not think there is a significant problem with vertical integration, although it is interesting that everybody is talking about how there is no synergy in owning generation and supply, and that there is very little netting off, but nobody wants to separate them. That leads me to think that there must be a benefit. However, I do not think that the question of vertical integration is the biggest problem.

The biggest problem is the lack of competition. I can tell you that one in five customers joining today are immediately leaving to go back to their previous supplier because of a win-back inducement that can be up to 15% of the bill. That means that when a customer leaves a supplier—I am not going to name any names—and calls up and says, “I am going to leave you today. I am going to switch to Ovo Energy or a competitor,” the supplier says, “Oh, hold on a moment, we have just found out that we can save you £160.” I am sure you will get a chance to investigate some of the answers of the witnesses coming next, but we have heard that British Gas seems to be the most active, with a dedicated win-back team whose sole job it is to call people and say, “There has been a terrible mistake. We have been overcharging you all this time, but we can now cut your bill.”

When that kind of behaviour is allowed to go unchallenged, and the ex-monopoly advantage that the big six have is allowed to go unchallenged by Ofgem—I know that you are seeing them later on, so you can ask Mr Wright about this—then you will never get effective competition. If you don’t have that in a retail market, you will always be trying to find out where the money is going. Time and time again, you will have clever, complex and confusing answers, and you will never get to the bottom of it. Effective competition is really the only solution to lower bills.

Tony Cocker: Can I pick up on two of the points made by Mr Fitzpatrick? He has made this point twice, first with respect to what I think used to be called discounts, and secondly with respect to win-back. Three months after I rejoined E.ON UK, we decided that we would not do that activity. We provide the same prices to our existing customers as to new customers. We are not prepared either to do deep discounts or to win back in the way that Mr Fitzpatrick has described.

Stephen Fitzpatrick: I accept that E.ON is by far on the right side of this argument.

Tony Cocker: Thank you.

William Morris: Neither do we, for the record, if there is any doubt.

Tony Cocker: My second point is that I have written today to the Prime Minister and the Secretary of State, and to Andrew Wright, whom you will see later, calling for a Competition Commission investigation. I fundamentally believe that this market is competitive. But as Mr Robertson has said several times, and I acknowledge it, we are not trusted. Therefore, I believe that we need to have a thorough Competition Commission investigation, supported by Ofgem, because they are the experts—they have been in the industry for a decade—but led by the Competition Commission, which has a deep insight into

competition law and into general competition across industries. I firmly believe that it would be helpful to depoliticise this debate and get experts in to look at it, so that we can sort it out once and for all.

Q77 Ian Lavery: It is easy to say, “Depoliticise this debate.” Every time we have had the big six in front of this Committee, they have cried, “I’m hard up; I haven’t got any finances,” and that they invest so much money.

There are people out there watching this on television. They need to know that British Gas made more than £1 billion in profit last year; EDF made £972 million; E.ON made £367 million; npower made £326 million; Scottish Power made £269 million; and SSE made £780 million. Is it not about time that you looked at the biggest problem, which is that consumers can no longer afford to pay their energy bills? Never mind depoliticising things. What are you going to do for consumers?

William Morris: Let us try to answer it clearly and simply.

Ian Lavery: That would be helpful, if you could.

William Morris: There are two key things to talk about. First, are those profits fair?

Q78 Ian Lavery: How can these profits be fair when people cannot afford to pay for their energy?

William Morris: The second part of the question is what you do with the profits. The reason why it is fair is that if I do not make a 5% profit in my business, I cannot afford to continue employing my 20,000 people, who are equally members of our society in Britain, and I cannot afford to operate the company. It is less than what supermarkets make and a fraction of what mobile phone companies make. However, I accept the point that it is still a big number, because 5% on a business my size is a big number.

So what do I do with those profits? Again it is right back to those same constituents of yours, Mr Lavery. We are investing this money—£4 million a day and more than £7 billion over the past five years—back in Britain, creating jobs and prosperity.

Q79 Ian Lavery: The system is obviously fractured, because consumers and lots of people up and down this country cannot afford to pay for what you are providing. There is a real opportunity here potentially to investigate renationalisation, because you cannot run the companies.

William Morris: As Mr Cocker said, there is a huge amount of value in putting all the facts on to the table and reviewing them. Clearly, we are not being as effective as we should be in getting the message across. The point I am trying to make is that if we were sitting here earning the kind of margins that other businesses earn in our country, you could rightly challenge me and say, “You are clearly ripping people off,” but the evidence is very different. It is very transparent that we are clearly not.

Tony Cocker: Mr Lavery, we understand that people up and down the country are worried about their bills. If your constituents are worried about their bills, ask them to contact us—call us, e-mail us, whatever—because we understand that completely. The debate today has asked, “How do we control those bills? Are there some parts of the bill that we can move out of that bill, either by making things more cost-effective or moving the cost into general taxation or both?”

Q80 Ian Lavery: I think you are very happy to move what Mr Cameron said last week—the green taxes, which wouldn’t have any impact on you. What about the profits?

Tony Cocker: Let me come back on that. As I said before, we have invested our profits. We have 10,000 people in this country who work hard to service our customers every single day. This morning, I got a lot of e-mails and tweets from my colleagues wishing me good luck in our conversation this afternoon. They are proud to work for us and they do a great job.

At the same time, we all understand that there is a lack of trust in the industry. We also all understand that we need to reinvest in this industry and in developing new power stations, greener power stations, cleaner power stations. We need to invest in energy efficiency to reduce the energy waste that leaks out of our buildings every single day.

When I wrote to Ed Miliband, I said that at a stroke he could reduce the cost of bills by moving some of those green levies and social obligations out into general taxation.

Chair: You have told us that several times. Dr Lee has been waiting patiently to come in.

Q81 Dr Lee: I am pleased that you are converted to the idea of a Competition Commission inquiry, Mr Cocker, and grateful to everyone else who has backed you in that. The challenge is that you are an oligopoly. How do you respond to that?

Tony Cocker: We are not, which is why we want the Competition Commission to demonstrate that.

Q82 Dr Lee: Okay. You have been very smooth—not just you personally. I am expecting the same. How many of you employed public relations companies before coming here? If you did, did any of you share a public relations company?

Guy Johnson: We certainly did not employ a public relations company before coming here. A couple of things to say: the first is that—

Q83 Dr Lee: No. The point of what I am trying to say is that there is a suspicion, whether it is accurate or not, that you are a chorus line acting in concert in everything you say, although you try to tease out differences between you—we heard it on ECO and various other things. That raises the question: why isn’t there more competition in the market? I look

at electricity market share, and for 2008 E.ON had 18%; in 2007, 17%; and in 2012, 17%. The same figures for npower are 15%, 13% and 14%. There is not much change, so your share of the market is pretty static. That suggests to me that, generally speaking, unless there is a huge amount of churn, your customers are pretty static and view their power companies like they view their banks. Do you think this market is competitive? There is so much consensus and agreement in terms of timing of bills, and when they go up. I get a sense that this is more monopoly than competition. That is my sense, anyway.

Guy Johnson: There are more national supply companies in the UK than in any of the other EU 15 countries.

Dr Lee: Sure, but your market shares are not changing.

Guy Johnson: We now have 15 small suppliers, which we did not have a while ago. If you look at UK domestic gas prices compared with the EU 15, we are the second lowest. If you look at the comparison for UK domestic electricity prices, we are the fourth lowest.

Dr Lee: Yes, but your market shares are not changing.

Guy Johnson: To be honest, to suggest to a company that has invested—including our generation profits as well as our supply profits—£2.9 billion in the UK over the past five years and made a profit of—

Dr Lee: You are still not answering my question. Your market share is not changing.

Guy Johnson: I am trying to—

Q84 Dr Lee: If your businesses were truly competitive, you would hope that your market share would gradually increase. That is what tends to happen in a true marketplace. Is not the problem here that you are all dealing with gas and electricity—two commodities—and trying to deliver them along a single pipeline system and a single set of wires and circuits, but actually there is a limit to how much competition in retail will deliver any further price reductions? Therefore it would be better for all of us if we got out of you guys “competing” with each other on retail, and just got you competing over generation. Would you agree with that?

Tony Cocker: No.

Q85 Dr Lee: Why?

Tony Cocker: Both generation and retail are competitive in separate ways.

Q86 Dr Lee: Have you delivered price savings to customers thanks to the way that you run your retail businesses? In effect, you are competing on customer service. There is not much more for you to compete on.

William Morris: The reality is that the product range is relatively limited.

Dr Lee: Two.

William Morris: Gas and electricity. Obviously, we have many other products, such as home services, telephony and others, that we would like to bring into the market to make it more diverse, but the reality is that there is competition. You made a point about market share variance. Our company has been recognised by uSwitch for eight years in a row as being number one for service, so we are trying to hold on to customers. In fact, if I take this outside our sector to the retail space, you do not see massive fluctuations in market share between supermarkets, although you obviously do see more diversity in products. It is a fair challenge. We need to inject more diversity of product into our offers, so that there is a perception from customers that they are getting a different experience and not just a better service experience, as in the case of SSE.

Stephen Fitzpatrick: As I mentioned earlier, we have noticed that if all the big six were to charge the same prices that we were able to charge last year, there would be a £3.7 billion saving, so I am not entirely sure how all these guys are running their businesses. We have invested in very up-to-date technology and we employ some very bright people in our trading team and it sounds as though we are managing to beat the professionals here at buying energy at the right price. We are passing those savings on to customers. At the moment, it looks like our energy tariff, which is fixed for 12 months, is £164 a year cheaper, which is some 13% or 14% more than the price rises we have heard about. There is a real argument for more competition in the sector, because that is the best way to keep everybody on their toes. The steps we have seen from Ofgem, which—let us be clear—is responsible for ensuring a competitive and well-functioning market, have almost entirely failed during my company's lifetime, which is just four years. We are among the fastest growing of the independent energy companies. We have gone from a standing start to just over 0.5% market share in the last four years, but Ofgem has not done nearly enough.

Ofgem's latest retail market review, which was headlined as the biggest shake-up to the energy market since deregulation, contains almost nothing that will address the concentration that the big six enjoy. They have an ex-monopoly position. If you look at market shares, you should look at the regional market share. Each one of the big electricity companies came from a region. Their regional market shares are huge. Similarly, British Gas's concentration in the gas market is enormous. That is one of the big problems that we are yet to deal with.

Q87 Dr Lee: I have one final question. What is an acceptable level of return on capital? Comparing the UK with Europe, is there much difference between the two? You are talking about all this investment that you are making. What sort of return are you looking for on that capital and how does that compare with your other European operations?

Tony Cocker: If you are looking at the return on capital on the upstream generation business, that is a capital-intensive business. The return on capital in this country has been comparable with that required in other western European countries.

Q88 Dr Lee: Over what period of time?

Tony Cocker: Over the last five or 10 years. When we look at it internally, the required return for the UK is similar to that for Germany, Sweden or Holland. Over the weekend, I read Dieter Helm's commentary on the Labour party policy and I must say that I agree with it. He said that, at a stroke, the announcement of a price freeze has increased the cost of capital, which has increased the long-term costs of electricity and gas supply for customers in this country.

Q89 Dr Lee: How does that compare with other countries? I am trying to get some sense of whether you are getting or expecting a higher return on capital in the British market, as currently structured, than you would in the French market or the German market or elsewhere.

Tony Cocker: They have been quite volatile; I think that volatile is the right word. In Germany, the gas-fired power stations are really suffering and that affects our youngest, most efficient gas-fired power station, which was for some period not running. That demonstrates a zero return on capital outlay. It has now got a capacity contract, so it is doing better than that, but it has not been—

Guy Johnson: The reality is that there are some power stations, for example in Germany, that are being mothballed. That has not yet happened in the UK, at least so far as our portfolio is concerned, but the fact remains that with Pembroke, which has had expenditure of more than £1 billion and is one of the largest and most efficient gas-fired power stations in Europe, we have concerns about its profitability into 2014.

Q90 Dr Lee: I find this bemusing. You need energy to exist on Earth and the number of people on Earth is increasing. Their energy footprint is increasing, because we are using more electronic devices and whatever, yet you are telling me that you are not getting a great return on your generation. How have we arrived at this stage? I would have thought that building an electricity generating plant of some kind would be good, because you have a captive audience and we cannot do without it. It is not like how I can suddenly give up eating honey and eat something else because the price has gone up. Gas is gas and electricity is electricity.

Guy Johnson: Certain parts of our generation, such as the coal-fired power stations, have been more profitable. Raw material coal prices have dropped to an extent, because of the prevalence of shale gas in the US, and coal-fired power stations have been more profitable. Clearly, as Mr Cocker said, some of the nuclear stations have been very profitable, where they have very low input costs. I can only speak for npower, where our portfolio is very much skewed towards gas-fired power stations and where the outlook is pretty bleak.

Q91 Dr Lee: If Governments continue to go down the energy efficiency route and spend heavily on saving energy, it will screw your businesses. If you are apparently working on such narrow margins that you are mothballing in Germany, which, incidentally, has a

growing economy, it strikes me that you will be screwed if we go down the path of creating a really energy-efficient nation.

Tony Cocker: Over the longer term, there is clearly a challenge to the generation business. At E.ON, we are investing heavily in energy efficiency. You will perhaps know that a few weeks ago we acquired Matrix, an energy management company that is based in Glasgow and Manchester. It works with companies, both in the UK and overseas, to manage energy consumption and it can achieve some significant energy savings. We see that as a trend and are therefore pushing our business in that direction.

Q92 Dan Byles: Would you accept that the lesson from everything that we have heard today is that your accounting and reporting practices utterly fail the basic test of transparency?

William Morris: No, I certainly think that from an SSE point of view—

Q93 Dan Byles: We have sat here for an hour trying to get to the bottom of exactly where and how you make your losses and profits. I do not know about anyone else on the Committee, but I am still none the wiser. That cannot be very transparent.

William Morris: Speaking for our company, we are UK-registered. All our accounts are published and our consolidated segmental statements are published. Ofgem, the Government-endorsed regulator, has employed BDO, which is an independent auditing company, to look at those accounts. It came up with a clear statement, which I will quote. Given your statement, it is critical that we are explicit. The statement said: “Given that the EBIT of all segments is disclosed and reconciled to the group’s UK accounts, there is no possibility to disguise or hide profit. There appears to be relatively little scope for SSE to intentionally distort its presentation.” That is the official—

Q94 Dan Byles: I am a bit concerned if the lesson that you guys are taking is that you are transparent enough.

William Morris: No, I want to build on that point. I wanted to start by being factual about the body that is charged to look at this thoroughly and independently. It is evident from all our conversation and from the media conversation of the previous months that we need to go even further and find a way of being more transparent in an accounting sense and being more articulate and clearer on what is going on. If we are ticking the first box, we are not ticking the second one. From our point of view, we have been very transparent—forgive the pun—about wishing to participate in anything that can do that, both with the Government directly, or Ofgem or anybody else.

Q95 Dan Byles: So you could implement, for example, all BDO’s recommendations to increase transparency? You could do that unilaterally?

William Morris: We have implemented most of them. One of them is around our financial year end, as we are different. Our point is that we are a British company and we follow the UK tax law, but most of the other large companies use the European calendars. We are going to review that. Our financial director will review it. If that is deemed to be of great value to make everything easier and comparable then no doubt he will take the view to do that.

Q96 Dan Byles: Do you have a date by which that review will be complete?

William Morris: I don't have a date today but I know it is in conversation. I can certainly produce it for you subsequent to this hearing.

Q97 Dan Byles: I know we don't have much time, and it may sound as if I am going over old ground, but bear with me a moment. The percentage of the average dual fuel bill that represents a profit—we will keep picking on SSE for the moment—is about 5%?

William Morris: Correct. That is our margin: 5p in the pound.

Q98 Dan Byles: Of the whole of the bill?

William Morris: Yes.

Q99 Dan Byles: So if we strip out the 10% of the bill that is green levies and social levies, which are just pass-through costs, it is higher than 5% because that is nothing to do with what you are doing. You are just doing it on behalf of the Government. If we strip out the distribution and transmission costs, which again are nothing to with your business, you are passing that straight through to the consumer, the percentage profit starts to rise, doesn't it?

Tony Cocker: I am sorry, Mr Byles, but I would disagree with that. Yes, those costs are driven by Government policy, and they are not completely in our control, but we can influence them and they are a huge risk. So, for example, on the ECO, if we don't deliver it, Ofgem can fine us up to 10% of our turnover, which is very significant. So these are not just simple paths. It is not a regulated business where we go along with an invoice and say, "We've spent this" and they say, "Fine." As a company we take significant risks in managing that and similarly in managing the energy supply. With respect to transmission and distribution, there is less risk, although there is due change from time to time as you know.

Q100 Dan Byles: What about VAT? You include VAT in the headline figure.

Tony Cocker: VAT is clearly a pass-through.

Q101 Dan Byles: One small example of this wonderful transparent nature here is that you could strip 5% of VAT out straight away and your percentage profit would be slightly higher than you reported.

Guy Johnson: If I can help here, Mr Byles, your criticisms would have been very fair a few years ago. The fact is that we do now all publish financial statements. Those differentiate between our supply business and our generation business. They differentiate between our domestic supply business and our non-domestic supply business. In relation to your specific question, the Committee asked us to let you know what our profit was in terms of pence per kWh over the last four years. That is the data we have provided. You asked us what our profit was, splitting out some of what you call pass-through costs. I share Mr Cocker's view that where, as we discussed in relation to network costs, we do not know what our costs will be next year, it is difficult to call them pass-through costs, but never mind. We have written to the Committee and we have set out what our profit is both on a pence per kWh basis and as a percentage of the bill, excluding the costs that you referred to.

One of the things that we are focused on at npower—I know that we are trying to do more—is trying to improve transparency. I think the consolidated segmented statements have done that. I think that the “Energy Explained” event that we held in July was about saying, “This is what we believe the components of the bill are; this is what we believe the components of the bill will be in 2020.” We are going to do that again in January. We want it to be a six-monthly event. Transparency is important but a lot is happening. The other thing that I would say is that in relation to customers, fewer tariffs, clearer bills, those sorts of things will also improve transparency.

Q102 Dan Byles: One point I particularly want to ask you about, Mr Johnson, concerns the 16% difference between your standard variable and your cheapest tariff. Do you make a different profit on each of those bills, with more profit on the bill that is 16% higher? Do you reflect that on the statement on the back of the bill that says where the money goes, or is that a generic average?

Guy Johnson: We have a standard product, which we talked about, and two fixed-term, fixed-price products: one runs to April 2015 and the other runs to December 2017. Those three products have different unit rates and terms. In relation to the fixed-price products, clearly it is more certain and if we are, therefore, better able to hedge our wholesale costs, we are better able to manage the variability.

Q103 Dan Byles: Can you give an estimate of the profit as a percentage of that bill?

Guy Johnson: I cannot in relation to specifics, but I can tell you that in 2009, 2010 and 2011 we made a loss on our domestic retail business, supplying to our domestic customers. In 2012 we made a profit before interest of 3.6%.

Q104 Dan Byles: Is that on average, across all bills?

Guy Johnson: Yes.

Q105 Dan Byles: When you put that chart on the back of the bill that gives people a breakdown of where their money goes, is that a generic average across all bills, or is that specific to that bill?

Guy Johnson: No, it is generic.

Q106 Dan Byles: So somebody who is on the more expensive tariff, paying 16% more, is being misled because they are probably paying a higher percentage of profit on their bill than you put in that table.

Guy Johnson: I hope that we are not misleading them, but in the same way as “Energy Explained” was, some of this data is inevitably public data. We think that is the right way of doing it as that is the more transparent, clearer way. One of the things we need to be aware of is competition law issues. Clearly, the more we can use publicly available data, the better.

Q107 Ian Lavery: On the profits, in line with what Mr Byles has been saying, do you publish your trading profits?

Mr Lilley: We have been over that.

Guy Johnson: When I replied, I said that our trading profits are included in those segmental statements; those financial statements that I talked about.

Q108 Ian Lavery: You are not obliged to provide details of your trading profits from generation and supply to Ofgem, though, are you?

Guy Johnson: The trading profits in relation to our generation assets and our UK supply business are included within that financial statement.

Q109 Dan Byles: Mr Fitzpatrick wanted to come in on my question.

Stephen Fitzpatrick: Very briefly. I am pleased that you picked up on the per customer profit. One of the things that strikes us at Ovo is that a large number of people contribute heavily to the bottom line of large energy companies and a smaller group of people may be loss-leading, but, generally speaking, energy companies hope that they will become profitable customers over time. If we want to run trustworthy energy companies, you should not be able to save 16% by moving from one tariff to the next while using the same amount of energy in a world where we say that the profit margin should be 5%. Similarly, I do not think you should be able to call up your energy company to say, “I want to switch to another energy company”, for them to say, “No, no—we can save you 15%”. If that is the case, immediately, you think, “Hold on a second—for how long have I been overpaying?”.

Until we get to a point where people are paying a price that individually reflects the cost of selling their energy, you are never going to have trust in the energy industry. I encourage all of my competitors to think about treating every customer fairly and saying, “We will sell the same gas and electricity to one house and the house next door, and we will charge the same price.” If you were to do that, you would find that your businesses would be profitable. We hope to make a 5% profit and our bills are about 12% lower, so I do not think that profit is the issue. It may be that they are not efficiently run.

If every customer ended up paying the same price for the same amount of energy, with perhaps some movement on cost of service, which could be 2% or 3%, everybody would feel that there was much more transparency and customers would think, “I get the same quote from every energy company for the same amount of energy. I guess that is the price of energy.” Instead, every time they call up to complain, they get a deal dangled in front of them, so they think, “We’d better take it, but next time around I am not sure.”

Dr Cocker, I do appreciate that not all energy companies are the same.

Tony Cocker: Thank you.

Chair: I think on that point we should move on to the next set of witnesses.

Examination of Witnesses

Witnesses: **Neil Clitheroe**, Chief Executive Officer, Retail and Generation, ScottishPower, **Ian Peters**, Managing Director, Energy, British Gas, **Martin Lawrence**, Managing Director, Energy Sourcing and Customer Supply, EDF Energy, and **Ramsay Dunning**, Group General Manager, Co-operative Energy, gave evidence.

Q110 Chair: Thank you for coming to give evidence. Please introduce yourselves with your name and company, starting on the left.

Martin Lawrence: My name is Martin Lawrence. I am the managing director at EDF energy.

Ian Peters: I am Ian Peters, the managing director of residential energy at British Gas.

Neil Clitheroe: I am Neil Clitheroe, and I look after the retail and generation business at ScottishPower.

Ramsay Dunning: I am Ramsay Dunning, general manager at Co-operative Energy.

Chair: Before we come on to some of the general wholesale prices, one member of the Committee had a few issues that we did not manage to get to in the previous round. So we shall start with Albert Owen.

Q111 Albert Owen: Yes, I think maybe the other ones got off a bit lightly. You were sitting at the back and you heard what they were asked. You will not have had any time to prepare for this one, but it is a serious question.

To justify your price rises, we have heard some detailed explanation about the complexity of the market and various things and reasons about the commodity prices, levies and so on. One thing that my constituents and the British public who have contacted us prior to this meeting want to know is, when people are struggling, when inflation is at 2.5% or 2.6%, how can you justify these rises, and at the same time give your senior executives huge pay rises? That does not square with some of my constituents and customers.

I received a letter from British Gas. I am a customer of British Gas—I might not be for very long, by the way—and therefore declare an interest. You have said the reasons for putting up prices and have given a very detailed explanation, but not in any of the literature did you mention that dividends were being paid to your shareholders, or indeed that the chief executives of your companies have had huge bonuses at a time when people are struggling and you have put up prices considerably. That is not just British Gas, but I am making that point to you. I would make the point to the others as well. How can you justify that at this time? Don't you think that the restraint the British public is under should apply to your senior executives as well?

Ian Peters: Let me take that.

Q112 Albert Owen: I've got some more for you.

Ian Peters: I am sure you have. Let me start by saying that I am acutely aware of the stresses and strains on customers that these prices make. I talk to customers most days of the week and most of the weekend.

Q113 Albert Owen: I am sure they raise this with you.

Ian Peters: They have indeed. So let me deal with the three points. We will come to the underlying increases in a minute, as to the rationale. You heard that in the previous session and I will give you my version of that in a minute. At the heart of that is a very difficult trade-off between being responsible towards our customers, and delivering a fair profit—that is a longer debate—to enable us to invest in securing supply. We agonised over the decision for a long time. We debated the root causes.

Let me deal with the two points you made around dividends and executive payment. British Gas is part of Centrica, a British company, and we are completely transparent on this. Our dividend payout has been broadly constant at around 60% post-tax for the past several years.

Q114 Mr Lilley: Sixty per cent. of what?

Ian Peters: It is 60% of post-tax earnings. That is against a benchmark for utility companies around Europe of around 75%. That creates a yield of about 4.5%. It is worth saying that, given our heritage, we have 700,000 small shareholders from the days of privatisation. These are paid into pension funds. That is a responsible dividend policy, given the benchmark.

Q115 Albert Owen: What percentage of your shareholders now are individuals?

Ian Peters: There are 700,000 who are what you would regard as—

Q116 Albert Owen: What percentage are those?

Ian Peters: In terms of total holdings, I haven't got the figures.

Q117 Albert Owen: You should know, because it is very low.

Ian Peters: I would have to come back to you on the total percentage. Executive remuneration is a bigger issue than just the energy industry. Our executive bonuses are determined by an independent remuneration committee and are based on long-term performance. This year, as in previous years, underlying performance will be the benchmark. It is very transparent and the terms are put to our shareholders every year. The remuneration committee this year will be very aware of the context in which those bonuses are assessed. I do not sit on it, Mr Owen, but they will be very aware.

Q118 Albert Owen: I am talking about justification here. As I have said, how do you justify these rises to people who are struggling? I am not talking just about this annual rise that you talk about, Mr Peters. The average British Gas bill in 2008 was £625 and it is now £865, a 38% increase. At the same time, the chief executive of Centrica, who is not here today—you are here instead of him, otherwise I would have asked him the same question directly—had a rise of 36%. His annual salary has shot up to £2.35 million for one individual, yet people are struggling. That is the question I am raising in that context. How do you justify that? Gas prices going up by 38% and wages going up by 36% to your highest earners.

Ian Peters: Prices do not necessarily follow through to bills. Because of all the work we have done with our customers to help manage their consumption—

Q119 Albert Owen: Isn't it a real indictment? You tell us your profit margins are always flat and various things, but you think that your chief executive deserves a 36% increase and at the same time this year, you are putting up bills almost 10%.

Ian Peters: The residential prices, which is where your focus is, have gone up for my customers over the last four or five years by about 4% because of everything that we have done to help reduce their consumption.

Q120 Albert Owen: My bill in that period has gone up by only 4%?

Ian Peters: On average.

Q121 Albert Owen: I am not Mr Average, then, I'm afraid.

Ian Peters: It is the nature of averages, Mr Owen. There is a big spread. Sam Laidlaw overall looks after a global group, and a lot of the growth in the Centrica profits, which post-tax are 5.9%, I would add, has come from expansion overseas. So it is not just about what is happening in the UK. We are very aware of this issue. As I say, it is subject to an independent remuneration committee.

Q122 Albert Owen: So you are quite comfortable with putting people's prices up and still taking huge bonuses at the top of your company. Yes or no?

Ian Peters: We thought deeply about what to do with pricing, because of the impact on household bills at a time that incomes are stressed. We do more than any other company to help those most in need and last year alone 2.1 million—

Q123 Albert Owen: But you do not lead by example, your senior people. The rest of the country is suffering wage freezes or even cuts in many places, in the public sector and in the private sector, and small businesses are suffering. They are hit buying your energy.

Ian Peters: I recognise that and say that on executive pay, salaries have not changed since 2010.

Q124 Albert Owen: But bonuses have gone up.

Ian Peters: Bonuses have gone up. That is a matter of record, I'm afraid. This year the remuneration committee will take fully into account the context in which we are.

Q125 Albert Owen: They haven't done since 2008. Can I ask the rest of you to answer a similar question, though obviously I won't quote British Gas prices to you?

Neil Clitheroe: The most difficult decision that you take in a year is the movement of prices, because you immediately get customers calling you, worried about their bills and the difficulties. When there was the price rise last week, we had over 60,000 customers call us virtually straight away with worries about their bills. We managed each one of those and continue to manage each one. It is the hardest decision that we take and for us the recovery of costs within that—and I want to come back to it—was the key reason. We were very clear that our profitability will be within this 4% to 5% range for this year, next year and obviously for last year.

It is extremely difficult to make these decisions and they are based on the recovery of costs. On how that feeds through into my remuneration, I am rewarded based on a very simple balanced scorecard that looks at where we fall in terms of—

Q126 Albert Owen: I do not want to personalise this, but are you on a bonus?

Neil Clitheroe: I am, yes.

Q127 Albert Owen: Have your bonuses gone up in the last two to three years?

Neil Clitheroe: They have remained flat. They have remained around the same level for the last couple of years. How I get rewarded—you can imagine what is in there—is based on customer satisfaction, employee satisfaction, profitability, cost control, and a whole plethora of things, as it is for Keith Anderson and the other executives in ScottishPower.

Q128 Albert Owen: You are comfortable with taking bonuses at a time when your customers are struggling and phoning you up in the way you suggest.

Neil Clitheroe: I am not comfortable with what is happening to my customers at all. That is something that we are working really hard on. If we do not deliver to our customers, then we do not get our bonuses. If we do not deliver that, then that does not happen, because it all flows through from it.

Q129 Albert Owen: But I am arguing that they are paying for your bonuses. Mr Dunning?

Ramsay Dunning: Co-operative Energy is obviously different, because we are owned by our customers.

Q130 Albert Owen: That is why I asked you—to give a balance.

Ramsay Dunning: That gives a completely different dynamic to it. When we have an AGM, the people sitting in front of me as our owners are also our customers, so the democratic approval process takes everything in the round. We have the usual things with—

Q131 Albert Owen: Do they approve any bonuses you get?

Ramsay Dunning: Yes, they do. There is a sub-committee of directors, who are of course voted for by members as part of the democratic process, that oversees all that, and there is democratic voting on that.

Q132 Albert Owen: I do not want to leave you out, Mr Lawrence.

Martin Lawrence: I will try to be brief. Across the whole company, we recognise that our customers are finding it tough. We have exercised pay restraint across the whole organisation for a number of years now, including at executive level. I received a below-inflation pay increase last year. My bonus last year was lower than the year before, which was lower than the year before that. That is the picture—

Q133 Albert Owen: But you still have a bonus. Do you still take a bonus on top of your salary?

Martin Lawrence: The way the remuneration is structured is that there is a fixed piece and a variable piece. I only receive that variable piece if I achieve a range of targets—some of them are financial; some are to do with health and safety; some are to do with customer engagement; some are to do with people engagement—across a range of measures.

Q134 Albert Owen: So you think it is okay to put prices up and still take a bonus when people are suffering?

Martin Lawrence: The way my remuneration is structured is with a fixed piece and a variable piece, and I only get that variable piece if I hit the targets.

Albert Owen: That has exhausted that.

Q135 Chair: You will have heard the previous panel, which started on the issue of Ofgem's view of the wholesale price and the view of other players in the market. What is your view of the state of the wholesale price?

Ian Peters: Let me talk about what of the commodity price went into the recent increase. We had seen an 8% year-on-year increase through 2013 on 2012—to go back to an earlier point, that is roughly half the bill—so 3% or £37 of our increase was attributable to that. Ofgem's 1.7% is actually a forward-looking, rolling 12-month view of the market, so to an extent we are comparing apples with bananas. If you ask my view about whether I think Ofgem's forecast for the next 12 months is broadly accurate, yes I do, but it is done on a different basis from the one that underpinned the price increase.

Q136 Chair: Do others have any different views?

Neil Clitheroe: In terms of the price announcement that we made, there was a £34 increase per customer from the wholesale cost, which was a 7% increase for 2013 versus 2012. That is based on our actual costs, so it is based on precisely what we paid in 2013 versus precisely what we paid in 2012. That is the basis for the movement, and obviously when we publish the segmental accounts in 2013, that number will be shown.

Chair: I have to suspend the sitting while Members vote.

Sitting suspended for Divisions in the House.

On resuming—

Q137 Chair: We have enough colleagues here to get started again. There were two votes, not just the one. Mr Clitheroe, you had just finished an answer. Perhaps you could repeat the figures.

Neil Clitheroe: Yes, of course. In terms of the wholesale increase that we reported last week, we saw a £34 per customer increase, which represents 7% of an increase. That is effectively based on our actual costs in 2013 for the purchase of electricity and gas versus our actual costs in 2012. That is the increase in the wholesale cost that we announced last week when we did the price rise.

Q138 Chair: Mr Dunning, what is your view?

Ramsay Dunning: Our view is not dissimilar really, and not dissimilar to Ofgem. We announced a price increase as well. Ours was 4.5%, which leaves us about 6% below four of the big six that have already announced price increases. It was cost-driven. We looked at the costs and reflected that through. It was wholesale costs, transmission and distribution and other charges. That is where we got to.

The follow-up question would be how do we leave ourselves cheaper than other people. If you would like, I will just explain that briefly. The first part is that there are some costs that we have that are different to the big six. We do not yet have full ECO costs. We have partial costs, but not full, and that, we estimate, saves us probably around 3% to 4%. On the other hand, we believe that if we were the same size and scale as the big six, there would be economies of scale, principally operational, which would come through, so that is a difference there.

The other difference is down to the target levels of profitability. As a member-owned business, we can achieve and we can sustain ourselves on lower levels of profitability, and that bridges, if you like, the gap that we now have between us.

Q139 Chair: Mr Lawrence, what is your view of the whole scenario?

Martin Lawrence: Obviously, we have not announced any price increase for our customers for 2013, and we have made no decisions about whether we will or not. We certainly hope to keep prices constant for the entire calendar year at the very minimum. We can see what is happening in the wholesale market; they have published figures. We recognise the numbers that have been quoted by both Ofgem and our colleagues. We face similar cost pressures from the other components of the bill. They have been richly discussed this morning. If you want, I can go into detailed numbers—

Mr Lilley: Yes please.

Martin Lawrence: Which would you like in particular?

Q140 Mr Lilley: How your costs are broken down, and the contributions from wholesale, transport and what others call “policy costs”.

Martin Lawrence: We have not published or announced anything, so I am telling you as a general trend. It may not be the same when the time comes. If we do, the price increases are included in there. We are not seeing a very large increase in wholesale costs. As far as the way we run our business, they are relatively stable, but there is a small increase. We recognise—

Q141 Mr Lilley: What is a small increase—2% or 3%?

Martin Lawrence: I do not know what the number is going to be, but it is of that order of magnitude. We recognise the 10% increase that you have had described to you by others, in terms of the costs of distribution and transmission for both electricity and gas, and we have also seen increases in the mixture of costs that make up the remainder: renewable obligation certificates, levy exemption certificates, feed-in tariffs, the warm homes discount and the energy companies obligation.

Neil Clitheroe: We broke down in detail what the cost movements are. Maybe I will go through those for a moment for the Committee. In transportation—the movement of gas and power to customers’ homes—the cost of moving the Ofgem average consumption of 3,200 kW of electricity and 13,500 of gas went from £233 to £258 or £259, which was £26 or 11%. That £26 can be split into distribution costs of £10, transmission costs of £2 and gas transportation costs of £13. Those increases occurred on 1 April this year, in line with the normal regulatory timetable operated by Ofgem.

We then get into the environmental and social schemes. We announced an increase of £20. The £20 can be split. ECO rose £8. It went from £53 to £61 per household. The renewable obligation rose by £6, from £21 to £27 per household. Feed-in tariffs rose by £3, from £7 to £10 per household. The warm household discount rose £3, from £7 to £10. That is the £20.

We then saw a VAT increase of £5, which is just 5%. In other costs, we saw an increase of £13, which was 4%. That is the cost of the IT systems within ScottishPower, the cost of the people supporting the business and general inflationary costs. That is the full breakdown of the £98 that our prices moved, which we announced last week, from £1177 for a dual-fuel customer in 2012 to £1275 for a dual-fuel customer in 2013.

Obviously, we will write to the Committee straight after that with the detailed numbers so you can see the breakdown. In the announcement that we made on Thursday, we purposely decided to break down all the costs so that it was very clear where the increases were through the bill.

Q142 Mr Lilley: That is extremely helpful to the Committee—at least, I find it extremely helpful—but your rise in wholesale prices, if I have it right, seem to be higher in percentage than other companies’.

Neil Clitheroe: The rise that we saw was primarily on the gas side. That is where the majority of the £33 was. There are two or three reasons for that. One is that in 2012, we had the lowest direct cost for gas of any of the big companies, at 62p per therm versus an industry average of 67.5p per therm. That is because we had a number of long-term contracts that our customers benefited from in 2012, and they came to an end in 2013.

We also faced some increases in costs in March and April this year, when the winter was very cold. It spiked, and gas prices went above 100p per therm. We were buying gas for our customers at that point that we had to cover. So the 7% is our actual 2013 versus our actual 2012. Our actual 2012 was from a low base.

Q143 Mr Lilley: I certainly was surprised to learn today about the 10% increase in the transportation, transmission and distribution costs, which somehow had passed me by. I know that is quite a significant part of the total cost increase that companies are reporting.

The other thing is the environmental and social costs having gone up significantly in the course of the year—I thought they were still quite small, although, as you know, I am extremely worried by how much they will go up in future. Do you see, other things being equal, those costs rising a lot in future as we move from fossil fuels to onshore wind, offshore wind, nuclear and biomass—all of which I think are at least twice as costly as fossil fuels?

Neil Clitheroe: I think the number you would look at to answer that question is the current renewable obligation number versus the levy control framework number within the energy bill. The current renewable obligation number for 2013-14 is £2.6 billion and, from memory, I think the levy control framework takes that up to just over £7 billion in 2019. That, obviously, is the payment that goes to support the decarbonisation and generation points in the UK. That is the current level.

The number for ROCs in 2014-15 was notified on 1 October by DECC and rose to £3.2 billion next year. That is based on retailers having to purchase ROC coverage for 24.4% of their retail customer usage versus, I think, 20.6%, but I may have that number wrong.

Ian Peters: We estimate that ROCs probably add about £5 to an average bill in 2013-14.

Q144 Mr Lilley: Am I correct that only roughly a third of the renewables' costs, be they ROCs or other things, goes on household bills and that two thirds goes on industrial bills? The costs therefore ultimately feed into household costs, because everybody ultimately bears those costs through higher prices in the economy as a whole, so the costs being borne by ordinary households is three times what they see on their energy bills.

Ian Peters: They are directly and indirectly affected.

Q145 Mr Lilley: Am I also correct that the levy framework does not include all the transmission costs necessary to bring windmills online in far off places, nor the capacity

charges that are necessary to have matching fossil fuel capacity to fill in for wind and variable renewables when the wind isn't blowing and the sun isn't shining?

Ian Peters: It certainly doesn't include transmission and distribution. I do not have an answer on capacity payments.

Neil Clitheroe: I don't know, either.

Martin Lawrence: Today there isn't a capacity market, so it is mostly done in fines. Ultimately, it will come through. We are talking about the first contracts in 2018, so it is some five years hence.

Mr Lilley: Thank you.

Q146 Christopher Pincher: I will try to get through this report quickly and perhaps finish with the first session. You said that, by 2019, the cost of the carbon reduction commitments that the Government entered into, as imposed on the bill payer, will be something in the region of £7 billion. If you divide that by the number of households in the country, you get to something like £280 per household. The estimates that have been in the press today are that, by 2019-20, green levies imposed on households could reach as much as £270 per household. Does that seem to you to be accurate?

Ian Peters: I think to get to that level we would need to include social charges, as well as green charges. We would need to lump them all together, from the figures in front of me.

Neil Clitheroe: I think that two thirds of the £7 billion is still applied to industrial and commercial customers. So it will not get as high as £270, because I think that is £7 billion divided by every household in the UK, whereas—I do not know the precise number—£4 billion will go to industrial and commercial, £3 billion will go to households and therefore the number will be £70 or £80 per customer.

The other key point, and it is a really important point, is that within energy bills the real focus all the time is obviously on the tariff—the actual pence per unit that customers pay and what we walked through today. But the other side of the bill is the consumption—what customers are using. That makes up their annual payment. And what we are seeing is a reduction in that consumption from many of the energy efficiency efforts that have occurred and many of the different appliances that people buy.

Actually, Ofgem has verified that this year; the average we used in the UK for the last four or five years was 3,300 kW for electricity, 16,500 kW for gas. From 1 December, Ofgem has said that those numbers are wrong, based on the DECC number. You need to move to 3,200 kW for electricity, 13,500 kW for gas, which automatically takes off £120 from the average annual bill.

That is what is happening in the background. The consumption of households in the UK is coming down, and that is why the Ofgem typical average consumptions are dropping. Now the question is how far—

Q147 Chair: How much of that consumption drop is people actually not affording to heat their homes properly?

Neil Clitheroe: That is a very difficult equation; I don't know the answer to that. What I do know is that 1 million households a year were insulated over the last three or four years. What we do know is that boiler efficiency has gone up and the underlying rules in terms of what boilers you can install have forced people to buy more efficient boilers. So there will be some sort of movement in terms of the underlying cost, but there has also been a huge energy efficiency drive in the UK that has dropped that consumption.

Ian Peters: We've done some analysis of our entire customer base, going back three or four years, on this. We have matched it with where we've known to insulate the property, or install a modern condensing boiler, or give another help to those customers.

Gas consumption is dropping—this is an average—at around 4.5% per annum. When we correlate known help for those customers, that explains about 3.5% of it directly as a consequence of insulation, improved boilers and so on. The 1% is harder to explain. Some of it will clearly be down to changing consumer behaviour. So I am not explaining that away, but that is the gap in the hard analytics: about 1% of the 4.5% is not due to specific help.

Q148 Christopher Pincher: If consumption does fall, then it would seem that the proportion of the bill taken up by green levies is going to increase.

Ian Peters: That is true. It is a mathematical—

Q149 Christopher Pincher: It is a mathematical fact, is it not? But why, in terms of the ECO and the proportion of the green levy that it constitutes, do the big six companies all have different views as to what that proportion of the overall green levy is?

Martin Lawrence: The reason is that we all discharge our obligations in different ways. The obligation is on delivering carbon savings targets within three different categories, and it is up to us to find the most efficient way possible of delivering those carbon savings. Some will do it more efficiently than others; some will have a different mix; and others are at different parts of the stage.

I suspect that we are one of the companies that are more advanced in terms of having delivered our ECO obligation for this year; I think we are at about 38% or something already discharged with Ofgem in September. So we have incurred higher costs than those that have not achieved that level of obligation yet. It is not surprising that there are different costs across different companies.

Q150 Christopher Pincher: But they are very different, are they not? The British Gas cost is something like one third less than SSE. I think that RWE npower suggested that its ECO cost is something like 6% of a dual fuel bill, which I worked out to be something like

£76. That is a 26% difference between RWE and SSE. They are very significant differences, are they not?

Martin Lawrence: I can't comment on what individual companies' costs are, but given the way the scheme is designed, it is natural that you will find differences across the companies.

Ian Peters: There are different approaches to execution. Clearly, as this is a direct contributor to the bill, it is in everyone's interest to do this as efficiently as possible. We are going about it in different ways.

From a British Gas point of view, if I break down the whole obligation, which runs to March 2015, roughly £900 million of it is in the carbon emissions reduction obligation, which is in individual households. To date, based on DECC's figures, we are delivering that cheaper than anybody else, at around £72 a ton of carbon. Our obligation under what was affordable warmth is some £250 million over the period and, again, we are cheapest according to DECC's figures at 14p a measure.

Under the carbon saving community obligation, which is the smallest component at some £200 million, I will admit that we are more expensive than the average. We have taken decisions to change the structure of how we deploy that and we are getting closer to the average with every month that goes by. This year, we will do between £400 million and £500 million of that total £1.4 billion commitment. Next year will be £700 million or £800 million.

We are accelerating because we have chosen to deploy this typically with larger contracts, such as working with local authorities and housing associations, the biggest of which, Warm Up North, is a £200 million programme with nine local authorities. There are different ways of doing it and it is everybody's interest to do this at as low a cost as possible, to help as many customers as possible.

Q151 Christopher Pincher: Is your way the most efficient? The IPPR's analysis of your approach says that a third of your tariff increase, which is £35 a year, could be avoided if you delivered the energy efficiency policies as effectively as SSE. What are you doing badly that SSE is doing better?

Ian Peters: I have just been through the figures. Of the three components of ECO, we are the cheapest in the market on two of them, including the biggest single component, CERO, so I do not understand where that analysis comes from. What is different is the acceleration of how we are choosing to deliver it between 2013 and 2014. That is where the year-on-year growth comes from. That is the nature of the contracts we have chosen to deploy.

Martin Lawrence: Because the obligation covers a relatively long space of time and you incur the costs in different calendar years, you will see different elements coming in. We hope to be almost 50% compliant by the end of this year. Others will not be. They will have lower ECO costs this year because they have done less work, but the converse will be true in the later part of the programme.

Ian Peters: We have already contracted for £900 million of that programme.

Q152 Christopher Pincher: I have one final question. The Prime Minister said in the House of Commons last week that he would look to roll back the green levies. We will find out in short order what specific levies the Government are looking at rowing back and stress testing. As and when they do, will you be able to pass on the savings that you make directly to your customers? Will you be able to do that in total and quickly?

Ian Peters: The short answer is yes. I do not know the details, but there are various options for how to do it. There is an argument for extending it as well as reintroducing the cheaper measures. Cheap cavity and loft insulation, which costs some £300, delivers the same consumption of carbon savings as solid wall for many times that. As in the previous discussion, there is merit at looking at shifting this into general taxation. The way that ECO is currently deployed through the bill takes no account of ability to pay. We would argue for that. The short answer to your question, however, is yes.

Q153 Chair: What would drive efficiencies in the delivery cost? At the moment, in theory, you should all be looking to do ECO in the most cost-effective way, because it is coming out of your operation. If the taxpayer was paying for those projects, what would drive the efficient delivery?

Neil Clitheroe: There are various different parts to ECO, but the simplest explanation is that, within the affordable warmth obligation, we have to verify benefits. We have to get signed statements from customers verifying the benefits that they receive from DWP and we then use that to validate that customer and install the measure in their property. Obviously, we do not have that data, which is held by the Government. That is one area of efficiency that we have highlighted several times that could be improved. With the warm home discount, there is a very good relationship between the energy companies and DWP for the transfer of data. There are a variety of ways to improve the efficiency and the measure mix that exists within ECO. Whether it is the most efficient measure mix for today's housing stock, and what needs to be done on today's housing stock, has been a debate for two or three years.

Jumping back to the question on the bills and how quickly that will come through, if the green levies went into general taxation they would roll into the bills very quickly. It would be just a case of managing that and the detail. There is a fundamental point that the UK is one of the few countries in Europe that does not identify green levies separately on the bill, but rolls them into unit rates and standing charges. Other European countries separate them out as levies—this is the amount that you pay for the energy, you pay another 10% levy for the environmental schemes and you pay 5% VAT, or whatever the numbers are in Germany, Spain or wherever. The UK is one of the few countries that effectively submerge that into the unit rate and the standing charge.

That, therefore, leads to the questions that we are answering today around the transparency of these costs, because it is just not articulated as a charge on bills; it is rolled in. That has been the case in the UK for a number of years, but it is certainly not the case in a lot of European countries, and it is not the case in a lot of the states in America that have similar schemes that are identified separately on the bill. Then you have got a decision on whether it

is general taxation or paid by the energy bill, but it is identified separately and it is there as an amount. There is a real part of me that says that if that was on the bill, the debates that we have around ECO, around ROCs, around levy control frameworks—if that was separate, people could just reference that point straight away and say, “That is the amount I pay.”

Martin Lawrence: Another way in which we could save costs in this area is by having programmes that are stable for a lengthy period of time and on which we actually know what is going to happen. We have been through various acronyms—CERTs and CESP—s—and now we have ECO. We know that ECO 1 is now fixed until March 2015, but we have got no idea what is happening after that date. We have to gear up enormously to deliver this, but we are not quite sure what is coming in after it. It is very difficult for the people on the other side of the business as well who are actually using the business. Some degree of stability and clarity for long-term programmes would also drive the cost down.

Q154 Dr Whitehead: I want to move on briefly to integration of companies. Before I do that, can I just clarify an issue on green levies? If, let us say, the carbon floor price were to be removed from the equation of the levy, Sir Lawrence, I presume that that would make a big difference to your company in comparison with the other companies that are represented here today, because of the effect from which your portfolio benefits in terms of how that floor price works. That, presumably, would be a disaster for your company’s trading position in terms of how you might reflect that through price increases.

Martin Lawrence: It impacts on our business in two different ways. We have a very large coal fleet, we are paying the carbon floor price into the coal that is actually burning and we have hedged that in advance. That would be one position. The second is the way in which that will feed into the electricity price. We do not actually pay a carbon floor price on the generation that comes from our nuclear fleet, so we would have to manage the combination of those two factors, which will change the economics of our business where the wholesale price will be set. That is a point to take account of.

Q155 Dr Whitehead: That would make a substantial difference, wouldn’t it, in terms of your potential profit for generating and the extent to which that might support what you are doing on the retail side?

Martin Lawrence: It would improve the economics of our coal fleet, and to a lesser extent our gas fleet. To the extent to which it resulted in a lower wholesale price of electricity, it would benefit the nuclear fleet.

Q156 Dr Whitehead: We heard from our earlier witness panel this afternoon that they would be quite happy to have either a virtual or not quite an actual separation between retail and wholesale as far as energy companies are concerned. How do you react to that as the other members of the big six on our panel today?

Ian Peters: I think the key to this is transparency of information. I have written to the Committee before on this, but I will share with you again the Centrica energy numbers, for

the sake of completeness. Our upstream gas business—this is 2012 information—did make a pre-tax margin of 25%, but it incurs tax at a blended rate of 75%. So, post-tax, it is 7%. Our power generation business—similarly in 2012—made a pre-tax margin of 25%. It has a lower tax rate, so that nets out to 18%. But on a return on capital basis, because there is £4 billion invested in that, this year we estimate the power generation business will make a 4% return on capital, which is very thin.

We are the only ones who have broken out of the entire make-up of our power business, including trading—one of the earlier points. We made £20 million in power trading last year as a disclosed item. This year we will lose over £100 million in gas-fired power generation. That is completely transparent, top to bottom, in terms of upstream.

On the self-supply question—the previous witnesses talked about netting—I will share our figures with the Committee. Last year, 6% of our gas came from our upstream and 10% of power. Those numbers in the half-year were 10% and 12% respectively. I think there is a material difference between a virtual separation in the way that I have just described and a physical one. By putting the two businesses together, there is a significant cash effect in terms of the capital. The downstream business does not require to hedge itself. If those two businesses were to be physically separated, there would be a significant capital requirement on the downstream business to hedge. Depending on the volatility of the wholesale market, that could add somewhere between £10 and £25 to a bill, depending on how that played through. The A credit rating, which Centrica has, is partly there because those two businesses are joined together in a legal structure.

Q157 Dr Whitehead: You trade particularly long in terms of initial supplies and then shape them afterwards.

Ian Peters: I don't know about "particularly long", but we do trade longer than many of them.

Q158 Dr Whitehead: And then you shake them down afterwards.

Ian Peters: Yes.

Q159 Dr Whitehead: To an extent not reflected in the strategies of other—

Ian Peters: I don't know what the others are, but given our share of the gas market, security of supply and making sure that we have enough physical commodity is our primary concern, so we do buy at various lengths. We do run to a degree a short book to cope with the volatility of the weather. I will not get into the percentages of how that plays through, but the general shape is longer than Ofgem's own analysis, which works on 18 months. We are longer than that.

Q160 Dr Whitehead: I was interested to reflect on precisely the question of why price rises, particularly of the big six companies, have marched in such step over the past few

years—and, as I mentioned earlier, not just in step, but in the same order. Mr Lawrence has mentioned that he may not be in step this year round, which I think might be interesting in its own right, but that appears to be a pattern from the previous years. Bearing in mind, for example, that your hedging strategy is very different from other companies, as far as I can see, it is worth noting that the price rises turn out to be exactly the same. Is that because everything comes together at the end and everything nets off against each other, or are there other factors at work?

Ian Peters: I think there are a number of factors. Just as a matter of record, if you looked at the last several price rounds, the order has changed from one to the other. I think SSE has gone first in the last two, but npower went first and ScottishPower went first in the previous year, so the sequencing changed. Commodity is clearly a part of it. We have also got transportation distribution, which comes through broadly the same for all suppliers. ECO is a very different one this year. As we have just been discussing, different suppliers have taken different routes on how they execute that.

There is one other added factor, I think uniquely, in 2013, which is the requirement to implement Ofgem's retail market review, which is a substantial change to customers' terms and conditions. That all had to be done by the end of the year, and I think different suppliers have taken different routes on how to bring that through. 2013 is an unusual year, because of the combination of ECO and RMR.

Ramsay Dunning: May I add a couple of points? First of all, we announced our price increase very recently. We did it because the first couple of the big six announced and we were getting inquiries from customers, so we took the view that it was better to make the announcement a little earlier than we would have done, in order to provide clarity and answer questions. It does not apply to our existing customers until the new year, but it applies to new customers so that they know what they are signing up to. People moving together is generating the questions, so we are answering the questions as to what we are doing there.

The other thing, before we got on to this, was that you were inquiring into the vertical integration model—that was what you were driving at. Our view—my view here—is that as an industry, we have a problem. From the outside—I mean the people watching us on the six o'clock news, rather than people sitting in this room—it looks a bit like an oligopoly. It looks a bit like a cartel. I actually do not believe it is—I have not experienced that at all, and I do not believe that anybody is behaving improperly—but it looks like it from the outside, and that, in turn, deters competition. It deters potential parties who are not sitting in this room, because they are not in the industry, from looking at the industry from the outside and saying, "If we build a power station, we know that there is an open, transparent market that we can sell the power through to." It equally deters others from coming in as potential suppliers and saying, "We know that if we establish ourselves, there is an open and transparent market that we can buy all the power from."

I have heard a couple of quotes about what I might be saying—I am not asking for the break-up of the big six, but I think I am saying that we need to do something to change that appearance. That, I think, is where we need complete operational managerial reporting separation of the generation side of the industry from the supply side, and all the power going through an open, regulated, highly transparent market, visible for everybody to see. We are hearing that a number of the people sitting here and who were sitting here earlier are, in

practice, doing that. But that is not the perception, and until the perception is there, I do not believe that we will get the people who are sitting completely outside the process, saying, “Actually, pension fund money. A 40-year long-term investment. A power station is a good thing to do. Let’s go into it.” That, I believe, is key to some transformation of the industry and public perception of that transformation, bringing in the competition on both sides.

Q161 Dr Whitehead: Thank you. For the record, Mr Clitheroe and Mr Lawrence, may I ask what proportion of your trades is netted?

Neil Clitheroe: None of our trades are netted. Every trade, in terms of what retail buys and what generation sells, is based at open market prices. We said that at the last Committee—

Q162 Dr Whitehead: So there is no longer-term trading at all.

Neil Clitheroe: No—we have long-term gas contracts and do some long-term trading, but it is separate in terms of retail and generation.

Q163 Dr Whitehead: Right. So effectively, you have separated out your activities.

Neil Clitheroe: Yes. They are separate books. And then, in our segmental accounts this year, we separate out our generation, our thermal generation, our renewable generation and our supply, but this time—this was voluntary from ScottishPower—in the segmentals, we put our energy management, our trading area, in full profitability on our segmentals. We made £2.8 million EBIT on trading last year in 2012. What you see on the page for ScottishPower and the segmentals is that entirety of the retail generation value chain. It is all within that. There is a lot of movement within the energy management number, because they buy and sell, but the actual netting effect is £2.8 million. That is the entirety that we have. That reconciles back, as it should, to all the audited accounts and the accounts that we submit to HMRC and so on. That is how we try to bring more transparency. We need to explain it better but it is all there on paper.

Martin Lawrence: As far as EDF Energy is concerned, there is a similar model to that described by Neil for ScottishPower. We operate our business to consumers, our business to businesses and our generation business entirely separately so that they buy from the market and sell from the market at the interface. The information that we show in the segmental accounts is identical to that on how we run the company internally. Indeed, on all the management information you will see exactly the same numbers written in there.

I would just like to make one additional point. It relates to what Mr Peters referred to. We are living in a world now where wholesale prices are relatively stable. We have forgotten that it was not very long ago that we had extremely volatile markets. Companies went under. So Drax had major problems. British Energy went under. As you know, we acquired the British Energy business because they could no longer survive in the wholesale market as it was there. The price at which the energy is transferred out of British Energy into its

shareholders, Centrica and ourselves, is mandated by the Secretary of State and signed off by the Secretary of State who made the acquisition to ensure that there is no risk of any cross-subsidy between the generation and the customer businesses to guarantee the continued existence of funds in the business to support the nuclear operation. Not only do we run the business separately, there are also some additional constraints that mean we have to do so.

Q164 John Robertson: There seems to be talk about two entirely different things. When are you putting your prices up?

Martin Lawrence: We have not made any decision.

John Robertson: Okay. That is fine.

Martin Lawrence: The one thing—

John Robertson: No, no. I don't want anything else. You haven't made your mind up yet. I don't need any more gobbledegook. Let me ask another question. Here is a question for all of you.

Martin Lawrence: I have some good news—

Q165 John Robertson: You keep it to yourself. You'll put a press release out, I am sure.

Let me ask you another question that came from a member of the public. They want to know why they are getting charged for debt visits between £20 and £67 a time. Why are they getting charged between £10 and £38 a time for a letter? Surely that is not right. We did the banks for doing this. Are you doing the same? Is this another cheating way of getting money?

Ian Peters: There are charges for managing debt. They are agreed with the regulator and they are entirely cost reflective. We review them from time to time. Clearly we do everything we can to keep our customers out of debt. I can only speak for British Gas. We have fewer customers in debt than a year ago. We helped 2.1 million customers last year with special payment plans.

Q166 John Robertson: I understand what you are saying. It is said that you are the worst company, by the way, so I wouldn't be too quick on this. The fact of the matter is that you are charging £10 to £38 to write a letter to the people who can least afford it, and £20 to £67 for a visit for the people who can least afford it and who are already in debt. All you are doing is giving them more debt. Is this right? Tell me, is this right?

Ramsay Dunning: I'll give you a really quick answer. At Co-operative Energy we don't have any of those charges.

Q167 John Robertson: The Co-op are okay. You guys have put your prices up 4.5%, which is still too much. But it is better than the rest of them.

Gentlemen, go back to your companies and stop these charges. Not only are they excessive; they should be looked at by other people to find out whether you are in effect breaking the law. We did it with the banks when they were charging £25 for letters. It is ridiculous. How long does it take to write a letter and stick a stamp on it?

Ian Peters: They are scrutinised by Ofgem. On a question you asked a previous audience about disconnections—

Q168 John Robertson: That's the next thing I'm coming on to. In the case of disconnections, are you going to agree that you will not disconnect anybody who is vulnerable or elderly?

Ian Peters: I have not disconnected a customer for nearly four years.

Q169 John Robertson: Okay, but this is what you have done: you have told them to move, because they are in debt, on to pre-payment meters and then, in effect, they cut themselves off by not buying anything on their card. Now you have, via the back door, disconnected them. You have put the onus on them to do it.

Ian Peters: Let me be clear about what happens there. Moving to a pre-payment meter—and we equalised the tariffs on that three or four years ago—is a responsible way of repaying debt. The weekly repayment rates have gone out significantly over the last three years.

Q170 John Robertson: How do you stop an elderly or vulnerable person from being disconnected?

Ian Peters: Let me explain what we do—

John Robertson: I know what happens; I know how it works. I just want to know, when this person runs out of money, how do you give them electricity?

Ian Peters: We proactively scan every one of our prepayment customers periodically to watch their consumption profile. To the extent that we watch consumption patterns drop, and we do, we contact those customers to find out the explanation behind that. As far as I know, we are the only energy company that does precisely that. It is deliberately to guard against—

John Robertson: That does not help people with other companies. This came from a member of the public, by the way; I did not make this question up.

Ian Peters: No, but it is a fair question. That is why we changed what we do, to be proactive and to guard against what I think is called “self-disconnection”.

Q171 John Robertson: Okay. Mr Clitheroe, what about you?

Neil Clitheroe: We never disconnect a vulnerable customer and we do not disconnect any customers through the winter. On prepayment, we do proactively monitor. If a customer does not effectively charge their key within 30 days, we proactively contact that customer at the 30-day point, because that is an indication that their credit has come down.

Q172 John Robertson: They could be dead by that time, Mr Clitheroe. That is the problem. These people are cut off. We reckon that thousands of people die because of a Government policy—I am not having a go at this Government; it was all Governments' policies. They die of hypothermia, the big reason being they cannot afford to keep the heating on. By the time you have gone to look for them, it is too late.

What about you, Mr Lawrence?

Martin Lawrence: We have a similar story: we do not disconnect anybody, whether vulnerable or not, during—

Q173 John Robertson: Be honest: you are going to have to do more to protect these people, particularly if we get a very bad winter.

Neil Clitheroe: I think there are two points. For any customer in difficulty, we work extremely hard to help that customer, whether that be through repayment breaks, better tariffs, no disconnections—whatever it is, we work really hard. Can the identification of those people be improved? Can we ensure that no one falls through the net? Can we use data from Government in terms of benefits profiles better? Can we create better signals to identify customers better? Yes. That is an ongoing—

Q174 John Robertson: Don't ask me questions; give me the solution. Write to us. Think about what I have said here. I would like the other companies to do the same, if you can get in contact with them—I am sure you talk to them occasionally. Let me know exactly what you can do to help these people. Believe me, I will support you in everything you want to do, but, just to say that you move them on to prepayment because they have got trouble paying their bills—sorry, I need more protection, particularly for elderly people. I have a lot of them in my constituency and I have a lot of vulnerable people who need to be protected and looked after as well.

Martin Lawrence: We will certainly write to you. May I say one other thing, please? Could you please help us, because in those situations, those people need to call their energy suppliers?

John Robertson: Absolutely. I offered to help you in the past. Two companies took me up on that, but I did not hear from the other four. So there you go; the ball is in your court.

Ian Peters: One immediate thing we did, particularly for the elderly and disabled, was increase the warm home discount voluntarily: we broadened the criteria and put another £60 in on top of the £135. That is an immediate help.

Chair: Votes will interrupt us in a second. Ian has one brief question.

Q175 Ian Lavery: Two brief questions for Mr Peters. First, I had tears in my eyes when you explained how hard it was to make ends meet at British Gas. I think a lot of the people listening to and reading what you had to say will wonder how on earth you keep the company afloat with the financial constraints you have. Will you confirm that you made £1.081 billion in profits in 2012?

Ian Peters: Okay. That is the totality of British Gas, so that includes British Gas Services, the central heating, electricals, plumbing and drains business—

Ian Lavery: That figure is right, is it?

Ian Peters: It also includes British Gas Business, which looks after the corporate. The British Gas Residential element of that pre-tax was £606 million, so you have to take that and build it up. But that is a pre-tax number.

Ian Lavery: But the figure I have got is right.

Ian Peters: For the totality of British Gas, including services and the British Gas Business element.

Ian Lavery: Yes; you made £1.081 billion profit.

Ian Peters: Pre-tax, yes.

Q176 Ian Lavery: I am sorry, Mr Peters, I just want to ask you another simple question. Can you tell us whether, when Ofgem launched a call for evidence on pricing benchmarks for gas and electricity, Centrica provided information to price reporting agencies?

Ian Peters: We co-operated fully with that investigation. We have been through every trade. We have independent experts look through it. We have collaborated absolutely 100% with Ofgem.

Q177 Ian Lavery: So you still report to the reporting agencies.

Ian Peters: Sorry, I may have misunderstood the question. I thought you were talking about Ofgem in terms of that investigation. Our traders have no direct relationship with price reporting agencies.

Q178 Ian Lavery: Have they ever had a relationship? Never ever?

Ian Peters: No.

Chair: We will write to you if there is any further evidence. As for what you have agreed to send in writing, if you could do that urgently that would be great. If we could have Ofgem in now.

Examination of Witness

Witness: **Andrew Wright**, Interim Chief Executive Officer, Ofgem, gave evidence.

Q179 Chair: Thank you for coming to give evidence. If we could go straight to the heart of the matter, it is the lack of confidence in the competition in the market. When will you be producing a first annual review of the state of the market?

Andrew Wright: Following our previous appearance at the Select Committee, we are committed to publishing an annual review of the state of the market, particularly focusing on the impact of our reforms of the retail market. We are looking to do that in the spring of next year.

Clearly, that will have several elements to it. One of those will be looking at the way that consumers are reacting to our proposals. Given some of our reforms will not be in place until March, we would not expect that impact to be huge. We will also be looking at how the suppliers are responding as well. I think that is going to be a key moment.

Q180 Chair: Do you understand that what the Prime Minister announced is going further?

Andrew Wright: We are doing a review of the state of competition in the market. We are going to be working with the Competition and Markets Authority and the Office of Fair Trading to establish the metrics and the framework within which we make that assessment. We will look at all aspects that have an effect on the state of competition of the market. I think that is broadly consistent with what the Government are saying.

Q181 Chair: What powers does Ofgem or the Competition Commission or the CMA have to restrict or reduce prices?

Andrew Wright: We operate within a public policy framework in which prices charged by consumers are set through companies competing in the market. That has been the case, the public policy framework, for the past 25 years and has been supported by all Governments over that period. It is absolutely right that there should be a public debate on that. We will continue to work within that public policy framework.

Q182 Chair: But your job then is to make sure that people can have confidence that there is a market.

Andrew Wright: Yes; our job is to make the market work as effectively as we can. That is why we are at this moment in the process of introducing the most significant range of reforms of the retail market since competition was introduced, in the retail market review, which will make the market simpler, clearer and fairer and will make a real difference to the ease with which consumers can engage in the market and make effective choices between suppliers.

Q183 Christopher Pincher: Can I just interject here? You mentioned the Prime Minister and his announcement that green levies will be rolled back, and you heard, I hope, what the companies said, that in the event of levies being rolled back they would pass on that saving quickly and completely to their consumers. If they don't do that quickly—for example, because different companies are in different stages in their ECO cycle—or if there is opacity in what they pass back to their consumers, what powers do you have then to take action against them?

Andrew Wright: As I say, we don't have powers to regulate end prices directly, but that situation would be a pretty clear indication that competition wasn't working effectively in this market. There are a range of things that we can do to investigate companies, leading ultimately to a market investigation reference. So there are a range of powers that we have, or a range of options that we have, for addressing markets that aren't working well in favour of consumers. Indeed, that is what we have been doing over the past few years, including through the introduction of the retail market review and of our liquidity measures to improve access for new entrants to the market.

Q184 Mr Lilley: We heard from all the companies that they run their generating businesses entirely at arm's length from their supply businesses. Suppose that they were required to divest themselves of their supply businesses—the generators generated and then sold their electricity in the wholesale market. What scope would there then really be for competition between the supply companies? The only thing they own is the wires in the ground, but they all have access to the wires in the ground, so really they are competing in the delivery of bills, aren't they?

Andrew Wright: In most cases, they don't even own the wires in the ground. They own only the supply businesses that are responsible for procuring electricity on behalf of the customers and selling it to the customers.

Q185 Mr Lilley: So they serve a price-smoothing function in the way they buy the electricity, but otherwise they are competing on the efficiency with which they deliver bills. You will be able to tell me if I am right or not, but I believe in some countries—capitalist countries like America; this example is in New York—the generating companies own the distribution network and the billing function through a co-operative. In other words, they

don't compete. It is a bit like how the banks own BACS, the clearing house. Wouldn't that be a more logical structure in this contract? We could have fierce competition in generating electricity but accept that the downstream business is not really susceptible to competition and should be co-operatively owned by the generators and, we then hope, run more efficiently; allegedly, the margins in America are well below those in the UK.

Andrew Wright: There are many different models of organising and running electricity systems around the world. There are also models, such as that in Texas, which are very similar to the UK model, with retail competition. Once again, it is the Government's policy to have a market in retail supply of electricity and gas, and that is the context in which we operate. There are a number of different alternatives that Governments could consider and we would work with any Government to ensure that those worked effectively in the interests of customers.

Q186 Mr Lilley: Would you examine these foreign models to see which work and which don't? If you, together with the CMA, are going to have a review of competition, surely at the end of the day you have to be able to propose structural reforms that will make things more competitive if you thought that was necessary or desirable.

Andrew Wright: That is an interesting point. There is already a pre-existing framework for the type of review you are talking about. It is a market study that will potentially lead to a market investigation reference to the Competition Commission or ultimately to the CMA. They have the power to recommend that scale of structural change. It is not something that we would sensibly be able to do ourselves, not least because the companies would most likely challenge us and we would end up at the Competition Commission in any case.

Q187 Dr Whitehead: One of the earlier witnesses mentioned that some companies respond to switchers by offering new tariffs or discounts as a mechanism to get the customer back or to stop them going. Is that something that would concern Ofgem, in terms of how the switching mechanism might work overall? Is that something that you might want to look at?

Andrew Wright: It's something they wouldn't be able to do under the retail market review because all tariffs need to be available to all customers. They wouldn't be able to reserve certain tariffs for buy-back or for acquisition, for example. All tariffs need to be available to all customers. On top of that, they have to tell their customers about the cheapest tariff they have. If they had such tariffs, they would have to tell all their customers about it, and clearly that would lead to the risk of many of those customers moving on to that tariff. That sort of buy-back activity would really be quite difficult to do without attracting many of your own customers on to it. This is what we have been trying to do to make this market simpler and fairer for all customers.

Q188 Dr Whitehead: And how many of the BDO recommendations that we have looked at in this Committee would have similar traction to Ofgem's retail market review?

Andrew Wright: As I mentioned, we implemented a number of the BDO recommendations the first time around, and there is a number that we rejected. Since our previous appearance at this Committee we have committed in our reply to the report to look again at the BDO recommendations and at whether there are other ways in which we can improve transparency, including those specific recommendations. We will shortly be coming out with a consultation and a call for evidence. We will be engaging with stakeholders about whether there is more we can do, whether we got those decisions right the first time around and whether there is other evidence that we should take into account. We have certainly listened to the Committee and taken action on that.

We have led the way in improving transparency in this market. We introduced the segmental statements. We introduced all the information that has been debated in the papers over the past few days and weeks. Without the actions we took, this debate would not have been possible. We are committed to ensuring transparency in the market, and hopefully we can live up to that expectation with the consultation and further work.

Q189 Dr Whitehead: Is netting off included in that transparency concern?

Andrew Wright: Can you explain that further, please?

Q190 Dr Whitehead: That is trades that stand completely outside any sort of transparency in the market because they are netted off one against the other before any trades are actually purported to exist. When a company trades with itself it may do that.

Andrew Wright: It depends exactly what you mean. If a company is trading in two different parts of the market and hedges that internally, it is very difficult to see how we can take that into account in reports that we publish. That is very much them managing their own risk internally, if I understand what you mean. I am not sure that I quite understand.

Q191 Dr Whitehead: Why would that be difficult? Could that not just be regulated for transparency?

Andrew Wright: We will look to try to provide as much transparency as is practical in this market and we will look at all recommendations and possibilities as part of the consultation. Rather than giving an instant answer now, it would probably be best to wait until we see the outcome, the possibilities and what we can do.

Q192 Chair: Can I just clarify quickly how competition works for people on dynamic teleswitching such as total heating or total control? How do you ensure that they are not being unnecessarily charged extra because the wiring means that they cannot switch suppliers and there is no real competition?

Andrew Wright: This is a difficult situation. It has been a long-standing issue and problem. There are alternatives that those customers can switch to, but there are not very many and they are not particularly competitive. We have recently done a review and the

broad conclusion is that although there are real obstacles to those customers engaging in the market, the silver lining is that there is no evidence that they are receiving particularly uncompetitive prices or tariffs compared to others. We are not satisfied with that. The long-term solution will be the introduction of smart meters, but we will be looking at ways of getting more competition into that part of the market.

Chair: Unfortunately there is now possibly a series of votes and we have not really finished. We would like to welcome you back to complete the evidence session very soon. I understand that you had an opening statement that there obviously wasn't time to hear, but when we meet again at the next session we can hear that and build on the evidence that we have taken.

Andrew Wright: I would be glad to do that. Thank you very much.

