

# Business, Energy and Industrial Strategy Committee

## Oral evidence: Energy Price Caps, HC 470

Tuesday 17 October 2017

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Members present: Rachel Reeves (Chair); Vernon Coaker; Drew Hendry; Stephen Kerr; Albert Owen; Mark Pawsey; Antoinette Sandbach; Anna Turley.

Questions 1-122

### Witnesses

I. Stephen Fitzpatrick, CEO, Ovo; Greg Jackson, Octopus Energy; Sarwjit Sambhi, Managing Director UK Home, Centrica; Catherine Waddams, Professor of Regulation, Norwich Business School, Centre of Competition Policy.

II: Dermot Nolan, CEO, Ofgem; Rachel Fletcher, Senior Partner, Consumers and Competition, Ofgem.

## Examination of witnesses

Witnesses: Stephen Fitzpatrick, Greg Jackson, Sarwjit Sambhi and Catherine Waddams

**Chair:** Thank you very much for coming to give evidence to our Select Committee today on the energy price cap. We have a number of questions for you, as you can imagine, and we will be sharing those amongst the Select Committee members. We will start with Albert Owen.

Q1 **Albert Owen:** Good morning. Can I ask you all a very simple question: is there a need for an energy price cap, and why? We will start with Centrica, please.

**Sarwjit Sambhi:** In terms of the background to the cap, in our minds it arose because there was a sentiment that the market was not working, particularly engagement with those customers on the standard variable tariff. In our view, there is an issue with engagement, but the solution is not one of price caps. Price caps will actually hinder competition and innovation in the energy market.

Q2 **Albert Owen:** With respect, I do not think it was because the energy market was not working that I was asking these questions to your company and others at the time; it was because prices were going up at a very fast rate. That was the reason for the focus and attention on it. Do you think this cap will help to alleviate price hikes?

**Sarwjit Sambhi:** Price caps would not have alleviated the changes in prices that we have seen. As we have said before, prices in the retail energy market have largely moved in recent times—we have seen cuts on gas and increases in electricity—reflecting the changes in the cost of supplying energy to customers.

**Stephen Fitzpatrick:** To answer the question, “Are price caps necessary?” I would rather say that they will have a dramatically positive impact on the energy market, rather than being necessary. We think one of the biggest issues in the energy market as it exists today is the lack of trust between consumers and suppliers. There are very many reasons for that, but by far the most significant is the assumption that when energy prices are going up they will not come back down again if there is a reversal of the circumstances that led to prices rising, and also that prices rising equates to profiteering on behalf of energy companies.

My personal view at the moment is that there is such an inconsistency in the prices that consumers pay, for what is a commodity product, that there really are very few ways other than a price cap that we will get past this lack of trust. I have brought with me examples of some of the regulations from the handful of documents that currently an energy supplier has to adhere to. By and large, the rationale behind all these documents is to protect consumers from unfriendly behaviour from



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energy companies. By far and away the simplest way to protect consumers from the biggest threat or biggest risk they face in the energy market, which is overcharging, is to have a well-set regulatory price cap, which would determine the maximum that could be charged per kilowatt hour. We could do away with the majority of these regulations.

**Albert Owen:** That is an enthusiastic yes.

**Stephen Fitzpatrick:** Yes.

**Catherine Waddams:** I am an academic, so I will sit on the fence and say it depends what you want. If you are concerned about the outcome and the prices that people are paying—and I think there is a lot of public concern about that—then a price cap is a good way to go. If you are concerned about the process of competition and the opportunities that are available to people, then a price cap is going to work against that. I think it is a political choice, and I am delighted to see that it is a political decision that has been made.

**Albert Owen:** Thank you. That is clear as well.

**Greg Jackson:** A price cap is absolutely essential. We have already heard the usual argument of the big six, essentially blaming consumers for not engaging. The idea that you should have to switch supplier every year in order to avoid getting literally ripped off is absurd. If you imagine having to switch supermarket every year—if you usually shop at Asda and you have to switch to Tesco or Sainsbury's—no one would wear it, so why do we wear it in energy? It is the idea that the consumer is to blame for getting ripped off.

Just to give you an example, earlier this year British Gas attracted a tremendous amount of criticism for raising its prices by about £100 on its standard variable tariff. It was offering discounts of up to £244 to new customers, just the day before it raised its prices for existing customers. Surely that is not a market that is working well for consumers.

We agree with Catherine that competition is important, which is why we believe in a relative price cap, which will make this market behave far more like supermarkets so that everyone gets a good deal.

Q3 **Albert Owen:** The proposed cap applies only to domestic customers. Is there a need for one for non-domestic customers and businesses?

**Greg Jackson:** Small businesses should not be given contracts that look like that for their energy supply, which is what currently happens, so you would argue that businesses with fewer than 10 employees should be covered by the same rules, broadly speaking, as domestic customers.

**Albert Owen:** Catherine, I do not think you were on the fence last time, so let's have another answer like that, please.



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**Catherine Waddams:** It is sort of on the fence, in that I think we need more information about what is happening, particularly to the very small companies. We have done a little bit of research, and it seems that the very small companies are more engaged in the market than is true in the domestic market. There may be less need, but I think we need more information.

**Stephen Fitzpatrick:** We are almost entirely focused on the domestic market, so I do not feel very qualified to comment.

**Sarwjit Sambhi:** Notwithstanding my earlier comment on price caps, in the business market it does operate differently, where actually contracts are offered that are a fixed term. The business market engages in fixed-term contracts, and our proposal as an alternative to price caps that would engage customers is to move to more of a model that looks like the business market.

Q4 **Albert Owen:** That is interesting; thank you very much. We talked briefly—Mr Fitzpatrick gave us a demonstration with his folders there—about the regulation. Is there too much regulation? Should we just simplify things and make the whole thing simpler?

**Sarwjit Sambhi:** In my view, principles-based regulation, which now Ofgem is taking on, similar to the approach adopted by the FCA, will address issues like this to simplify, say, a supply licence.

Q5 **Albert Owen:** Okay, but I am not doing it to help you; I am doing it to help the customer. I am asking this question to help the customers, in many ways. If we had simpler but less regulation, would that help the customer?

**Sarwjit Sambhi:** Removing prescriptive rules that limit customer choice will help consumers.

**Stephen Fitzpatrick:** There is this document, which is the first chapter on the electricity supply licence conditions after the RMR, which was the regulatory review in 2014. There was a limit to energy suppliers to have four tariffs. There were about 35 pages within the pricing section of the regulations defining what kind of discount we could offer, and this was again to get away from dressing up attractive pricing with discounts that were hard to achieve. All of these regulations, including what would constitute a standard variable tariff or what would constitute a deemed tariff or a default tariff or a premium tariff, will have to be defined, and they will run to dozens and dozens of pages, if not 100 pages or more.

This is where you need a simple per-kilowatt-hour cap on the amount you can charge for gas and electricity, without a customer opting in to paying more. Without that, you are going to end up with more and more regulations defining exactly how we operate, which will be bad news for customer choice.



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**Catherine Waddams:** Simplification is better, and there could be more use of general consumer protection law in markets such as this. There is a tendency, where there is a specialist regulator, to start looking at things in a different way. So I think perhaps there would be a possibility to take more advantage of consumer protection that is already there, and not have quite so many books here.

**Greg Jackson:** Catherine is absolutely right. The simple rules mean that supermarkets show us the real price we are going to pay for the real products we are going to get, with honest labels, means that they do not need that many pages of regulation. What we need is some simple, strong rules around transparency, looking after vulnerable customers, and pretty much the rest can be seriously reduced.

Q6 **Albert Owen:** My next question is on SVT, and it is aimed at the large suppliers cross-subsidising, so the argument goes, the cost of cheaper fixed-term ones. I know your answer because you have indicated it. If I start with the academic to give her view first, then come to Centrica to defend itself, and then bring in the two others.

**Catherine Waddams:** If you look at it over time, then a consumer may be paying a low rate now and will then pay a high rate later, so it may not be such a worry. It is a worry if people are staying on it forever and ever, but you do need to take that into account. To the extent that it is then cross-subsidising, that is doing more than putting most of the fixed costs on the SVT. If they are actually charging less than the cost then that might be a problem in competition law, even if there was a dominance. Again, it is looking at other ways of getting at that issue.

Q7 **Albert Owen:** Centrica, are they used to cross-subsidise others?

**Sarwjit Sambhi:** If I take British Gas as an example, our fixed-price tariff is only £13 different from our standard variable tariff. Cross-subsidisation is not a practice we engage in. However, if you look at the market, where there are significant differences between the headline standard variable tariff price and the average fixed-term contract in the energy market, it is possible that you would have a customer start on a very low fixed-price tariff and, for that supplier, go on to a more expensive standard variable tariff. This is why our proposal to address that is actually to end the evergreen nature—i.e. a rolling contract—of the standard variable tariff, and—

Q8 **Chair:** Can I just come in for a moment, on the answer to that question? At the moment there is a gap of £13, as you say, between your standard variable tariff and the cheapest tariff, but if we had asked you the same question in July, the gap would have been £105. At the moment there is a small gap but it was wider just two and a half months ago, and presumably you could widen it again. I think it is also true to say that if you do not pay by direct debit, that gap is £73, not £13. Would it be fair to say that customers who are not on direct debit, who are often the most vulnerable, are cross-subsidising other customers?



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**Sarwjit Sambhi:** In terms of cashing cheques, to be clear—this is regulated by Ofgem—the difference is justified by the actual cost to serve on—

Q9 **Chair:** I do not know where you bank, but £60 to cash a cheque seems pretty expensive to me, Mr Sambhi.

**Sarwjit Sambhi:** But it is not just to cover the actual cost of the activity in the bank; it is the whole collection process. It is transparent, it is measured and monitored by Ofgem, and it reflects the actual cost to serve that customer.

Q10 **Chair:** Okay. It is interesting that many of the other suppliers do not have that difference between direct debit customers and others. However, just on the issue about your pricing structure in July, Albert Owen asked you a question about cross-subsidy; in July, is it the case that customers on standard variable tariffs were cross-subsidising the cheaper tariffs for other customers?

**Sarwjit Sambhi:** Our fixed-price tariffs do change on a regular basis, and they do reflect the actual cost of delivering the energy to the customer at that moment in time. It is unfair to compare prices now in the fixed-term market with where they were in July.

Q11 **Albert Owen:** It is unfair for somebody who pays cash or cheque on time to be paying that differential.

**Sarwjit Sambhi:** As I said, Mr Owen, the cost of cash-cheque is different from somebody paying on direct debit. The difference between those two payment methods is transparent. It is monitored by the regulator.

**Albert Owen:** It is not fair.

**Stephen Fitzpatrick:** I find myself in the uncomfortable position of defending British Gas.

**Albert Owen:** You never used to. You must be growing.

**Stephen Fitzpatrick:** Just to explain some of the complexities, for the benefit of the Committee, if somebody pays by cash or cheque, it is likely that their bad debt risk will be higher, because they will normally be paying three months in arrears, instead of by direct debit, monthly or in advance. Also there is a propensity for those customers to telephone the contact centre and therefore the costs are higher. It is genuinely more expensive to serve customers who want to pay in arrears by cash or cheque, and it is common practice to charge them differently.

If you did not have a difference in price between the cash-cheque customers and direct debit customers, then direct debit customers that would be cheaper to serve would not get a benefit from adopting a method of payment that led to lower costs. I would just say that in defence of the principle of differential pricing.



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The question that I would be asking if I were in your position is about the difference in payment or difference in charging across British Gas's tariffs and, for example, Sainsbury's Energy, which is supplied and white-labelled by Centrica. In the past there have been very large differentials. If I look at the moment, in terms of price differentials between SVTs and the cheapest tariffs, some of the worst offenders have price differentials that exceed £300—not £13, but £300. That is going to be between 40% and 50% more if you are on an SVT than if you are on the cheapest tariff.

**Q12 Albert Owen:** You cannot justify that. You cannot defend that.

**Stephen Fitzpatrick:** Of course it is indefensible.

**Greg Jackson:** It is particularly indefensible because energy is a unique market, in which if you cancelled the direct debit the product would keep coming through the pipes and wires. You are still going to rack up charges. It is a market in which, when you get to the end of the fixed price period, your direct debit can be held the same by a supplier, because your direct debit is usually fixed, whereas your consumption varies with seasonality. What that lets suppliers do, when you get to the end of the fixed term, is ramp up the charges. The biggest difference is £398 for a standard household. They will ramp up the charges, but they will leave the direct debit where it is. It might be six months, nine months or a year later that you get a phone call from your energy company saying, "You are running up a debt. We just need to adjust your payments." Not once did they tell you, other than buried away in a letter, that your price had gone up.

Even a careful customer who looks at their bank statement every month will not know that they have been through this tease-and-squeeze practice.

**Q13 Albert Owen:** How do you avoid that?

**Greg Jackson:** You avoid it with a relative price cap, which basically says that if a company wants to offer a cheap deal to bring new customers in, it has to give a great price to its existing customers as well.

**Q14 Stephen Kerr:** Centrica, just to be absolutely clear, you are completely opposed to all price caps; is that correct?

**Sarwjit Sambhi:** Yes, as a principle, but it is based on the fact that we think a price cap—this has been shown in other markets—is detrimental to competition and to innovation. The examples that I would cite are California, where retail prices ended up being below actual wholesale costs, and resulted in under-investment. The same applies in Ontario. There are other examples as well.

**Q15 Stephen Kerr:** Okay. Let's deal with those who are for a price cap, then. How does a price cap of any sort support customer engagement and competition, and how does it protect vulnerable customers?





**Greg Jackson:** The reason we all get a good deal in supermarkets is that a customer who is price-sensitive will leave a supermarket if they put up the price of one of its goods. That forces the supermarket to keep the prices down for everybody. That means that people who do not notice the price of flour or cornflakes or milk, on any given day, are not getting ripped off. In energy, because of the cross-subsidisation, when somebody goes hunting for a better deal, they are literally being subsidised by the long-term loyal customers who do not realise they are getting ripped off.

A simple relative price cap just makes the market transparent, and what that does is harness the efforts of the 20% of people in any given year who may switch to bring the prices down for everybody. We think that is going to be more effective than an absolute cap, because the problem with an absolute cap is that the kinds of levels we have seen mooted will still be £150 to 200 more expensive than the cheapest deals. A relative cap will get the bargain hunters bringing prices down for everybody.

Q16 **Stephen Kerr:** Can you describe exactly what you mean when you talk about a relative cap?

**Greg Jackson:** It just means that whatever price an energy company advertises today has got to be within, say, 6% of the price it charges its loyal customers. What that means is that any company that is uncompetitive, ripping off its loyal customers, can never win another customer.

We have seen the figures that this month has seen a record outflow from the big six to independent suppliers. What has driven that is the political pressure that means that companies that previously deployed extreme tease-and-squeeze tactics are currently avoiding doing so. We are seeing how much it is hurting them because some of their customers are hunting for a better deal. With a relative price cap, that would bring the price down for everybody.

Q17 **Stephen Kerr:** Let's hear from Ovo now, first of all on the objectives behind the price cap, in terms of customer engagement, competition and protecting vulnerable customers.

**Stephen Fitzpatrick:** I think of a price cap as being a relatively blunt tool, whether it is a relative price cap or an absolute price cap, but what it is trying to address is an imbalance in our energy market between the incentives that we should provide consumers to engage in the market and to shop around, and the protection for those who do not. It is simply a question of finding that balance. At the moment everything is completely skewed towards providing incentives, hence £300, £350 or £400 savings to switch. What that means is that there is absolutely nothing in any of these documents or in any of the dozens of others that we have to protect the customers who do not engage in the market. There is simply nothing there; there is no safety net of protection for





customers who do not or cannot shop around for a better deal. In my mind, whether it is a relative price cap or an absolute price cap—

Q18 **Stephen Kerr:** Which is your preference?

**Stephen Fitzpatrick:** We supported the relative price cap when that was the only game in town. I have two concerns. First of all, it is very difficult to explain to consumers what it means.

**Stephen Kerr:** I thought his explanation was pretty straightforward, actually.

**Stephen Fitzpatrick:** The second point is that there is still no upper limit on the price you can charge per kilowatt hour. If you have a relative price cap, what you may see—it is not necessarily the case; I am not saying this is what I believe will be the case—is only cheaper deals from the market being pulled and tariffs bunching at a higher level. Trying to explain to consumers why that has been a good thing will be playing into the hands of energy companies that have been arguing against price caps.

On reflection, we decided that, given a relative price cap option and an absolute price cap option, the better of two blunt instruments was the simpler one, which is simply to say, "This is the maximum price you can charge per kilowatt hour." It is not perfect, but it is simple to explain to consumers on any level of sophistication, and it gets away from the accusation that prices will rise for the average consumer because of the price cap.

**Catherine Waddams:** There are several questions tied up in what you are asking. I do not think a cap of any kind is going to be good for engagement. If you were a consumer who thought they might actually venture into this market, the fact that there is a cap coming is going to deter them, so that will not help engagement.

You talked about protecting vulnerable customers. Now some of them have switched, so you have to be careful. If introducing a price cap does mean that we lose the very lowest offers, which is a possibility, then those vulnerable consumers who have switched will indeed see their prices go up. We need to be careful about that. I would argue for trying to identify vulnerable customers—it is very difficult; we know Ofgem has been trying—and protect them directly. Otherwise, they might be protected but they might not.

In terms of an absolute or a relative cap, I worry about a relative cap, because if you think from the point of view of a company, a big six company in particular, it has a lot of very loyal customers who are very profitable. It has a smaller number of customers who it is recruiting with its lower prices. If you tie those two prices together, there is a strong disincentive for them to keep that low price. If they increase that low price, that means they can have a little more headroom for the large



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number of much more profitable consumers. I think a relative price cap is more likely to mean we lose the most competitive prices in the market now, but I know that Greg does not agree with me on that—we have had many discussions.

**Q19 Stephen Kerr:** Just one last question from me, Chair. If not a price cap, what is better? What is better to stimulate this marketplace, in terms of the engagement of those standard variable tariff customers? What can be done?

**Greg Jackson:** Customers in this market are engaged—some 20% this year will switch. That is more than almost any other consumer market. In fact, if John Lewis were losing 20% of its customers, the world would be up in arms about what had gone wrong with retail. What we have to do is move away from this idea that customers are disengaged. Customers are simply being systematically ripped off, and the wool is being pulled over their eyes.

There are two things you could do. One would be that whenever a company changes the amount it is charging a person, it should have to change the direct debit by the same amount. If that is running customers into debt or credit, they should have to phone them up and explain what is going on. The second one is that price comparison websites, and the front of every letter, envelope and email that a company sends, should have its default tariff in huge letters.

**Catherine Waddams:** I certainly agree with the second, in terms of information being given. One of the things you might try to do to work with the grain of the market is to explore a little bit more collective switching, and in particular opt-out collective switching. If you could identify vulnerable people—perhaps people who live in particular social housing, building on some of the local energy companies that we have—and try to give them a better deal and give them the chance to opt out. There are all sorts of challenges in that; I am not pretending that is an easy process. However, that would be one way of working with the grain of the market while still offering some protection.

**Stephen Fitzpatrick:** I would say that after 19 years of deregulation, nothing has worked. Since I launched Ovo Energy in 2009, we have had five reviews, four by Ofgem and one by the CMA; we have had countless political discussions; and I have been in these chambers five times, answering the same question, and nothing else has worked.

The idea that we are going to auction off a portfolio of vulnerable customers—I can tell you that an unscrupulous supplier would be very willing to pay a high price to win a portfolio of, by definition, disengaged customers, knowing that they are very price insensitive. That is how it works in the real world. If I were an unscrupulous energy supplier, I would pay a very high price to win 1 million disengaged customers, and then I would have to recoup that money by charging them a very high price for years to come, knowing, however, that they are unlikely to



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switch, because they never have. This is one of the challenging things about collective switching, auctioning off portfolios of customers and so on.

The other thing that we have heard—I think Catherine has proposed this or supports this idea—is that we simply write to these customers, and that Ofgem can somehow give their information to competitors and say, “There are cheaper ways to buy your energy.” However, of course, after 19 years most people have already heard the message that if you swap around you save money, and after 19 years they still have not. Also, how many envelopes through the door do I want to get as a customer? There are around 100 registered energy companies now, so if everybody writes twice a year, that is four promotional envelopes every week. Which one should I choose? I was not sure before; I am definitely not sure now.

Again, it is not perfect, but the simplest way to engender trust and provide some protection for customers is to set a price cap—I believe it is probably in the best interests of customers to be an absolute price cap—and say, “This is the maximum you can be charged. There is plenty of headroom for competition below this. You can charge as little as you like as a supplier, and we can do away with a lot of these regulations.”

**Catherine Waddams:** Just to be clear, it was the CMA’s proposal. I have the same problems as you do with it.

**Stephen Kerr:** I am most interested to hear Centrica’s answer to that question.

**Sarwjit Sambhi:** From the other witnesses, you have heard that there is an issue of disengagement with customers on standard variable tariffs. A key reason for that is that the standard variable tariff is evergreen—i.e. it keeps on rolling forward; it never stops. Our proposal is to end the standard variable tariff that we have today; ask all suppliers to say to their customers on standard variable tariff at the end of a maximum of a year, “You are on standard variable tariff. You have other choices. Standard variable tariff is coming to an end. Here are the alternatives,” and to make it very clear as to what the price of the new choices are versus the tariff that they are currently on, which is the standard variable tariff. That will increase engagement with all of the customer base, it should result in more competition, and it should be better for consumers in the long run.

If I may, just going back to the price caps, we have an example right now in terms of the prepayment price cap, where prices have narrowed to within 1% of one another, and the latest data has shown that switching has decreased since the price cap was introduced.

**Chair:** We have four panel members today, and we have a session after this with Ofgem, so can I ask people responding to questions to keep it a little shorter so that we can get through all of the questions we have.



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**Q20 Anna Turley:** I want to ask Catherine specifically whether there have ever been any policy interventions previously that are like a price cap. Is there anything similar to that we can draw on, either here or abroad?

**Catherine Waddams:** We had the price cap when we were introducing competition, and we were right to remove it at the time and see how the market worked. That was removed in 2002. We had the non-discrimination clauses that prevented the electricity companies who had inherited inactive people in particular regions from charging more for them than they were charging where they were being competitive in other regions. That did not work very well, and there is quite good evidence from our research and others that it did stifle competition. A relative price cap would be not quite as bad as that, but it has some elements of the same.

There have been some price caps introduced more recently that have tended to damage competition, in Australia and the US.

**Q21 Anna Turley:** What has the impact been on the customers in terms of competition, particularly for vulnerable people?

**Catherine Waddams:** People have paid less in the short run, but the problem is we tend to get less innovation. If the very best offers disappear, the people who are on those offers, some of whom are vulnerable, will suffer. It is a question of whether you want to deliver a cap on the average of what everyone is paying, or whether you want to offer opportunities to some people for lower prices. It is that trade-off.

**Q22 Anna Turley:** Does anyone else want to come in on that?

**Greg Jackson:** I have read the reports on the regional price cap, and indeed on Ontario, New Zealand and the other markets Centrica mentioned. None of them are comparable. With the regional one, it was at a time when there were six major suppliers and a couple of smaller ones. There are now 70. It is impossible for companies to collude to keep prices high when there are as many companies as there are now.

The second thing, when we look at those international examples and indeed the prepayment price cap, is they brought prices down for people who needed it most. For example, in New Zealand it brought the fixed component for low-energy users down 30-fold, and with a prepayment price cap so far prices may have clustered near the cap, but there are still plenty below it, and it brought down prices for the most vulnerable people by hundreds of pounds.

**Chair:** You do not all have to answer every question.

**Stephen Fitzpatrick:** Back in 1997, when we were discussing bringing in a minimum wage, I remember economists lining up to say this was going to destroy jobs and make employers reluctant to hire people. In May this year we had the highest workforce participation in history—75.8%. That is a minimum; that is a safety net. It is not saying that there is no



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incentive to apply for new jobs, and that now that there is a minimum wage that you do not apply for promotion or try to move companies. It is a safety net, and it allows plenty of room for competition for employers to try to bid for the best talent.

This is exactly the same. This is not saying you may not charge less. This is not saying that you should not innovate. In fact, what I see is that there is a lot of innovation in the energy market around convincing customers they are getting a good deal, but very little actual innovation on cost reduction, on energy technology such as batteries, solar, electric vehicles and so on. This is the kind of innovation we want, not better marketing.

**Sarwjit Sambhi:** Very quickly, the only other example I would cite other than the ones I have already cited, which I think are good examples, is tuition fees in the UK. That is the only one I would add.

Q23 **Anna Turley:** Is the point you are making is that you set a cap and everyone goes up to it?

**Sarwjit Sambhi:** They bunch around the cap.

Q24 **Vernon Coaker:** Can I just ask: we have obviously talked and concentrated a lot on the energy cap, but as energy suppliers what else should you be doing to try to attract people? What else are you going to compete on? You talked about innovation, Stephen; what else are we talking about here? To anybody really: how are you going to compete apart from price?

**Greg Jackson:** Some customers do care about service. It is one of the main reasons people choose to switch: that they phone up their supplier and spend 20 minutes waiting to speak to someone, and then they argue with them about whether they are going to be given their own money back, so service matters. Beyond that we are moving to a world with smart meters, solar and wind generation, meaning there are going to be times that it will be very cheap to generate electricity and times it will be very expensive. Enabling customers, through smart meters, to benefit from the cheap renewables in the good times and be able to shift their consumption in the other times is going to be really important.

That is why we have to fix pricing now, because the signals that we use to tell people, "The sun is shining, the wind is blowing, electricity is cheap, charge your car," are going to be absolutely price driven. If we stay in this world where price is so fully obfuscated, where the major innovation amongst the big companies is how best to hide their real prices, all we are going to do is make smart meters fail to deliver their benefits, and make it harder to move to that renewable future.

**Sarwjit Sambhi:** In terms of what it is customers want from their energy supplier, when we talk to customers it is more than just energy supply. However, if I stick with energy supply for a moment, we are investing £300 million per year on the smart meter programme. That



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includes training up 2,000 engineers to fit smart meters. That requires a successful energy supply company.

Also, specifically on the question of what customers are asking for, they are asking for rewarding loyalty, and one of the things that we have done is introduce something called Rewards. Since we have launched it in the summer, 500,000 customers have signed up for it.

**Q25 Vernon Coaker:** Is the bottom line that it is not only on price that people will choose who to get their energy from?

**Sarwjit Sambhi:** When we talk to our customers, price is not the only determinant.

**Catherine Waddams:** I do not know about marketing, but our research on why consumers switch or do not switch shows that price is the main driver, so if the prices narrow fewer people will switch. However, other things matter, and different things matter to different consumers. For example, the ethical stance of their supplier might matter—whether they have a green tariff. Some people will stick as a positive move with their current supplier. It is not always negative if they are not switching.

**Q26 Vernon Coaker:** Have you done any research into what different customers use to choose their energy supplier? Would it be fair to say that the better-off would look at green energy and ethical stances, whereas the most vulnerable customers will simply want to know what the energy company does in terms of their price and in terms of what they will do if they find it difficult to pay their bill?

**Catherine Waddams:** All customers have a variety of preferences. One thing we discovered with older people who tended to be less active is they expected to get less. It was not that there was less available for them, but their expectations of the gain were lower. One thing might be talking to customers about whether they know enough about the energy. Perhaps it is un-obfuscating the energy price.

**Q27 Vernon Coaker:** I had somebody the other day say to me they had changed because they spoke to somebody who actually explained what was going on.

**Catherine Waddams:** There is a lot of anxiety and distrust.

**Q28 Antoinette Sandbach:** Can you—particularly Centrica—explain the Ofgem finding that the highest proportion of customers on standard variable tariffs are also those at a high risk of being vulnerable? I note that about 74% of Centrica's customers are on SVTs.

**Sarwjit Sambhi:** It is actually nearer 65%, notwithstanding the fact that we do have a high proportion of customers on the standard variable tariff. When we have actually looked at the demographics—we have detailed data on this—across all our different tariff types, the vulnerable customers do not over-index, i.e. it is not concentrated in just the





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standard variable tariff. So I am not saying that it is less or more, but in general it tends to be consistent across the tariff types we have.

Q29 **Antoinette Sandbach:** What proportion of your vulnerable customers are on standard variable tariffs?

**Sarwjit Sambhi:** It reflects the base, and in terms of—

Q30 **Antoinette Sandbach:** So what is that?

**Sarwjit Sambhi:** There are 2 million customers we would put in the category of vulnerable.

Q31 **Antoinette Sandbach:** What percentage of those are on SVTs?

**Sarwjit Sambhi:** About 30%.

Q32 **Antoinette Sandbach:** What about Ovo and Octopus?

**Stephen Fitzpatrick:** I am not sure I entirely follow the question. We have around 25% of our customers on the standard variable tariff, and this is one of the best examples that I can give of evidence of the need for a cap for SVTs or for all energy tariffs. We are a very engaging energy company. We spend a lot of time talking to our customers; we have a very good reputation for service and for treating people fairly as well. Even we have a quarter of our customers who, at the end of their contract, default on to an SVT and we cannot oblige them to re-engage.

Q33 **Antoinette Sandbach:** Do you have mechanisms for identifying who are your vulnerable customers? I believe that you have quite a high proportion of prepayment meter customers.

**Stephen Fitzpatrick:** We have quite a high proportion of prepayment meter customers. I would say that in actual fact there is an assumed correlation between prepayment customers and vulnerable customers. This is one of the biggest challenges that faces energy suppliers that Government can do something about. It is difficult for us as energy suppliers to know which customers are vulnerable. Vulnerability is defined by measures set by the Government, and the data is not shared with us, so when we define customers as vulnerable, one of the things we do is look towards defined pension credits. This is one of the mechanisms by which you can qualify for the Warm Home Discount.

Just to highlight, this is something that is defined by age as well as by income, and it is something that we feel quite strongly about. There are millions of homes in the UK with children that are not eligible for subsidies or for regimes related to fuel poverty, simply because it is easier to identify the older customers.

**Antoinette Sandbach:** That is perhaps the broader question.

**Stephen Fitzpatrick:** Yes.

**Antoinette Sandbach:** I know we are very limited for time, so I am





going to ask Octopus to come in.

**Greg Jackson:** Our standard variable tariff is 70p per year different from our fixed tariff. It does not really matter which group is on which, and the idea that it is necessary to have high default tariffs is the exact problem. Tesco do not have to worry about which of their customers are vulnerable and which are not, because everyone is getting the same great deal. We need to reform the energy market to learn from supermarkets.

One quick thing I would note is the number of ways in which people try to pull the wool over customers' eyes. I am hearing it today. So when, for example, you asked Centrica what percentage are on SVT, Centrica say, "We want to get rid of the SVT and replace it with fixed tariffs." Currently, their SVT is £1,119 per year, depending on the region. Their highest fixed tariff? £1,119. The reason the big companies want to get rid of the SVT is that they know it gives politicians and the media a figure that they can talk about as "the price," and they know that the time they put "the price" up is the time that they experience the greatest amount of negative PR and the greatest outflow of customers who finally realise quite how much they are being ripped off. Ending the SVT is dangerous, because it takes away the one bit of transparency that currently holds companies to account. The great thing about the relative price cap is that it will make that figure the beacon to bring prices down for everyone.

Q34 **Antoinette Sandbach:** In terms of delivering support to customers identified effectively under the ECO, so the Warm Home Discount, how many of Centrica's customers qualify for the Warm Home Discount?

**Sarwjit Sambhi:** For the core and the broader group, it is 600,000 customers.

**Antoinette Sandbach:** I believe there are roughly 2.6 million people who qualify.

**Stephen Fitzpatrick:** Just to clarify one point, our understanding is there are about 4 million customers who are eligible, of which 2.2 million customers actually receive it. It is a big challenge, because for energy suppliers the idea that there are 60 of us all trying to identify vulnerable customers is incredibly wasteful.

**Antoinette Sandbach:** I understand that, and that goes around data-sharing and needs to be dealt with under the Digital Economy Act rather than the Energy Act, and I think that is perhaps a separate inquiry, rather than this one.

**Catherine Waddams:** Could I just say something about vulnerability. It is absolutely right that the nature of vulnerability and the understanding of it is changing. It is very difficult to identify which consumers are vulnerable. We have done some work on people in various measures of fuel poverty that we might measure subjectively or objectively, and our initial findings, which remain to be confirmed, are that there does not



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seem to be a great deal of persistence. People seem to move in and out of various measures of vulnerability, so it may be rather difficult to have a firm database if this is such a fluid group.

- Q35 **Mark Pawsey:** I just want to go back to why you feel the cap may be necessary. There is disagreement on this panel about whether it should be an absolute or relative cap. It is going to take a long time to come in. We hear from Greg that increasing levels of customers are switching, and I get your argument that bargain hunters are getting a better price for everyone, but my constituents will travel 10 miles to get cheaper petrol. Perhaps a better analogy would be that when their motor insurance comes to the end of a year, they will hunt around if the price has gone up, and they will use one of the price comparison websites.

Why can we not get switching levels higher? I hear Mr Fitzpatrick say nothing has worked in 19 years, but the trend is going in the right direction. My question is: if we can get switching levels higher—let us say we are at 20% now and we get to 30%, 40% or 50%—will higher switching levels encourage supplies such as Centrica to keep their prices more competitive, Mr Centrica?

**Sarwjit Sambhi:** This is a core part of why we are saying to end the standard variable tariff. Switching rates will go up. It should replicate what happens in the insurance market.

- Q36 **Mark Pawsey:** What are you doing to make switching easier for your customers?

**Sarwjit Sambhi:** First of all, the industry is trying to do a lot—

- Q37 **Mark Pawsey:** No, what is Centrica doing? I know what the industry is doing. What is Centrica doing to make it easier for your customers to look at the alternative prices?

**Sarwjit Sambhi:** One of the things that we did, starting in October of last year, was to actually contact every single customer on a standard variable tariff and say, "You do have a choice. You do not have to be on the standard variable tariff. Here is an alternative". That resulted in a 10% response rate, which, if you talk to a marketer, is four times if not five times higher than an average direct marketing campaign. That is one example. That led us to launch Rewards, which we are offering to all of customers, saying, "Sign up for Rewards," to engage with customers, and actually we will be offering them other competitive offers, and not just on energy but on services. We are engaging with our customers. Switching will go up from one energy product to another. That is good, because we think that will be good for competition.

- Q38 **Mark Pawsey:** Catherine, we have some customers who cannot engage and some who will not engage. We seem to be focusing on those who cannot engage because those are what we call the vulnerable. Should we worry about those who do not bother to engage, who perhaps know that there is a better deal out there but who are content in paying a higher



price than they might otherwise pay? Should we worry about that?

**Catherine Waddams:** No, I do not think we should, and I do not think we do in some other markets. Insurance is a good example, where actually exactly this happens, as I discover when I fail to pursue things. Nobody feels that the price has to be capped. For those who are not vulnerable, I think there would be more advantage in letting the market work out and giving them good opportunities. They will take it if they want it.

Q39 **Mark Pawsey:** Mr Fitzpatrick and Mr Jackson, if you guys are so much better than the other guys, what is preventing you taking a bigger slice of their business?

**Greg Jackson:** It is exactly this problem. Our cheapest price at the moment is about £910. We can sustain that to loyal customers throughout their lifetime, but we get undercut by people who charge £900 in year one—the price the customer sees—and then move it up to £1,200 a year later. I do not think that is good for customers.

Two quick things: first of all, in car insurance every few years people change their car. They have to engage with the market.

**Mark Pawsey:** Some of them move house.

**Greg Jackson:** It is 14%—a much smaller number moving house than changing car. The second thing is when your car insurance goes up, your direct debit goes up. You look at your bank statement and you will see it. You do not see it in energy. The reality in this market is that the wool is systematically pulled over customers' eyes. In previous markets, the Weights and Measures Act was brought in to prevent that kind of behaviour in grocery. It is time for a relative price cap now to prevent it in energy.

Q40 **Mark Pawsey:** Catherine, as an academic, how can we deal with Mr Jackson's concerns? I would rather see the market become freer and much more open. How can we help him with his concerns?

**Catherine Waddams:** I think he is saying not that the market is a problem, but that information in the market is a problem. I would want to address that problem.

Q41 **Mark Pawsey:** How do we get better information in the market?

**Catherine Waddams:** Not by a relative price cap but by requiring more transparency, and I hope it does not mean more regulations about the way companies have to display their prices.

Q42 **Mark Pawsey:** Would more transparency be a better route than a price cap, in your view?

**Catherine Waddams:** Yes, it would, as long as customers respond to it. We do not know until we try, and the problem is how long we go on trying and how long people's patience will last.



**Q43 Drew Hendry:** Catherine, you said earlier that you worry about the effects of a relative price cap. What effects are you aware of in terms of the impact that the prepayment price cap has had on prices and competition, so far? Also on that, how do you think the price cap will impact on rural areas?

**Catherine Waddams:** There are two different questions there. There seems to be evidence that the prepayment cap is getting rid of the very lowest offers that were there, and we have already seen that people are not switching as much in that market because there is less for them to gain, and all the research shows that is really what drives switching at the margins, though I think we are not necessarily talking about the margins. On the other hand, it is delivering savings to many prepayment customers who otherwise would not have switched. Some people are gaining and some people are losing, and that is what we would see with a cap on standard variable tariffs also.

Your second question was about people in rural areas. Fewer of them tend to switch, and it is partly to do with those who are not connected to the gas systems, so they only have one incumbent with whom to relate. Probably their prices are on average higher, so they may be losing more now. I have not actually researched that, but that would be my guess. One could go and look at that.

**Albert Owen:** That is a hugely important point. All of you are referring to dual fuel. Many people do not have that option, which is why they are falling behind.

**Catherine Waddams:** They do not have to fall behind, but in practice they are, yes.

**Q44 Drew Hendry:** Greg mentioned earlier about the prospect of smart meters being able to effectively change the tariff depending on the availability of electricity. Would a simpler solution be to allow people to switch their energy suppliers digitally and actually take that forward as a proposal to make it a fairer market?

**Catherine Waddams:** We already have some brokers who do it automatically for you, so we have that possibility in the market. People are not taking it up very strongly at the moment.

**Q45 Drew Hendry:** Sorry, I was suggesting using the smart meter technology to allow people to do it by essentially pressing a button on the meter.

**Catherine Waddams:** It then becomes a very different market, does it not? It becomes a procurement market almost, so that everybody is going to suddenly move on to the cheapest tariff, so you would have to have some way to moderate that so that people did not get swamped. My worry is that actually we are getting more smart meters at the moment that have just been announced, which are tied to the existing supplier, and so smart meters are not necessarily very quickly going to



bring that sort of possibility about. I think there is that possibility, but it is a different kind of market if that is what is happening on a large scale.

**Stephen Fitzpatrick:** I just have a couple of points on that. I have been quite quiet, and have not responded to the last two or three questions in the interests of time. There are a couple of things I would like to pick up on, and one is quite a dangerous argument, in this context, that some people win and some people lose. The idea that you have a price cap and it deters people from switching and therefore you get winners and losers and we are no better off is crazy. Millions and millions of households have saved money under a prepayment price cap, and the idea that some customers have been disincentivised from switching and that is a reason not to have it is just crazy.

About 30% of our customers are pay-as-you-go customers, and we are still registering 300 to 400 new customers per day, even with the price cap, because we offer different technology. We operate pay as you go-plus, which means customers can use their phone to buy energy instead of going to the shops. It is a very different user experience, and we are competing on service and customer benefit, rather than simply price. However, millions of customers benefit, so the idea that we get some winners and some losers and it will be the same for a price cap in pay-monthly energy is just dangerous. I would ask you to quantify the cost versus quantifying the benefit, and it is very clear to me that customers have overwhelmingly benefited from lower prices under the pay-as-you-go price cap. That is the first thing.

Secondly, I had a very in-depth discussion on several occasions with the chair of the CMA, Roger Witcomb, around a price cap and the need for a price cap versus the need for transparency and information, and again the response from the economist was that we need more information and more transparency and for consumers to engage, and the typical response was that when customers do not follow an economic model there is something wrong with the customer, not something wrong with the model. I can tell you that when I asked Roger Witcomb, he told me that we need greater incentives: if we want a better market and we want more switching, we need more incentives. I asked him, "What does more incentives mean? Does it mean more pain? Does it mean more overcharging?" And his answer was, "Yes. We need bigger price differentials. We need lower cheap deals and higher standard variable rates, and we need to encourage more pain in order to have more incentives." I just could not believe the answer.

It is quite clear to me that after 19 years the model is wrong. It is not that the customers are wrong; the model is wrong. There is something about the energy market that is either too confusing, too abstract or too obfuscated for consumers to really engage in it. We need to redress the balance between incentives and protection.

Q46 **Chair:** I just have a couple of questions to finish the session, specifically



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to Mr Sambhi. Mr Sambhi, what proportion of your customers are on standard variable tariffs, and what proportion of your profit margins from the domestic retail sector are from customers who are on standard variable tariffs?

**Sarwjit Sambhi:** We have 4.5 million on the standard variable tariff out of a base of 8.3 million currently, so it is about 60%. In terms of average profitability—sorry, 30% on SVT.

Q47 **Chair:** 60% or 30%?

**Sarwjit Sambhi:** It is 4.5 million out of the 8.3 million, so about 60% on standard variable tariffs.

Q48 **Chair:** What proportion of your profits are from customers who are on standard variable tariffs? Around 60% of your customers are on standard variable tariffs, so what proportion of your profits come from them?

**Sarwjit Sambhi:** Our average profitability per account is about £50, and it varies. If you look back at the last few years, it varies between £40 and £60 per customer.

Q49 **Chair:** That does not answer my question, Mr Sambhi. I asked what proportion of your profits come from customers who are on standard variable tariffs.

**Sarwjit Sambhi:** In terms of our profit that we declared last year and in the energy supply business in the UK, it was about £550 million. Of that roughly 70% was from the standard variable tariff customer base.

Q50 **Chair:** So you are making more profits from customers who are on standard variable tariffs?

**Stephen Fitzpatrick:** Slightly more, on average.

Q51 **Chair:** Are vulnerable customers more or less likely to be on standard variable tariffs?

**Sarwjit Sambhi:** As I said in the question that was asked before, between fixed and standard variable tariff the proportion is about the same. In terms of prepayment meters, there are more vulnerable customers on prepayment meters.

Q52 **Chair:** And their prices have already been capped.

**Sarwjit Sambhi:** Yes.

Q53 **Chair:** There is some question about whether the Government need a Bill on capping energy prices and whether Ofgem could do it without the Government taking a Bill through Parliament. We now have a price cap on prepayment meters. Ofgem announced last week a price cap for customers on the Warm Home Discount. Centrica have not put in a legal challenge to either of those. Would Centrica put in a legal challenge if Ofgem were to cap the prices with an absolute price cap for all domestic customers?





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**Sarwjit Sambhi:** The Bill came out last Thursday. The extension of prepay to vulnerable came out on Wednesday. We are still digesting the document. What we have said is that we are going to work with Ofgem and BEIS on what happens next. What we will be looking for, in terms of the energy Bill in particular, is how the price cap will actually be constructed. In our mind it has to be a cap that allows for the cost to supply energy and allows for a return to continue investment in programmes like the smart meter programme.

Q54 **Chair:** I understand all of that. Can I just go back? Last Wednesday Ofgem said that they would cap prices for customers on who are on the Warm Home Discount. Maybe I did not totally understand your answer, but will Centrica put in a legal challenge to that?

**Sarwjit Sambhi:** No, we are going to work with Ofgem.

Q55 **Chair:** If that cap had been for all domestic customers, would Centrica put in a legal challenge there? I am just trying to work out whether we actually need a Bill to cap energy prices, or whether Ofgem could just do it anyway.

**Sarwjit Sambhi:** That is a question for Ofgem, in terms of needing the Bill. From Centrica's point of view, a key outcome of the energy Bill, if put into legislation, is that the cap should reflect the costs of actually supplying energy to the customers in the UK.

Q56 **Chair:** One concern that Ofgem have—and we are seeing Ofgem afterwards—is that if the Government do not legislate for a price cap, energy companies like Centrica would put in a legal challenge. I am just asking you whether you would put in a legal challenge if Ofgem were to cap the prices.

**Sarwjit Sambhi:** I am not trying to duck the question. The point I am trying to make is that in the current energy Bill there is not sufficient detail to say, "This is how the cap will work."

Q57 **Chair:** I am not talking about the Bill, am I, Mr Sambhi? I am making the exact opposite point. I am saying that Ofgem have already capped prepayment meters, which has happened and the industry have gone along with it. Last Wednesday you said you will work with Ofgem and not put in a legal challenge to the cap for customers who are on the Warm Home Discount. I am not asking you about the Bill, so you do not need to answer the question I have not asked. I am asking you about whether, if Ofgem were to cap prices for all customers instead of capping prices for people on the Warm Home Discount, you would work with Ofgem on that, or whether you would put in a legal challenge.

**Sarwjit Sambhi:** No, we will work with Ofgem on that.

Q58 **Chair:** In your view, do we need this Bill that the Government published last Thursday, or could it just happen anyway?



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**Sarwjit Sambhi:** Again, our understanding is that Ofgem have said that a Bill is required to give them the power to implement a market-wide price cap.

Q59 **Chair:** I do not want to go around in circles over and over again, but Ofgem say that they need a Bill because otherwise there may be a legal challenge from companies like yours, Mr Sambhi. If you could say, "We will not put in a legal challenge," we will not have to wait another year, another winter and another winter after that to cap prices, and Ofgem could just get on with it, but they need your assurances, do they not, Mr Sambhi, that you would not put in a challenge? Would you put in a challenge if they were to do it for all customers?

**Sarwjit Sambhi:** If the price cap reflects the costs of actually serving energy to customers in the UK, and if it is clear on when the price cap will come to an end and the conditions on which it will come to an end, then the answer to the question is that we are going to work with Ofgem.

Q60 **Chair:** So if it was like the prepayment cap or like the Warm Home Discount cap, Centrica would be comfortable with that; you would go along with that, and we would not have to go to court.

**Sarwjit Sambhi:** No, because we do not think the prepayment cap is cost-reflective. To give you a specific example, in the prepayment cap the costs allowed for smart meters are £1.50. That is not the average cost per customer of installing a smart meter.

Q61 **Chair:** When customers wonder why, when all the Government rhetoric is about price caps, they are not going to have their prices capped this winter or possibly the winter after that, it is because companies like yours will not rule out a legal challenge.

**Sarwjit Sambhi:** I do not think that is the case. If we can quickly understand what the nature of the price cap is, how it is constructed, then we can move at pace.

**Chair:** Thank you very much.

### Examination of witnesses

Witnesses: Dermot Nolan and Rachel Fletcher

Q62 **Chair:** Thank you very much, Mr Nolan and Ms Fletcher, for coming in to give evidence to our Committee today. As you know, we have just taken evidence from three of the energy companies and also Catherine Waddams, so some of our questions will be following up from the evidence we have already heard today. I just want to start where we left off with Centrica. Mr Sambhi from Centrica says that he would work with you, Ofgem, on a domestic customer-wide cap to cover all households. Is that what you hear from them? We are trying to explore whether we need a Bill at all, or whether you could cut the prices for all customers.



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Mr Sambhi was suggesting that they would co-operate with you. Is that what they say to you?

**Dermot Nolan:** I would find that that would not necessarily be a good construal of the conversations that we have had with them, in the sense that their position has been fairly clear: they have opposed price caps and do not feel that they are a good idea. In that situation, I find it difficult to imagine how a consultation could go forward without legislative backing and the legal certainty that that would provide.

Q63 **Chair:** Mr Nolan, is it your understanding that, if you were to cap prices for all households, Centrica and/or other companies would legally challenge that decision?

**Dermot Nolan:** I cannot give you an answer on what any particular company would do. Frankly, I would suggest that the only way would be to ask them. I am not sure, with great respect to anybody you ask, who I am sure would be telling the truth, that such a commitment could be construed as credible or legally binding. I do not think that any company could give up its right to appeal; certainly a judge would not consider that in any sense binding. Therefore, as I said when I was before this Committee in the spring, before the election, price cap legislation would give it the legal certainty that would be required.

I would also draw an analogy to a somewhat similar situation in the financial services, where legislation was required to give the Financial Conduct Authority the authority to set a price cap in payday lending.

Q64 **Chair:** You think and feel that you need the cover of legislation to put in this cap. Would the fact that a Bill had been published give you cover to cap prices, or do you need to wait for that Bill to wind its way through Parliament?

**Dermot Nolan:** Before setting any final cap, I believe we would need Royal Assent to give that degree of legal certainty. We said last week that, if the Bill is going through the House—and obviously that is a matter for the House—we would try to consult on details of the Bill to try to make sure that we were in a position to go forward as soon as Royal Assent was given.

**Chair:** The key thing, then, is finding time for this Bill on the Floor of the House and getting it through before the vast majority of customers will see their bills capped.

**Dermot Nolan:** Yes, I would say that, Chair.

Q65 **Mark Pawsey:** You would introduce the safeguard tariff. I wonder if you could just take us through the processes that you went through before coming up with that proposal.

**Dermot Nolan:** There were a couple of things. First, a safeguard tariff originally was proposed by the Competition and Markets Authority for people who were on prepayment meters. That came out of the CMA;



they said, "You should put it in place. This particular portion of the market is not working well; please put a tariff in place." We designed the tariff with the CMA and put it in place very early this year.

Over the course of the few months following, we thought further about some of the issues in the market. We have a statutory obligation to protect vulnerable customers, and we also looked at evidence that suggested that such customers were on a bad deal, and we decided then, at that point—and we announced this during the course of the summer—that it would be reasonable to put safeguard protection in for such customers as well, because of our statutory duty in the sense that they were suffering most harm from being disengaged in the market.

We announced that last week, or we announced the first version of it, which is the earliest we could get it in. We decided on what we thought in terms of bringing this in relatively quickly, and hopefully removing some of the detriment, that we would use the methodology used in the prepayment cap. Essentially, we hope to bring that in by February.

**Q66 Mark Pawsey:** We heard evidence in the last panel on whether a cap should be absolute or relative. The case in favour of the relative cap is that it assists those further down. Why did you go for absolute rather than relative?

**Dermot Nolan:** There are a couple of points. We thought it was the simplest thing to follow the CMA methodology, which was already in place for the prepayment meters and caps. Both cases were slightly different but the customers affected were people who had found it perhaps more difficult to switch and did not perhaps have very good offers from the market available to them, and also, I would say, spent particularly large fractions of their income on energy. We borrowed the methodology of the absolute cap.

If you are asking me about the more general question of absolute versus relative caps, that is something we have thought about perhaps more in the context of a market-wide cap, if indeed it was adopted. I can expand on that now, if you would like.

**Q67 Mark Pawsey:** If you would, if you could tell us what your position would be.

**Dermot Nolan:** We have thought about this quite a lot. We have talked to a number of economists and other people in the area. There are different types of relative price caps. In our view—and understanding that we cannot know what will happen until it happens—the kind of relative price cap that actually placed a condition on any supplier, particularly a large supplier, that they could only charge a certain differential between their tariffs, is likely to be more harmful than positive. We have tried to model—not perfectly—what the reaction would be to one of the larger suppliers, but our view is that, given the two-tier structures they are functioning with, they would be more likely to retain



the relatively high-price standard variable tariffs and actually withdraw their fixed price deals within the market.

As I say, I cannot say this with surety unless it happened but we believe—and our conversations with other economists has suggested to us that—that form of relative price cap would be likely to keep standard variable tariffs relatively high. However, the effect of withdrawing some of the fixed cheaper deals from the bigger suppliers would be good news for the smaller suppliers but not, obviously, good news for average levels of prices for consumers.

**Q68 Mark Pawsey:** Some of the smaller suppliers that we heard from earlier are supportive of the relative price cap rather than the absolute, so we could probably take it that, if there were to be a price cap, you would be suggesting an absolute one rather than a relative one.

**Dermot Nolan:** For all kinds of reasons, including legal ones, I do not want to specify, depending on what authority Parliament gave us, what we would choose, but that would be our current thinking. I will say, however, that a different version of a relative price cap, which would look at capping price differentials between a basket of prices in the market or low-price deals in the market—not one because that could be gamed very easily—and then a relative price cap on top of that has some appeal to us, whereas the other proposal does not.

**Q69 Mark Pawsey:** You said that you introduced the safeguard tariff because part of the market was not working very well. Is it your view that the remainder of the market is also not working very well?

**Dermot Nolan:** It is very clear from the CMA report that a large fraction of the two-tier market, as they call it, with the majority of people on standard variable tariffs, is not working well. It is working somewhat better than it was two years ago. There has been a significant increase in switching over the last year. We have more people on prepayment meters<sup>1</sup> and there are positive signs of engagement. However, it certainly has not happened quickly enough, and that part of the market is not functioning well.

**Q70 Mark Pawsey:** Are there any measures that you would suggest to accelerate the pace of improvement in the market?

**Dermot Nolan:** The kind of measures put in place in terms of the vulnerability price caps will help. They will particularly help those suffering most detriment. We are taking a range of other measures that are coming out of the CMA, plus extra ones, which will improve engagement in the market. We believe they will make it easier for people to switch. There are also technological advances. The question is about time; it is whether or not they will happen sufficiently quickly to erode the detriment the CMA identified.

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<sup>1</sup> Note from witness: please replace “prepayment meters” with “fixed tariffs”.



Q71 **Mark Pawsey:** In your view, is the pace of change fast enough?

**Dermot Nolan:** The pace of change is faster than it has been for some time.

Q72 **Mark Pawsey:** Is it fast enough?

**Dermot Nolan:** That is a difficult question to answer. I appreciate you asking it. I personally think that some form of further intervention could help.

Q73 **Peter Kyle:** About 60% of the market that you regulate is failing. When you look back over the last couple of years, where did you make the mistakes?

**Dermot Nolan:** We referred the market to the CMA. I do not believe that was a mistake. It answered a significant number of questions, particularly about the vertical integration of companies. It also proposed a number of remedies, which we are putting in place and will fully put in place within two years in the CMA.

Q74 **Peter Kyle:** It seems that you are always reacting and never being proactive in the market. I was on the Committee when you came last time and that was a really good session. In the year that this Committee has had this energy brief, we have been asking the same question time after time. I do not see why Parliament was needed to sort this problem out. I thought that we set the regulator up to regulate the market, but the majority of the market is failing still.

**Dermot Nolan:** There are a couple of points on that. First, the last time I was here, which I also think was a good session, I said that a price cap is not, in my view, a matter for statutory implementation by Parliament. People may or may not agree with me but I did say that very clearly at the time, and that was before the election. An intervention of that nature is such that it needs to be backed up by Parliament, and I used the example of the price cap issue.

The second point is that regulators are absolutely supposed to sort the markets out, and I accept that the market is not working as well as it should be. It has improved over the last year. We will publish figures<sup>2</sup> showing that the detriment identified by the CMA has dramatically reduced and will continue to reduce, and the engagement measures we will put in place will make the market more effective.

I accept that but this kind of intervention—an intervention that will, frankly, have significant distributional effects—is really a matter for Parliament, and I have been relatively consistent on that.

Q75 **Peter Kyle:** A questioner after me we will go into more of the first part of your answer. There is a thirst out there, both in Parliament and in the public, for an interventionist policy when it comes to the energy market.

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<sup>2</sup> Note from witness: replace “figures” with “a report”





The thirst is often not coming from the people who need it the most. That is the challenge but that is why we have regulators and why we have Parliament. Why are you not being more assertive? It is really strange to me because at some point somebody will have to break this deadlock. We are all trying to avoid legislation that could be too blunt to do the job that needs to be done, which is quite a sophisticated one. You are involved in the market in a granular way. You are the only person and the only organisation that can do it. I am really struggling to see why you do not and why you have not.

**Dermot Nolan:** There are a couple of points. I would not accept that we have not been interventionist. One of the things that we announced last week is that we are bringing forward a price cap for those who are vulnerable in two stages, as quickly as we can. We have introduced price protection for an extra 1 million customers and, we hope, 3 million before that<sup>3</sup>. We did that because we thought we had strong evidence to intervene in a market that was particularly affecting the vulnerable and particularly affecting those who are on bad deals, and we thought that was a positive thing to do.

Q76 **Peter Kyle:** So you have done modelling. If the trend of the last year continues with people moving away from standard variable tariffs, how many years would it take before the market is corrected and we have less than 10% on variable tariffs?

**Dermot Nolan:** I would say 12 to 18 months, most likely.

Q77 **Peter Kyle:** Before the 60% moves to less than 10%.

**Dermot Nolan:** We would obviously have to take cognizance of the Prime Minister's announcement but we would have set up targets to be met within a period of time for the reduction of standard variable tariffs and the movement off default tariffs. We are still likely to do that.

**Peter Kyle:** It has been a trickle in the last year.

**Dermot Nolan:** I do not think it has been a trickle.

**Rachel Fletcher:** Can I step in? We have seen a big shift of customers away from standard variable tariffs.

Q78 **Peter Kyle:** How big is "big"? Can you be specific?

**Rachel Fletcher:** About 2 million households a year for the past couple of years<sup>4</sup> have been moving away into the more competitive, good-value part of the market. That is before we have had a chance to really use some quite important new powers that the Competition and Markets Authority have given us to trial engagement tools and to have measures

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<sup>3</sup> Note from witness: replace "3 million before that" with "an estimated 2-3 million after that".

<sup>4</sup> Note from witness: replace with "About 1 million a year – 2 million in total from April 2015 – April 2017."



particularly targeted at those who have been with their supplier for more than three years. These are new tools that we are really determined to use, irrespective of what happens to price-capping. This is something that we want to press on with in parallel.

To your point about us being proactive, it is a really good challenge and I would say, on behalf of Ofgem, we are absolutely determined to get this market to work for consumers. It has not been easy.

**Q79 Peter Kyle:** When was Ofgem established?

**Rachel Fletcher:** Up until now, we have been focusing on very many measures, trying to help customers to engage in what has been a very complicated market. I believe that we have made the market more simple. We have been successful in giving customers better information, and that has driven some of the increase in engagement that we have seen.

We also want to be looking ahead and thinking about whether the current market structure really is fit for purpose and is ever going to give what the public are calling for, frankly, which is good value regardless of whether a customer is active in the market or not. We are actively now looking to see what changes we should be making to bring that about.

**Q80 Antoinette Sandbach:** Rachel, you chose a Warm Home Discount as a proxy for vulnerability, but there are other indicators of vulnerability available. Why did you not pick those?

**Rachel Fletcher:** First, defining and identifying customers in vulnerable situations is not a straightforward task. What we have tried to ask ourselves is what we can do to get something in place as quickly as possible.

**Q81 Antoinette Sandbach:** You have picked the easiest option, rather than the one that might actually tackle the vulnerability. We have heard something about people who do not have access to dual fuel discounts because they live in rural areas so they cannot access the best deals because they cannot access dual fuel. What have you done, for example, to look at that vulnerable group who might be spending a huge proportion of their income on oil, for example, in order to heat their homes and yet cannot access help because they do not qualify for the Warm Home Discount?

**Rachel Fletcher:** We have said that, as a first step and in order to get something in place as quickly as possible, we will use data that the suppliers already have in place, and that is those customers who have been given a Warm Home Discount.

**Q82 Antoinette Sandbach:** By nature, the customers who have the most energy-efficient measures installed and have the most energy-efficient houses probably, for that reason, have far lower bills. How will you deal with the vulnerable customers who have homes that are not



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energy-efficient and who, for many reasons, cannot claim the Warm Home Discount and cannot get help?

**Rachel Fletcher:** What we have said is that we will straightaway start looking at a more sophisticated approach to identifying deserving customers, and we would like to get well beyond the 1 million that we announced last week. We see that basically just as something that we can do quickly and we want to do quickly, but it is not a substitute. We will be consulting later this year on different and wider measures of vulnerability, including the kind of measures that you talked about.

**Q83 Antoinette Sandbach:** Will you be looking, for example, at fuel poverty?

**Dermot Nolan:** Yes, we will specifically be looking at the people in the situations you referred to—people relying purely on electric heat who, as you say, have higher bills. We will be seeking to extend the vulnerability price cap to those who we feel are vulnerable. As Rachel said, it is not a perfect measure. It is the measure we had that we could put in place as quickly as possible. Regardless of an SVT price, we plan to focus on bringing that to more vulnerable people, but particularly those who, as you say, have high bills and potentially poorly heated homes.

**Q84 Antoinette Sandbach:** At the moment, what do you do to identify and protect vulnerable customers who do not claim the Warm Home Discount and either do not disclose that they are on benefits and therefore qualify for schemes, or who may not have applied for benefits, for example, but are vulnerable?

**Rachel Fletcher:** We have put in place really wide-ranging obligations on suppliers to pay special attention to the needs of their vulnerable customers and to go out of their way to identify them.

**Q85 Antoinette Sandbach:** The question was: what do you do to identify them? It was not about what the suppliers do but what you do.

**Rachel Fletcher:** I would not underestimate the importance of that new rule. Only yesterday we came out drawing attention to suppliers' performance in terms of protecting vulnerable customers and giving them extra help.

**Q86 Antoinette Sandbach:** As we are short of time, can you focus on what you do to identify vulnerable customers, how many there are in the market, and what indicators you use to identify them?

**Rachel Fletcher:** We will be doing an extensive piece of work.

**Q87 Antoinette Sandbach:** I am not asking what you are doing; I am asking what you have currently done to identify vulnerable customers.

**Dermot Nolan:** I will give one example, and it is a small example. We have put in place a cap, for instance, on when a prepayment meter is installed. Previously, when a prepayment meter was installed under warrant, which happens generally to vulnerable people with problems paying their bills, they would be charged the full amount. We capped



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that particular amount. That is one specific measure for people who are vulnerable.

- Q88 **Antoinette Sandbach:** Okay, but the evidence we had, certainly from Ovo, which has a lot of customers in the prepayment market, is that it is not right to equate prepayment with vulnerability. How, for example, are you identifying mental health vulnerability that may not necessarily affect payment but still may affect vulnerability?

**Rachel Fletcher:** We have done a lot, actually, with the suppliers, who are the ones with the day-to-day contact with customers and who are best placed to put in place special measures to help them if they are struggling to pay bills and special measures to help them meter-read.

- Q89 **Antoinette Sandbach:** I am really sorry to interrupt you but if you cannot identify vulnerability, how are you able to supervise and regulate the suppliers?

**Rachel Fletcher:** We have made it very clear, actually, that vulnerability is a transient concept. It is something that a supplier has to assess every time it is having contact with customers. Somebody may fall into vulnerability because they are suddenly bereaved. That is the kind of thing we are expecting suppliers to pick up and to deal with. It is not for Ofgem to go around saying, "These customers over here are vulnerable; treat them specially." We are saying, "In your day-to-day dealings with customers, you need to have specially trained people who are able to pick up the specific needs of customers." We then place very, very important and enforceable rules on suppliers that we will take action against if they are not complying.

- Q90 **Chair:** We will have to move on, but I think Antoinette makes some important points, and these were issues touched on in the first session today. Perhaps, Mr Nolan and Ms Fletcher, you could get back to us on what you are doing to identify vulnerable customers, what you are obliging the companies you regulate to do, and perhaps what more you think Government might be able to do to ensure that vulnerable customers get the support they need from their energy companies. Is that okay?

**Rachel Fletcher:** Yes.

**Dermot Nolan:** Of course, Chair.

- Q91 **Albert Owen:** Can you remind us why the safeguard tariff runs only until December 2019?

**Dermot Nolan:** Do you mean the one we introduced last week?

**Albert Owen:** Yes.

**Dermot Nolan:** We introduced it for that period of time. We will review it. I do not personally anticipate it being removed at that point in time. We will review.



Q92 **Albert Owen:** On the previous group of prepaid, you were indicating that there would be a roll-out of smart meters.

**Dermot Nolan:** The CMA suggested that, when smart meters were all installed, the prepayment tariff might no longer be necessary because—it is quite complex—they would have reasons; they would not have the technology, which resulted in poor options being presented to them in the market. However, as the previous questioner said, I totally accept that prepayment and vulnerability are not the same thing; none the less, there is a reasonably strong congruence in certain cases. If a prepayment cap went off, there would still be people who are vulnerable within it, which we imagine would be taken within the scope of any vulnerability cap.

Q93 **Albert Owen:** I have to ask this: are you confident that the roll-out of smart meters is going to happen or are you envisaging a slippage? If I am vulnerable on a prepayment meter and I cannot get the alternative meter for whatever reason—the installation does not work or I live in a block of flats and they are not doing that block of flats until X date—you are saying that, within this criteria, you can extend the safeguard.

**Dermot Nolan:** Yes.

Q94 **Albert Owen:** Relating that to the energy cap proposed by the Government, do you think that has to be in place sooner and then people would not need that vulnerability cap safeguard and they come into the cap?

**Dermot Nolan:** A full cap put in place by Parliament would cover a large fraction of people. Presumably many PPM people are on standard variable tariffs—not all but many are. If the cap envisaged by Government goes through similar to the current legislation, I would imagine that would continue with the prepayment cap. Many of the prepayment cap people might fall into the SVT tariff. Ultimately, depending upon when the SVT cap was taken away, we would have to see what would happen to the prepayment cap. I appreciate I am not being terribly specific at this point, but one thing I would be clear on is that everyone who is on a prepayment meter will retain a cap protection as long as they have a non-smart meter.

Q95 **Albert Owen:** You were clearer the last time you came before the previous Committee, because what you said—and I think you were being frank and honest with us—was that you had wished that you had looked at the vulnerability cap being brought in sooner and extended to everyone else a lot sooner. I want to push you on this because we will be asked to be involved in the legislation: do you think that we need that legislation as soon as possible so that you can get on with your work?

**Dermot Nolan:** If the legislation is going to happen, it should happen as soon as possible, yes.

Q96 **Albert Owen:** I need to ask this perennial question that I ask with regards to loyalty bonuses of the energy companies: did you ever inhibit



them having loyalties to their existing customers?

**Dermot Nolan:** No.

Q97 **Albert Owen:** They used that as an excuse; they said that switching was the only option and that is the way the model was framed. They are bringing bonuses now. Do you think, if I was a long-term customer with one of those companies, that I would be required to switch if they gave me a bonus that was worthwhile?

**Dermot Nolan:** Would you be required to switch if they gave you a bonus?

Q98 **Albert Owen:** No, most people do not switch. Why should they not get loyalty bonuses, like a bonus card that you get in a supermarket?

**Dermot Nolan:** A company absolutely has the right to do that. We are not stopping them in any way; I want to be very clear on that. I appreciate that we have a time shortage but the loyalty issue, as you say, is not unique to energy. I am certainly not trying to fob the energy issue off because it is a matter of concern, but the patterns that we see in energy are similar, to some extent, to home insurance, motor insurance and telecoms.

**Albert Owen:** I would argue that what we are talking about here is heat and light, which are hugely important, and companies are making large profits. I do not see why they should say to their customers, "Go and switch if you are not happy with us." I really find that perverse.

Q99 **Vernon Coaker:** In your decision around the safeguard tariff, you said that it would only address certain aspects of some vulnerable customers' needs. You also went on to say that you would expect suppliers to do much more to identify those needs. What do you actually mean by that? What are you actually saying, Mr Nolan, to suppliers about what they should actually specifically be doing, rather than an aspirational plea?

**Dermot Nolan:** There are two or three points. I am saying to suppliers that they are absolutely free to do what the previous questioner said to me, which is to offer some sort of loyalty bonuses, but, more generally, that they should continue and accelerate the pattern of moving people off poor-value default tariffs. As Rachel said earlier, I appreciate that we are nowhere near yet where we should be, but more than 2 million have moved off in the last year<sup>5</sup>. I said that it is very much in suppliers' hands, if they say they are serious about consumer welfare, to actually be seen to move people on to better deals.

Q100 **Vernon Coaker:** Are you saying they are not acting quickly enough?

**Dermot Nolan:** I do not believe many of them are acting quickly enough. I noticed two of the larger companies in the last couple of months have announced moves to get people off standard variable tariffs.

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<sup>5</sup> Note from witness: replace "year" with "two years".





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These are not perfect moves, but none the less they represent some progress. The other companies should act more quickly. In terms of what I can do, ultimately—I have to be blunt—I have no control over their prices unless I have the power to set a price cap.

**Q101 Vernon Coaker:** What can you do? Unless I have misunderstood what you said, we are in a situation where you believe that the companies should be doing more to accelerate some of the policies that they are pursuing and that they need to quicken that up. You are saying to suppliers that there is a problem here. You cannot act on price, so what can you do?

**Dermot Nolan:** We can promote engagement. We can promote transparency. We can bring to light, and indeed will bring to light on a regular basis, progress made by each of the larger companies in the coming months and year, in as clear a fashion as possible, to indicate what progress they have made to get people off the poor value deals that they are currently on. We can bring that into the public eye.

**Q102 Vernon Coaker:** Are you doing that? Are you naming companies that you are saying, in Ofgem's view, are companies that are not doing their best for the most vulnerable customers, and are you saying that you expect them to? Are you putting that up in lights?

**Dermot Nolan:** The answer is yes. We already publish information every three months, which actually shows the differentials between the prices of the more expensive and cheaper tariffs of some of the bigger companies. I agreed with my board last week that we would go further and we would publish information and try to actually give a fairly simple measure of whether a company has been effective or not, and that we would do so in the coming months.

**Q103 Chair:** Vernon asked whether you are putting it up in lights and you suggested that you were publishing that information. Who are the worst two companies in terms of switching customers to better tariffs?

**Dermot Nolan:** I would say the two largest companies that certainly have the highest proportion of people on standard variable tariffs are Centrica and SSE. My understanding is that, of all their customer base, they have the largest proportion on poor-value default tariffs.

**Q104 Chair:** You do not think that Centrica and SSE are switching their customers fast enough.

**Dermot Nolan:** They have not made progress or initiatives in the way that perhaps some other companies have announced.

**Rachel Fletcher:** If I may, Chair, it is perhaps a little more of who is doing a good job rather than who is falling behind. There are a couple of the larger suppliers where we do see much better efforts at getting their customers off standard variable tariffs than we see from others, and they are particularly thinking about what messaging and what information you



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need to give a customer to help them engage in a market. We have seen them improve there but they are in the minority, rather than the majority.

Q105 **Chair:** Is there any particular example of good practice that you would like to share with the Committee?

**Rachel Fletcher:** Scottish Power has done a lot to make sure that any customer who is on a competitive fixed deal does not roll on to an uncompetitive default deal, and they have seen about 70% of their customers going on to another good deal.

Q106 **Vernon Coaker:** I just have a very quick follow-up. At the end of the last session, the Chair asked Centrica about where they make their money and profit. Why would you say that Centrica and SSE are worse than the other companies in terms of the value they give? Is it to do with fixed-value tariffs and the money they make from that as opposed to other companies who perhaps do not make as much money in that way? Why are they bad or slower to progress than other companies?

**Dermot Nolan:** They have a higher proportion of people on poor-value deals and perhaps have been less effective at moving them off such poor-value deals.

Q107 **Vernon Coaker:** Where do they make their money from?

**Dermot Nolan:** They would make the majority of a thing called profitability from people on such deals.

Q108 **Antoinette Sandbach:** Why do you not regulate it? Your own evidence shows that they are making between 11% and 15% more on standard variable tariffs. Why have you not acted to regulate that?

**Dermot Nolan:** There are a couple of points. We have acted to regulate, or are acting to regulate, on a particular set of people. More generally, in order to control any price of a market-wide price cap on that level of thing, as I said to the Chair, that is where legislative power is needed: to actually regulate prices.

Q109 **Drew Hendry:** Ms Fletcher, coming back to the safeguard tariff, can you tell the Committee what other options you considered and discarded and why before deciding that was the best mechanism?

**Rachel Fletcher:** Yes. In the document we published last week, we did look at a range of alternative measures. We thought that simply applying the level that is in place for prepayment meter customers would bring about the quickest and most effective benefits to those vulnerable customers. We looked at other alternatives, such as putting a social tariff obligation on suppliers; that has been in place. In the past, frankly, it has not revealed very much in terms of benefits to consumers. We looked at specific measures to help vulnerable customers engage in the market but, yet again, we are concerned that those customers in



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particular quite often have barriers to engagement—for example, they may not have easy access to the internet.

We did look at a range of measures that are set out in the document we published last week, and we actually talked about the options with consumer groups over the summer. There was very strong support from consumer groups for a safeguard-tariff approach for protecting vulnerable customers against alternatives.

**Q110 Drew Hendry:** You said in your decision that non-eligible customers may be negatively affected.

**Rachel Fletcher:** For anybody who is currently on a competitive deal, there is a small chance that those competitive deal prices may increase. However, in our decision we said that what we are bringing in place in February will affect 1 million customers only. We are not expecting that to have a significant effect, if any, on the prices that other customers will get.

**Q111 Drew Hendry:** Mr Nolan, given that your remit is to protect all customers, is it not odd that some people will be disadvantaged by this?

**Dermot Nolan:** That is a fair question. I will give the example of the prepayment meter price cap, which I said I thought was a good idea, and in some ways we wish, on the vulnerability thing, that we had imposed it earlier.

I want to be clear, though. We have seen about eight months of the evidence for that. The majority of prices have fallen. The majority of people on prepayment meters were, by and large, getting a bad deal for various reasons. I accept the point that not all were vulnerable. However, the majority of prices have fallen. Some prices have risen. Some of the deals that were below the cap have been withdrawn from the market. That is a minority but some have been affected. By and large, most prices in the prepayment meter world are in or around the cap. A significant majority of people have gained and some have lost. That is the nature of such a mechanism. It certainly was the nature of the PPM. I wish I could absolutely guarantee that such deals would not be withdrawn but I cannot. We put in place a cap that we felt, on average, would benefit those people, and I believe it has done so.

**Q112 Drew Hendry:** Given that answer, what other measures could the Government take to make sure that vulnerable people are protected?

**Dermot Nolan:** I very much take Ms Sandbach's point, and we will come back to her on this. On vulnerability, we have a special obligation. The safeguard tariff has been put in place. There are the measures that we will push forward with, working with the Department for Work and Pensions, in identifying other vulnerable people. I would like to feel that we will push forward with those as strongly as possible and I do not feel that we need further legislative backing for that. That is my own view.



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Rachel spoke earlier about the future, and, looking forward, it seems to me that some of the points I have heard made about markets and insurance, etc, are that we are seeing evidence of a degree of ability of any company in any of these markets to, if I may use the phrase, “price segment”—to use the advantage of data to be able to charge people differential prices. We certainly see this pattern very strongly in home insurance, to a lesser extent in motor insurance and certainly in telecoms. People are being charged differential prices.

My own view of the future, which I am genuinely positive about, in an enhanced digitised energy sector, is that it is always likely that there will be people who find it more difficult to engage with that kind of digitised framework. Given, as Mr Owen said, the role of heat and light, my own sense is that even 10 or 15 years from now there will be a need to protect vulnerable users and people who cannot access the market, and that is likely to include some form of safeguard tariff.

**Q113 Drew Hendry:** Do you think it is fair that people in rural areas, in particular, already have a price differential in terms of the unit price appearing? Has that been considered in the round with your decision making over the best way to protect vulnerable people?

**Dermot Nolan:** In the Warm Home Discount we used as it. In developing a further measure, we will focus on rural people and we will particularly focus on the significant number of rural people who get their heat from electricity and who are paying higher electricity bills as a result. I would imagine that we would focus on that in the second round of any vulnerability price cap.

**Q114 Drew Hendry:** You say, “I would imagine.” Is it that you will be, or you imagine you will be?

**Dermot Nolan:** I will be.

**Q115 Albert Owen:** Just on the back of that, in most of these areas where transmission costs and distribution costs are higher, are you confident that the Government review looking into that will be helpful to you? If the outcome is that there is a huge differential for people in rural areas, is there anything you can do about it?

**Dermot Nolan:** We look forward to the review by Professor Helm. I have some sense of what might be in it. I discussed it with the professor and we will see what he comes out with. I probably cannot say any more than that.

**Q116 Albert Owen:** British Gas said that the reasons they hiked their prices last time was to do with transmission costs. I know you jumped on them.

**Dermot Nolan:** They did. I remember the day that price announcement was made and I said—I can go back and look at it empirically—that those network prices had fallen over that period of time. We said that very clearly, and I can go back and look for any evidence of that as needed.



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Q117 **Anna Turley:** Dermot, your second decision was to allow energy suppliers to roll customers, when they came to the end of their fixed-term contract, on to another fixed-term contract rather than an SVT. Why was that necessary?

**Rachel Fletcher:** That was necessary because we had rules in place to say, up until that point, that a customer coming to the end of a fixed-term contract, if they did not make an active choice themselves, had to be rolled on to an evergreen tariff that would have no exit fees. That was particularly to make sure that customers did not get locked in to another deal without their express consent. What we have now announced over the last few days is that, if a customer is going to be rolled on to a fixed deal, that is perfectly fine from our point of view as long as there are no exit charges to that customer and as long as that fixed deal is no more expensive than the equivalent evergreen tariff.

We already know that there are some suppliers who, as a default, want to roll their customers on to their good-value, fixed-term deal, and several other suppliers have said that they are considering new default fixed-term deals for their customers. It may be that that arrangement means that, even if a customer does not make an active decision at the end of the fixed-term that they have chosen, because they know that they are in a temporary arrangement, they are encouraged to go out into the market, search and make an active choice again at some point.

Q118 **Anna Turley:** Who will be primarily affected by this? What sort of bill payers?

**Rachel Fletcher:** This is obviously specifically for anybody who is already engaged in the market and is on a fixed deal. However, this also means that it is in the supplier's gift, if they want, to put everybody who is on an SVT on to a fixed-term deal. There should be no regulatory barriers to them doing so—we have made that very clear to the suppliers in question—and we have a regulatory framework now that puts the ball back in the supplier's court to decide what arrangements they have in place for customers who are not making an active choice in the market.

Q119 **Anna Turley:** In essence, the criticism is that this is only affecting customers who are already engaged in the market.

**Rachel Fletcher:** They are absolutely the primary beneficiaries. They are probably the customers who will see this change first, but it is now leaving it wide open for suppliers to decide to put all of their default customers on to fixed-term deals if that is what they want to do.

Q120 **Anna Turley:** Could we see the end of the SVT?

**Rachel Fletcher:** We could. E.ON have already announced that as customers get smart meters they are going to put them on a default tariff that is fixed. We are yet to see the prices that go with that arrangement but it is an interesting development in the market. We know that other suppliers are looking at something equivalent. I would, however, be



keen to point out that changing the name does not necessarily mean that it is better value. While this may be another engagement tool for customers, what we really care about at heart is what people on default deals are paying.

**Q121 Mark Pawsey:** Mr Nolan, at a time when the average price of gas and electricity is below the median in Europe and the profits of the energy companies are about 30% lower than the peak year of 2010, do you think their profits are currently excessive?

**Dermot Nolan:** Their profits have been broadly stable for a few years. They could be driven down and, by and large, competition is the way of driving that down. I do notice that, if you look at the larger companies, you see considerable variations. Some companies are profitable; some companies are actually making a loss. One of the things that the CMA identified was significant cost differences between the big companies; some are more efficient than others.

**Q122 Chair:** Finally, the price cap that the Government are looking to legislate for would be a temporary price cap, and so at some point everybody hopes that we will not need price caps. However, if the market is not working today and there is a temporary price cap, what is to say that, at the end of that period, we do not just revert to the situation that we have today, which most people agree is a broken market?

**Dermot Nolan:** Chair, I would hope that, in the next week or two, we will set out more of a vision of why that would not happen. I can say a little about that now. If there is a price cap in place and it lasts and it is then removed, we have worked on various ways in which a market could see people more engaged generally, including, if I may say, the supply licence being changed to remove the requirement that the only interface that someone can have with an energy entity is a licensed supplier. I could see a profusion of smaller suppliers, local suppliers and peer-to-peer energy suppliers, with engagement being much easier. I could see quite a strong vision of that.

As I said earlier, there is likely to be, even in that world, some problem with disengaged and vulnerable people and some form of protections. We are also thinking about such issues, including things like collective switches, which, in my view, could be a very good way of dealing with disengaged people without the bluntness of a price cap.

I do not want to sound overly naïve, but I think the power that data will have for consumers and the power that consumers will enjoy from having their own data, from having numbers of people using that data—obviously in a private way—is obviously quite powerful when allied with smart meters. If there is a price cap in place, it is obviously incumbent on the regulator and the industry to have something that is far more positive when it is removed.

**Chair:** Thank you very much. Our Select Committee will be doing





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pre-legislative scrutiny of the Government's Bill, so no doubt we will be seeing you in the weeks and months ahead.

***Dermot Nolan:*** We are at your disposal, Chair.