

Business, Energy and Industrial Strategy Committee

Oral evidence: Pre-legislative scrutiny of the draft Domestic Gas and Electricity (Tariff Cap) Bill, HC 517

Wednesday 10 January 2018

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

Questions 334 - 421

Witness

I: Dermot Nolan, Chief Executive, Ofgem.

Written evidence from witnesses:

- [Ofgem - written evidence](#) | [PDF version](#) ( 81 KB) 

Examination of Witness

Witness: Dermot Nolan.

Chair: Thank you very much, Dermot, for coming to give evidence to our Committee again on the Government's draft energy price cap Bill. We have a number of questions to get through this morning. Thank you as well for the extensive evidence that Ofgem has given us on this. We want to pick up on some of those themes, as well as some questions arising from the other evidence that we took before Christmas.

Q334 **Antoinette Sandbach:** Good morning, Mr Nolan. In paragraph 20 of the evidence that you sent into the Committee, you said it is likely that there will need to be continued protection for vulnerable customers, even in a more digitised, competitive market. Does this mean that you think that the Government's price cap will not fix the market for vulnerable customers?

Dermot Nolan: Thank you for having me. In my view, if properly implemented, a price cap will significantly reduce detriment and go a long way towards fixing the market. A price cap will also provide protection to those customers who are vulnerable during the period of a full market price cap. If such a price cap is ultimately withdrawn, as would appear to be the intent of the Bill, it seems to me—looking at both the experience of the energy sector generally and some other markets that have been more digitised—that there is likely to always be a need to protect customers who would not be fully able to engage even in a digitised, more competitive market.

In that sense, I see a situation with one potential analogy. Recently, Ofcom has introduced a price cap in fixed-line telcos, a market that was liberalised and has probably been more competitive and more technologically advanced than the energy market. Some customers still find it difficult to engage in it. I note in the last few days there has also been some discussion about open banking, and the sense that open banking and personal data will in some sense revolutionise the banking and mortgage markets, and make it easier to switch and engage. I believe that, if properly implemented, that will be the case in banking. It strikes me that you will again have customers who, for various reasons, find it more difficult to engage and will need a degree of protection.

Q335 **Antoinette Sandbach:** Just to clarify, you think the price cap will protect some categories of vulnerable customers. I am not really clear how that is. Can you explain how you think that is going to work?

Dermot Nolan I think the proposed legislative price cap will protect all customers on default or standard variable tariffs. Our evidence suggests that many customers who would be recognised as vulnerable are on such tariffs. Indeed, our evidence is relatively clear that such customers,



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particularly on some of the more expensive standard variable tariffs, switched less.

Q336 **Antoinette Sandbach:** Can you explain to me how you think the price cap will help vulnerable customers to switch?

Dermot Nolan: It will not, by itself, help them to switch.

Q337 **Antoinette Sandbach:** What will Ofgem do to make sure that there are adequate protections for vulnerable customers?

Dermot Nolan: I would give three answers. First, they will have a basic level of price protection. It strikes me that vulnerable customers on standard variable tariffs are now paying some of the highest prices in the market. In my view, a price cap will reduce their prices. That will offer them direct protection.

Secondly, in general as we go forward, as was said by the CMA panellists before Christmas, we will attempt to promote engagement and we will specifically attempt to promote engagement for vulnerable customers. Thirdly, we have a variety of other protections for vulnerable customers, including a vulnerability principle that every supplier in the market must treat its vulnerable customers fairly.

Q338 **Antoinette Sandbach:** Given that you accept that a high proportion of vulnerable customers are being failed by the current system, is that not a failure of engagement and a failure of regulation by Ofgem?

Dermot Nolan: It is a problem, and I accept the point that we could and should have done better on vulnerable customers. We have relatively recently put in place principles for vulnerability, which will give a stronger level of protection. As I said last time I was here in October, we are pushing forward with price protection for vulnerable customers in any case. We think this is consistent with our statutory duties. It is not for me to opine on what the House does on the legislation itself, but we will continue to push forward with specific price protection for all vulnerable customers in any case.

Q339 **Antoinette Sandbach:** Given that you accept you have a statutory duty to protect those vulnerable customers, you have just effectively admitted that you have failed them to date.

Dermot Nolan: We have not done as well as we could have. I fully accept that.

Q340 **Stephen Kerr:** You said in your submission that, even in a more digitised marketplace, vulnerable customers on default tariffs would need protection. Does that mean that you agree with some of the witness testimony that we have received: that smart meters would help consumers engage with their levels of consumption and maybe even change their behaviour, but would have no impact on switching levels?



Dermot Nolan: It is still very hard to tell. I apologise for that answer, but I will explicate it further. In my view, smart meters are a good idea in their own right. The cost-benefit analysis the Government have published, and I think they will continue to update, suggests that the benefits for smart meters outweigh the costs. Personally, I find those arguments convincing, but they were not necessarily based on the issue of encouraging switching. They were based on driving reductions in energy consumption, particularly at peak levels. They were based on giving customers surety in the amount they were paying.

In that sense, I do not think that smart meters by themselves will make switching or engagement easier. In my view, they will give customers confidence that they are paying the right amount for their energy and they should enhance trust in the system. It seems to me that it is possible that that will help engagement, but smart meters by themselves are not the answer. This is why a faster switching system and other engagement measures will be needed to combine with them.

Q341 **Stephen Kerr:** Have you conducted research to support what you just said? Where would you point us to in order to find the evidence to support what you have just said to us?

Dermot Nolan: The Government have done a lot of work on the costs and benefits of smart meters.

Q342 **Stephen Kerr:** You accept it.

Dermot Nolan: Yes. It is a cost-benefit analysis, but I broadly accept the essence of it. We are doing some work at the moment—coming back to vulnerability issues—looking at the impacts of smart meters. In particular, will they have an effect on engagement? That has not yet been tested, in the sense that we do not have enough smart meters in, with the switching available, to determine whether they have helped engagement. That will have to become clearer over the next 12 to 18 months.

Q343 **Stephen Kerr:** Finally, do smart meters provide the means by which we arrive at a more competitive marketplace?

Dermot Nolan: They are a necessary means to do so, yes. They are not sufficient.

Q344 **Mark Pawsey:** Mr Nolan, I am quite interested in the measurement of effective competition. I take it we would all agree that there is not currently effective competition in the energy supply market.

Dermot Nolan: Yes.

Q345 **Mark Pawsey:** If you are striving to achieve effective competition, and you are obliged under the legislation to carry out a review annually, how will you determine whether you have reached a position of effective competition?



Dermot Nolan: We will look at a number of indicators. No one indicator will be particularly determinative in capturing whether competition is effective. One of the most obvious things that have been used so far is the number of switches. Indeed, that is an important element. If the number of switches is high, if people seem to find it easy to switch, that is one sign of a competitive market. It is possible—and I can discuss this further—but not definite that, in the presence of a price cap, the number of switches may fall. The actual quantitative level of the numbers in itself will not be determinative.

We will look at a number of indicators including qualitative issues: qualitative research as to whether people have found it easier to engage; how measures have changed over the period—one, two or three years—for which a price cap has been in place; if customers are still finding it easier to engage; the proportion of customers remaining on default tariffs; and the level of variation in the market. In a competitive market that is working effectively, you would not expect to see huge differentials.

Q346 **Mark Pawsey:** Are you discounting number of switches? It is obvious that if everybody is on the same price, nobody is going to bother to switch. Why would you? You cannot use number of switches as a measure of effective competition.

Dermot Nolan: Certainly it would not be determinative. We can discuss this further if people wish. If everybody was on exactly the same price all the time, I think the number of switches would be very low. It could still happen. The companies may differentiate themselves in terms of quality or other services going forward.

Q347 **Mark Pawsey:** Are you happy for the other measurements to be prescribed at this stage, so that we can judge whether the cap has been effective in encouraging effective competition in the market.

Dermot Nolan: That is a matter for the House. I would see no particular reason to prescribe in legislation, no.

Q348 **Mark Pawsey:** Have you had any discussions with government about how this definition should be arrived at?

Dermot Nolan: We have had some general discussions with officials, yes, but by and large my understanding, which may be incorrect and obviously the House may do as it wishes, is that it would be up to the regulator to determine what “effective competition” meant and to consult on that.

Q349 **Mark Pawsey:** We are going to pass this legislation and hand over to you in its entirety the responsibility for determining whether we have reached a position of effective competition.

Dermot Nolan: My understanding is that we are being given the duty to assess it, and then report to the Secretary of State, who then makes the decision.



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Q350 **Mark Pawsey:** That does not instil massive confidence in me, because in your response to an earlier question you said that you could have done better in respect of vulnerable customers. How do we know that you are going to be effective in these particular tasks that you are being given?

Dermot Nolan: It is a very fair question, Mr Pawsey, but we will work incredibly hard at doing so. We have expertise in competition matters. We will work hard with the CMA. We have learned a lot from the CMA process itself. We will talk extensively to Ofcom, which has had a similar task in recent years of removing regulations and potentially price caps, and determining whether the market is effectively competitive. We will work as exhaustively as possible to determine effective criteria.

Q351 **Rachel Maclean:** I wish to follow up a bit on Mark Pawsey's questions. You said in answer to Mr Pawsey that you would make a recommendation but the final decision would be down to the Secretary of State. Is this not effectively a case of you washing your hands of the responsibility of that very difficult decision, which is the thing that makes the most difference to customers?

Dermot Nolan: Personally, I am neutral as to who makes the final decision. The current draft legislation suggests the regulator reports yearly; we started to make reports last year. Coming out of the CMA recommendations, we have published what we call a state of the market report, which was an assessment of conditions of competition and consumer welfare across the market, including in the retail space. We will use that as one of the primary vehicles to develop yearly reports on the price cap.

The draft legislation envisages the final decision with the Secretary of State. By no means would I suggest we are washing our hands of it. If the House wants to give the final decision to the regulator, that is a matter for the House, and the regulator will then make the decision. I am relatively neutral as to whether the final decision is made by the Secretary of State or the regulator, but I can assure you that if it is made by the Secretary of State we will not wash our hands. We will work as extensively as possible and advise the Secretary of State as best we can.

Q352 **Rachel Maclean:** You are saying that it could work if you as a regulator had the final responsibility.

Dermot Nolan: It could. That is a matter for Parliament.

Q353 **Rachel Maclean:** You said that you are neutral on that.

Dermot Nolan: Yes.

Q354 **Rachel Maclean:** What would be the advantages if you had the say on this? It seems to me that this is the heart of the Bill—defining effective competition—and no doubt people will have widely differing views across the House. We look to you as the experts in this and the people that have done the research. Effectively, Members will find it very difficult to



know—if they are not experts in economics—what is effective competition or not.

Dermot Nolan: It is difficult for me to comment on Members' expertise. We would try to do as much analysis as possible, but then we would give a binary recommendation to the Secretary of State—yes or no—or we would make the decision ourselves. As to whether that is a political or a regulatory decision, as I said, I do not think I can go any further in advising. I am happy for it to be either one. It seems to me that, in a situation where the regulator has spent a lot of time and effort, as it would, in providing an analysis and has given it an either/or decision, Members of the House would be perfectly capable of deciding whether they agreed with it.

Q355 **Rachel Maclean:** What customers want, at the end of the day, is lower prices.

Dermot Nolan: Yes.

Q356 **Rachel Maclean:** Are you confident that effective competition will lead to lower prices?

Dermot Nolan: Yes, I remain of the view that effective competition in the medium to long run is better than a regulated market, if competition is effective. It is not as effective as it could be yet.

Q357 **Albert Owen:** Good morning. You said in your submission that you agreed with the Government that the cap should be a temporary measure. Do you think the 2023 sunset clause is right, and what do you expect to happen by 2023 to make the cap unnecessary?

Dermot Nolan: Again, I find the issue of whether it is right difficult to opine on. I can talk about it, but it is ultimately a matter of judgment for the House. It seems to me, presuming the legislation goes through and by 2023 there has been a price cap for a period of time, that it is possible that we will have opined relatively quickly that competition is more effective. Hopefully, over that period of time, there will be two or three aspects: we will have smart metering; we will have faster switching; we will have taken various further engagement measures, which have come out of the CMA report and which we are pursuing; a variety of other technological changes will have come into the market, giving it the possibility of changing dramatically, subject to the comment I made earlier to Ms Sandbach that I still think many vulnerable customers will find it difficult to engage.

These are the kinds of things that would have happened. I see a possibility that, by 2022 or 2023, engagement is sufficiently easy that people can look at their mobile phones, hit literally two, three or four buttons, and switch supplier, and that is just standard and easy to do. This would cause its own issues, but nonetheless they will have hit one or two buttons and given an agent the power to switch on their behalf.



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These are the kinds of things that I see coming into the market and that will enable more effective competition and more entrants. There are various other measures that could help, which I can discuss either now or at some other time. Based on that, we would have to decide whether there was effective competition. If by 2023 we decided there was not, what would happen then is a difficult issue.

Q358 **Albert Owen:** Let us say the legislation goes through in the next 12 months and by next winter it is the start point. Do you think that by 2023, in four years, all the energy companies will be in a position and competent to switch their customers off these standard variables and the cap will have an effect?

Dermot Nolan: I think the cap will have an effect over the next two or three years in driving down prices for standard variable customers. That is positive. Engagement measures will have to proceed parallel with that to make it easier for a cap to ultimately be withdrawn. I see that as the kind of thing that should happen and could happen in four years. I believe it is possible that even the phrase “energy companies” will have changed in the next four years. We may have companies offering a wide range of services including energy. You may have new entry and you may have the existing set of companies in a far less important position than they are in today.

Q359 **Albert Owen:** Just sticking to the Bill—the legislation that has been drafted and gone before the House—in 2023, if there is the sunset clause, do you think that you should have regular contact with the Secretary of State so that the powers could be extended? Cynics like me might look and say, “Energy companies are going to behave themselves for three to four years, then after that they can revert back to type”. In the past you have talked a lot about the behaviour of customers, and you are quite right: people should be more savvy, but the energy companies should be more responsible as well. Do you think in 2024 there should still be a means by which you or the Secretary of State can look at the cap for a variable period?

Dermot Nolan: That is difficult for me to judge. Any company will have commercial motivations, now or in the future, and they are not going to magically change. I hope the energy companies have learned some lessons from the last few years, but I cannot predict what they will be like.

Q360 **Albert Owen:** Some of them have already changed, though, have they not?

Dermot Nolan: Many have improved their behaviour over the last two or three years. My personal view is that if in 2023 it was felt that the conditions were not effectively competitive, it would be hard to explain to people that the cap was being removed.

Q361 **Chair:** Do you think that you might need to have something more permanent for vulnerable customers? You spoke earlier about people



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being able to press two or three buttons on their phone in order to switch. We can probably all think of constituents of ours who, even in three or four years' time, might not find that that easy. They may not have a smartphone. They may not be as adept at using technology as other people are.

If that solution would not help them to switch, is something more permanent needed for vulnerable customers to ensure that they are not paying higher prices than others?

Dermot Nolan: In my view, yes. It is likely that such protection will be needed for vulnerable customers, and that could take a number of forms. As I said earlier to Ms Sandbach, we are proceeding with a price cap for people we define as vulnerable, which is difficult, but obviously a challenge we should be meeting. I would envisage a very possible situation in which if a full, market-wide price cap was removed, Ofgem would continue with the price cap for vulnerable customers. That would be one solution for those who are particularly vulnerable or possibly those who are particularly disengaged, if the research had seen that they were not adopting this technically savvy, digitised switching in the way that the majority of the population was.

I see that as a very likely scenario. I see it particularly in this economy. Over my time as energy regulator, I have been reminded that people regard heat and power, as I think Mr Owen said last time, as some sort of special good. It is an essential service. I fully accept that. A number of previous witnesses said, "If you have a price cap here, why not everywhere?" My experience has indicated people feel energy is special—essential—and that the vulnerable need to be protected. I personally believe that. You would then have the statutory powers to have such protection and a price cap set by a regulator alone.

Q362 **Chair:** Drew Hendry will come to the issue of data sharing in a bit, but at the moment do you have sufficient powers and information to be able to protect vulnerable customers?

Dermot Nolan: I would reiterate the point I made to Ms Sandbach that, on SVT, a full price cap will offer protection to vulnerable customers.

Q363 **Chair:** Yes, but at the moment do you have those powers? Would you have them in 2023, or would you need to have changes in legislation outside of this Bill, or within this Bill, to give you them?

Dermot Nolan: I do not believe we would. If data sharing is coming, I will address it then, but secondary legislation is being proceeded with at the moment that would allow us to take DWP data and engage in data sharing. That will help us to put in place a vulnerability price cap if, indeed, the market-wide price cap does not happen. Subject to that, I believe we would have appropriate powers for, say, 2023, to have a full vulnerability price cap if needed.

Q364 **Drew Hendry:** As we have just said, data sharing is going to be critical



in delivering protection. What discussions have you had with the Government about the likelihood of the legislative obstacles to data sharing being removed in the near future?

Dermot Nolan: The GDPR will make data sharing somewhat more difficult overall. We have recently had conversations with Government, with both BEIS and the DWP, about taking DWP data of people who are vulnerable—again, the definitions are never perfect, but the DWP definition of people who are vulnerable is reasonably accepted—to allow that data to be transferred by very secure means, to give a set of individuals who will be protected by a price cap. This would be written as a flag on their account, so that any company who was supplying energy would know they were vulnerable and would feel they were bound by a vulnerability price cap. We are proceeding with discussions with Government on that.

Q365 **Drew Hendry:** The principles of that sound good, but have you received reassurance that these changes will be made in time for you to extend the safeguard tariff protection to the additional 2 million vulnerable customers?

Dermot Nolan: I think we have, in the sense we have worked with DWP and BEIS. A piece of secondary legislation needs to take place. I am not sure of the precise timing, but I am reasonably confident it will proceed in time.

Q366 **Drew Hendry:** To be clear, I am asking about reassurance of these things. You have said you believe they will be there. What actual dates and figures have you been given to underline that confidence that it will be ready?

Dermot Nolan: My apologies for not knowing the precise date, but my sense would be that that secondary legislation will be done by the end of February. I will write to you with specific dates.

Q367 **Peter Kyle:** Your *State of the Energy Market 2017* report showed that the prepayment meter cap led to two outcomes: there was a convergence towards the threshold, and there was a decrease in the number of people who were switching tariffs. Was that what you expected and hoped for?

Dermot Nolan: It was broadly what we were expecting. We have looked further, and I might update a little now. There has been a convergence. The majority of prepayment prices have come down, which is a good thing. Some prepayment tariffs are now no longer available; some of the cheaper ones that were below the cap have been withdrawn, but not all. There are still some prepayment tariffs out there that people can switch to that are below the level of the cap, but there has been some convergence.



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By and large, most prepayment prices have come down. Some of the cheaper ones have come up and are being withdrawn, but there are still some cheaper ones. By and large, there has been convergence.

We had early indications that the number of switches had fallen, and indeed we wrote that in the submission we sent. Just before Christmas, we did another trawl of switching data and PPM, which is difficult because—and we will change this—switching data, by and large, is not provided specifically for PPM customers, so we have had to try to piece things together in that particular picture.

The picture we have is much more nuanced now: switching rates appear to have fallen somewhat, but not collapsed, in the PPM market. That is not a perfect piece of analysis, but we have looked at issues. Firms that are predominantly PPM-based, of which there are at least two or three reasonable large ones, have continued to grow at almost the same rate, or possibly a little more slowly, after the PPM cap came in. While not definitive, this seems to us indicative that there is still a reasonable amount of switching going on in the PPM market.

Q368 Peter Kyle: On average, customers benefited to the tune of about £60, but the convergence went both ways and there were other customers who lost out. Is that a price worth paying?

Dermot Nolan: That is an ethical choice, and with the PPM cap it seemed, yes, it was a price worth paying, because the overall level of detriment in prepayment meters was higher than the rest of the market. It was definitely a price worth paying.

Q369 Peter Kyle: If you do not mind me saying, throughout the testimony here and before, you have been describing what is happening in the market; you are the single most important player in the market, because you have the most extraordinary powers as a regulator, yet your testimony sounds so incredibly passive. Do you ever just roll your sleeves up and get stuck in? I do not really see the evidence of that.

Dermot Nolan: I apologise if I seem passive. I honestly do not feel passive. As I said to Mr Owen before, I wish we had moved earlier in putting price caps in.

Q370 Peter Kyle: What lessons have you taken from that, and how has that changed your behaviour?

Dermot Nolan: We are rolling up our sleeves very strongly at the moment, and have been doing so over the last year since the CMA finished, in terms of bringing forward a price cap for vulnerable customers, which is at the limit of the powers we have; in generally pushing companies to behave better; and in trialling and improving switching. There is a large amount of work going on in the market to make switching easier, to help smart metering, and of course in the non-retail sector.



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Q371 **Peter Kyle:** The Secretary of State says this Bill is not even needed, because you have the powers already. You do not seem to be a regulator that is stretching the bounds of your power in defending the consumer in the market you regulate.

Dermot Nolan: I do not think I accept that. The second to last time I was in front of the Committee, before the last election and before the manifesto, I said very clearly—and I do not think it was contested at the time—that an intervention through a full, market-wide price cap, a significant policy change to the framework set up, was a matter for Government. I think I have been reasonably consistent with that.

However, I have also said that we would put in, and regretted not putting in earlier, price caps for vulnerable customers, and we would proceed intensively with that and have a targeted campaign over time to try to ameliorate the harm in the market. I said a market-wide price cap was for policymakers, and I think I have been consistent in that, but I also said we would implement it to the very best of our ability.

Q372 **Peter Kyle:** You have just admitted that you wish you had acted earlier, but the consequence of you not acting earlier has been that many customers, particularly vulnerable customers, have paid much more money than they should have done.

Dermot Nolan: I said to Ms Sandbach earlier on vulnerability we should have moved earlier.

Q373 **Peter Kyle:** Do you apologise to those consumers?

Dermot Nolan: I do.

Q374 **Vernon Coaker:** Mr Nolan, can I just have a word about green electricity tariffs? They are to be exempt, under proposals, from a market-wide price cap. You have expressed concerns about that. What have you said to BEIS and what has BEIS said back to you about this?

Dermot Nolan: Broadly, we said to BEIS that we think this is very understandable as an exemption, but that we think it likely that suppliers may try to game it in some fashion, in the sense that we could imagine a larger supplier offering a standard variable tariff that was green significantly or maybe just a bit above the price cap, and saying, "This is a green tariff; therefore, we are not bound by the price cap". BEIS said there are ways to check whether a tariff is green, and there are ways. They are imperfect but we will, if it is included in the Bill, police it very intensively. However, it is a potential thing that suppliers will choose to game, in my view.

Q375 **Vernon Coaker:** Do you think the energy companies would themselves look at it and say, "Here is a way around the price cap"?

Dermot Nolan: Possibly. Commercial companies will generally try to make money. To assume they will not is probably not wise. As I said, we



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will police it as intensively as possible. I would have absolutely no hesitation whatsoever if we thought it was not green.

Q376 **Vernon Coaker:** How does that work? It really builds on what Peter Kyle was saying. How would that work—how would you know, and what would you do?

Dermot Nolan: There are ways to determine the source of energy as to whether the generation of energy by that company has occurred in a sufficiently green fashion, which we have a definition for already, although not a perfect one. We would make specific requirements of companies on that. We would audit them and we would police it. If they were not compliant, we would tell them they must immediately withdraw the tariff or face enforcement action.

Q377 **Vernon Coaker:** What powers do you have? Supposing they did it and it was obvious they were doing it, what could you do? Can you compel them to stop? Can you compel them to pay the money back? What can you do?

Dermot Nolan: We can take enforcement action against them, with substantial penalties.

Q378 **Vernon Coaker:** What does that mean? I do not understand what that means.

Dermot Nolan: We would say that they were breaching their licence conditions.

Q379 **Vernon Coaker:** What is the consequence of that?

Dermot Nolan: The consequence of that would be a fine, with requirements to pay all the excess money back, plus a punitive element on top of that.

Q380 **Vernon Coaker:** Who determines what that punitive element would be?

Dermot Nolan: The punitive element will be determined by Ofgem, not by the executive in Ofgem but by a panel of experts set up to conduct enforcement cases.

Q381 **Vernon Coaker:** That goes to the nub of it. Your evidence to us just now is saying that it is potentially a really serious loophole in the Bill. You believe that some companies may choose to use it. Are you prepared to act pre-emptively?

Dermot Nolan: Yes.

Q382 **Vernon Coaker:** What does that mean? Also, is it not something that the companies ought to hear loudly and clearly from here that, if they do what you think they may do, you as a regulator will use every single power that you have to stop them and, if they go ahead with it, take punitive action against them so that the market operates effectively?

Dermot Nolan: Yes. I am saying that loudly and clearly.



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Q383 Chair: Do the Government need to amend the draft legislation to stop this happening in the first place? You have spoken about the action you might be able to take but, in the meantime, customers potentially could be paying higher bills, if companies try to exploit the system in this way. This is draft legislation, and the reason we are doing pre-legislative scrutiny is to try to improve the legislation.

Dermot Nolan: I can understand the motivation behind it. It will make implementation more complex. That, as no doubt you will tell me, is my job, so we will do the job, if that is what the House wants. It will just make it slightly more complex but, as I said, we will police it as extensively as possible.

Q384 Chair: I am asking for your advice as the regulator. Would your advice, to this Committee or to the Minister, be that the draft Bill should be strengthened to try to avoid this loophole, so that you do not have to then take remedial action? Would it be possible to strengthen it, in a way?

Dermot Nolan: Without going into the drafting, if the desire is kept to have green tariffs exempted, it should be clearly set out in the legislation that it should be up to, presumably, the regulator or the department to define this and how any breach should be treated. I am not sure of the precise language but strengthening the language would be useful.

Q385 Chair: That is helpful. One thing that the Government could potentially do to avoid the exploitation of customers is to strengthen it in some way. I do not know what other Committee members think, but I think green tariffs should, in some way, be excluded. If people want to pay a bit more to ensure that they are doing the right thing for climate change and the environment, they should be able to do that, but the businesses should not be able to exploit the system without providing the green, clean energy that people would expect to get.

Q386 Stephen Kerr: You have said in the past that you accept the CMA's energy market investigation findings and recommendations. Is that correct?

Dermot Nolan: Yes.

Q387 Stephen Kerr: That includes the CMA's majority view that a market-wide price cap would be detrimental to market competition. What actions are you going to take to mitigate any negative impact on the market resulting from the Government's price cap?

Dermot Nolan: We will take a number of actions. The CMA conclusions were split. I think all said it was finely balanced, and I think two members appeared here before Christmas. Our broad strategy will be, if there is a price cap, to implement it as effectively as possible, given the statutory duties we will have, but to proceed with the majority of the other CMA remedies as well. We will try to make engagement easier, in order to proceed to a situation in 2023 where all those recommendations have been tested, trialled and are fully in place, and we feel that other



things, including smart metering, faster switching and various other changes, have made it easier to engage in the market. In some sense, the issue is about implementing a price cap but trying to strengthen the ability to engage and the conditions for competition from where they are now.

Q388 **Stephen Kerr:** Can you give some examples?

Dermot Nolan: I can give some examples. For instance, over the last year, we have done a number of trials of various things to improve engagement. One of the CMA recommendations was a database, where disengaged customers—people who had not switched for more than three years—were being given digital prompts and/or letters to switch themselves. We have seen some of that. The trials we have done in Northampton have improved engagement by people who have not switched in three years to some considerable extent. It is not necessarily a game-changer, but we want to proceed with that. We want to proceed with various other trials we have done and with those digital things that I spoke about earlier.

Coming back to Mr Kyle's point, though, the PPM metering experience is mixed but it seems possible that, as standard variable tariff prices fall and disengaged customers benefit, some cheaper tariffs will come out of the market. There will be some convergence. That seems likely to me. I cannot guarantee that some prices will not rise. However, it strikes me that, particularly for the newer and smaller suppliers, which are offering cheaper tariffs anyway, those tariffs will still be there. Those relatively efficient new firms will be there. That will provide scope for competition and scope for switching by those who are already engaged.

Q389 **Stephen Kerr:** Will you commit to setting mandatory targets for suppliers to take their customers off standard variable tariffs?

Dermot Nolan: As of now, I will not commit, because such a policy is not the right policy when there is a price cap on standard variable tariffs, if you see what I mean. There will be a price cap on standard variable tariffs—on all default tariffs, in fact. The core of the CMA remedies is still to improve engagement and competition in the market. The price cap will bind all market prices on that area. The policy that I spoke about last time of making mandatory commitments of companies is no longer necessary in a full price cap environment. I do not see the point of doing both, I have to say.

Q390 **Stephen Kerr:** The price cap is not practically going to help these standard variable tariff customers, then, if they are still stuck on those default tariffs.

Dermot Nolan: I think it will. Without specifying what the level of the price cap might be, we are seeing discrepancies in the market between the cheapest tariffs and standard variable tariffs of £300. We published data before Christmas. The price cap will affect standard variable tariffs.



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It will directly push down the price of standard variable tariffs and thus help those people.

Q391 **Stephen Kerr:** In terms of the percentage of an energy company's customers on SVTs, we are not likely to see much change in movement in terms of the proportion of customers still stuck on SVTs.

Dermot Nolan: We may see change. We may see reductions in SVTs, but the point of the price cap is—

Q392 **Stephen Kerr:** What will cause that to change, if you have just said that there will not be any mandatory targets and there will not be any measurements?

Dermot Nolan: There has been a reduction in the number of SVTs, over the last year, anyway—not as dramatic a reduction as I had hoped, but there has been a reduction.

Q393 **Stephen Kerr:** It is marginal, is it not? It is a point here and a point there.

Dermot Nolan: It is not dramatic.

Stephen Kerr: It is not moving at all, really.

Dermot Nolan: Again, I would say the main purpose of the price cap is to protect those on the standard variable tariffs. It will reduce their prices significantly. That seems to me the core of the whole reason for the price cap: their prices will come down.

Q394 **Stephen Kerr:** There will be no mandatory targeting to see that something changes in terms of the proportion of an energy company's customers who are on SVTs.

Dermot Nolan: Not in the presence of a full, market-wide price cap. It does not seem appropriate to me to do both.

Q395 **Chair:** Do you think you should have had mandatory targets before now? Stephen Kerr is right, is he not, that it has been a percentage point here and a percentage point there? There has been very little change.

Dermot Nolan: There has not been as much change as I would have liked, no.

Q396 **Chair:** Since you have been the chief executive of Ofgem, what has been the reduction in people on standard variable tariffs?

Dermot Nolan: I think we are down to 56%, and it was 63% or 64% at the end of the CMA. It has not been as dramatic as I had hoped.

Q397 **Chair:** I guess this is the point that Peter Kyle raised earlier: that it is not about what you had hoped for. You are the regulator for the energy companies. My children hope for lots of things from Father Christmas at Christmas. They can hope; they do not have much impact on what Father Christmas delivers in their stockings. Yours is not about hope. You are



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the regulator. You are the person who is delivering, or supposed to be delivering, on this. All the language that you use is like a bystander rather than an active participant in the market. The role of Ofgem, and your role specifically as chief executive, is not to hope that, next year, fewer people are paying more than they should be for standard variable tariffs but to stop this exploitation of customers.

Dermot Nolan: I accept that. The whole principle of the CMA investigation was to look at the market as fully as possible. It said that there is significant detriment in the market. We have not questioned that. It agonised about the price cap. It split a decision because it was finely balanced. The whole point of its recommendations was to say people are paying excess prices on standard variable tariffs. You can either price-cap that, or you can enhance their engagement and get them to switch, make it easier for them to switch, make it easier for them to engage and rely on a competitive method. We have implemented those methods as much as we can.

Q398 **Chair:** Again, it is relying on other people to do the work, so the Competition and Markets Authority did this review. Parliament is now considering draft legislation. The Government are minded to put forward a Bill. It was in the parties' manifestos. Why do other people have to do this work? Why are you not doing the work? That is what Ofgem was created, 18 or 19 years ago, to do. That is what you were brought in, four years ago, to do. Do you think that your time as Chief Executive at Ofgem has been a success? Are you proud of what has happened in the last four years?

Dermot Nolan: I think good things have happened. As I said earlier, we should have done better, particularly in the retail sector, but I would stress that the CMA investigation was what was supposed to happen. There were significant problems in the market. The whole statutory framework suggests that, if that happens, as has happened in other markets, the regulator should refer the market to the CMA and then implement its remedies. We did that. We are implementing the CMA remedies, which were thrusting towards to, "Make engagement easier. Make the market smarter. Put smart metering in. Make faster switching. Make engagement easier." These are the things we are trying actively to do and are working hard to do.

As to whether to price in a price cap, the CMA was not sure whether to do it and, as I said before, that kind of intervention is a policy issue. We are working as hard as we can to improve engagement, to implement the measures and to try to reduce harm in the market.

Q399 **Chair:** My earlier question was whether you should have had these mandatory targets previously. I understand the point that you made to Stephen Kerr that that might be superseded by a price cap, but the price cap has not been legislated for yet. You could still introduce mandatory targets for the next year, before a price cap, if it does come into effect. I would not say that mandatory targets are necessary for the next year,



but should you have had mandatory targets for the last three or four years?

Dermot Nolan: I do not think we could or should have done so during the CMA reference, which was looking at the market exhaustively, was designed to provide a set of solutions and did not say that targets for standard variable tariffs were the right thing. I think mandatory targets will help in getting people off things. If there had been no price cap, we would certainly have put them in. Lowering standard variable tariffs is likely to be helpful, but it is not perfect. Standard variable tariffs will be replaced by other forms of tariffs, which is why, ultimately, we do not see the obvious appeal of the Centrica proposal to simply rebrand tariffs. In that sense, getting people off standard variable tariffs is likely to be positive but it is not a panacea in itself to the issue of engagement.

Q400 **Chair:** You said earlier that Ofgem could have done more and you could have done more. You have apologised to vulnerable customers for not acting earlier. Despite these apologies and the acceptance that Ofgem could have done more, you received a bonus last year, and the bonus pot at Ofgem was £921,000—almost £1 million—being paid out in bonuses at the same time as vulnerable customers were paying more than they should on their energy price bills. How do you justify that bonus pot for you but also for Ofgem as a whole?

Dermot Nolan: For Ofgem as a whole, a large proportion of work done at Ofgem is not in the retail sector. Ofgem bonuses are given out to exactly Civil Service guidelines, which we match. On me, I accept the point. I will tell the Chair I did not receive a bonus this year.

Q401 **Antoinette Sandbach:** I want to deal with questions around Section 1(6). There was quite a lot of criticism from the industry about the methodology used for the prepayment meter cap. How will you set the cap in order to meet the competing criteria in Clause 1(6)?

Dermot Nolan: We will set the cap by using a methodology that builds up an efficient cost stack. That will involve looking at the different components of prices and adding an appropriate level of profitability. We will build it up by, in some sense, using a similar methodology to the prepayment meter cap used by the CMA. The industry has said that that is too harsh. I am not necessarily commenting on that.

Q402 **Antoinette Sandbach:** The requirements of Clause 1(6) include, for example, the need to maintain incentives for domestic customers to switch and the need for licence holders to improve their efficiency. That did not seem to feature in your answer.

Dermot Nolan: I will come on to that. In Professor Cave's comments about the price cap, one of his thoughts is that it will drive efficiency. My own sense of what a price cap can do in the first two or three years is likely to be in two areas. First, it will bring down the discrepancy between standard variable tariffs and fixed tariffs, so it will bring down the prices of standard variable tariffs. Secondly, as in his view, it will force



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companies to become more efficient. The CMA felt that the relative level of efficiency among different companies was such that a price cap would help drive it down. We will try to achieve those aims.

The key point in setting a specific value for the price cap will be the trade-off of those particular statutory objectives as to whether—and this is not a binary choice, I stress—one goes for the lowest possible price cap, which is likely to bring SVT prices down more, but perhaps makes it less obvious that people would switch.

Q403 Antoinette Sandbach: Have you seen other examples elsewhere of a methodology that you would be interested in using, for example in Northern Ireland?

Dermot Nolan: The Northern Ireland one is somewhat different because it only applies to one company, the traditional incumbent, which has slightly higher costs than average. We have looked at various methodologies. We have started talking to the Financial Conduct Authority, which is the most recent example of a price cap being put in place in a significant British industry. We have talked to them about the kind of analysis that they tried to do on that and how they managed to balance the particular level of the cap. We have talked to them and looked at other methodologies, but we will probably develop our own methodology and start consulting on it when the Bill is laid before the House.

Q404 Antoinette Sandbach: Would a cap on standing charges be fairer and less detrimental to the market than the Government's cap on prices per unit? We have seen huge increases in standard charges, have we not?

Dermot Nolan: We have seen some. Personally, I would say no. I think a standard variable cap is better because, if you cap one component of the price, the variable price may change in response.

Q405 Antoinette Sandbach: What is to stop the companies putting up their standing charges, as they have quite significantly over the last few years?

Dermot Nolan: I have a reasonably strong sense that this legislation is designed to ensure that the overall price paid by anyone on a default tariff is not going to be above a certain level. That seems to be the intent of the legislation; therefore, we would actively, as I said earlier to Mr Coaker, make sure that it was not gamed. It will protect anyone on a standard variable tariff. If you are putting in a price cap, it seems to me the most appropriate mechanism to use.

Q406 Albert Owen: Again on the lines of your role as a regulator, part of that is to be the customers' voice and the champion for the customers. Do you conduct regular surveys? What do the customers think of you and what do they think of a price cap? It is important, as parliamentarians, that we get some feedback as to what the public think about this, not just those involved in industry.



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Dermot Nolan: We conduct surveys every two years on what stakeholders, including the public and consumer bodies, think of us. We have not directly done a survey on what consumers think of a price cap, I have to say.

Q407 **Albert Owen:** Would you consider doing that on a price cap? It might be helpful for us.

Dermot Nolan: I would. I will come back to you on that within a matter of days.

Q408 **Albert Owen:** What do they think of you—not personally?

Dermot Nolan: They are conducting a survey in the next month or two, in any cases, on stakeholders, including consumers and consumer groups. To be honest—and perhaps I should not be honest—name recognition of regulatory bodies in general is not that high among the public.

Q409 **Albert Owen:** Can I just finish on this? You have said that you work in the retail sector but what worries me is that, if we get this legislation right and we do the right thing by the customer, there could still be external factors that will push prices up. Are you looking at shielding people from high prices of gas and oil? You have the legislation and you have the cap in but, all of a sudden, the energy companies might come to you and say, “We have to put prices up considerably”.

Dermot Nolan: This cap, it seems to me, will operate in a fashion that a mechanism is set. It seems likely—and I am not saying definitively; it will depend on the legislation—that a price cap is updated every period of time, perhaps every six months. I cannot guarantee, and no cap can guarantee, that, ultimately, prices will not increase. The prepayment cap has broadly benefited prepayment customers. We have had two iterations of it and the next change is due in February. I do not know the precise details of that, and we will work through them and bring them out, but I cannot guarantee that that will not lead to an increase. Over time, the point of a price cap is that it reflects efficient cost in the market. If costs rise over time, then a price cap will reflect those costs, and I would be foolish to say otherwise.

Q410 **Mark Pawsey:** On more than one occasion in your evidence to us this morning, you have said “If there is a price cap”, not “when”. Is there any particular reason?

Dermot Nolan: I did not want to be presumptuous about what the House might or might not do, so perhaps I was being overly careful in my language.

Q411 **Vernon Coaker:** Finally, to pick up what the Chair was asking about the speed of change and the need for an injection of urgency and pace into what is happening, just before Christmas you published the league tables, essentially. I was absolutely astonished, given all the things that



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have been talked about over the last three or four years, by the numbers of people on standard variable tariffs for the three largest suppliers: SSE, British Gas and E.ON. SSE still has 71%. If I was just an ordinary member of the public, I would have thought, "It must be coming down because there is such bad publicity about it". British Gas has 67%, and E.ON 61%.

As the Chair was saying, you are the regulator and it is just not good enough from the companies. We do not know when the price cap is going to happen, or if or how it will happen. Will you act with more urgency, more demand and more active involvement in ensuring that the market operates in a way that is to the benefit and in the interests of the customers?

Dermot Nolan: We will, but I should be clear. We will. It is a very fair question and we will. But I have no powers to determine what a company should or should not do vis-à-vis its standard variable tariffs. I think a price cap will change that and will reduce it. We will act with as much urgency as we can in the period coming up to that, and we will reflect further on what the Chair and others have said about standard variable tariffs. I would encourage companies to get them off, but I have no direct power to do that, I should stress. I think a price cap will, however, change that. It will not necessarily reduce the number of people on standard variable tariffs but it will significantly reduce the amount of harm being suffered by them.

Q412 **Vernon Coaker:** But you have no power.

Dermot Nolan: I do not have the power to say to a company tomorrow, "You should go off standard variable tariffs". I accept the point that we need to act, and I need to act, but if I had the power to say to a company, "You must get them off standard variable tariffs", a company might well respond by saying, "I am moving off a standard variable tariff. I am calling it something else but I am charging roughly the same price for it". The point of this legislation is its use for all default tariffs, not standard variable tariffs per se. It is designed to try to minimise any possibility that companies will game.

Q413 **Rachel Maclean:** In a market that is demonstrating effective competition, is there still a differential of prices between the highest and lowest price in the market, of whatever tariff?

Dermot Nolan: In my view, probably yes. Taking it to the end extent, definitely. I cannot think of any market in the world where you see exactly the same prices being paid by anyone. The point is that, in an effectively competitive market, you should not see significant differentials, because it should not be possible for the company to charge in excess of what other people are paying, because it would lose customers and lose profitability. The CMA has talked through its analysis of differentials of £200 or £300. My own sense is that, by 2023-24, you should have differentials of significantly less than that.



Q414 **Rachel Maclean:** What figure would be acceptable?

Dermot Nolan: I would talk about maybe £50 to £100 as being acceptable economically. That is not meant to be a definitive comment and it would also depend upon the overall price of energy at that particular point in time, but they are the kind of figures one might think about.

Q415 **Rachel Maclean:** Potentially, £50 to £100 might be a fair differential.

Dermot Nolan: It might be a differential that is consistent with effective competition. Whether it is fair is a slightly different thing. As I said, the sense that the energy market, of all markets, must be fair is something that has been brought back to me over my time as a regulator. They are the kinds of things that would be consistent with effective competition.

Q416 **Rachel Maclean:** You are saying to us that, in that case, effective competition does not necessarily lead to fairness. Does it not depend on how you define "fair"?

Dermot Nolan: It depends on how you define fairness. Literally all markets will have some differentials, and some markets will have even bigger differentials than energy. In the home insurance market, the penalties for not switching are significantly more onerous than they would be for energy. If you do not switch your home insurance, you will probably pay significantly more—maybe twice as much after two or three years. Whether that is fair, I do not know. It does not seem terribly fair, but home insurance does not have the same primacy or the same absolute necessity that energy does.

Q417 **Rachel Maclean:** No. There is a premium on fairness in this market. Would you not agree?

Dermot Nolan: Yes, absolutely, I would agree.

Q418 **Rachel Maclean:** It is your role to define what "fair" means in this market, is it not?

Dermot Nolan: Not in legislation but, going forward, that is something that we will need to do.

Q419 **Rachel Maclean:** You will need to make that recommendation to the Secretary of State, will you not?

Dermot Nolan: Yes.

Q420 **Rachel Maclean:** He will then have to justify to the House and to the country whether it is fair or not.

Dermot Nolan: I just need to be clear here. That is something that we need to do as a regulator. The word "fair" is not, to the best of my knowledge, in the legislation.

Rachel Maclean: I will check that, but thank you.



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Dermot Nolan: Perhaps I am incorrect and I apologise if I am. I think it is "effective competition".

Rachel Maclean: That is fine. Thank you.

Q421 **Chair:** We are taking evidence next week from the Minister and then we will consider all the evidence, written and oral, that we have taken. Then the Government will need to decide whether they want to introduce this Bill or an amended version of it. When would the Bill need to be introduced or, perhaps more importantly, when would it need Royal Assent for energy prices to be capped next winter?

Dermot Nolan: I said before that I would have thought it would take up to five months after Royal Assent for it to come into force, so work back from that. I would hope to beat that time but I would be cautious about guaranteeing beating that time. We would need to do a statutory consultation just after Royal Assent. Working back from that, if it was required to be in before Christmas 2018, Royal Assent would be needed before the summer recess.

Chair: Thank you very much. Thank you for coming to give evidence to us today on this issue, and I am sure we will have you in front of our Committee again soon.

Dermot Nolan: I am at your disposal. Thank you very much.