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Business, Energy and Industrial Strategy Committee

Oral evidence: Pre-appointment hearing with the
Government's preferred candidate for Chair of
Ofgem, HC 1353

Tuesday 3 July 2018

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Watch the meeting

Members present: Rachel Reeves (Chair); Vernon Coaker; Peter Kyle; Sir Patrick McLoughlin; Albert Owen; Mark Pawsey; Anna Turley; Antoinette Sandbach.

Questions 1 - 66

Witness

[I](#): Professor Martin Cave, Government's preferred candidate for Chair of Ofgem.

Examination of Witness

Witness: Professor Martin Cave.

Q1 **Chair:** Thank you very much, Professor Cave, for coming in today ahead of your appointment to be the chair of Ofgem. This is your pre-appointment hearing. Can I first ask you why you applied for this role as chair of Ofgem?

Professor Cave: I have been involved in regulatory matters for quite a long time. I have written about them extensively, economic regulation in particular. I have advised a lot of regulators in a large number of countries, in a number of sectors. I spent six years at the Competition and Markets Authority chairing inquiries and, as it turned out, six of those inquiries, including the energy market investigation, were actually about the energy sector, so that gave me an interest in energy. For me, this is an opportunity to apply myself to a sector that is changing very rapidly and is of fundamental importance to households and firms in the UK.

Q2 **Chair:** Were you encouraged by anybody to apply for the role, or where did you see this role advertised?

Professor Cave: No, I was encouraged by somebody who was working for the head-hunter, but they were the only person who spoke to me about it before I decided to put in my application.

Q3 **Chair:** You have said a little bit about this already, but what has your experience of regulators been, before taking up this role?

Professor Cave: I started working as an adviser to the telecoms regulator some decades ago and I have kept up my interest in that particular sector. I have worked for most of the UK regulators in one form or another: the Office of Rail Regulation, Ofgem itself to a very limited extent, quite extensively in water. I was also asked by the Government to conduct a number of independent regulatory reviews. In the hands of that Government, it was quite a common instrument for them to use to get somebody to make proposals about the regulation of a whole sector, so I did a number of those.

Two of them were relating to telecommunications. One was related to competition, investment and innovation in the water sector. One was dealing with airports. The final one was on the regulation of social housing, which I found an extremely interesting task. I have done that and I will not bore you with what I have done overseas as well; that is probably quite enough to be going on with.

Q4 **Chair:** We have also seen your CV. You have been an academic for most of your working life. What leadership experience do you have and would you bring to this role?

Professor Cave: When I was an academic at Brunel University, I was the deputy vice-chancellor for seven or eight years, and one of my jobs was to basically hand out the money to the academic departments,



which, as you can imagine, was quite a gruelling and complicated process. I was also responsible for developing the academic work in a number of academic disciplines. Over the past 15 years, I have worked for much smaller organisations, first at Warwick and then at the London School of Economics, but my leadership experience has really been there.

I was also at the CMA. The way the CMA works is that a group of four or five members and about 20 or 30 staff is assigned to a particular inquiry, and then it represents a kind of competition authority microcosm. It is really up to the chair of the inquiry, which I usually was, and the project director to provide the leadership in that process. I must have done 15 or 20 inquiries in my period there.

Q5 **Chair:** I do not think you have worked in the private sector during your career. To what extent do you understand the private sector and the energy firms operating within it?

Professor Cave: I have done quite a lot of assignments for public sector firms, mostly in other countries than the UK, but I have worked in various regulatory and competition proceedings for some companies in the UK. In the course of that, I interacted very extensively with the executives who were dealing with the matter, and that normally involved the chief executive, because these are quite important matters. Then, of course, in competition hearings, the people who turn up on the part of the firms are almost invariably the chief executive and senior managers, so I have had extensive interactions with them. I think I have a reasonable understanding of what their motivation is, but I do not have any private sector management experience.

Q6 **Peter Kyle:** In your experience, how different is the energy market from other markets that you have examined, worked in or helped to regulate in the past?

Professor Cave: It has a lot of features in common. It is a vertically structured industry, so you have generation, transmission, distribution and retail. Almost by definition, because it is regulated, it has bits in it that are bottlenecks and require regulation. At the retail end, there are similarities, because the services provided are often fairly complex and it is difficult for people to get their heads round energy tariffs, as I know. It is equally difficult for them to get their heads round communications tariffs because they are often buying them in packages of three or four, so there are difficulties of that kind.

There is that basic commonality, given the nature of the problems in retail markets and in bottlenecks, and upstream too, in introducing more competition where that is possible, as has happened in generation. That structure is common to all of them, but a characteristic of the energy sector that makes it so important and so challenging is that, first of all, people spend such an enormous proportion of their income on it and they do not really have any choice. You can just about do without a mobile phone, although not many people do, but with energy it is wholly



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impracticable. Secondly, energy is basically a massively important input into water production as well.

Q7 Peter Kyle: In terms of your personal approach to the role, what is your view of the role of Government and the regulator to intervene in markets?

Professor Cave: There is notionally a dividing line between Government policy and regulation. The Government determine the key policy decisions; then the regulator implements them in a way that is separated from Government, so it minimises the degree of political interference in the massive investments required in the network industry. In the case of energy, very roughly speaking, as I understand it, the renewables policy and the goals are a matter for the legislature and Government, and then Ofgem plays a role in implementing those things in an anonymous and technocratic way.

From one industry to another, the balance between policy and regulation is changing. For example, in the telecoms industry, the great interest on the part of the Government in bringing fibre to the whole economy means that their policies in relation to fibre have a big impact on regulation, whereas previously the equivalent impact would have been much less, so there is a kind of territory there. In a way, it is really up to the Government to decide, through their policy decisions and via their guidance to regulators, where they want the line to be drawn.

Q8 Peter Kyle: Looking at the specific role of Ofgem, its history within the market itself and the role it has played in shaping that market, have its interventions been effective? Under your leadership, is its approach to regulatory intervention going to change in any way?

Professor Cave: I would prefer to concentrate on the second part of that question, although I will come back to the first if you wish. My approach to regulatory matters has always been to see the problems through the lens of the end user. By the end users, I mean households, because that is what we all are, but also firms, because they are very important consumers of the product. If you look at it through that lens, the regulator is trying to provide support to those end users. In one of the phrases used in regulation, the focus is upon the long-term interests of the end users, so that means you are concerned to make sure the prices are not excessive.

Q9 Peter Kyle: Let me be blunt and cut to the chase. I have a bit of form in this on this Committee. We have had numerous regulators come before the Committee now and apologise for not going far enough in protecting the rights of the consumers or the people who use the services in the industry that they are regulating, including Ofgem, which made a very explicit apology for not protecting vulnerable customers and for the impact it then had to their detriment, for which we are now paying the price in policy terms. We have never had, to my knowledge, a regulator come before Parliament and apologise for going too far in the interests of



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consumers and perhaps stretching the bounds of the legislative environment that they are operating in. Do you see it as your job to test those boundaries from time to time, and perhaps be a little more assertive with the industry on behalf of the people who are consumers within the market you are regulating?

Professor Cave: As you know, I have quite consistently espoused a fairly strong approach in the household energy market, which I am happy to say, thanks to the legislation that is going through Parliament, is now being implemented.

In my time at the CMA, I undertook three price reviews. One of the price reviews was in connection with an electricity transmission and distribution company in Northern Ireland. In the course of that we had to, as you always do, identify what rate of return it is appropriate for the company's investors to use in order to make sure that you get continuity of supply within the sector.

In the course of that inquiry, the group that I chaired introduced a very substantial reduction in the basis upon which that rate of return was calculated. If I could just explain what the problem was, after the global financial crisis, as you know, real interest rates went from risk-free investments, from basically plus 2%, to minus 2%. Yet, many utility regulators carried on assuming that the minus 2% was what was required in order to attract money into the industry. With that inquiry, we managed to adopt a different approach and to start the process of resetting the rate of return that was allowed.

That decision we made has largely been adopted by regulators now, which is part of the explanation why Ofgem's proposal for the allowed rate of return in a price cap that is going to start in 2021 will be much, much lower than was the case when the price capping started in about 2014. It is possible to do that, but you have to strike out an independent path when you are doing that, and you have to have the courage of your convictions.

Q10 **Antoinette Sandbach:** What do you see as the biggest risks facing Ofgem in the next five years, and what do you see as your role in mitigating those?

Professor Cave: It is quite clear that there are big changes taking place within the energy sector. Roughly speaking, there has been a renewables transformation, but now there is also the kind of digital transformation that is taking place across all sectors in the economy. That is going to change regulation in a radical way.

One way of looking at it, essentially, is to look at the monopolies that exist at the moment: the transmission monopoly and the distribution monopoly. I have set to one side for the moment the kind of unilateral market power that energy companies exercise in the retail markets. Just looking at those network components, there are opportunities coming to



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light that have the capacity to reduce the market power that they exercise, basically by bypass. A generator can bypass the transmission mechanism and go straight and feed into distribution. Equally, a household can bypass the distribution mechanism by just getting the electricity down from the roof.

That kind of chipping away at the bottleneck powers of the networks has enormous potential. If you manage to chip away, first of all, you are introducing innovation, which otherwise probably would not occur and probably has not occurred to a very large extent, in terms of market-think. That is a risk—how you do that, how fast you can go in introducing those changes, how, for example, in setting a price control that might last from 2021 to 2026, you should factor in how large those changes are likely to be and how you can ultimately encourage them. That is a substantial risk.

- Q11 **Antoinette Sandbach:** The previous Committee highlighted a statement in one of our reports that there are technical differences between the UK and EU energy systems, and there is therefore a potential long-term risk of the UK losing influence on the design and detailed rules underpinning the internal energy market in order to access and share resources. How confident are you that we can mitigate regulation or, indeed, that we will be able to participate in the internal energy market? If we cannot, what kind of risk does that present to Ofgem?

Professor Cave: It is probably inevitable that if we cease to be members of the European Union, we cease to play the role that we play at the moment in determining the shape of the European energy market. I believe that it will be possible for Ofgem and other bodies to continue to play some form of role in European institutions, and to continue to have a smaller level of influence.

How serious the risk is depends upon, in essence, the degree to which Brexit is likely to impact upon the energy sector. In my understanding, apart from the loss of influence that we are likely to experience as a result of abandoning our membership, there may be an impact via the amount of investment that takes place in interconnections. But outside the island of Ireland, which is a massively separate problem, as far as GB is concerned, energy is not one of the regulated industries that is going to be very seriously affected. It is not in the same condition, for example, as aviation.

- Q12 **Antoinette Sandbach:** In anticipating that the UK may leave the internal energy market, how should Ofgem manage the interactions between the anticipated increases in electricity trading transaction costs and the price cap?

Professor Cave: To be honest, that is a question I have not applied my mind to, such as it is.

- Q13 **Antoinette Sandbach:** Would you like to write to us?



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Professor Cave: In terms of the details of how you would do it, we are essentially talking about generation. There is a market in that, which takes place every half hour and a price emerges, and the price depends on the amount of investment in place and the opportunities, including interconnector opportunities. If there were fewer interconnector opportunities, the impact of that would probably be to introduce greater volatility in pricing.

Under the current arrangements, that volatility in pricing is then fed through into the tariffs that are paid by household and industrial users, and it would continue to do so. The mechanism by which that exists, apart from the problem of excess profits and the retailing activity, which is a separate thing, would continue to operate. Unless I have misunderstood your question, I do not see that as being one of the bigger risks that Ofgem faces.

Q14 **Albert Owen:** The principal objective of Ofgem is to protect the interests of the consumers. It is on your website. How effectively does Ofgem meet the needs of the customers, in your opinion?

Professor Cave: Clearly, we know roughly what customers want. They want cheap, reliable energy that is provided with a good quality of service, and all those things are present. As for the question of to what degree consumers are getting those benefits, I have often argued that, as far as households are concerned, and perhaps equally importantly as far as small businesses are concerned, they are not being very well served, simply because the prices are too high. I have suggested particularly that the problem arises within the retailing sector, where the big six companies exercise too much market power. Something should be done about that.

Q15 **Albert Owen:** What are you going to do about it, as chair?

Professor Cave: As we speak, Ofgem, in anticipation of the price cap legislation that is going through Parliament, is working hell for leather on developing a price cap, which is planned to be introduced by the end of 2018, and will affect all households on default tariffs, roughly 11 million.

Q16 **Albert Owen:** Can I push you on this, before we come on to the price cap? You said that they had not been well served. Does that mean that Ofgem has not been doing its job properly in the past?

Professor Cave: It means that, in my opinion, there is an endemic problem, which has been partly relieved by the partial price caps that exist, one on the instigation of the Competition and Markets Authority, the second for vulnerable customers on the part of Ofgem. But now there is a big gap that has to be filled.

Q17 **Albert Owen:** Was there a lack of powers there? Does the regulator need more powers from Government?



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Professor Cave: That is a legal question and I do not feel entirely competent in answering it, because I am aware that there are substantial differences of opinion.

Q18 **Albert Owen:** With respect, Ofgem has been set up to protect customers, in particular vulnerable customers. That is why it was set up by statute. I am asking whether it has sufficient powers to carry out that principal objective.

Professor Cave: As we speak at the moment, it does, because once the legislation is passed it will be able to do so. There is another question about what the endgame is for this and what happens afterwards, but I am not aware of any clear deficit in Ofgem's powers, which it would be a very high priority for me to try to fill.

Q19 **Albert Owen:** You did mention that it was a little weak with protecting vulnerable customers, and it did have those powers and did not use them until very recently, with prepaid. When the price cap is in full swing, will that be sufficient to safeguard customers?

Professor Cave: In my opinion, once that price cap is available, with respect to price, household customers will be able to get reasonable prices. I am still a bit worried about business customers, because small businesses are a really important part of our economy. In fact, the CMA report indicated that the margin on electricity sold to small business was greater than the margin that was sold to households. It is very important to get working on the various methods of improving engagement within the small business sector, in order to give people a better deal.

Q20 **Albert Owen:** On the small businesses, do you need more powers as a regulator, or do you have sufficient powers but just need to look at it in greater detail and help customers?

Professor Cave: It is very difficult to impose a price cap on small businesses because they are all different and they want different things.

Q21 **Albert Owen:** How are you going to protect their interests?

Professor Cave: There are various things that can be done. There are various changes that have already been put in place, affecting the smallest element of this, the so-called microbusinesses. There are things in the pipeline that seem to have the potential to enhance engagement and have been tried in many other countries. The thing I have been examining most recently is something roughly equivalent to open banking, whereby a small business agrees that its data concerning consumption can be made available to agencies, which will then go and get the best deal for it, because we all know that the people who run small businesses are often incredibly overworked and are not able to spend ages working on reducing their energy consumption.

Q22 **Albert Owen:** That is a very interesting set of answers. For the first time, business is going to become an important element of Ofgem.



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Professor Cave: It is a very important element.

- Q23 **Albert Owen:** Can I finally mention the energy price cap? You were on the CMA, and it reported that it was very political and it would be very difficult to get rid of the cap, once it was in. Do you still hold that view, or was that your view?

Professor Cave: I dissented from that view. My view, in relation to price caps, is that there are dozens of cases where retail price caps have been reduced because competition has developed. All our telecoms prices were capped 10 or 15 years ago, but now we have enough competition with Virgin and TalkTalk that that is not considered necessary, although in relation to some groups of customers there was suggestion that they needed to be protected and the regulator stepped in to protect them.

Equally in energy, in the UK 20 years ago, the price caps were removed and we had a golden age of fairly successful retail competition. In Australia in recent years, again, all the price caps have been removed. I am not saying that the price cap does not have some impact upon the amount of competition when it is in place, but there is an enormous number of examples where price caps have been successfully introduced.

- Q24 **Albert Owen:** Do you think the price cap will still be in place at the end of your term?

Professor Cave: I would have a five-year appointment and, roughly speaking, it would be co-extensive with the maximum period for which the legislation would permit the price cap to exist. You are really asking me a question about what, in the worst case, if the engagement measures had not worked so that the price cap could be lifted previously, the outcome at the end would be. I struggle at the moment to convince myself that vulnerable customers in particular will be able, at the end of that period, to find satisfactory, non-exploitative energy prices within the marketplace. We just do not know. It is one of these difficult things.

- Q25 **Albert Owen:** As the chair of Ofgem, you will have to do a report to Government. In what circumstances would you say that it needed to stay? What would be the criteria that had not been met?

Professor Cave: I am going to predictably say that it is very difficult to describe a formula that you can apply, with numerical tests about when a market is sufficiently competitive for it not to require a price cap. Other regulators have looked holistically at the market. They have looked at switching behaviour, prices, profitability and expressions of satisfaction by customers. Then, on foot of those inquiries, they have decided whether to lift the price cap.

In essence, how you approach it depends upon the details of the duties you have or the duties that are imposed on you by the legislation, so each case has to be different. It is clearly going to be a difficult and possibly controversial task, but it is one that has to be done.



- Q26 Anna Turley:** Just to follow up Albert's line of questioning, you used the words "endemic problem" about vulnerable customers. We have had before this Committee many of the big six energy companies giving evidence, and they have enormously frustrated me, because all the time they have emphasised that the market should be shaped by the individuals and the responsibility is on the users to switch and drive competition. They have never accepted any responsibility on behalf of the providers. Do you think that recognises a failure of the big six providers? Does the price cap, essentially, represent a failure of Ofgem and of those energy providers to have a properly regulated market that protects and supports consumers, rather than them having to drive through their switching behaviour a fair market?

Professor Cave: In practice, the interests of people selling stuff in the markets are not always the same as those of the people buying stuff, and that applies to energy as it applies anywhere else. If there are opportunities to get a higher price out of particular kinds of customers, firms are quite likely to take them up.

- Q27 Anna Turley:** Does that not mean that the market is failing? It is Ofgem's role to manage and limit that behaviour.

Professor Cave: Excessive pricing is a key example of market failure. In a sense, that is why a regulatory system is set up, because you can have a market failure of that kind in any industry, following investigation by a competition authority, or in energy, which is obviously a very special industry, as I have indicated, because it is an essential service and a huge part of people's budgets. Tools are then available to correct that market failure.

In my opinion, a price cap is an effective and reliable tool, but if at the same time as the price cap you could encourage much greater engagement, if the changes taking place in the industry that we spoke about earlier take the form, for example, of households being able to delegate some of those decisions to other parties to do it for them, and if that process can be automated some way, you might be able to remove the need for a price cap by correcting the market failure through that kind of measure. I shall speak out strongly in Ofgem in favour of simultaneously with the price cap making sure this other stuff is going on because, if that works, we end up with a better solution for everybody.

- Q28 Vernon Coaker:** Thank you very much, Professor Cave. You can see the line of questioning, which I will continue. If I speak for myself and, I think, for many others on the Committee, there is a loss of confidence in how the regulatory system has worked. To that extent, why is it going to be any different with you as the new person in the role? That is really what this is about. For example, Ofgem fairly recently criticised the profits of the energy networks. You said, however, that your view of Ofgem's approach and yours are congruent; in other words, they are the same. What is going to happen to those profits? Is Ofgem's approach necessary and appropriate? What is it and what is going to happen?



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Professor Cave: The so-called excessive network profits arose, essentially, because of something that I mentioned earlier, when in 2013 and 2014 Ofgem was allocating an allowable return to the companies.

Q29 **Vernon Coaker:** Can I just interrupt? Do you accept that they were excessive?

Professor Cave: In hindsight, they were excessive. It is very difficult to put yourself into the mindset of somebody in 2014 who was making it. In essence, Ofgem has recognised that the rates of return have been higher than they need be, bearing in mind the risks that the companies took.

Q30 **Vernon Coaker:** I know you are trying to avoid the word, but if they are higher than they need to be they must be excessive.

Professor Cave: That would be my interpretation. You are asking me why it is going to be different.

Q31 **Vernon Coaker:** I am asking whether Ofgem's approach to these high profits is both necessary and appropriate. In other words, does it need to be done because they are excessive, and would it make a difference because it is appropriate?

Professor Cave: We have a better understanding now of what those allowable rates of return should be. Ofgem has already made it clear that it is going to bring them down very substantially in the next price control period.

Q32 **Vernon Coaker:** The question is, if they are excessive, what you as the regulator are going to do about it.

Professor Cave: One of the difficulties with this particular price control, as you probably know, is that it goes on for eight years. That has the consequence that, with a period of that length, if something starts to go wrong, figures tend to go off in one direction. Then, after eight years, the gap can be quite significant. One thing that is contemplated in the next round of price controls is having a much shorter period. However, you have to have a period in which the regulator commits itself to allowing a particular revenue, because if you have an alternative system where you just say to the company, "Well, let's see how much things cost you to do and then we will give you the money," they have absolutely no incentive to keep their costs down.

Q33 **Vernon Coaker:** That is a really interesting answer. You have a massive opportunity. If you are confirmed, you will be the new chair. The RIIO-2, which is the new pricing framework for the energy industry, is going to be set under your chairmanship for 2021 and afterwards. We have had the eight years and you are now going to be the person who sets the framework for 2021 onwards. That will happen under your chairmanship. What will that framework be like? Is Ofgem's approach right now or are you going to change it? What is going to happen?



Professor Cave: The two things that are most important, which Ofgem has already proposed, although not explicitly, are, firstly, to have a smaller period.

Q34 **Vernon Coaker:** What does a shorter period mean?

Professor Cave: It means going from eight years to five years, or something like that. I do not know; it will be three, four or five. That is one thing. The second thing, which is already in Ofgem's proposals, is to have a lower starting point for establishing the profits that can be made.

Q35 **Vernon Coaker:** What does that mean?

Professor Cave: You might say that the allowed return on equity built into the calculations would fall from, say, 6% to 4% or something of that nature. The third thing, which is very important, is that you have a kind of correction mechanism so that, if things start to go wrong, there is a built-in element that actually gets things right. A very clear example of this would be that, if the rate of return on equity rose above a certain level, the company would have to cut its prices to bring it down to a lower and more appropriate level. That is a way of stopping the ballooning of returns that could take place.

Q36 **Vernon Coaker:** That is really interesting because, in answer to Albert Owen's point, when he was trying to ask what the new powers are, you are saying—correct me if I have misunderstood—that in the new framework, which you will have the opportunity to put in place from 2021 onwards, you are going to put in place one or two things that currently do not exist, which would allow Ofgem to have more power, in particular this so-called correction mechanism and a change to the equity return from 6% to 4%. That would give much greater power to the correction mechanism because Ofgem would in a sense be intervening and saying, "You cannot make more than that on your equity." A correction mechanism is quite a big deal. The question then is whether it would be a legal requirement or something for which you would determine whether you would intervene.

Professor Cave: It would be a mechanism that you would set out in advance, covering the whole x-year period of the price cap. Then, having done so, it would be part of the rules of the game and the companies would have to set their prices with that in mind. I must emphasise that these are not things that have just sprung from my brain. They are already being worked on very extensively by Ofgem. I am, so to speak, pushing an open door as far as advocating these changes is concerned.

Q37 **Vernon Coaker:** Some people in the Committee may know better than I do, but I had not heard of the proposed correction mechanism in the next price framework.

Professor Cave: I emphasise that it is proposed. Preparing these things, for reasons that, to be honest, I do not fully understand, takes years and years and years.



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- Q38 **Vernon Coaker:** You have the opportunity. You are going to be the chair. You are going to be one of the most important people in the energy market. You can actually grasp this. It is what Peter Kyle is saying. You can get hold of this and say, "It's been unacceptable, the way the regulation has worked until now. Consumers have been ripped off; 12 million people have been on the standard variable tariff. We're fed up with it. The country is fed up with it." You are going to be the new chair and can say, "I'm not going to have it."

Chair: Vernon, are you going to put your bid in? Watch out, Professor Cave.

Professor Cave: It is worth mentioning that I would have a board. No, that expresses my personal view.

Vernon Coaker: If that is what you do, that is what it is crying out for.

- Q39 **Albert Owen:** Is there a need for greater competition in the distribution and transmission networks?

Professor Cave: There is a need for greater competition, but it is not in the form of duplicating the network because that would be nuts. The greater competition comes because people have a way of bypassing the network. People will say, "I can generate electricity on my roof and, if the distribution charges get too high, I will find it worthwhile doing so," and that will act as some kind of constraint. It is what is known in the trade as "bypass competition" that is likely to have an impact.

- Q40 **Albert Owen:** What about not-for-profit companies?

Professor Cave: Not-for-profit companies may be able to come in and operate local distribution and trading arrangements. In some countries that has happened already, where they have a very large amount of self-generated electricity and they trade in particular streets and so on, but the notion of completely new distribution companies coming in is, I suspect, pretty fanciful. In other words, it is not going to be standard head-to-head competition.

- Q41 **Albert Owen:** Are private monopolies okay in the energy sector?

Professor Cave: No, I am saying that distribution and transmission will have to be regulated to avoid excessive profits and to ensure appropriate quality of service, but at the same time my beloved end users, the firms and the households, may have other opportunities of bypassing that, so that will be an additional constraint, a sort of quasi-competitive pressure, which will require the companies to increase their efficiency, as well as the price cap. Those two things together will become available in the future and may have beneficial effects, but not to the exclusion of the price cap.

- Q42 **Anna Turley:** Is Ofgem ready for that future market? Are you currently equipped to adapt to cope with new entrants to the market, small generators and so on? Is Ofgem ready for that?



Professor Cave: New generators have been entering the market in very large numbers, and transmission arrangements have been made onshore and offshore to enable wind-generated electricity to be fed into the network. That has all been done. The issue of the very large-scale transformation of the network into a much smarter, digitally transformed network is a matter on which I hope Ofgem will take the lead in discussions. It cannot lay down the law, because these are decisions that are basically made by operators, but if Ofgem can help to introduce a framework that is very friendly towards these changes, which are pro-choice and pro-competition changes, that is something I would see as a real priority for me to pursue.

Q43 **Anna Turley:** Is there a role for Ofgem in regulating the price comparison sites and the switching services? Is there anything you would like to see change in that aspect of the market?

Professor Cave: There is a lot of controversy over exactly what price comparison sites are required to show. One of the interesting things that Ofgem is doing at the moment is to run some controlled experiments about different availabilities of information on sites in different areas, to see how behaviour is affected. Since we are talking about, basically, customer engagement—a different form of customer engagement, in this case via price comparison sites—in the past, when the regulator decided what to do and just rolled it out universally, it often did not work, because consumers did not behave as they were supposed to and it was a complete waste of time.

This notion of trialling them and seeing if they work—you have a control area where the comparison sites have shown this and another area where they are showing that, to see what the difference is—is the way forward in working out how to deal with these consumer engagement problems.

Q44 **Anna Turley:** Finally, do you have enough staff and resources to deal with this?

Professor Cave: To be honest, I do not know. I know that the staff numbers are declining. I know that the price cap is imposing additional burdens and I know that this pretty amazing new stuff that we have been talking about is going to require quite a lot of fairly deep thinking. But I am not in a position to say that there is a massive shortage of resources. I guess, if you ask me in a year's time, I will probably be in appropriate pleading mode.

Q45 **Mark Pawsey:** Professor Cave, how do you think the public view Ofgem?

Professor Cave: I suspect that, as with all regulatory agencies, they view it with some bafflement about what it is supposed to do. We have a pretty clear idea about how the public view energy companies, and Ofgem, ideally, would be seen by the public as a bulwark against some of the practices of the energy companies. Whether it is at the moment, I just do not know.



Q46 **Mark Pawsey:** Do you think the public are aware that Ofgem exists?

Professor Cave: I should think it is probably a fairly minority activity, that knowledge, but I honestly do not know. It is very important that organisations have access to stakeholders' views of them, by polling. It is also desirable that they publish that. I know that at the CMA we had extensive interviews with stakeholders, and I think and hope we actually published them, so people could see how we were doing over time in relation to those groups. But these were often commentators, lawyers and people of that kind, rather than consumers, who are very important.

Q47 **Mark Pawsey:** How do you think energy companies view Ofgem?

Professor Cave: I honestly do not know. I had extensive interactions during the two years of the CMA market investigation with executives of energy companies but, as I have indicated, in the last two years I have not. One of the things I intend to do, if my appointment is confirmed, is to go out, talk to people in the industry and essentially ask them the question that you have just asked me.

Q48 **Mark Pawsey:** Do you anticipate a difference in view between the new, smaller challenger companies and the big six?

Professor Cave: I would certainly expect a difference in view.

Q49 **Mark Pawsey:** What would the difference be?

Professor Cave: It is pretty clear that the big six did not, to put it mildly, favour the imposition of a default price cap on energy customers.

Q50 **Mark Pawsey:** That is of Parliament's doing. That is not of Ofgem's doing. That is of Parliament's doing, so why should that affect their attitude to Ofgem?

Professor Cave: Ofgem is Parliament's instrument in this matter and I am sure that some of the opprobrium that falls upon you may actually rub off on Ofgem at the same time. Equally, I am hoping that some of the praise that falls upon you may also rub off on Ofgem.

Q51 **Chair:** Don't hold your breath. They might judge you, though, Professor Cave, because you dissented from the CMA view on the price cap, so it is not just Parliament, but you personally have been an advocate of a price cap. That might affect the industry's view of you.

Professor Cave: That is true. Do you mean the views of the industry or the views of the public?

Q52 **Chair:** The public might like you and the industry might not.

Professor Cave: I have to say, nobody has shaken my hand in the street or anything like that. I think regulated companies recognise that the regulator is not there to be nice to the companies. The regulator has entirely specific duties, and the relationship that I have observed between regulated companies and regulators has been perfectly correct.



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Obviously there are arguments and disagreements between them, but each side represents that the other is trying to do a different thing, and that is just in the nature of the arrangement.

Q53 Mark Pawsey: May I follow up with some questions about your leadership style and the organisation you are inheriting? You said that staff numbers were declining. Are you aware of the gender pay gap in the organisation?

Professor Cave: The gender pay gap is actually 5.8% in the last thing, which is astonishingly low compared with many institutions. There is a gender pay gap in relation to the payment of bonuses. It is not enormous, but I do not regard that as something about which Ofgem should be complacent. There are obviously lots of other things that can be done. The fact that everybody is way over on one side indicates that there is probably something systematic going on.

Q54 Mark Pawsey: Is that a task for you as chairman, or is that something for the chief executive?

Professor Cave: I would regard it as a task in which the board would take a very keen interest and which the board would pursue. Admittedly, the starting point is relatively speaking very good, but at the same time it would not be appropriate for us to rest on our laurels.

Q55 Mark Pawsey: As chairman, would you see yourself taking a higher profile than perhaps the past chairman, for example? We know who the chief executive is because he has been to us to give evidence, but I do not know that we have previously taken evidence from the chairman. Do you see yourself as playing a higher role and having a higher profile?

Professor Cave: That is a matter that I would have to discuss with the board, on which I have no strong opinions. The person who does the best job should play that role.

Q56 Mark Pawsey: What would you do if you found yourself in conflict with Ministers?

Professor Cave: If I thought that what I was being asked to do was contrary to the duties that have been set up, and if I thought that it was an unnecessary infringement upon Ofgem's independence, I would resist it with all might and main.

Q57 Sir Patrick McLoughlin: Professor Cave, what role is there for Parliament in scrutiny and accountability for your work and for Ofgem more widely?

Professor Cave: Parliament plays a very important role in scrutinising regulators' work. I have seen hearings where regulators have been brought before you and often had some quite uncomfortable moments, but I find it very hard to believe that that is not generally to the benefit of the regulatory process. I have seen cases in which the National Audit Office and the Public Accounts Committee have scrutinised what



regulators have done, and that is beneficial. As a user of that kind of information in the past, in my role as an academic, it would be a bit hypocritical if I took a different view now.

- Q58 **Sir Patrick McLoughlin:** In asking about the effectiveness of the chairmanship, I would like to refer back to what Mark has said. If I look at your previous record, in 2001 and 2002—we are talking about 17 years ago—you were asked by the Chancellor and Secretary of State for Trade and Industry to carry out an independent review of radio spectrum. Was that the one where they paid vast sums of money and overpaid for them? Was that the first one where they sort of went a bit wild?

Professor Cave: That is interesting. It actually followed that event, and the question was how, in one sense, you could introduce a more normal and rational process of distributing spectrum, which eventually happened. Nothing like that 3G auction has ever occurred since, which is a good thing. It is now a much more routine business. It is like renting office space. You just rent some spectrum.

- Q59 **Sir Patrick McLoughlin:** You have then done lots of inquiries—I will not go through them all—over the past 17 years, covering housing, the water sector, airport regulation and many others. Do you have a bit of a reputation in the Civil Service for delivering what Government want?

Professor Cave: I am not aware of it.

- Q60 **Sir Patrick McLoughlin:** Would they have used you for so many inquiries?

Professor Cave: Another way of looking at it is that the Minister does not have to set up an independent inquiry. The Minister has the choice of setting up a departmental group that makes an investigation and makes recommendations. In my experience, Ministers often set up inquiries because they thought there was something on which they wanted a considered view by outsiders, and they set them up in that way because they did not have very strong priors themselves.

For example, in the inquiry I did into the regulation of social housing, it was pretty apparent that there was some problem with it because tenants had very little redress against ineffective landlords. The then Minister, whose name now escapes me, I think, set it up because she wanted a view as to how this problem could be resolved. When I was doing the review, I always had to try to work out a way to resolve the problem in a fashion that would not antagonise everybody within the industry. I would start, as I always do, with the interests of the tenants, but you also have to take into account how the regulatory system is going to affect the councils and social housing organisations that do this. I tried to thread a path through these things that achieved the tenants' objectives but, at the same time, through discussion with the parties, was acceptable to them and did not impose, for example, massive regulatory costs upon them.



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- Q61 **Sir Patrick McLoughlin:** Imagine that we are in 2023 and we are coming to the end of your five-year appointment. What criteria should we be using to judge if you have been a success or not?

Professor Cave: The first one, as always, is the position of end users and households. Are they overpaying for their energy? Has a way been found to protect them adequately? It could be a way that is reached by much higher levels of engagement. If that fails, in respect of those households that it fails, particularly vulnerable customers, are they still being protected or are they reverting to the situation before the price cap came in? That would be very important.

I would also emphasise that it is very important to look at the success of the five years in respect of small and medium-sized enterprises, because they may be getting the short end of the stick at present. The other thing I would particularly look at is the degree to which the benefits of the new stuff that is coming along had been spread. That is largely a decision of customers and firms, but I would look at the question of whether the regulations had impeded or assisted the spread of these things to the benefit of the end users. Those would be the two things I would look at in particular.

- Q62 **Sir Patrick McLoughlin:** This is a part-time appointment. Are you seeking any other public appointments?

Professor Cave: Not any other public appointment, no.

- Q63 **Sir Patrick McLoughlin:** This is three days a week. Am I right?

Professor Cave: Yes. That is the plan. If it turns out to be too little, I will work more.

- Q64 **Sir Patrick McLoughlin:** When you did the CMA investigation, you would have had then quite a lot of information that was privy to the CMA. Is there any conflict of interest with the information you received on that CMA report, which you have available to you and other members of the board will not have?

Professor Cave: No. When I left the CMA, I did not take any documents with me and the prospect of my remembering a detailed figure from three years ago is really extremely remote. Whenever I have to consult or recapture what the CMA said, I have to get up on my screen the publicly available report and work from that. There are no secret data to which I am privy.

- Q65 **Sir Patrick McLoughlin:** Can I ask if you have any connections with any political parties at all?

Professor Cave: No.

- Q66 **Sir Patrick McLoughlin:** How big is your board?

Professor Cave: At the moment, if I become chair on 1 October, it will be seven: four men and three women.



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Chair: Thank you very much, Professor Cave, for coming to see us today for this pre-appointment hearing. Within the next 48 hours, the Select Committee will give its view. Thank you very much for your time this morning.

Professor Cave: Thank you.