Making a positive difference
for energy consumers

Darren Jones MP
Chair, Business, Energy and Industrial
Strategy Committee

BY EMAIL

Date: 27 June 2022

Dear Mr Jones,

Thank you for the further opportunity to give evidence as part of your committee's inquiry into energy pricing and the future of the energy market.

Following the oral evidence session on 24 May, there were a number of areas where I agreed to write to the Committee with further information, alongside the additional information you requested, which we are happy to provide:

1. Implementing the recommendations from Oxera's Review of Ofgem's regulation of the energy supply market:

We fully accept the recommendations from the Oxera report, which the Ofgem Board commissioned, and we are working to implement them. As you say, the recommendations included the development of a living framework for how the consumer interest is defined and measured, strengthening our framework for assessing effective competition – and then using the qualitative and quantitative criteria from these frameworks in making evidence-based policy trade-offs. We are working at pace to do this. An initial version of the consumer interest framework will appear in a paper on Net Zero Britain that we intend to publish shortly.

Alongside this, we are continuing to make a number of important reforms to protect consumers, and deliver our objective of an energy market where energy suppliers are financially resilient, and where suppliers bear the appropriate cost of risk-taking so that costs are not inappropriately passed to consumers. This has included changes to the price cap, as well as specific proposals to strengthen financial resilience.

These decisions have been underpinned by extensive consultation, detailed and robust analysis, including, in some cases, impact assessments that we have published – and we are confident that this evidence, alongside the rationale laid out in our consultations, demonstrate that our decisions are in the interests of consumers.

2. Ringfencing customer credit balances and Renewables Obligation payments:

As I explained to the Committee, we want to move towards a market where energy suppliers are financially resilient, and where risks are not inappropriately passed to consumers.

In our written evidence to the Committee in March, we indicated that while it was subject to significant uncertainty, our estimate at that time for the total claims

associated with the supplier failures over the autumn and winter of 2021-22 was approximately £2.2 billion to £2.4 billion. While it is still subject to significant uncertainty, our latest estimate is that these claims will be approximately £2.7 billion in total. This equates to approximately £94 for a household with typical levels of consumption, under the price cap.

The proposals we published in our consultation on Monday 20 June are intended to prevent the kind of energy supplier failures we saw last year and to better protect consumers' money if they do fail. The specific measures include:

- improvements to the financial health of suppliers, to ensure they can weather the current challenges and reduce the risk of failures;
- protecting consumer credit balances and green levies when suppliers fail, to prevent the costs being picked up by consumers;
- requirements for suppliers to have better control over the key assets they need to run their supply business; and
- a tightening of the rules on the level of direct debits suppliers can charge customers, to ensure credit balances do not become excessive.

We commissioned the economics consultancy NERA to undertake an impact assessment of our proposals, which has been published alongside the consultation. It shows that we believe that there is a net consumer benefit that reasonably justifies the introduction of these protections to customer credit balances and Renewables Obligations payments.

To the extent these requirements result in the need to re-capitalise efficiently run suppliers, we are open to allowing a suitable transition period – and we are specifically seeking feedback on this in our consultation.

3. Staff turnover:

Similar to many civil service departments, Ofgem's turnover decreased during the Covid pandemic to approximately 11% in 2020, and increased to approximately 22% in 2021. This is broadly consistent with the level of turnover at Ofgem's before the pandemic – for example, Ofgem's turnover in 2019 was approximately 21%.

In order to respond effectively to the crisis in the energy market, in addition to redeploying existing Ofgem staff, we have also made use of consultancy support, particularly in areas where they provide technical expertise, and where it enabled us to bring in this expert capability at the speed that was required.

A key element of the new operating model that Ofgem is moving to, through our Transformation Programme to which you referred, will be a flexible resourcing model, which will enable us to move resources internally much more effectively to manage high priority work. While it is likely that there will always be specific pieces of work where it is cost-effective for Ofgem to procure expert or technical consultancy support, the introduction of this flexible resourcing model should enable Ofgem to reduce its consultancy requirements overall.

In addition, and as the Oxera report highlighted, there are areas in which Ofgem needs to continue to strengthen its mix of technical skills, including, for example, in financial regulation. Again, and through the development of a professions model, this is being addressed in our Transformation Programme.

4. Enforcement and compliance:

Ofgem monitors the energy market very carefully and using a range of sources of intelligence. When we come across breaches of our rules, we have a range of tools at our disposal which can include taking formal enforcement action when we deem this to be the best approach for consumers. This is often for the most serious breaches of the rules, or where companies dispute that they have done anything wrong.

In other cases, it can sometimes be quicker to resolve things for consumers by taking compliance action. At all times, our priority is to deal with the problem and compensate customers as quickly and fully as possible.

Since 2010, as a result of the enforcement and compliance action Ofgem has taken, over half a billion pounds has been paid in fines, payments to consumers, or to our Redress Fund, which is operated by the Energy Saving Trust. I have included a breakdown in each year since 2010 below:

Fines and redress as a result of Ofgem compliance and enforcement action since 2010:

Year	**Payments (£)**
2010	15,200,000
2011	13,638,000
2012	16,759,501
2013	33,000,001
2014	35,734,904
2015	71,927,379
2016	51,958,000
2017	19,031,000
2018	7,156,915
2019	50,886,663
2020	71,302,163
2021	183,981,139
2022 (year to June)	14,909,560
Total	585,485,225

We are continuing to take robust compliance and enforcement action. For example, earlier this month, we announced that a number of network operators had agreed to pay a further £10 million in redress payments – on top of nearly £30 million they had already paid directly to affected customers – as a result of the serious disruption after Storm Arwen.

Our enforcement and compliance teams naturally play a vital role in this work. They also work intensively with colleagues in other parts of Ofgem – for example, if Ofgem opened an enforcement case against a network operator, our networks team would be very heavily involved in the investigation and any subsequent enforcement action.

In addition, and as I explained to the Committee, we expect much larger resources for compliance and enforcement in the future – and, indeed, Ofgem is actively recruiting roles in our enforcement and compliance teams. We are also continuing to strengthen other capabilities, such as in digital and data insights, which are critical to boosting our operational capability in compliance and enforcement.

This resourcing is part of a wider request we submitted in April 2022 to HM Treasury for further funding for 2022-23, including to strengthen the resourcing in our enforcement, retail compliance, retail intelligence and market stability, and financial resilience and

controls functions. If this is approved, it should allow us to recruit a significant number of additional staff in these areas.

5. Neo Energy:

On 1 June we issued UK Energy Incubator Hub Ltd, which trades as Neo Energy, with a provisional order compelling it to take action to ensure that its customer service arrangements and processes are complete, thorough and fit for purpose. Specifically, the provisional order requires UK Energy Incubator Hub Ltd to ensure that:

- Customers are able to contact them by telephone at all reasonable times, namely, as a minimum, during weekdays between 9am and 5pm. Where the customer's enquiry or complaint is not able to be resolved on the first call, it must ensure a staff member qualified and authorised to deal with the matter contacts the customer by the end of the next working day.

- All emails from its customers are acknowledged within 24 hours and substantively responded to within ten business days. If the substance of the customer's enquiry or complaint cannot be resolved within ten business days, it must (before the expiry of that timeframe) provide the customer with an explanation for the delay and a suggested pathway to, and estimated timeframe for, resolution.

- Customer complaint remedies which have been determined by the Energy Ombudsman are implemented without delay.

We have also imposed a ban on UK Energy Incubator Hub Ltd taking on new customers until the issues above are resolved. UK Energy Incubator Hub Ltd is required to comply with this provisional order. Failure to comply may result in further enforcement action being taken, which could include a financial penalty, or the UK Energy Incubator Hub Ltd being stripped of its licence.

On 17 June Ofgem issued UK Energy Incubator Hub Ltd with a further provisional order, requiring it to immediately provide information relating to financial stress testing and its management control framework.

6. Applications for supply licences:

While it would not be appropriate for me to prejudge the outcome of any individual application for a licence that Ofgem has received or may receive in future, I do want to emphasise that Ofgem has significantly strengthened our entry requirements and the checks we undertake when a potential supplier applies for a licence – and we will not issue a licence to anyone who is deemed to have failed our fit and proper tests.

As part of these checks, we will consider someone's history, including unspent criminal convictions, insolvency history, disqualifications from acting as a Director, and/or professional or personal misconduct. We will also look at their past conduct in the energy market and whether an individual has been involved in any compliance or enforcement activity, and whether an individual has been involved in a supplier exit and what their role was.

In addition, Ofgem has already taken the step of writing to a number of directors of suppliers that have exited the market, highlighting this fit and proper test should another licence application be made. Alongside this, we will also be undertaking a market-wide assessment of compliance with our ongoing fit and proper requirements for suppliers active in the energy market.

7. Additional powers:

Supplier executive behaviour

Ofgem has already implemented a number of reforms to protect consumers under our own powers, and we remain committed to making the fullest possible use of our powers to protect the interests of consumers.

Nonetheless, we do believe that there are a number of areas where the regulatory framework, including the powers at Ofgem's disposal, should be strengthened in order to prevent a repeat of the supplier failures we saw in the autumn and winter of 2021/22. These would require legislative change. We have discussed these areas with the Department for Business, Energy and Industrial Strategy, which is ultimately responsible for the legislative framework within which Ofgem operates.

In particular, the recent insolvencies of suppliers have highlighted the urgent need to address several issues relating to the interactions between the insolvency and Supplier of Last Resort regimes, which we have discussed with the Department.

Of particular concern is that Suppliers of Last Resort cannot access the financial benefit of hedged positions of insolvent suppliers to reduce wholesale market costs that are mutualised. This can result in increased costs falling on consumers. This is because 'in the money' hedges, once the value is realised, can result in a financial surplus at the end of the insolvency process which is returned to shareholders, instead of being applied to reduce wholesale market costs that are mutualised.

We have identified a number of potential solutions that would reduce associated mutualised costs. This includes making the SoLR or the SoLR levy fund a deemed creditor of the business for the purposes of the Insolvency Act, amending the Companies Act to make consumer interests equivalent to other stakeholders and/or making consumer interests equivalent to interests of creditors when facing insolvency in terms of directors' duties, or a transfer scheme to transfer hedging agreements (of the liquidated value from such hedging agreements) from one supplier to another in circumstances where an energy supplier is facing insolvency, and where the Secretary of State considers that it would be equitable to do so.

This would provide the ability to offset the SoLR levy against the executives and shareholders of a supplier which has left the market, along with the ability to offset against any assets the residual company has.

In addition, having observed the approaches taken by companies, and their directors, as they approached insolvency, which in some cases put an unacceptable risk on consumers, we are likely to need a new set of powers to address this. This could include step-in rights, as some other regulators have, which would enable Ofgem to literally step into the shoes of a supplier (or request a third party to) to administer the business if we thought there was imminent action that would cause significant detriment to consumers. Given the behaviour of some executives and shareholders, we would also like government to consider whether retrospective action (from the point of legislation) would allow Ofgem to better change the incentives within the retail market.

Renewables Obligation

Alongside this, a number of suppliers that exited the market over the autumn and winter had significant outstanding Renewables Obligation (RO) liabilities. Our analysis of the drivers of unsustainable businesses has indicated that the use of renewable obligation funding as risk free working capital for new entrant suppliers has been one of the

reasons why undercapitalised businesses in the energy market were able to grow quickly.

As I mentioned earlier, we are consulting on a requirement on suppliers to ringfence funds required to discharge their RO obligations. However, these cannot provide full protection against poor business practices and may interfere with the incentives of the scheme. More frequent payments of the RO would fully resolve this issue – for example, quarterly payments. However, we cannot create quarterly payments without legislative underpinning.

Price cap

The events over the autumn and winter have also highlighted that the current price cap methodology, while protecting consumers from price spikes, exposes suppliers to risks that are hard to manage at times of high energy price volatility. If not tackled, these are likely to lead to higher costs for consumers.

Again, Ofgem has already implemented a number of changes to make the price cap more adaptable to volatile markets, such as the introduction of a price cap reopener in exceptional circumstances and the proposal to move to quarterly updates. Nonetheless, the events in the market in recent months and some of the changes we expect to see in the retail market, such as flexible tariffs and innovative smart technologies, mean we are working with government to consider how price protection can adapt to an evolving retail market. This work will ensure Ofgem can regulate energy prices effectively and in the interests of consumers.

Our preference would be a wide-ranging freedom for Ofgem in relation to the price cap. This could be provided in a number of ways, such as recasting the powers to create a much broader discretion for Ofgem to set the cap, adding a power for the Secretary of State to amend the price cap conditions by statutory instrument, or by adding a provision to the legislation, which allows Ofgem wider discretion in setting the cap when faced with certain circumstances, for example, such as a threat to security of supply, significant consumer or supplier detriment. As an alternative, more limited flexibility could be achieved by making textual amendments to the Act to enable different variants of the price cap to be implemented to suit the circumstances.

8. Administrators:

Concerns have been raised about the conduct of some administrators dealing with the affairs of suppliers that have exited the market. In particular, there have been concerns from consumers about their debt collection practices, and the speed with which credit balances are returned. From the perspective of suppliers that have been appointed to take on the customers of other suppliers that have exited the market, there have also been concerns about the smoothness of the process of transferring customers, and the costs some administrators have charged. Overall, it is fair to say that the customer experience has been variable – some consumers have seen fewer issues or issues resolved much more quickly than others.

Ofgem does not have direct regulatory jurisdiction over the conduct of administrators, but we do, of course, have a very strong interest in ensuring that the interests of consumers are protected as far as possible in this process. We have, therefore, engaged with administrators directly, and with other regulators with more direct powers in respect of administrators, including with the Insolvency Service and the Institute for Chartered Accountants. We understand that a number of suppliers have also raised these concerns directly.

In our engagement with administrators and other regulators, we have been clear that, in our view, administrators are bound by the same rules as suppliers themselves when pursuing a debt. This flows from a requirement for suppliers, which Ofgem introduced in January 2021, to include references in customer contract terms and conditions to the effect that activities relating to debt recovery will be executed as outlined in relevant licence conditions. Our view is that insolvency practitioners should have regard to the terms and conditions in customer contracts. We also continue to have frequent engagement in relation to the smooth transfer of customers from one supplier to another, and for credit balances to be returned as speedily as possible.

Ultimately, under the current regulatory framework, our formal powers in respect of administrators are very limited. As I mentioned earlier, there are issues relating to the interactions between the insolvency and Supplier of Last Resort regimes, which we have discussed with the Department, where we believe that legislative change is required.

While this does not necessarily involve greater powers for Ofgem itself in respect of administrators, especially given there are existing regulatory agencies with these powers, the way in which administrators' duties to creditors are balanced with the interests of energy consumers does, in our view, need to be addressed.

9. Ofgem Board members 2014 – present:

Members of the Ofgem Board are appointed by the Secretary of State, and comprise non-executive Board members, and executive Board members. Information about our Board, including its members, agendas and minutes of meetings are published as a matter of course on the Ofgem website, with further information also included in our Annual Report and Accounts. A full list of our current Board members, and Board members who previously served on the Ofgem Board since 2014 is provided below:

Current Board:

Name	Role	Term
Martin Cave	Chair	2018 -
John Crackett	Non-executive	2018 -
Lynne Embleton	Non-executive	2018 -
Christine Farnish	Non-executive	2016 -
Myriam Madden	Non-executive	2020 -
Barry Panayi	Non-executive	2020 -
Jonathan Brearley	Executive (CEO since 2020)	2018 -

Previous Board members who served from 2014 or later:

Name	Role	Term
Andrew Wright	Executive	2008 - 2018
Ann Robinson	Non-executive	2018 - 2020
David Fisk	Non-executive	2009 - 2017
David Gray	Chair	2013 - 2018
David Harker	Non-executive	2009 - 2015
Dermot Nolan	Executive (CEO)	2014 - 2020
Jim Keohane	Non-executive	2009 - 2017
John Howard	Non-executive	2009 - 2015
Keith Lough	Non-executive	2012 - 2019
Mary Starks	Executive	2018 - 2020

Nicola Hodson	Non-executive	2015 - 2017
Paul Grout	Non-executive	2012 - 2021
Rachel Fletcher	Executive	2016 - 2018
Sarah Cox	Executive	2018 - 2020
Sarah Harrison	Executive	2005 - 2015

10. Bad debt:

We closely monitor levels of bad debt in the energy market, including using our statutory powers to make requests for information from suppliers. We also consider a range of other information, including surveys of consumers, experiences in other regulated sectors, and undertake our own modelling.

As we mentioned at the Committee, in response to our most recent request for information, and considering a range of different scenarios, the eight largest suppliers were forecasting a central scenario in which bad debt reached approximately £1.3 billion over the course of 2022-23. I should be clear that these forecasts were submitted to Ofgem before the Government's package of further support for consumers with their energy bills was announced on 26 May. As a result, it is likely that this forecast is an overestimate of the actual level of bad debt that will arise this year.

We will continue to monitor levels of bad debt through regular information requests, and we expect suppliers to update their forecasts taking into account government support, along with the updated level of the price cap once it has been announced.

The methodology for the price cap includes a bad debt allowance, which enables suppliers to recover the costs associated with bad debt. Ofgem considers all the information available to it in setting this allowance and in ensuring that these costs are efficient and fair to consumers.

11. Self-disconnection:

Given the significant rise in energy prices, we are particularly concerned about the impact on vulnerable consumers, including those on prepayment meters who may go off supply if they do not top up their meters. This is known as self-disconnection.

In 2020 Ofgem introduced a number of important protections to support consumers at risk of self-disconnection. This includes a requirement on suppliers to identify prepayment meter customers who are self-disconnecting and to offer short-term support through emergency and friendly-hours credit.

Alongside this, we are continuing to monitor levels of self-disconnection very carefully. During the Covid pandemic, the number of instances of self-disconnection increased from around 270,000 instances per month in July 2020 to around 400,000 in September 2021. Self-disconnection is reported here as an instance where a smart prepayment meter sends an alert to the supplier that the meter is out of credit and a customer is off-supply.

While there are methodological challenges in producing precise figures – for example, where homes are empty for periods of time, or in obtaining exact figures for prepayment meters without smart meters – these figures do give us an indication of the overall trend in the levels of self-disconnection. In the majority of cases, these self-disconnections were for periods of one hour or less.

Since September 2021, we have enhanced our monitoring of self-disconnection further. Under our statutory powers, we have issued a quarterly request for information to

energy suppliers, which requires them to report to us on the proportion of self-disconnection, the number of smart prepayment meters customers using their emergency credit facility, and the number of discretionary credits provided to prepayment meters customers.

At the moment, the levels of self-disconnection appear to be broadly stable from the September 2021 level, as are the levels of emergency and discretionary credit provided to prepayment meter customers. However, we are aware of reports from debt advice charities and from Citizens Advice, which suggest that levels of self-disconnection may be increasing. We are, therefore, continuing to monitor the data on self-disconnection, as well as compliance with the protections in place for consumers, very carefully indeed, particularly following the increase in the energy price cap that came into effect in April 2022, and the further significant increase expected in October 2022.

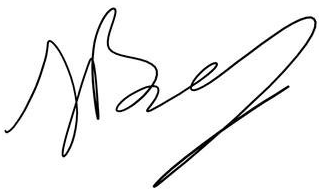
12. Transmission Network Charging Taskforce:

As the Committee will know, Transmission Network Use of System charges recover the annual cost of the provision, maintenance, and upgrade or expansion of the transmission system. They currently equate to approximately £3.5 billion per year. Recently, stakeholders have raised concerns with us about these charges – and we recognise it is important that transmission charges are fit for purpose as we move towards a decentralised, more flexible energy system.

As a result, in February 2022, we announced a Task Force to take forward a review of these charges. Our decision to progress this work through a Task Force reflects the need for a collaborative, joint industry and Ofgem response to the issues raised by stakeholders. We intend to provide a further update in July 2022.

I hope this information will be helpful to the Committee – and if we can be of any further assistance, please do not hesitate to let me know.

Yours sincerely,



Jonathan Brearley
Chief Executive