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Summary

The Office of Gas and Electricity Market's (Ofgem's) failure to effectively regulate the energy supplier sector has come at a considerable cost to billpayers. Since July 2021, 29 energy suppliers have failed, affecting around 4 million households. Customers have been left to pay the £2.7 billion cost of supplier failures, which equates to £94 per household, at a time when energy prices are already at a record high. Costs are very likely to increase, including when Bulb Energy, which was the largest of the failed companies and is being funded by the government, is sold or exits special administration by other means. While the Department for Business, Energy & Industrial Strategy and Ofgem had procedures in place to ensure that customers did not experience any discontinuation of their supply as a result of the failures, many customers, including more vulnerable ones, experienced other forms of disruption. The ongoing volatility in the market means that this report, based on evidence collected up to July 2022, has in some cases been superseded by events, in particular the announcement of the Energy Price Guarantee for UK households in September 2022. The energy supplier market remains unstable as a result of the ongoing volatility in the wholesale energy market and our conclusions regarding Ofgem's resourcing and regulatory approach very much still apply. It remains the case that Ofgem must urgently learn lessons to protect customers and prevent them from having to foot the bill in the event of any future failures.

It will be essential that the Department and Ofgem put the interests of customers at the heart of their approach to developing the energy supplier sector. In the short-term Ofgem is bringing in new rules to improve the financial resilience of the market but needs to manage complex trade-offs between improving the sector's resilience and encouraging innovation and competition. In the longer-term the Department and Ofgem need to ensure that the energy market is structured and regulated in a way that will support the transition to net zero.

Introduction

Most households and businesses in Great Britain are supplied with gas and electricity through the energy system. These are four main components of this system: generation; transmission; distribution; and retail. Energy retailers (known as suppliers) purchase gas and electricity from the wholesale market and sell it to homes and businesses. The Department for Business, Energy & Industrial Strategy (the Department) is responsible for setting and developing energy policy in the UK. The Office of Gas and Electricity Markets (Ofgem) regulates gas and electricity markets in Great Britain. Ofgem's principal objective is to protect the interests of existing and future consumers. Ofgem and the Department have two main processes for maintaining continuity of supply when a supplier fails: the supplier of last resort (SOLR) process and the special administration regime (SAR). Under the SOLR process, Ofgem transfers customers from a failed supplier to an existing supplier. In cases where SOLR is not viable, such as where it has too many customers to transfer to another supplier in one go, a SAR is where a temporary administrator continues running the failed company until it can be sold, or the customers transferred to other suppliers.

Between mid-2021 and spring 2022, the wholesale price that suppliers paid for gas and electricity increased to unprecedented levels. Between July 2021 and July 2022, the lack of financial resilience within many energy suppliers and the rise in wholesale prices, led to the failure of 29 energy suppliers. Ofgem transferred the customers of 28 of these failed suppliers to new suppliers through the SOLR process. The Department took Bulb Energy into SAR because, with 1.6 million customers, it was too big to go through SOLR. In May 2022 the government announced that all households in the UK would receive £400 of support with their energy bills through the Energy Bills Support Scheme.

Conclusions and recommendations

1. **Ofgem's failure to effectively regulate the energy supplier market has cost households an estimated £2.7 billion, with further costs expected.** Prior to 2019, Ofgem's approach to licensing new energy suppliers used a low-bar for new entrants and it did not undertake detailed scrutiny of licence applicants' financial situation. Ofgem's current best estimate of the cost of the 28 suppliers that have exited the market is £2.7 billion, which equates to around £94 per customer. These costs are being recovered from customers through a charge on their energy bills. Government spent £0.9 billion running Bulb Energy during 2021–22 and budgeted an additional £1 billion for 2023–23. The final cost to customers of government support for Bulb Energy will not be known until it is sold or exits the market by other means. The SOLR and SAR processes ensured that customers did not experience a discontinuation of their supply, but they came at significant financial cost, and some disruption. Energy suppliers are still under significant financial strain as a result of the ongoing volatility in the wholesale market and the risk of further exits is high.

   Recommendation: ***Ofgem and the Department should review the SOLR and SAR processes to ensure that they have learned the lessons from recent experiences and report back to the Committee as part of their Treasury Minute response on what action they are taking as a result.***

2. **Ofgem did not strike the right balance between promoting competition in the energy suppliers market and ensuring energy suppliers were financially resilient.** During the 2010s, Ofgem focused on attracting new firms to the sector to increase competition and reduce costs to consumers. Issues first began to emerge with the financial resilience of new entrants in 2018 but Ofgem did not tighten requirements for new suppliers until 2019, and for existing energy suppliers until 2021. Ofgem acknowledges that it should have tightened requirements earlier, but has found it complex to negotiate with the sector the appropriate balance between competition and resilience. In December 2021, Ofgem published an action plan on financial resilience and in April 2022 it published proposals on measures such as ring-fencing customer credit balances and Renewables Option payments. Many energy firms support Ofgem's measures to improve financial resilience, and some would support even more stringent measures. Others, however, are concerned that Ofgem's reforms could lower competition and lead to bigger bills. Ofgem accepts there are trade-offs it needs to consider between resilience and competition and is developing a framework to help it manage these.

   Recommendation: ***Ofgem should write to the Committee within six months setting out how it will monitor and balance levels of competition and resilience in the energy supplier market, particularly once government intervention in the energy market recedes, which could enable greater competition than is currently possible.***

3. **We are not convinced that Ofgem yet has the skills and capacity it needs to take a more proactive role in regulating the energy supplier market.** Ofgem has around 1,400 staff and has submitted a bid to HM Treasury asking for more resources to carry out its functions. This is partly because Ofgem is beginning to administer the Department's boiler upgrade scheme and is also taking on responsibility for regulation of the carbon capture and storage and nuclear sectors. In response to the

energy supplier crisis, Ofgem also plans to change its approach to regulating the retail energy market to make it more like the regulation of financial banks. Moving from a reactive model, where Ofgem works mainly with firms determined as being at risk, to a model where all firms operating in the market are assessed and tested, is a very big shift which will require different skills and resources. Ofgem believes it may also need more powers to carry out this role effectively. Some stakeholders note that Ofgem already has extensive powers but does not always use them. For example, Ofgem has not ensured that all suppliers have a customer supply continuity plan in place, setting out how energy supplies for their customers will be managed if the company fails.

Recommendation: ***Ofgem should write to the Committee as part of its Treasury Minute response setting out how much it has increased its capacity to regulate the energy supplier market and what additional activities it is undertaking as a result. As part of this, Ofgem should also set out which suppliers have customer continuity plans in place and its assessment of the quality of these.***

4. **The price cap is providing only very limited protection to households from increases in the wholesale price of energy.** The price cap limits the rates suppliers can charge customers for the standing charge and for each unit of electricity and gas used. The level at which Ofgem sets the price cap is largely driven by the wholesale price of energy. In winter 2021–22, prices in the wholesale market were six times their normal level, and by the summer of 2022 were ten times the normal level. In August 2022 Ofgem announced that the price cap for a typical customer paying by direct debit would rise to £3,549 a year in October 2022, from £1,971 in April 2022. It expects prices could get significantly worse through 2023. Ofgem considers the price cap to be a huge benefit for customers, and that it has made a substantial difference over the last six months in managing price rises. However, the price cap was brought in to ensure that energy suppliers were not making unfair profits and does not cap the energy bills paid by households. Since the cap was introduced, a typical customer's energy bill has risen by 221% and is predicted to further increase in 2023. Ofgem is moving from updating the price cap every six months, to every quarter, which would make the cap more adaptable to the market but means more frequent price changes for customers.

Recommendation: ***Within the next six months, the Department and Ofgem should review the costs and benefits of the price cap from a consumer's perspective to inform decisions about the future of the price controls in the supplier market, including the energy price guarantee.***

5. **It is unacceptable that many vulnerable customers, on top of having to pay higher energy prices, face extra challenges working with energy suppliers and accessing benefits designed to help people with their energy bills.** Vulnerable customers are most exposed to the rise in energy prices and some also face additional costs. Many vulnerable customers rely on prepayment meters, whose tariffs are typically more expensive than those paid by direct debit because the systems used to run them cost more which Ofgem reflects in the cost of energy. In addition, some vulnerable customers are not covered by the price protection available to other customers, or able to easily access the benefits available. For example, those who use district heating

systems are not covered by the price cap. The Department is unable to explain how it will ensure that all customers who use prepayment meters or do not pay their bill directly, such as residents of park homes, will receive their £400 of energy support.

Recommendation: ***The Department and Ofgem should urgently review the support that government has committed to providing to vulnerable households in relation to energy supplies and assess where administrative issues might prevent support being provided in a timely manner. It should, as part of the Treasury Minute response, update the Committee on their findings and how they are addressing them.***

6. **We are concerned that the Department and Ofgem do not yet have a clear vision of how the energy retail market will work in the best interests of customers during the transition to net zero.** The UK is seeking to transform its energy generation system away from gas, towards domestic and renewable sources of energy. The Department is looking at the appropriate market arrangements for electricity in the future as the UK transitions to net zero. New forms of regulation could also be required to enable suppliers to offer innovative products and services that support the achievement of net zero, such as by encouraging households to consume electricity at times of lower demand. The Department is revisiting its Energy Retail Market Strategy to take account of the lessons from recent months, and aims to publish a revised strategy once the market has stabilised. We note the challenge that will be involved in designing and regulating the energy system during the transition to net zero. But it will nonetheless be essential that the Department and Ofgem seek an appropriate balance between measures to control cost, improve resilience and encourage innovation in the interests of consumers.

Recommendation: ***The Department and Ofgem should, within six months, write to us to outline how they will, on an ongoing basis, ensure that they put the short and long-term interest of customers at the heart of their thinking around the transition to net zero, and how they will manage any trade-offs.***

1 Ofgem's regulation of the energy supplier market

1. On the basis of a report by the Comptroller and Auditor General, in July 2022 we took evidence from the Department for Business, Energy & Industrial Strategy (the Department) and the Office of Gas and Electricity Markets (Ofgem) on the regulation of energy suppliers.[1] This report is based on evidence collected up to July 2022 and does not take into account September's announcements of an Energy Price Guarantee to support UK households, or the Energy Bill Relief Scheme to support UK businesses.[2] Our snapshot assessment of Ofgem's regulatory approach and capability still applies, however.

2. Most households and businesses in Great Britain are supplied with gas and electricity through the energy system. There are four main components of the energy system: generation; transmission; distribution and retail. Energy retailers (known as suppliers) purchase gas and electricity from the wholesale market and sell it to homes and businesses. Between mid-2021 and spring 2022, the wholesale market price that suppliers paid for gas and electricity increased to unprecedented levels. By December 2021, weekly average wholesale gas prices (to which electricity prices are closely linked) had risen to nearly six-fold the level in February 2021. Partly because of the increase, during the period between July 2021 and May 2022, 29 energy suppliers failed, affecting nearly four million households in the UK.[3]

3. The Department is responsible for setting and developing energy policy in the UK. Ofgem regulates gas and electricity markets in Great Britain. Ofgem's principal objective is to protect the interests of existing and future consumers. Ofgem and the Department have two main processes for maintaining continuity of supply when a supplier fails: the supplier of last resort (SOLR) process and the special administration regime (SAR). Under the SOLR process, Ofgem transfers customers from a failed supplier to an existing supplier to maintain their continuity of energy supply. In cases where SOLR is not viable, a SAR is where a temporary special administrator continues running the failed company until it can be sold as a going concern, or the customers can be transferred to other suppliers. Ofgem transferred the customers of 28 of the 29 failed energy suppliers to new suppliers through the SOLR process. The Department took Bulb Energy into SAR because, with 1.6 million customers, it was too big to go through SOLR.[4]

The costs of supplier failure

4. In the period following the energy supplier market being opened to competition, Ofgem was keen to encourage new entrants to improve customer choice, ensure competitive prices and encourage innovation. Prior to 2019, it operated what it described as a 'low bar' approach to licensing new suppliers. It did not undertake detailed scrutiny of licence applicants' financial situation nor require commitments of shareholder equity

1 C&AG's Report, *The energy supplier market, Session 2022–23*, HC 68, 22 June 2022, para 1

2 Gov.uk, Government announces Energy Price Guarantee for families and businesses while urgently taking action to reform broken energy market, 8 September 2022 Gov.uk, Government outlines plans to help cut energy bills for businesses, 21 September 2022

3 C&AG's Report, para 5

4 Q 36; C&AG's Report, paras 2, 6, 8

prior to market entry. Ofgem accepted that, with hindsight, its requirements for suppliers should have been tighter and that financial resilience controls could and should have been stronger.[5]

5. Ofgem's current best estimate of the total cost of supplier failure dealt with through the SOLR process is £2.7 billion, which equates to around £94 per household. Ofgem told us that the majority of that cost consisted of the cost of suppliers of last resort buying energy for the customers transferred from failed suppliers at prices above what could be passed onto those consumers because of the government's price cap. It explained that other costs related to making sure that people had their credit balances returned to them and administrative and wider costs.[6] Of the £94 per customer, £66 was reflected in the price cap calculation for April to September 2022, and therefore reflected in customers' bills, and the remaining element will be reflected in future periods.[7]

6. During 2021–22 the Department spent £0.9 billion to enable an administrator to run Bulb Energy. The Department will need to continue funding Bulb Energy's operations until it exits administration, either because it is bought by investors or through other means, such as reallocating its customers to one or more other suppliers. HM Treasury budgeted an additional £1.0 billion to run Bulb Energy during 2022–23. At the time we took evidence, in July 2022, the actual cost was very uncertain partly because, in line with government spending guidance, the Department and HM Treasury chose not to hedge, which means its running costs are affected by the ongoing volatility in wholesale markets. The costs incurred may be offset by proceeds of any sale, although this will be subject to what value a potential buyer places on Bulb Energy. The Department has the power to recover the final net cost from bill payers through a levy, at a time of its choosing.[8]

7. We asked Ofgem how it ensured the needs of customers were considered in the event of an energy supplier failing. Ofgem told us that the SOLR and SAR processes had three main priorities: ensuring everyone was kept on supply; ensuring customers' credit balances were protected; and ensuring disruption to customers was minimised. It noted that the SOLR process had not been designed to run for 29 companies in such a short space of but that it had held up really well. It also said that, "by and large" customers kept their supply and their credit balances were transferred, but recognised that there was more work to be done to ensure that customers who were in debt to failed suppliers were treated fairly and reasonably.[9] It explained that it was considering other factors which might reduce the costs to customers in the event of future failures, but that these could require legislative change. We questioned Ofgem about the likelihood of future supplier failures. Ofgem told us that it did not think that it would be right for it to speculate on this, but noted that the energy market was still facing a period of high and volatile prices, and the risk was high. It explained that, of the 26 suppliers still left in the market, it was "quite possible" that there would be further exits.[10]

5 Q 27; C&AG's Report, para 13
6 Qq 45–46; C&AG's Report, para 2.8, Figure 8
7 C&AG's Report, para 2.15
8 C&AG's Report, para 11
9 Q 37, 40, 44
10 Qq 33, 72, 78–79

Balancing competition and supplier resilience

8. In the decade after it was opened to competition, the UK energy supplier market consisted of six large energy companies and a similar number of smaller suppliers. Since 2010, smaller companies have entered the domestic energy supplier market in greater numbers.[11] Ofgem told us that a small number of energy suppliers took advantage of customer loyalty to generate profits of up to 8%, equivalent to nearly £250 on top of the cost of energy. In 2016 it had therefore decided to prioritise opening up the energy market to new suppliers, in order to increase competition. We noted that there was a consensus between Ofgem and the Department about the need to increase competition in the market, but questioned the Department as to whether it should have foreseen the consequences. The Department told us that there was ultimately a trade-off between maximising levels of competition, and ensuring maximal resilience, and that managing the trade-off for the benefit of customers was the role of Ofgem. It also told us that, while hindsight suggested that the balance between competition and resilience should have been set in a different place, in its view the decision to create competition in the market was right.[12]

9. Ofgem told us that issues began to emerge with the financial resilience of new entrants in 2018 and in response it decided first to stop firms who did not have a resilient business model from entering the market, and then determine the ongoing requirements that suppliers already in the market would have to meet. In July 2019, Ofgem started carrying out a qualitative assessment of information provided by potential new entrants. Ofgem introduced new requirements for existing firms in January 2021, including a new financial responsibility principle that made it a legal requirement for suppliers to manage costs that would be mutualised in the event of supplier failure.[13] Ofgem told us that with hindsight requirements should have been tighter, but said that it took a long time to raise requirements for firms already operating in the market because it had to balance the need to keep companies financially resilient with ensuring that there was sufficient diversity in the market. This included making sure that the market attracted new entrants and developed new and changing tariffs. It explained that getting this balance right meant that the nature of Ofgem's ongoing monitoring requirements was a controversial topic within the sector and the length of negotiations reflected the complexity of discussions.[14]

10. Following the supplier failures that occurred in 2021, Ofgem implemented further measures to strengthen the financial resilience of the market. In December 2021 Ofgem published an action plan on financial resilience that set out how Ofgem would improve its collection and reporting of information on suppliers, and also introduced stress tests to assess how robust suppliers would be to shocks.[15] Subsequently, in April 2022 Ofgem published proposals to ring-fence customer credit balances and Renewables Obligations payments (which are made by suppliers that do not source a sufficient proportion of their energy from renewable sources), to reduce the scope for suppliers to operate with unsustainable business models and lower the cost consumers would have to pay if a supplier fails.[16]

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11 C&AG's Report, para 1.10

12 Qq 22–23, 25

13 Q 23; C&AG's Report, para 3.7 and 3.9

14 Qq 23, 27, 75

15 C&AG's Report, para 3.11; Ofgem, Action plan on retail financial resilience, 15 December 2021

16 C&AG's Report, para 3.13; Ofgem, Renewables Obligation (RO) | Ofgem and Ofgem, Update to December Action Plan: Customer Credit Balances and Renewables Obligation protection, 14 April 2022

11. Ofgem's proposals have drawn a range of reactions from stakeholders across the sector.[17] We received written evidence from suppliers who told us that they welcomed aspects of Ofgem's proposals to improve financial resilience, such as raising capital adequacy requirements and ring-fencing customer credit balances.[18] Some suppliers told us that there was scope for the reforms to be more ambitious. For example, SSE and E.ON suggested that Renewables Obligation payments should be made more frequently to reduce the costs that would need to be recovered from bill payers via a levy if a supplier fails.[19] Some suppliers acknowledged, however, that there was a risk that Ofgem's reforms could raise costs to consumers. We asked Ofgem about the suggestion from Octopus Energy that ringfencing supplier credit balances could add £15 per year to the bill of every UK customer. Ofgem accepted that asking companies to hold more capital could result in "a pressure on bills" and may increase costs to consumers. It explained that it considered that this was necessary to avoid the cost of supplier failures.[20] Ofgem explained that it was developing a framework for assessing how its policies and regulations affect the balance of these trade-offs to allow it to simultaneously increase competition, reward customers for using their energy carefully and encourage innovation.[21]

Ofgem skills and capacity

12. Ofgem told us that in order to undertake the functions being asked of it and to "play the role we want to play" in the sector, it would need different resources and different skills in future.[22] It explained that its past approach to regulating the energy sector had largely been reactive, in that it had worked mainly with companies identified as being under stress. It told us that it was changing its regulatory approach so it would assess the financial resilience and business management of every company and then respond accordingly.[23] Ofgem told us that the decision to change from a reactive model that looked at individual cases to a model similar to that in banking, where all firms are regularly monitored and assessed, was a "very big shift" that would require Ofgem to build its staff, skills and systems. Ofgem had already spent some time working with the Bank of England to identify the changes it needed to make and the skills this would require.[24]

13. Ofgem's headcount was approximately 1,400 in July 2022. This is higher than the 1,246 total staff Ofgem employed on average through 2021–22, and an increase of around 72% from the 816 total staff it employed during 2017–18.[25] It had submitted a bid to HM Treasury asking for more resources to carry out its functions. It told us that this was driven by three factors, only one of which was changing its regulatory regime for the retail energy market to be more proactive, based on the approach to regulation of the financial sector. Ofgem explain that it had also asked for more resources to enable it to implement

17 C&AG's Report, para 3.15
18 RES 0002, SSE Energy Solutions, 11 July 2022; RES 0009, EDF, 11 July 2022; RES 0007, Centrica 11 July 2022; RES 0005, E.ON, 11 July 2022; RES 0004, Octopus Energy, 11 July 2022.
19 RES 0002, SSE Energy Solutions 11 July 2022; RES 0005, E.ON, 11 July 2022
20 Q 70; RES 0004, Octopus Energy, 11 July 2022
21 Qq 65, 75
22 Qq 100–101
23 Q 32
24 Qq 32, 52
25 Q 100; Ofgem, *Annual Report and Accounts 2021–22*, HC 489, July 2022 and Ofgem, *Annual Report and Accounts 2017–18*, HC 1107, June 2018

new government schemes, such as the Department's boiler upgrade scheme, and to take on regulatory responsibility for new areas, such as carbon capture and storage and new nuclear power plants.[26]

14. We asked Ofgem whether it was able to deliver its plans for regulating energy suppliers using its existing legislation. Ofgem told us that it was testing its existing powers to assess whether it needed additional powers. For example, it explained that it may need more supervisory powers to allow it to undertake direct checks on companies it believed were not complying with regulations.[27] Some stakeholders told us that they agree that Ofgem needed to be provided with the powers necessary to operate the new regime. For example, Centrica, E.ON and Citizens Advice highlighted Ofgem's lack of authority over administrators brought in to manage insolvent firms.[28] Other stakeholders however noted the risks of extending Ofgem's powers. Octopus Energy in written evidence highlighted the burden suppliers face producing the significant volume of information Ofgem now requires.[29] We received written evidence from Energy UK that told us the energy license already had an extensive range of terms and conditions and there is scope for Ofgem to make more use of existing powers, before adding more.[30] For example, Citizens Advice told us that Ofgem had not enforced its own requirements that all suppliers develop a customer supply continuity plan that sets out how its customers will be managed in the event of the supplier failing. Citizens Advice explained that only one of the 20 suppliers that failed before November 2021 had such a plan.[31] We asked Ofgem how many of the 26 suppliers left in the market had a customer supply continuity plan in place. Ofgem was unable to give us an exact number, but told us that having a plan was not the issue, but the quality of the plan and ensuring that it was able to stand up to scrutiny. It explained that it was therefore carrying out a customer service compliance review to look at the plans in detail.[32]

26 Q 100
27 Qq 72–73; C&AG's Report, para 3.20
28 RES 0007, Centrica plc, 11 July 2022; RES 0006, Citizens Advice, 11 July 2022; RES 0005, E.ON 11 July 2022
29 RES 0004, Octopus Energy, 11 July 2022
30 RES 0010, Energy UK 11 July 2022
31 C&AG's Report, para 3.19; RES 0006, Citizens Advice, 11 July 2022
32 Qq 79–81

2 Wider issues relating to the energy supplier market

The price cap

15. Energy customers are either on non-default tariffs, where they have made an active choice about their energy tariff, usually fixing it at a certain rate, or on default tariffs, where they are more likely not to have done so. Since 2019, the government has capped the price per unit of gas and electricity for customers on standard default tariffs. In 2018, the Department determined that bills should be capped following findings from the Competition and Markets Authority that 70% of customers of the six largest energy firms were on expensive default tariffs and customers were paying £1.4 billion more per year than they would be in a fully competitive market. The price cap limits the rates suppliers can charge for the standing charge (the portion of customers' bills incurred regardless of the amount of gas and electricity used) and for each unit of electricity and gas used. It does not cap individuals' total bills, which depend on how much energy they use. The price cap also does not cover the energy costs of businesses.[33]

16. Ofgem sets the price cap every six months by calculating how much it costs an efficient supplier to provide gas and/or electricity to a customer.[34] Ofgem told us that, when setting the cap, it had to reflect the cost at which suppliers buy the energy in the wholesale market. It explained that in winter 2021–22 prices were six times their normal level, and by the summer of 2022 were ten times the normal level.[35] In May 2022 Ofgem estimated that the price cap for a typical customer paying by direct debit would rise to around £2,800 a year in October 2022, from £1,971 in April 2022. Ofgem told us that, as a result of energy prices continuing to increase, it expected prices to rise even further.[36] In August 2022 Ofgem announced that the energy price cap would increase to £3,549 per year from 1 October 2022. Ofgem warned that while the market remained too volatile to allow it to make projections, the market for gas in winter means that prices could get "significantly worse through 2023".[37]

17. Ofgem told us that, in its view, the price cap had been a huge benefit for customers and had done a lot of good for them over the last six months, and that while the price cap could not stop rising energy prices, it had "mitigated them somewhat". It explained that the price cap had prevented suppliers from immediately being able to put up their prices in response to the increases in wholesale prices, which meant price rises were staggered, helping customers to manage them.[38] It also explained that, more broadly, the price cap limited suppliers' profit margin to 2%, whereas in 2015–16 some suppliers were charging margins of up to 8%.[39] However, between the price cap's introduction in 2019 and April 2022, a typical customer's bill nonetheless increased by 78%, from £1,105 per year to £1,971. The subsequent 80% increase in the price cap to £3,549 in October will mean it

33 Q 59; C&AG's Report, para 1.6 and 2.6, Figure 3
34 C&AG's Report, para 1.7
35 Qq 21, 88
36 Q 56; C&AG's Report, para 2.14
37 Ofgem, Ofgem updates price cap level and tightens up rules on suppliers, Press release, 26 August 2022
38 Qq 21, 55
39 Q 59

will have increased 221% between 2019 and October 2022.[40] We asked the Department whether it had considered introducing a cap on the amount that customers pay on their overall bills rather than the profits that suppliers could make. The Department told us that this would create a crisis elsewhere in the energy system, and that it would require an "almost complete reinvention of the way our energy market works".[41] Ofgem told us that it had to reflect costs in the setting of the price cap, but that the Government had put in place a series of measures, such as the Energy Bill Support Scheme, as a way of mitigating those rises as best it could. We also asked the Department if anything more could be done to support businesses that are not protected by the price cap and find they cannot afford their energy bills. The Department told us that it was mainly focused on energy-intensive industries, and it had made significant commitments to support these.[42]

18. Ofgem told us that the price cap had not been sufficiently adaptable to the "once in a generation change" in wholesale prices during the winter of 2021–2022.[43] We asked Ofgem whether it had considered the possibility of high wholesale energy prices in designing the price cap. Ofgem told us that it had envisaged that there would be changes in wholesale costs, and put in place what it thought would be sufficient mitigations, including considering reducing the enforcement of the price cap in extreme circumstances. But it recognised that these mitigations had not considered the scale of the changes that had been seen in the energy market, or the circumstances in winter 2021–22.[44]

19. The NAO found that the vast majority of costs resulting from supplier failures was to make up the difference between what suppliers of last resort (SOLRs) could charge consumers under the cap and the cost of purchasing energy on the wholesale market.[45] To address this lack of adaptability, in May 2022 Ofgem set out its preferred position to introduce quarterly, rather than six-monthly changes to the cap. It explained that this will allow suppliers to adjust their prices more frequently to reflect prices in the wholesale market. Ofgem noted that some customers really welcome more frequent changes in the price cap, but others really do not like it. In the longer term, Ofgem told us it may need to continue to adapt the price cap to the changing market and that it may also need to reconsider how it is structured in light of net zero.[46] In August 2022, Ofgem announced that it would update the energy price cap every quarter rather than every six months, noting that the change would help provide the stability needed in the energy market and reduce the risk of further large-scale supplier failures.[47]

Vulnerable customers

20. We were concerned that some energy customers have been disproportionately affected by the energy crisis. For example, we noted that some vulnerable customers rely on prepayment meters but it costs more to administer the cost of energy paid by prepayment than by direct debit, which is reflected in the prices these customers pay. Some vulnerable

40 C&AG's Report, para 2.14; Ofgem, Ofgem updates price cap level and tightens up rules on suppliers | Ofgem, Press release, 26 August 2022
41 Qq 87–89
42 Q 59
43 Q 21
44 Q 60
45 C&AG's Report, para 3.23
46 Qq 55, 59–60
47 Ofgem, Ofgem confirms changes to the price cap methodology and frequency ahead of new rate to be announced later this month, Press Release, 4 August 2022

customers are therefore having to cope with the increase in wholesale prices this year, while at the same time also paying extra on top of that due to their method of paying for energy.[48] Other groups of customers have also been disproportionately affected by the crisis. For example, energy provided through district heating systems, where heat is distributed to surrounding homes from a central source, is not covered by the price cap and customers are therefore not protected from price rises.[49]

21. We asked Ofgem what it was doing to support vulnerable customers. Some stakeholders criticised Ofgem's decision to add the SOLR cost levy to the electricity standing charge when customers cannot influence this cost by reducing their energy usage. Ofgem told us that it was examining the impact on different groups of vulnerable customers of spreading the cost of supplier failures across the standing charge and the volumetric charge. It explained that it was also working closely with government on the package of support available to customers.[50] In May 2022, as part of its package of measures to help households during the cost of living crisis, the Government announced that all UK energy customers would receive £400 of support with their energy bills from October 2022 through an expansion of the Energy Bills Support scheme.[51] We asked the Department how it would ensure that this support reached the customers it was intended to help, particularly those with prepayment meters. The Department told us that "a large fraction" of customers who use prepayment meters would receive the payment automatically and that it would adopt this approach this where possible. It told us that where this was not possible, it had worked through what the right option would be to ensure that customers still benefited from the support available, including whether to use vouchers similar to those used in other schemes for customers on prepayment meters. It explained that it thought that it had a wide enough range of options to ensure that all prepayment customers to access the same benefit as others.[52]

22. We also asked the Department how it would ensure that customers still benefited if they were not the direct billpayers, for example those who live in park homes or in rented accommodation where the rent included bills. The Department recognised that this was an issue that it needed to address, and that it had included some possible solutions as part of its consultation on the scheme. But it noted that the customers affected represented less than 1% of the market, and that it had a solution for ensuring that 99% of customers were able to benefit from the scheme. The Department committed to using all the levers available to it to make sure that customers were able to benefit from the support available to them, but that "we have to be realistic: we may not be able to guarantee that in every single case". It told us that if it could not ensure that all customers received and all landlords passed on the £400 benefit then it would consider how to provide support for "the most-difficult-to-access-groups" through one of the other types of support available, such as the Household Support Fund.[53]

48 Qq 15–16, 21
49 Q 53; Department for Business, Energy & Industrial Strategy, Guidance: Heat networks, Updated 11 April 2022
50 Q 9; C&AG's Report, para 2.6
51 GOV.UK, *Millions of most vulnerable households will receive £1,200 of help with cost of living,* May 2022; GOV.UK, *Energy Bills Support Scheme explainer*
52 Qq 9–10
53 Qq 9–11

The future of the energy retail market

23. The UK government aims to reduce greenhouse gas emissions to achieve net zero emissions by 2050.[54] In April 2022, the Government set out its plans to reduce the UK's vulnerability to international oil and gas prices, and accelerate the UK's progress to net zero, by reducing the UK's dependence on imported oil and gas and moving towards domestic sources of power, such as renewables.[55] The Department told us that this shift was the longer-term underlying solution to challenges relating to energy security. Ofgem also told us that it wanted a retail market that could cope in a world where the country has more renewables and more energy storage, and where it was asking customers to buy and sell energy in different ways, such as flexing the times they use electricity to match times when demand is lowest.[56] Overall Ofgem wanted to achieve: a fair price for energy for consumers; a resilient energy market; a low-cost transition to a net-zero; and an improvement in service standards for customers.[57]

24. The wholesale price of electricity is set by the cost of the type of power that most recently met the peak demand for energy. This means the wholesale price is often determined by the cost of gas even at times when renewables or other sources are generating large parts of the energy supply.[58] The Department told us that, as the UK invests in more renewables and nuclear, more power will be generated by technologies with high construction costs relative to low running costs, in contrast to gas-fired power. We asked about the Department's plans to reform the market in response to these changing dynamics, including how it will uncouple the cost of electricity and the price of gas to enable consumers to benefit from greater proportions of the generating mix coming from low-cost renewables. The Department told us there was a question about how market arrangements should evolve as the UK moves to a "renewables-centric" system so that there is an operable system in place where customers pay the proper cost of production. It was looking at the appropriate market arrangements for electricity and intended to publish a consultation shortly. We also asked the Department how it intended to manage and maintain investment in the energy market whilst potentially changing the way the market operates. The Department told us that consulting with industry and investors was a critical part of developing its revised electricity market arrangements.[59]

25. In July 2021, the Department published its Energy Retail Market Strategy for the 2020s, which set out its vision for a retail market which enabled net zero. In December 2021 the Department announced it needed to refresh the strategy to take account of the lessons from recent months and launched a call for evidence with the aim of publishing a new strategy once the market had stabilised.[60] The Department told us that in order to deliver net zero, it needed to ensure the energy system supported innovation whilst balancing resilience, flexibility and cost. We therefore asked the Department and Ofgem how they intended to manage the transition towards renewable energy sources.[61] Ofgem recognised that it would be important to consider how best to influence changes in customer behaviour. It explained that, for example, people would need to be rewarded for

54 Department for Business, Energy & Industrial Strategy, *Net Zero Strategy: Build Back Greener*, October 2021
55 Department for Business, Energy & Industrial Strategy, *British Energy Security Strategy*, April 2022
56 Qq 61–62, 99
57 Q 102
58 C&AG's Report, Figure 1; Ofgem, What drives wholesale electricity prices in Britain?, 15 July 2016
59 Qq 96, 99
60 C&AG's Report, para 3.17
61 Qq 2–4, 61, 99

being willing to charge their electric vehicles at different times, such as when the wind is blowing or when demand is low. It committed to working with the Department in addressing this issue. Ofgem also told us that in the future customers are likely to use and be charged for energy differently, for example through more flexible tariffs, and that this might require different forms of pricing regulation.[62]

62 Qq 61, 99

Formal minutes

Monday 31 October 2022

Members present:

Sir Geoffrey-Clifton Brown

Olivia Blake

Dan Carden

Mr Jonathan Djanogly

Mr Mark Francois

Mr Louie French

Kate Green

Anne Marie Morris

Nick Smith

Regulation of energy suppliers

Draft Report (*Regulation of energy suppliers*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 25 read and agreed to.

Summary agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Resolved, That the Report be the Twenty-fifth of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Adjournment

Adjourned till Thursday 3 November at 9.30am

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Monday 11 July 2022

Sarah Munby, Permanent Secretary, Department for Business, Energy and Industrial Strategy; **Joanna Whittington**, Director General, Department for Business, Energy and Industrial Strategy; **Jonathan Brearley**, Chief Executive, Ofgem; **Neil Lawrence**, Director of Retail, Ofgem Q1–103

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

RES numbers are generated by the evidence processing system and so may not be complete.

1 Centrica plc (RES0007)

2 Citizens Advice (RES0006)

3 E.ON (RES0005)

4 EDF (RES0009)

5 Energy UK (RES0010)

6 Green Energy UK (RES0001)

7 Octopus Energy (RES0004)

8 Ombudsman Services (RES0003)

9 SSE Energy Solutions (RES0002)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the publications page of the Committee's website.

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