

Written evidence submitted by ScottishPower (EPM0029)

Business, Energy and Industrial Strategy Select Committee

Energy pricing and the future of the Energy Market inquiry

Written Evidence from ScottishPower

Introduction

1. ScottishPower is a major UK energy company with renewable generation, retail supply and networks businesses; we are a leading developer of wind power in the UK, and part of the Iberdrola Group, the world's leading renewables developer. Iberdrola is a global leader in tackling climate change, with a commitment to reaching carbon neutrality by 2050. ScottishPower is the UK's first 100% green vertically integrated energy utility, generating 100% renewable electricity, and we are committed to supporting our 4.5 million plus gas and electricity retail customers to make greener choices as part of the journey to Net Zero.
2. We welcome the opportunity to share our perspective on the issues raised by this Inquiry. There are obviously pressing cost of living pressures facing consumers with the recent upward trajectory in gas prices to be reflected in the next period for the Default Tariff Cap, and Government is rightly working closely with Ofgem on ways of addressing this in the near term. However, we seek to take a longer-term perspective in our response to this Call for Evidence.
3. First, we set out some thoughts around weaknesses in the regulatory framework which have contributed towards the current crisis in the energy retail market; second, we share some perspectives on how the focus of regulation should change in the medium-term; third, we note the urgent need for reform of the price cap methodology; and, fourth, we set out some steps that Ofgem and the Government might take longer-term to develop an effective regulatory framework that works for consumers and helps to facilitate the transition towards a smarter low carbon energy system, whilst ensuring that vulnerable consumers are properly protected.

(1) The contribution of weaknesses in the regulatory framework towards the current energy retail market crisis

4. Over the past decade, dozens of new energy retail suppliers have entered the market with insufficient oversight under the regulatory regime. As is noted in the recent report from Citizens Advice, Market Meltdown¹, many of the newer entrants had **unsustainable business models** (financed by debt and customer credit) combined with inadequate hedging strategies for the long-term.
5. With so many new entrant suppliers entering the GB energy retail market over the last few years, with ill-thought-out loss leading strategies and insufficient financial resilience, it was entirely predictable that there would be a further spate of insolvencies with the onset of sharp

¹ [Market Meltdown Citizens Advice](#)

increases in global gas prices. We consider that this situation was in effect facilitated by such new entrants not being subject to sufficient regulatory scrutiny by the regulator both upon entry to the market and on an ongoing basis. In turn, the rigidity of the framework created by the price cap regulation has served to exacerbate the impacts of the increase in global gas prices so that over time the stresses are having significant negative impacts across the entire energy market.

(2) Developing a more effective regulatory and policy framework

6. With its Supplier Licensing Review in 2019/20, Ofgem started to recognise some of the retail market risks associated with the lack of financial resilience of some market entrants and began to tighten requirements for new entrants. However, these reforms came too late, whilst in many respects they were not sufficient to address the weaknesses in the existing regulatory framework. For example, **insufficient steps were taken** to introduce prescriptive requirements to ensure adequate protection of consumer credit balances or of sums needed to meet supplier obligations such as payments under the Renewables Obligation scheme. Indeed, this is an area that still requires further attention from Ofgem and the Government.
7. We would also note that this failure to put in place an effective monitoring and oversight regime of the supply market went hand in hand in recent years with **a narrow focus on switching levels** as the key measure of a healthy and successful energy retail market. This focus on switching was apparent in the launch by BEIS last July of a long and detailed consultation on new and complex reform options intended to promote forms of so-called 'opt-in' and 'opt-out' switching. This consultation was launched just as the energy crisis was getting underway with the steady progression of small suppliers entering insolvency, thereby leaving their customers to be picked up by suppliers that they had had no part in choosing and with the associated costs of this Supplier of Last Resort process having to be met by consumers across the market.
8. That there was so much focus on these switching workstreams at this point in time, rather than on taking steps to address the pressing issue of a weak market oversight regime, would seem to be indicative of a regulatory failing that had been some years in the making. We, therefore, welcome the announcement last December by BEIS that the Department would pause policy development on the consultation on opt-in and opt-out switching whilst reassessing its strategic approach towards the energy retail market with a greater focus on market resilience and sustainability.
9. We do not consider that a simple focus on switching levels is the best way of assessing longer-term market competitiveness and health. For instance, ease of switching and the ability of consumers to access and understand information about their existing supplier tariff and other offers are key aspects of a healthy competitive market. Indeed, attributes such as a smooth switching process, clear customer information and transparency are vital to ensuring that customers are properly served. They will also be important in driving innovation across the market in a way that helps consumers to make choices that work for them on a pathway towards a low carbon energy system. A particular example relates to the need for greater transparency around green tariff offerings from different suppliers, recognising that this has

been an area of significant recent growth and is indicative of the important trend towards consumers wanting to engage with **meeting the Net Zero challenge**.

10. For a successful transition towards a smarter low carbon energy system with greater electrification and flexible/responsive energy usage, **supporting consumers in their choices** in adopting new technologies such as electric vehicles and heat pumps will be important. Energy suppliers will be at the front line of this consumer engagement, supporting customers to decarbonise their homes and transportation and use energy more flexibly. This focus on the consumer experience will be key to realising the benefits of a smarter energy system where consumers might make savings by being flexible with their usage, facilitated by the use of smart chargers, smart appliances, solar PV, in-home storage devices and vehicle-to-grid options associated with electric vehicles.
11. It will be essential that the energy retail sector, the Government and Ofgem work together to facilitate this consumer engagement on the journey towards meeting the Net Zero challenge. It is therefore more important than ever that consumer experience is a key focus for regulation and policy. By enforcing high standards of customer service and billing, Ofgem can promote positive consumer outcomes. It is also important to **address sources of consumer confusion and mistrust**, for instance, 'greenwashing' of energy tariffs and limited transparency from unregulated third-party intermediaries.
12. In the meantime, there are clearly immediate cost of living pressures facing consumers with the scale of the recent increase in gas prices and Government is rightly working closely with Ofgem on ways of addressing this in the near term, especially in terms of the challenges for low income, vulnerable consumers. Moreover, in the longer-term there are likely to be ongoing affordability challenges for a significant group of consumers in vulnerable circumstances, including looking towards a market beyond the price cap. We therefore consider that policy will need to be focussed on providing **effective targeted support to such vulnerable consumers** over the long-term.

(3) The functioning and performance of the 'energy price cap'

13. We welcome Ofgem's recent recognition of the urgent need to reform the price cap methodology. The default tariff cap, in combination with recent market volatility, is putting supplier finances under unprecedented strain; it therefore requires significant reform in the near term. The cap methodology must be reformed to ensure that energy suppliers can **properly recover the costs of supplying energy**, including in volatile wholesale markets.
14. In this regard, we welcome Ofgem's consideration of alternative methodologies for the wholesale cost allowance that might make it more responsive to market movements and with less of a time lag. To further mitigate the distorting effects of the current price cap, we believe Ofgem should change the nature of default tariffs from standard variable tariffs (SVTs) to fixed term fixed price tariffs (referred to as option 3, in Ofgem's December 2021 consultation²). This

option would help to mitigate the risk that price cap regulation introduces into the energy retail market.

15. Longer-term, we would note that there will be continuing challenges with a marketwide retail price cap which are intrinsic to this kind of regulatory intervention. Thus, it will always be difficult for Ofgem to accurately estimate efficient costs that should be recovered through the cap, and to strike an appropriate balance between smoothing of consumer bills and ensuring cost reflectivity in volatile markets. More generally, the presence of a cap is likely to weaken competition and act as a disincentive to market entry and innovation in the long run.

(4) Longer-term reforms of the regulatory and policy framework during the Net Zero transition

16. In the longer-term, we need a regulatory framework which balances prescription with a more principles-based and intelligent approach to regulation. Ofgem needs to take a more risk-based approach to ensuring financial resilience, focusing its scrutiny on suppliers who are at the greatest risk of insolvency, and giving further consideration to setting minimum capitalisation requirements.
17. In terms of the ongoing affordability challenges for those on low incomes and in vulnerable circumstances as mentioned above, and with a view to moving over time beyond rigid marketwide price regulation, we consider that one option that merits further consideration by Government and Ofgem is **a social tariff targeted at those on low incomes** and in vulnerable circumstances. We recognise that the design of this may not be straightforward: for example, a levelisation mechanism would be required to balance out costs between suppliers with different proportions of eligible customers. However, we consider that this kind of option offers the prospect of providing a targeted, long-term and sustainable approach towards helping those in vulnerable circumstances.
18. On the policy side, it is important that the Government progresses with its commitment to removing the supplier size-based exemption under the Warm Home Discount (WHD) and Energy Company Obligation (ECO) schemes. As was recognised in the Energy White Paper, the exemptions to these schemes create **a significant distortion in the energy retail market** that needs addressing, thereby establishing a level competitive playing field. Longer-term, we continue to support the funding of such energy efficiency and social schemes from government spending rather than from consumers' bills, which has a regressive impact. This clearly makes sense given that the underlying rationale of these schemes is to provide help and support to those at risk of fuel poverty.
19. In addition, it will be important that the Government maintains progress in meeting policy milestones under its delivery plan for promoting the uptake of electric vehicles, and in taking forward work under the recently published Heat and Buildings Strategy. This is essential to promoting the timely uptake of electric vehicles and of heat pump options, over time, thereby supporting the shift towards a smarter low carbon energy system.

Conclusion

20. In conclusion, we welcome this Inquiry as presenting a timely opportunity for exploring with policy-makers and the regulator lessons that might be learned from the operation of the energy retail market in recent years, whilst helping to scope out a strategy for the future in a way that is consistent with making progress towards meeting the Net Zero challenge. We are committed to contributing constructively to this debate, as well playing our part in supporting our customers in making greener choices in the context of the Net Zero transition, whilst ensuring that the vulnerable are protected.

ScottishPower

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