

Dr David Deller and Professor Catherine Waddams- Written evidence (ONZ0005)

Consultation response from the Centre for Competition Policy

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This consultation response has been drafted by the named academic member(s) of the Centre, who retain(s) responsibility for its content.

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Centre for Competition Policy response to the House of Lords' Industry and Regulators Committee call for evidence on 'Ofgem and net zero'

1. We welcome the opportunity to provide evidence to the Committee's inquiry into 'Ofgem and net zero'. We respond only to those questions where we can offer evidence and expertise.

Q2. How well does Ofgem balance environmental objectives against its responsibilities in relation to affordability for consumers?

2. Rather than commenting on Ofgem's existing performance, we note that tensions between environmental objectives and affordability are likely to grow sharper as the investments required to transition to net zero occur. This tension is likely to be the focus of heated political debate. Evidence in Deller and Waddams Price (2018)¹ highlights why the affordability of energy is politically salient, since it forms a significant share of low-income households' total expenditure (much higher on average than for wealthier households). A substantial increase in energy bills (both in nominal and real terms) has occurred in the last two decades, and has generated considerable political debate, particularly following the preceding decades of falling real energy prices (even though it simply returned bills to roughly the levels seen in the 1980s and early 1990s). Further increases in energy bills, linked to the energy transition, are therefore likely to attract political attention and could lead to hardship for certain (often low income) households, if suitable mitigation measures are not put in place. As noted in Waddams' oral evidence to the committee on 29th June 2021, the debate here could be framed in terms of duties to citizens (achieving net zero) and to consumers (affordable energy bills).

3. At the heart of any trade-off between the environment and affordability is a myriad of value and distributional judgements, including: the weight placed on future vs current generations; determining which households do and do not warrant affordability support; and how the costs of grid upgrades and obsolete domestic equipment, such as boilers, should be spread across consumers. In general, it seems to be more appropriate for elected politicians to take distributional decisions with technocratic regulators providing high-quality evidence to feed into these decisions and implementing actions in keeping with parliament's choices. The challenges to such allocation of responsibilities are discussed in our response to questions 7.

¹ Deller, D. and C. Waddams Price, 2018. (eds). Fairness in Retail Energy Markets? Evidence from the UK. See [Chapter 2 | A Long-Term View of Energy Affordability and its Political Salience](#)

4. Ofgem could be placed in an increasingly difficult position if government attempts to shift responsibility onto the regulator for unpopular decisions/outcomes lead either to increased bills or missing climate change targets. This risk is heightened by the timing of government decisions around climate change: ambitious climate change targets have been introduced ahead of households experiencing (or even being clearly notified about) the financial costs of meeting these commitments. As such, the most intense debates around meeting climate change targets are probably still to occur and, when they may provide incentives for government to divert criticism towards bodies with a role in delivering its policies, rather than being open about the implications of prior decisions.

5. Liu and Waddams Price (2019) explore some of the ways that charges for distribution costs might be levied on different groups of consumers, which emphasises how the burden falls on different types of household according to the methodology used. Ofgem has been engaging positively with the debates around how moving to net zero will result both in expenses for new systems and stranded assets from inherited infrastructure and how these costs should most appropriately be met.

Q5. Is Ofgem’s current system of price controls appropriate? Does it provide sufficient incentives to invest in the context of the transition to net zero?

6. The current mixture of price control within a competitive market involves inevitable trade-offs, as demonstrated by the current levels of concern over rising levels of the price caps. This may be as important in affecting the expectations of both suppliers and consumers as in the direct incentives that the process itself provides. As costs rise, the government may need to be clearer about its own trade-offs between protecting consumers and competitive markets (see our response to the consultation on introduction of the price cap²). Prices in the domestic market under the cap have been largely driven by wholesale and policy costs.

Given potential perceived conflict between protection of consumers and the benefits of a competitive market we welcome the exploration of new arrangements for Ofgem’s role, in particular through opt-in and opt-out auctions on which BEIS is currently consulting and which can build on encouraging results from Ofgem’s own field experiments in this area. Our own research on the energy market makes us doubtful that competition can be effectively stimulated by consumer action alone³, and we are more confident that opt-out auctions, or competition for the market, can combine the benefits of both competitive pressure and consumer

² Deller et al. (2017b)

³ See Waddams Price and Zhu (2016), Flores and Waddams Price (2018), Deller et al (2021) for analyses of consumer switching behaviour.

protection. For a survey and discussion on some of the experience, benefits and challenges see Deller et al (2017a).

7. Incentives to private homeowners may also need to be balanced with equity considerations. For example, highly effective feed-in tariffs have encouraged home owners to invest in photo voltaic cells, but have left the burden of meeting the costs of the legacy system to fall on those unable or unwilling to make such investment. Since the latter group are likely to include a disproportionate number of households who may be struggling to meet their household bills (for example those who rent rather than own their homes, or have insufficient capital for the initial investment), effective incentives are likely, by their nature, to be distributionally regressive (see Liu and Waddams Price, 2019).

Q 7. Are Ofgem’s duties and powers appropriate and sufficiently clearly defined? Do Ofgem’s objectives conflict and, if so, how should any conflicts be managed?

8. Parliamentary Committees and government reviews⁴ have emphasised the importance of regulators being:

- i) assigned a clear statutory remit;
- ii) issued a clear steer on prioritising their duties; and
- iii) protected from deciding political issues (see Deller and Waddams Price, 2018).

9. Despite these exhortations, duties have moved beyond pure economic regulation to incorporate expanded social and environment objectives. Figure 1 (see page 4) illustrates that since the 1986 Gas Act, there have been 20 pieces of amending legislation, 8 of which have been substantive changes to the content and presentation of the duties of the gas regulator⁵.

10. A greater number and complexity of duties transfers ambiguities around prioritisation from government to regulator by raising potential for conflicts between duties. The lack of clarity both gives the regulators themselves considerable responsibility and freedom for balancing different objectives, and leaves them open to public and political interference by those who disagree with the balance chosen. These ambiguities increase the need for detailed government-regulator communication, which can provide more opportunity for government to pressurise the regulator, undermining regulatory independence. CCP research⁶ with interviewees in the regulatory community noted that the proliferation of duties had made it more difficult to pursue any one of them successfully.

11. For effective policy design and implementation, government needs to be explicit in prioritising objectives where there are trade-offs between them. However, based on past and current behaviour by governments, reluctance to take on the burden of hard policy choices, or provide greater clarity when there are conflicts in policy aims, could further obfuscate the defined role of the regulator. For instance, trying to simultaneously tackle

⁴ For instance, the House of Lords Select Committee on regulators (2007) noted that “government should be careful not to offload political policy issues onto unelected regulators” (paragraph 3.13, p25)

<https://publications.parliament.uk/pa/ld200607/ldselect/ldrgltrs/189/18902.htm>; see also BIS, 2011.

<https://www.gov.uk/government/publications/principles-for-economic-regulation>

⁵ See Chapter 3, Deller, D. and Waddams Price. C (eds.) (2018). The relevant research was undertaken by Prof. Michael Harker and Dr. David Reader, and further details can be found at Harker (2019) and Harker and Reader (2022). The latest version of this diagram, plus companion diagrams for the water and telecoms sectors, is contained in National Infrastructure Commission, ‘Technical annex: Duties diagrams for water, energy and telecoms – Centre for Competition Policy’, Regulation Study, available at:

<https://www.nic.org.uk/publications/technical-annex-duties-diagrams-for-water-energy-and-telecoms-centre-for-competition-policy/>

⁶ Deller, D. and Waddams Price. C (eds.) (2018)

social justice issues (such as fuel poverty) with environmental concerns (increasing reliance on renewables) can be difficult if encouraging renewable energy raises bills.

12. The 2007 Lords report into economic regulators⁷ and the 2011 BIS 'Principles for Economic Regulation'⁸ provide a good basis for undertaking a wide ranging 'simplification' of regulators' duties. This overall review of Ofgem's statutory duties would be particularly desirable if there is a push to have the alignment of policies with government's net zero objectives introduced as a new statutory duty. Simplifying Ofgem's statutory duties could produce numerous benefits, including:

- (a) reducing potential conflicts between duties and thereby alleviating the need for potentially arbitrary value judgements when trading-off duties;
- (b) greater consistency and predictability in the decision-making process to the benefit of market participants and potential investors;
- (c) reducing the risk of regulatory effectiveness being diluted by the pursuit of "too many" duties;⁹
- (d) identifying, and encouraging where appropriate, the role of competition as a driver of consumer benefits;
- (e) greater uniformity between regulatory assessments, allowing for more effective cooperation between regulators in different sectors, and
- (f) an opportunity to recast the duties so they are more representative of the modern-day challenges faced by consumers, markets and the environment.

Q8. Is Ofgem's relationship to Government and Parliament appropriate? Are there issues related to the split of responsibilities, transparency or accountability

13. In responding to this question we direct the reader to our responses to questions 2 and 7. The central concern is the incentives for government to shift responsibility (or at least the blame) for unpopular policy decisions involving trade-offs onto unelected regulators.

⁷ See House of Lords: Select Committee on Regulators, 2007. UK Economic Regulators, Volume I: Report, 1st Report of Session 200607, HL Paper 189-I, available at:

<https://publications.parliament.uk/pa/ld200607/ldselect/ldrgltrs/189/189i.pdf>

⁸ Department of Business, Innovation and Skills (BIS), 2011. Principles for Economic Regulation, April 2011, London, available at:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31623/11-795-principlesfor-economic-regulation.pdf

⁹ This was a prevailing view among interviewees, who suggested that the proliferation of regulatory objectives had made it more difficult to pursue any one of them successfully.

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Figure 1: The Evolution of the GB energy regulator's general duties in respect of gas

