OFFICIAL REPORT
AITHISG OIFIGEIL

# Net Zero, Energy and Transport Committee

**Tuesday 10 May 2022**

Session 6

The Scottish Parliament
Pàrlamaid na h-Alba

# Tuesday 10 May 2022

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## NET ZERO, ENERGY AND TRANSPORT COMMITTEE

**15th Meeting 2022, Session 6**

**CONVENER**

*Dean Lockhart (Mid Scotland and Fife) (Con)

**DEPUTY CONVENER**

*Fiona Hyslop (Linlithgow) (SNP)

**COMMITTEE MEMBERS**

Natalie Don (Renfrewshire North and West) (SNP)
*Jackie Dunbar (Aberdeen Donside) (SNP)
*Liam Kerr (North East Scotland) (Con)
*Monica Lennon (Central Scotland) (Lab)
*Mark Ruskell (Mid Scotland and Fife) (Green)

*attended

**THE FOLLOWING ALSO PARTICIPATED:**

Neil Kenward (Office of Gas and Electricity Markets)
Neil Lawrence (Office of Gas and Electricity Markets)
Elena Whitham (Carrick, Cumnock and Doon Valley) (SNP) (Committee Substitute)

**CLERK TO THE COMMITTEE**

Peter McGrath

**LOCATION**

Committee Room 2

# Scottish Parliament

## Net Zero, Energy and Transport Committee

*Tuesday 10 May 2022*

*[The Convener opened the meeting at 09:31]*

## Decision on Taking Business in Private

**The Convener (Dean Lockhart):** Good morning, everyone, and welcome to the 15th meeting in 2022 of the Net Zero, Energy and Transport Committee. We have received apologies from Natalie Don; Elena Whitham joins us as her substitute. Good morning, Elena. Do you have any relevant interests to declare?

**Elena Whitham (Carrick, Cumnock and Doon Valley) (SNP):** I have nothing to declare, convener.

**The Convener:** Thank you very much.

Under agenda item 1, we will consider whether to take in private item 3, which is consideration of the evidence that we will hear this morning. Do members agree to take item 3 in private?

**Members** *indicated agreement.*

## Energy Price Rises

09:32

**The Convener:** Our next agenda item is an evidence session in our inquiry into the significant increase in energy prices that we have all witnessed in recent months, what is driving the increase, the impact that it is having and what can be done to alleviate the worst impacts of increasing energy prices.

I am pleased to welcome our witnesses from the Office of Gas and Electricity Markets. Neil Kenward is the director of strategy and decarbonisation, and Neil Lawrence is the director of retail. Thank you very much for joining us.

We have allocated about 75 minutes for the session. I believe that Neil Lawrence would like to make a brief opening statement.

**Neil Lawrence (Office of Gas and Electricity Markets):** Thank you very much.

As the energy regulator, Ofgem's job is to protect the interests of energy consumers, and we know that many consumers in Scotland and across Great Britain are finding the cost of living increases very tough. I spend a great deal of time with consumer groups, charities and customers, so I am very aware of the pressure that everybody is under.

Wholesale gas prices across Europe and Asia have been extraordinarily volatile and have risen to unprecedented levels over the past year, which has put global energy markets under severe pressure. As a consequence, there has been a significant rise in consumer bills in Great Britain. The price cap increased by almost £700 in April for approximately 22 million customers, and a further price rise is expected in October. Many suppliers simply could not cope with such a sustained price shock; 28 suppliers have exited the market since August.

Throughout the crisis, Ofgem has worked to protect consumer interests. Our safety net has protected more than 4 million customers and has ensured that, when a customer's supplier fails, they are kept on supply and their household credit balances are honoured. The price cap has also meant that customers who are on their supplier's standard variable or default tariff have been protected against an instant price rise.

We need a retail market that will be more robust in relation to such volatility in the future. We are therefore making two very important changes to our regulatory framework. First, companies were not resilient enough, so financial regulation needs to be significantly enhanced. We are already implementing tougher and tighter financial regulation, with greater oversight, in the retail market.

Secondly, although the price cap has protected consumers from unfair price rises, it needs to be more adaptable to rapidly changing market conditions. We are therefore reforming the price cap to make it more flexible, although it will still retain the benefits of protection for consumers.

In all this, our priority has been, and remains, to act in the best interests of energy consumers. We accept that there are lessons that need to be—and have been—learned from the crisis. Earlier this year, our board commissioned an independent review into the root causes of the recent supplier failures—specifically, into the part that regulation of the energy industry had played. We published the report last week, and we accept its recommendations, many of which are already being implemented. We will ensure that all recommendations are implemented in order to further strengthen our regulatory regime.

I will end on a more optimistic note. My colleagues and I have spent a great deal of time in the past few months with many retail and consumer groups. It is clear that, through closer dialogue and closer working relationships, we are addressing the challenges that customers face. That closer working relationship between the regulator, retailers and customers is key to building what we need in the long term, which is a resilient, competitive and dynamic energy retail sector that is fit to support the transition to net zero.

We look forward to discussing those important issues with the committee and to answering questions.

**The Convener:** Thank you for those opening remarks, which set the scene very well. We move on to questions and answers; I will ask a couple of questions before I bring in other colleagues.

In your opening remarks, you mentioned that Ofgem will introduce new measures to boost financial resilience in the sector, including financial stress testing for all suppliers and increasing the number of times a year that the price cap can be adjusted. What is the timescale for implementing those new measures? Evidence that has been given to the committee by other stakeholders suggests that the price cap will have to be increased between now and the winter season later this year. Can you talk us through your expectations for the price cap increases that we might see over the next six to 12 months?

**Neil Lawrence:** Ofgem absolutely recognises that the price rises that we have seen are having a huge impact on consumers, and we really care about that. Our job is to make sure that we pass on a fair price for energy and that suppliers are able to charge that fair price to consumers.

We do not comment or speculate on future price rises more than to say what I have already said, which is that we expect prices to rise. Prices are driven by wholesale markets, in the main. Those markets are very uncertain; we are in the middle of an observation window, so we will not comment on where the price rises are expected to go in October.

As you rightly pointed out, convener, we are taking a number of steps to ensure that the market is more financially resilient. We did a lot of work in 2019 to bring in measures around financial resilience and fit and proper operational capability. All that was aimed at strengthening the market and had a really good effect. However, we recognise that we need to go further to make the market more resilient.

The financial resilience measures that we are talking about now are around capital advocacy, protecting credit balances further and making sure that we protect customers, moving forward. We are bringing in those changes at pace. We started on the process last October and we expect to complete the work later this year.

**The Convener:** You also mentioned in your opening remarks that around 30 energy supplier companies have failed and have had to close shop since early 2021. I believe that the supplier of last resort—SOLR—process has added £2.8 billion to consumer bills, which is on top of the increasing wholesale costs. That has affected around 4.3 million domestic customers. As you will know, many of the failed energy suppliers did not hedge their exposure to wholesale prices and were taking massive speculative risks that are not taken in other sectors. Do you recognise that Ofgem's previous regulatory approach, which allowed that market risk and lack of hedging, now looks to have been inadequate?

**Neil Lawrence:** First, we must recognise that we have seen absolutely unprecedented rises in wholesale prices: they are 500 per cent more than they were last year. That is truly unprecedented, and it is a global issue.

Ofgem had taken a number of steps to make sure that the market was more resilient. Throughout the Covid pandemic, we had a range of monitoring regimes to look at supplier finances and their hedging levels. In early 2021, we introduced tougher regimes to try to make sure that we could monitor suppliers and take action, where necessary. We have gone further with the proposals in our latest financial resilience measures to make sure that we are fully across suppliers. When they do not have the level of capital that they need, and if they choose not to hedge, we will take action.

It is important that the committee understands that we have robust monitoring regimes in place. Weekly, we receive and review financial reports from all the suppliers in the market, as well as data on their hedging levels. We keep a really close eye on those things.

It is also important to understand that it is not our job, as a regulator, to choose the risk management position that a business takes—that is up to them—but we need to make sure that if a business takes a position that involves risk, it has capital adequacy to withstand shocks. That is what a lot of the financial regulation changes that we are making will do, which will protect customers in the long run. Rest assured that we do not ever want such a number of suppliers as exited the market in the past 12 months to do so again in a year. We recognise that that has had an impact on consumers.

**The Convener:** In the banking sector, for example, the Financial Conduct Authority imposes market-risk and capital-adequacy limitations. I know that hindsight is a wonderful thing, but do you think that those capital adequacy and risk buffers should have been in place 24 months ago for new suppliers coming into the market?

**Neil Lawrence:** The number of suppliers that are coming into the market has dropped dramatically. There were only two new entrants in 2021, and one of those was a pre-accredited supplier. The measures that we already had in place were making sure that suppliers that entered the market had a robust and fit business model in order to succeed in the market. We have very robust checks across “fit and proper” criteria, financial projections and customer service plans for new entrants to the market. That is to ensure that we feel that they will be able to operate, deliver value to customers and avoid the cost of exit. When suppliers do not meet the thresholds, we do not let them in. We have refused licence applications over the course of the past 12 months.

**The Convener:** The supplier of last resort process has added £2.8 billion to consumer bills. How has that been spread to the average consumer’s bill? Do you have a number on what each domestic consumer will have to contribute in their bills towards the cost of that process?

**Neil Lawrence:** The cost from the SOLRs to date is £68 per consumer. We must accept that that is absolutely unprecedented. The wholesale price rises last August, September and October were truly unprecedented, which presented a real struggle for many suppliers, and we were not expecting that. Those costs are passed on through the SOLR mechanism, which is the safety net. We must remember that we protected consumer balances and managed to transfer over 4 million customers to new suppliers so that they did not lose supply and continued to receive the essential service that they needed.

In the future, the SOLR cost will rise. It does not include all the costs that suppliers will claim through our process, so there will be additional costs later this year. Of course, there are the costs of the Bulb Energy Ltd administration, which is a matter for the Government—we are not in control of that.

**The Convener:** I am sure that other members will want to come back to some of those issues. I will bring in Fiona Hyslop.

**Fiona Hyslop (Linlithgow) (SNP):** Good morning, and thank you for joining us.

We have a cost of living crisis that is being made worse by an energy crisis, but we also have a climate crisis. My questions will be directed to Neil Kenward, because we want to address the potential tensions between the immediate issues and the transition to net zero, if there are any. What reforms need to be made—they might be in the longer term—so that we have an energy supply sector that can protect consumer interests, but also ensure that we can transition to net zero? What would success look like?

09:45

**Neil Kenward (Office of Gas and Electricity Markets):** You have put your finger on the really important long-term aim, which is to achieve the transition to net zero, ensure that it happens smoothly and in the interests of consumers, and keep the costs of the transition down. Even before the big surge in gas prices, we were seeing that some forms of renewable power had become cheaper than gas-generated electricity. We were already seeing the structural move to a point at which decarbonisation can reduce costs for consumers. With gas prices as they are now, the low-carbon transition is not in conflict with a lower-cost system. Going faster on that transition will actually help to bring costs for consumers down faster.

Ofgem stands ready to support that. Through our regulatory regimes, we help to ensure that the infrastructure is built to allow the low-carbon transition to occur, and that it is built at low cost to consumers, through things such as our regulatory asset value regime and network regulations.

I observe that, if you put all the environmental schemes and subsidies together, their total cost per consumer, although it is not insignificant, is just over £130 annually in the current price cap period. That is less than it was in the previous price cap period. That is because renewable generation is increasingly on fixed-price contracts, which means that when the price in the market is high—driven by the gas price—those contracts actually pay back to consumers. We are in a situation now in which the costs of decarbonisation are helping to bring down the cost of bills for consumers.

**Fiona Hyslop:** You will know that, in Scotland, we have an extensive range of renewable assets in generation, and we export much of our renewable electricity. However, your regime is tailored to the United Kingdom market as a whole, so clearly there are inhibitors for the expansion to net zero energy production in Scotland. Not least of those are the exorbitant transmission costs and the danger that, even under the new regimes that might be coming, the subsidy will go to the consumer bases rather than to the generation of energy.

What can be done to ensure that Scotland can contribute to net zero by powering ahead with renewables? What might have to happen in a UK market regime to enable that to happen, and what changes would you see—in transmission charges, in particular?

**Neil Kenward:** Our commitment is to getting the net zero transition happening at the lowest cost to consumers. We try to establish rules and the incentives that will ensure that there is a low-cost system overall. The transmission charges are set up in that way. They are meant to incentivise new generation in locations that are closest to the main centres of demand, which is why transmission charges vary for different parts of the country.

Of course, there are ways in which we are helping to facilitate new infrastructure investment to enable growth in the amount of renewable energy. Obviously, the potential for renewable power in Scotland is vast. The system operator—National Grid—is developing new network plans. Those strategic plans will help to facilitate more transmission capacity to get low-carbon power from Scotland down to England when there is a surplus north of the border. That long-term structure is really important for making sure that increased capacity is built. When it is, we will have an efficient system across Great Britain.

**Fiona Hyslop:** Do you acknowledge that National Grid's plans still penalise Scotland, and that we have people living in fuel poverty in the part of the United Kingdom that generates the most energy, in terms of both renewable energy and oil and gas? Is that not wrong?

**Neil Kenward:** Fuel poverty is a problem across GB. As my colleague has been saying, we try to establish a least-cost system, but we do not have the ability to introduce new subsidies. For us, it is about fair prices across the whole of GB.

**Fiona Hyslop:** Are you saying that subsidy issues would be addressed by the UK Government in an energy market to deliver what you wanted?

**Neil Kenward:** That is right.

**Fiona Hyslop:** Bearing in mind the recent energy price spikes, is there a case for wholesale energy market reform? You have said that gas is the marginal generation technology and sets the price. What options are there? What major changes are needed? Obviously, as the regulator, you need the UK Government to instruct you as to what the changes will be, but what would you like them to be and what do you expect them to be? Bearing in mind the immediate issues that we face, do you envisage any steps being taken in the Queen's speech today to enable changes to happen?

**Neil Kenward:** We fully accept that we and the Governments need to look at the current energy market and ensure that it is reformed so that it is fit for the net zero future. It will be a very different energy system. As you will be fully aware, the growing dominance of renewables in the system changes the nature of the electricity market considerably. There will probably be surpluses of low-carbon power when the wind is blowing and the sun is shining but, obviously, we will have to use other sources when that is not the case.

Therefore, it is absolutely right that the Westminster Government looks at how the market operates and considers where reforms are necessary to ensure an efficient system. A few weeks ago, the Westminster Government announced that, as part of the energy security strategy, it is undertaking a review of the energy markets and will publish documents on that in the coming months. We in Ofgem are keen to work with the Westminster Government on that and ensure that the interests of consumers are fully protected in that consideration.

**Fiona Hyslop:** How long will that take? People are facing an energy price crisis now. Some of the changes that we need will require wholesale energy market reform. What would be the desirable timeframe for the wholesale energy market reform to start to make an impact?

**Neil Kenward:** As I am sure you appreciate, making major changes to wholesale markets—if that is what the Westminster Government chooses to do—is a process that is likely to take years, so it is important that Ofgem, the sector and Governments in Westminster, Holyrood and elsewhere take what steps they can to support consumers in the short run. The high prices that we see this year—as Mr Lawrence says, they will probably be higher still in the autumn—cannot be addressed by long-term reforms such as wholesale market reform.

**Fiona Hyslop:** I am sorry, convener, but I just want to say that there does not seem to be a sense of urgency. During the Covid pandemic, we saw whole-system changes because of a world emergency. I get a sense that the approach is to wait and see, and it might take some years.

What is Ofgem, as the regulator, trying to do to increase the pace, scale and impact of the changes and reforms?

**Neil Kenward:** We are taking steps to make sure that the system works effectively. We are supporting the creation of the new system operator to ensure that it can do the strategic planning and that we can make the changes that are needed. We are looking at how markets function to ensure that they are as efficient as possible. We are absolutely moving at pace but, inevitably, some of those major changes take time, particularly if they require legislation.

**The Convener:** Liam Kerr has a supplementary question.

**Liam Kerr (North East Scotland) (Con):** The deputy convener talked about transmission charges being higher for generators in Scotland, but does that not simply reflect the reality that demand is concentrated elsewhere, further away from where it is generated; that demand customers pay the overwhelming majority of TNUOS—transmission network use of system—charges; and that, therefore, actually, consumers in Scotland are paying a cheaper rate for their electricity than they otherwise would be if we had the market reforms that the deputy convener has outlined? Can you help the committee to understand that?

**Neil Kenward:** I will not speculate about potential reforms, but the transmission network charges are set up to incentivise the most efficient location of generation. As you rightly say, the greater demand is where the greater population is, which is in the south. Obviously, there are enormous low-carbon assets in Scotland, and getting more infrastructure built to get that low-carbon power down to England when it is demanded is absolutely fundamental to the network plans that the system operator is developing. From our perspective, we will try to ensure that the regulatory process can accelerate those investments and that they can come forward at least cost.

**The Convener:** That is great—thanks. Next up is Jackie Dunbar, to be followed by Monica Lennon. Over to you, please, Jackie.

**Jackie Dunbar (Aberdeen Donside) (SNP):** Good morning, gentlemen. I will follow what the deputy convener said about the cost of living crisis. I am interested in your thoughts on how that should be tackled in the short to medium term, without compromising the strategic emissions reduction goals. Maybe I will start with Mr Kenward—or would it be better to hear from Mr Lawrence?

**Neil Kenward:** We can both chip in. It is useful to point out some statistics. As I mentioned, the total cost of the environmental schemes and programmes has fallen from about £145 per household on an annualised basis to just over £130. In the same period, the cost of the wholesale market component has doubled from £500-something to more than £1,000. It is clear where the key cost drivers are coming from in the market.

As Mr Lawrence said, we as a regulator cannot tackle the affordability challenge—Governments must tackle that. However, we are requiring suppliers to take the actions that they can take to ensure that consumers who are struggling to pay their bills get financial advice and perhaps emergency credit. Individual suppliers have their own support schemes that are available to consumers who are in need. However, none of that will be sufficient to deal with the price rises that are coming.

**Neil Lawrence:** I will add a couple of words. We support the UK Government's £200 rebate scheme for households, which will make a difference this year. We will work hard to ensure that that is implemented, alongside the limited role that we have.

From a compliance perspective, we announced a series of market-wide compliance reviews to ensure that suppliers are looking after customers in the right way—that they have the right customer service standards and the right processes in place on vulnerability and affordability. We will take that role seriously. When we find that suppliers do not come up to scratch and are not setting the standards that we expect in the industry, we will take action.

Suppliers have a range of schemes available. Our advice to all consumers who are struggling with high bills is to contact their energy supplier in the first instance. Schemes such as fuel direct, winter fuel payments, the warm home discount and cold weather payments are available. As Neil Kenward said, suppliers will do a range of things to help.

We must recognise that these are absolutely unprecedented times. A lot of people are asking for support now, and the numbers will increase as we go through to next winter. Our role as the regulator is to ensure that suppliers are set up and resilient enough to cope with the increased demand and that they can service customers. Energy is an essential service and this really is serious stuff.

**Jackie Dunbar:** Will the measures that you have outlined be enough to ensure that the situation does not have a huge impact on achievement of the reduction goals that have been put in place? To balance out the position, will one aspect have to suffer rather than the other?

**Neil Kenward:** To clarify that, are you talking about the central tension between the decarbonisation goals and the—

**Jackie Dunbar:** We have the strategic emissions reduction goals. Will what is being put in place affect whether they are met?

**Neil Kenward:** In the UK and in Scotland, we have extremely ambitious decarbonisation goals. It is Ofgem's job to facilitate and help to deliver them at least cost to consumers. We do that in a number of ways. As I said, in a sense, I do not think that there is a tension between the short term and the long run. There is a short-term problem for all energy consumers in the UK and across Europe, but that should not stop us moving ahead at pace with the decarbonisation agenda, which is ultimately the best way to bring down costs for everyone and to get a low-carbon, low-cost and secure energy system.

**Jackie Dunbar:** The convener mentioned the £2.8 billion that has been added to consumer bills, on top of the increase in wholesale costs. Do you think that that is the best way to recover the costs? Were any other options considered? Do you think that other options should have been considered?

10:00

**Neil Lawrence:** The cost of the SOLR impact is £1.8 billion—or £68 per customer—and there are costs on top of that for Bulb Energy. To protect consumers, we have a set SOLR process in place, which enables us to move consumers across to a new supplier, and enables the cost of that transition to be charged into the SOLR levy mechanism. That is the process that we used. With 28 suppliers going out of the market, the process was tested to stress, and we are really pleased that we managed to move those 4 million customers, protect them, ensure that they were kept on supply and protect their credit balances.

**Neil Kenward:** In a sense, we do not have options to change the way that the costs are recovered. The SOLR system is set up so that costs require to be recovered from consumers over a period. I am afraid that only Governments, not us, would be able to change the way that costs are recovered.

**Monica Lennon (Central Scotland) (Lab):** Good morning to our witnesses—thank you for joining us. This morning, I have heard you both mention fair prices a couple of times, particularly Neil Lawrence. Many people across the country will be wondering what a fair price is, because what is happening right now does not feel fair. From an Ofgem perspective, what does fair pricing mean?

**Neil Lawrence:** I recognise that consumers up and down the country are struggling with the price of bills and the wider affordability crisis that we are seeing. It is unprecedented, and the energy bill increases are driven by the high wholesale prices that we have talked about.

To take a step back, our role as regulator is to ensure that suppliers charge a fair price to consumers for their energy. That means that they have to pass on the costs of supply. If the wholesale price increases, suppliers have to be able to pass that on. Energy in the UK is not subsidised at retail level, so there is no subsidisation for consumers. Therefore, we have to allow suppliers to pass on those fair costs, otherwise business models would not be sustainable. Suppliers would go out of business and, ultimately, that would lead to a bigger cost for consumers, because of supplier exit, which might lead to further special administration regimes or SOLRs. That is what the mechanism does under the price cap.

Those costs are challenged. In the price cap methodology, we look through a supplier's costs, robustly challenge them and look for evidence, so that we set the costs at a fair level. However, any decision around price subsidy to the consumer is a matter for Government and not within our gift.

**Neil Kenward:** It is worth noting that the price cap has had its desired effect, which was to prevent price exploitation of consumers who were not active in the market. Before the cap's introduction, those consumers were sometimes charged considerably more than the cost of delivering their energy. The price cap has been set at such a tight level that suppliers, collectively, were making losses, because we were trying to drive efficiency through the system. That has been successful in preventing exploitation of inactive consumers. Of course, we are seeing a record rise in prices, but the cap has smoothed the impact of the rises in gas prices over the past few months.

**Neil Lawrence:** To build on that further, over the past two or three years, suppliers have not made any money in the retail market, so it has been a very tough time for them. We have removed the loyalty penalty, but we must recognise the costs and pain that suppliers are feeling at the moment. That is coming through in our data. We need to create a market that is investable and fair and which will enable the transition to net zero.

**Monica Lennon:** In a previous evidence session, some of my colleagues touched on the very healthy profits that have been made by the big six suppliers—albeit perhaps not from the current retail market—so they are not exactly in fuel poverty.

Neil Lawrence, you talked about the importance of the regulator, retailers and consumers working together, to try to foster some trust. I am looking at a news article from yesterday, which reported on comments by Martin Lewis, who is known through his work as the money saving expert. It is fair to say that the public trusts Martin Lewis more than it does politicians or energy companies.

In the article, he says that an

"energy bill surge 'smells wrong' as direct debits 'increase by 100%'".

People have always been encouraged to pay for energy by direct debit. However,

"After energy prices took a 54 per cent spike in April, some users of"

his

"website complained their bills went up by 100 per cent."

Does that seem right and fair to you? What is the explanation behind it?

**Neil Lawrence:** I recognise that the affordability crisis means troubling times for consumers and that people are struggling to pay their bills. We understand that and empathise with them.

We were aware of a number of reports of direct debit increases. Earlier this year, we announced a series of market compliance reviews, the first of which was into direct debits. That is reviewing how suppliers set up and increase direct debits and whether they are fair. It is a very invasive review. We are collecting a range of data and we are examining the management control frameworks that suppliers have in place, to assess whether they really take the matter seriously.

Martin Lewis has conducted some independent analysis. We welcome that. It is very helpful and he has agreed to share the information and data with us.

Direct debits can increase for a range of reasons. We have seen a drift from contracts to standard variable tariffs, which might have increased direct debits. We must recognise some of that data. However, rest assured, if I and my colleagues find that suppliers have not treated customers fairly, we will take robust enforcement action over it. Customers must be charged a fair price for their energy by their suppliers. We take the matter very seriously. We are on it, and I look forward to getting the results back from our compliance work.

**Monica Lennon:** We heard from Citizens Advice Scotland and others that they are struggling to keep up with the demand for advice. I draw to your attention one of the comments that we heard. When Frazer Scott from Energy Action Scotland came to the committee, he warned us that the energy price rises could lead to

"a catastrophic loss of life"—[*Official Report*, *Net Zero, Energy and Transport Committee*, 26 April 2022; c 23.]

this winter if the UK and Scottish Governments do not take further action.

What further action needs to be taken by Ofgem as regulator, the energy companies and Governments in the short term and, perhaps, in the medium to long term? Is there anything that local authorities, as they pull together their administrations after the elections, could do to help people at community level?

**Neil Lawrence:** I recognise and am aware of the comments that have been made. Our job is to protect consumers but, ultimately, matters of affordability and the cost of living are for Government.

In Ofgem, we have a limited set of tools at our disposal. We have redistributed the redress fund fines as fuel vouchers for a number of consumer and charity groups in the past, and we will continue to do that this winter to help the people who are most in need. A number of schemes that I have outlined, such as the warm homes discount, are available.

Our advice is that, if someone is struggling with their bill, they should contact their energy supplier in the first instance. It will provide them with the help and support that they need.

**Monica Lennon:** Does Neil Kenward want to add anything on the longer term?

**Neil Kenward:** We will take a number of measures. For example, as we move to the more renewables-dominated system, there will be a premium on flexibility. If we can put the frameworks, incentives and markets in place for people to flex their demand for electricity so that it more closely matches when it is windy and when it is not, that level of flexibility could reduce costs on the system by up to £10 billion a year. That is a long-run figure, but those are the sorts of savings that we think that we can help to deliver through our regulation of the sector.

**Liam Kerr:** In his opening remarks, Neil Lawrence said that wholesale gas prices are volatile and that, as a consequence, consumer bills have risen. The UK Government's energy security strategy will launch a further oil and gas offshore licensing round with a view to improving energy security and affordability. What impact could there be on prices for domestic and commercial customers if the gas that we need were to be sourced locally rather than imported?

**Neil Kenward:** Ofgem does not have a remit in relation to the upstream oil and gas production industry and we are not experts in the sector. What I can say is that prices in those markets, particularly gas markets, are set at European or global level—you can read from that how much contribution increased production at UK continental shelf level might make. For us, the broader transition to net zero is the best way to bring down costs in the long run.

**Liam Kerr:** The deputy convener and Jackie Dunbar asked pertinent questions about the net zero agenda, and I want to explore the issue. Some people are understandably worried that an energy price crisis could undermine our drive to net zero, while others suggest that the transition can be accelerated if we increase the use of domestic gas—which we heard from an earlier panel has about half to a third of the carbon footprint of imported gas—rely more on nuclear generation and continue the current focus of both Scotland's Governments on, for example, heat in buildings. What is your view? How do this committee and the Parliament ensure that we strike a balance between continuing the transition and considering the cost to consumers?

**Neil Kenward:** The critical thing is to keep an eye on the long-term transition. Yes, we need to focus on the short term and ensure—as my colleague is doing with his teams—that the market is stable and we are protecting consumers in the short run, but we must not lose sight of the transition to deliver a lower-cost, low-carbon system in the long run.

There are a number of ways in which Ofgem can help to do that. For example, we are likely to be asked to set up new systems of economic regulation for new nuclear power and carbon capture and storage, and we can use our regulatory tools to facilitate the billions of pounds of investment that will be needed in low-carbon technologies, making sure that that investment happens at the lowest possible cost to consumers.

We are also supporting the development of other new technologies, such as clean hydrogen, which might have an important role in future—that role is yet to be determined. Through our innovation funds, for example, we are helping to test how hydrogen might work in, say, a domestic heating environment, to see whether that is a viable and low-cost form of energy for the future.

Those are the kinds of step that Ofgem, as a regulator, can take. I am not able to comment on the oil and gas exploration market and its impact on oil and gas prices, because that is outside our remit. For us, the focus is Ofgem's ability to support the transition and help to keep costs in that regard as low as possible for consumers.

**Mark Ruskell (Mid Scotland and Fife) (Green):** The witnesses have presented really interesting evidence this morning.

Monica Lennon talked about the impact on individual households. It is clear that, for some people and households, the situation is and will continue to be devastating. The witnesses said that they cannot predict what energy prices will be in October this year, let alone in October 2023. I am concerned about the people who might end up in spiralling debt.

Keith Anderson, from Scottish Power, has proposed the setting up of a deficit fund to help people who are in deep debt when it comes to their energy bills by, in effect, giving them £1,000 to get them out of fuel poverty—or at least to stop them sliding even deeper into fuel poverty. The money would be paid back, I assume by all consumers, over 10 years. What is your analysis of the proposal? How does it compare with what the UK Government has announced?

10:15

**Neil Lawrence:** I have said it time and again, and I will keep repeating it, but we absolutely recognise that this is an incredibly tough time for consumers. I truly appreciate that those in most need in our society are finding today's conditions incredibly tough.

We have openly supported the UK's announcement of a £200 rebate on household energy bills this winter and we are working actively to support that. That is a Government policy. All those decisions around affordability and other measures, such as the one that Keith Anderson talked about yesterday, are a matter and decisions for Government. They are not within our gift. They are decisions and questions for Government.

**Mark Ruskell:** As regulators, you have a duty to protect the short-term and long-term interests of energy consumers. Are you saying that you have no role in modelling or working out the impact of a policy such as that in relation to advising Government?

**Neil Lawrence:** We collect a range of data from charity groups and use our independent analysis to look at the impact of those things. I do not have that information with me today, so I cannot comment on the impact of Keith Anderson's proposal from yesterday. However, as I said, our role is not to decide on those things. We can analyse their impact and see what they could do to a consumer, but it is not our role to make those decisions. That is not within our gift.

**Mark Ruskell:** I am not asking you to make a decision. That is obviously the role of politicians. However, in your role as regulator, surely you are able to look at everything that is in the toolbox. Scottish Power made that suggestion several weeks ago. Keith Anderson was at this committee several weeks ago. He made the suggestion of the deficit fund at Westminster—I think—a month ago now.

Why is it that you are not looking at that right now? Why have you come to the committee today without a clear view on what the impact of that idea would be on consumers? What else is in the toolbox? What other options might there be that you are actively looking at, not in the sense of, "We think you should do this, minister," but very much in the sense of, "Look, this would be the impact if you went down this or that route"—as advice, or at least data, to Government and parliamentary committees?

**Neil Lawrence:** We work very closely with Government on a range of issues in the market. We are able to provide our information and data on affordability issues and on how tough it is for consumers. I speak to consumers all the time personally as well as to a range of charity and consumer groups in order to try and get the data and information that we need as regulators so that we can provide views.

However, the decisions and drive around any affordability measures or social policy are not for Ofgem but for Government. Although I do not have the information that you asked for, I can take that away and look. However, those decisions and the drive of social policy are a Government decision and not ours.

**Mark Ruskell:** If you had some form of independent analysis of that specific proposal and how it measures up against what the Government is currently proposing, including pros and cons, that would be very useful for the committee.

I have another question that I hope does not fall into another area where you will say, "Well, that's nothing to do with us." The cost of fuel oil—or liquefied petroleum gas—is a massive issue, particularly in Scotland and particularly for off-gas communities, which are seeing price spikes and enormous volatility in the cost of fuel oil. To be honest, they have been seeing that for years, but particularly so at the moment. That is driving rural fuel poverty, often in homes that are very hard to heat and to retrofit.

If I can tempt you to say something on it, what is your thinking about regulation of oil and LPG? Does that need to be brought into the regulatory framework, or what might the options be?

**Neil Kenward:** I am afraid that it is not an area that we have regulatory responsibility for. We do not have the ability to regulate that. We absolutely recognise and understand that there are millions of homes that are off the gas grid and use other forms of fuel for their heating, and that those can sometimes be expensive and subject to considerable volatility. We see that happening in the market, but we do not have the remit to regulate it. However, if Government asked us to do that and gave us those powers, we could of course do that.

Heat networks are an area where, historically, we have not had a regulatory role. However, it looks like we will be given a remit to oversee heat networks. I believe that the Scottish Government and the Westminster Government want us to take on that role. That is an example of where Ofgem can take on additional responsibilities if we are asked to do so by Government.

**Mark Ruskell:** Do you think that, in 10 years' time, we will have completely transitioned away from oil and LPG heating in rural areas and will have other options, such as biomass or high-temperature air-source heat pumps, or do you think that the situation will be sticky and that, in 10 years' time, we will still have homes that are being heated by heating oil, which means that we will still have to regulate?

**Neil Kenward:** My understanding is that the intent is to prioritise off-gas-grid homes for decarbonised heating. Certainly, that is what the Westminster Government talks about, partly because the costs are often higher for those homes. Those homes may not all be suitable for heat pumps because those need certain levels of insulation. However, where heat pumps are viable, it is important that off-gas grid homes are supported to move away from the higher-cost and high-carbon forms of heating that some of them currently use.

**The Convener:** Eleanor Whitham is next up.

**Elena Whitham:** Thank you, convener, and good morning.

I am also the convener of the Social Justice and Social Security Committee, and we have been taking a huge amount of evidence recently about debt and poverty. As you can imagine, that is an area that that committee is acutely focused on.

Several times, Mr Lawrence has mentioned that the current situation is unprecedented. To the people at the sharp end who we are taking evidence from, the situation feels like a return to the days when you could not afford a bag of coal, you had no heating and you had no means to cook some food.

Following on from Mark Ruskell's questions, I will look at some data. If we think about winter 2021-22—the period that we have just come through—how difficult an increase in prices was that for consumers in Scotland to cope with? Have there been more self-disconnections? We know that there were self-disconnections already. In my local authority area, a couple of years ago we uncovered that around 300 people had self-disconnected. Will self-disconnection only increase as we go forward?

**Neil Lawrence:** I recognise the issues that you have talked about. As I said, I have spent a lot of time with consumer groups to understand those issues first hand, and I truly empathise with consumers. This is an absolutely extraordinary time; it is very difficult, and we are aware of that. There are probably 613,000 households that are in fuel poverty in Scotland, and there are 311,000 households in extreme fuel poverty, according to the numbers that we have. We recognise the size and the scale of the challenge that those individuals are facing.

We are aware of self-disconnection—when customers choose not to heat their homes, switch off all their appliances and disconnect their pre-payment meters as a way of reducing costs—occurring in the market. As part of our regulation, we require that suppliers look out for and monitor that happening. Earlier this year, we announced a series of market compliance reviews to get under the skin of what suppliers do to protect consumers, including around vulnerability and affordability concerns. We will consider how suppliers treat consumers and what steps they take to protect them, particularly those who are most vulnerable in our society. Those measures are very stringent and invasive. We will be looking at a range of data and, more importantly, the overall control framework that suppliers have in place to make sure that they protect consumers and that they get into areas such as self-disconnection.

It is a tough time, and we recognise that; our role is to try to support consumers. If we find that suppliers are not up to scratch—for example, they are not scaling their operations or they are not ready for the increased call volumes that we expect later this year as a result of vulnerability and affordability concerns—we will take action. There are a number of things that we can do, such as banning those suppliers from taking on new customers or taking action under the operational responsibility principle, and we will do that to try to protect consumers in the best way. We recognise that these are unprecedented times; we would not have expected that from the UK energy market. The higher wholesale prices are a global issue.

**Elena Whitham:** With regard to those measures, are you saying that they are going to be increased and that sanctions are going to be applied to companies that do not actively look out for those individuals and start to offer them some type of support? In the past, people have been self-disconnected for years without any support being offered. Are you assuring this committee today—and me, as the convener of another committee—that that action is forthcoming?

**Neil Lawrence:** Through the market compliance reviews in this area, we will have the information and data that enable us to understand which suppliers are treating customers fairly and which ones are not. Where we find that they are not adhering to the rules, we will take action to protect consumers.

We absolutely understand that this year is a key moment and that what we are doing is a key set of work. We have to ensure that consumers are protected. This is a vital service. We have heard from other colleagues around the table today about the impact that it could have and we have seen the comments in the press. We take that role very seriously. We are working and will work at pace with regard to those reviews. Where we see that suppliers are not acting in the best interest of consumers, we will take action to protect consumers.

I will just add, if I may, that this is an area where extra legislation could help us. I do not have the step-in powers that I would like. If I saw a supplier not acting in the best interest of consumers and I saw severe detriment, I would not have the ability to step into that organisation and take over and do the right thing. We would like to see that changed in legislation, as it would make us more effective as a regulator.

**Elena Whitham:** I have one further question. As is usually the case, there is not enough disaggregated gendered data, but there is strong circumstantial evidence that women are at higher risk of experiencing circumstances that are known to make households more vulnerable to fuel poverty. I am thinking about having lower incomes, heading single-parent families and having a carer status. It is important that policy makers understand what role gender might play, so that they can respond accordingly.

What gendered analysis has Ofgem, as a regulator, employed prior to lifting the price cap? How do you intend to monitor its impact on women going forward?

**Neil Lawrence:** I am sorry, but I do not have that data with me today. I will have to go back to base and write to you after this meeting. I do not have that information or statistics of that nature.

I will say that we are here to protect all consumers. I absolutely recognise the challenges across households, particularly those of single-parent families, and the impact that this could have. There are stringent rules in place for protection of customers, and you will see a very low number of disconnections. A range of measures are in place to protect those consumers.

As I said, I regret that I do not the information that you are asking for, so I cannot answer that exact question now.

**Elena Whitham:** I think that that highlights the fact that we do not always have that information, and it is information that we need everybody to start pulling together.

**Neil Kenward:** We have tried to improve the sophistication of our distributional analysis, and we have introduced a more sophisticated way of understanding consumer groups, including low-income groups. We have a stronger framework now for looking at those impacts.

**Elena Whitham:** Thank you.

**The Convener:** I have a couple of questions, and there are a couple of supplementaries to follow up on this line of questioning.

Going back to the 29 energy companies that have failed over the past 18 months—in some cases because of financial mismanagement in terms of a lack of hedging, which was designed to maximise their profits—has Ofgem taken any action against those companies or the directors involved? Do you have the power to do so, or have you referred those companies to other regulators that have the power to take further action?

**Neil Lawrence:** I absolutely recognise the issue. As I said before, we have robust monitoring regimes in place. They have been through continuous improvement since the Covid crisis started, so that we can monitor the financial resilience of suppliers by getting under the skin of the business models and understanding what hedging levels they take. I get reports weekly on the hedging levels across the market and on the financial viability of suppliers. We have the ability to step in and do audits. We have done a number of audits in the past year in order to really understand the financial health of suppliers. All of that is about acting in the best interest of consumers and protecting them moving forward.

We are going further with our financial responsibility measures so more robust steps are in place, and we absolutely will take action.

With regard to action against directors, I cannot comment on the specific cases in a public forum, but we have worked extensively with the Insolvency Service on a number of cases and have made reports. However, I cannot comment on those today, and I would be grateful if you do not push me further on that.

**The Convener:** I totally understand that, and I appreciate the response.

10:30

**Jackie Dunbar:** Earlier, Neil Lawrence said that consumers choose to self-disconnect, but I am afraid that I have to disagree—there is no choice when they get to that stage.

Households with pre-payment meters, which are normally our most vulnerable, pay more than households with direct debits. They pay a premium for their energy. We have touched on that in other committee evidence sessions. There is little to protect our most vulnerable in households with pre-payment meters. Are there any protection methods in the system? What more should be done to protect our most vulnerable? They are paying the highest tariffs.

**Neil Lawrence:** First, to be clear, we absolutely recognise the difference in tariff prices between pre-payment and credit customers. You are right that there is a difference—pre-payment customers pay more.

The wider context is that we have to allow suppliers to charge a fair price for their energy, and the costs of supplying pre-payment meters are higher than those of supplying credit meters, because there are higher operational costs. If we did not let suppliers pass that cost to those consumers, ultimately, they would not have a sustainable business model. However, we accept that there is a difference.

The transition to smart pre-payment meters will reduce the cost, and we will focus on making sure that that happens across the pre-payment community. That will make those tariffs cheaper in the long run.

I absolutely understand that it is a difficult time. Some of the most vulnerable customers are, indeed, on pre-payment meters. We have a range of measures in place to try to protect vulnerable customers. As I said earlier, we are actively assessing suppliers' ability to meet those obligations through our market compliance reviews, which cut across credit and pre-payment—they apply to all customers. As I said, we will take action if we find that suppliers are not supporting vulnerable customers. If they are not doing what they need to do or not meeting their obligations, we will take very firm action. We recognise that, if suppliers do not provide that support this winter, that could have a catastrophic impact on those customers.

**Neil Kenward:** Last week, we fined one energy network company the significant sum of £15 million for giving insufficient support to some of the vulnerable customers on its network.

**Jackie Dunbar:** We also hear that pre-payment meters are left in houses when people move out and that, when new tenants move in, they are automatically put on to the higher tariff. We have heard that it is up to the tenant, not the landlord or supplier, to get the meter taken out. Some folk cannot afford to take out the meter, so they are left with higher payments. Can anything be done about that? I am not sure whether you will be able to answer that, but it would be interesting to hear from you.

**Neil Lawrence:** We advise customers who move into a property with a pre-payment meter but who want to move on to a credit meter to contact the energy supplier and have that discussion. The energy supplier is obligated to work with the customer. If customers are in debt, pre-payment meters can, at times, be a source of moving them out of debt. Customers often choose to be on pre-payment meters, so it is not a case of suppliers enforcing their installation. A lot of customers choose that option for budgeting purposes, and we have to be aware of those facts. Members whose constituents speak to them about that issue should pass on our advice to talk to their energy supplier and see what it can do.

**Monica Lennon:** I want to follow up on Neil Lawrence's offer to write to the committee in response to Elena Whitham's important question about gender-disaggregated data. Does that mean that you are confirming to the committee that Ofgem holds that data? How recent is the data, and has it been analysed? I just seek clarification, so that you do not need to write to say, "We don't have that data."

**Neil Lawrence:** I am sorry if I was not clear. I would have to check what data is available on that. I do not have the information in front of me right now; I will have to go back to base. That is why I said that we will write to you after the meeting. I cannot answer the question right now—apologies for that.

**Monica Lennon:** That is what I thought. I thought that you seemed a bit uncertain. Thank you for that.

**Mark Ruskell:** Neil Lawrence talked about smart meters and consumers' ability to move on to variable tariffs. Where are we with the roll-out of smart meters? Could it be significantly ramped up between now and October, or between October and when the price cap next goes up? Could a large number of households who have smart meters move on to variable tariffs, or is there still a low number of consumers who have found out that that is even a possibility, let alone had a smart meter installed?

**Neil Lawrence:** We recently agreed a set of targets with the industry on smart meter roll-out. All suppliers have an obligated target that they need to meet this year. We monitor the position regularly by looking at the number of complete and forecast installations and considering suppliers' progress on the targets.

The targets are hard baked; if suppliers do not meet them, we can and will apply penalties. We take that seriously, and a set of people in Ofgem are responsible for looking at the issue.

The capacity in the system is the capacity in the system. Suppliers are not planning to roll out 100 per cent of smart meters this summer. They have obligated targets to progress, and that is what has been agreed.

**Mark Ruskell:** Is there an argument for revisiting those targets and, if there are supply chain issues, scaling up installation more rapidly over the next 12 months? Perhaps the roll-out could be targeted at consumers who are most affected by price increases.

**Neil Lawrence:** We would like smart meters to be rolled out across the country, because we see the benefits that they can have in reducing energy consumption. That is what we are focused on at the moment. There are no plans at the moment to delve deeper into the smart meter roll-out by each supplier, to target vulnerable cases.

**The Convener:** Fiona Hyslop has the final set of questions.

**Fiona Hyslop:** If I understood you correctly, Neil Lawrence, you said that support for individuals and subsidies are the responsibility of Government and that you have limited capacity to intervene, although you can direct and fine companies and intervene if you think that they are not providing sufficient support to individuals. You said that you would welcome legislation to give you more powers. Will you be a bit more specific about what would constitute useful legislation?

We talked about pre-payment meters. Is there, or should there be, legislation that requires an energy supplier to replace a pre-payment meter if an individual requests that it does so?

**Neil Lawrence:** The point that I made earlier was that, if I see that a supplier is not acting in the best interests of consumers and there is severe consumer detriment, I do not currently have the option to step in, take over the supplier and mend the issues. Additional, step-in powers would be really helpful and might protect customers.

From our monitoring, we can see suppliers' performance on a range of customer service metrics and affordability issues. We talked about the additional work that we are doing through the market compliance reviews. We can use our existing powers, but step-in rights would provide an ultimate sanction and enable us to move more quickly. The pace of change is important. When we see that things are going awry or that a supplier is in trouble, having the ability to step in would be useful.

Other powers that we have talked about include the ability to intervene during the process when a company goes bust. We have had some challenges when working with administrators; how the legislation around administrators and the supplier licence regime works can cause issues in the industry. Additional powers in that regard would be useful.

It would also be useful to have additional powers to strengthen our ability to revoke licences, so that, rather than our having to go through a long process, it would be made easier for us to take away a supplier licence if we felt that a company had an unsustainable business model, was getting into difficulty or was just not acting in the best interests of consumers. Having such powers, which would be a significant change, would help us to perform our role as regulator.

**Fiona Hyslop:** What about a legal obligation to replace a pre-payment meter?

**Neil Lawrence:** That is an interesting question. I will have to take it away and do some analysis of the benefits. What I said earlier rings true: some consumers really like the pre-payment method—they choose and use it. We would have to be careful about assuming that taking that method away or changing it would benefit consumers.

**Fiona Hyslop:** I was asking about a legal obligation to replace a pre-payment meter if the consumer requested that. That would hardly be revolutionary, and it would be practical.

**Neil Lawrence:** Yes, but we need to strike a balance and bear in mind that, if there is a debt on a meter, a pre-payment meter is often the best solution when it comes to enabling the debt to be recovered. If that enables the industry to work as a whole, it might be the right way forward—

**Fiona Hyslop:** Maybe—

**Neil Lawrence:** We are getting into a debate about policy—

**Fiona Hyslop:** In an energy price crisis, the balance might need to shift from the companies to the consumers. I will leave it there. I think that you said that you will get back to me.

Neil Kenward, as Brexit proceeds, the Great Britain and European Union energy markets remain closely aligned. I do not know whether you heard President Macron's speech. He is looking at the potential for wider alignment of non-EU European countries, particularly on defence and energy. We heard from Scottish Power and other suppliers that sufficient domestic energy market reform to deliver what you have talked about could take place without the need for wider EU reform—although I suspect that there will be wider reform of GB and EU energy markets. What opportunities and challenges are there in the short term and, strategically, in future?

**Neil Kenward:** We have to prioritise getting the GB market to work as effectively as possible for the new, net zero world.

The critical link for us with the European market is through the interconnectors, as you will appreciate, and as we move to a more renewables-dominated electricity system, the importance of interconnectors will become ever greater, so that we can export. We talked about exporting surplus Scottish renewables to England, but, in future, the whole of GB will have surplus renewables on windy and sunny days and the interconnectors will enable the GB system to export those surpluses and maintain a more stable, low-cost system. When we do not have as much wind and solar power generation, we will be able to bring power in from those interconnected zones.

Of course, those zones now include Norway, which is a great addition to the network, because Norway has a separate, hydro-dominated system, which is very low cost. In future, it might be possible to export surplus power in GB or Scotland along the pipes to Norway to be used for pumped hydro—whereby water is pumped up to dams—and, when we need the power back in GB, Norway might be able to send the hydro power back to us.

That is a really effective way to integrate the markets. Ofgem is keen to ensure that there is a pipeline of further interconnector projects, because it is strongly in the interests of GB consumers that we continue to develop such projects as we move to the new, net zero world.

**Fiona Hyslop:** You are talking about infrastructure such as our own Cruachan dam, which performs a similar function when it comes to pumped storage.

**Neil Kenward:** That is right.

**Fiona Hyslop:** Can you confirm that we do not necessarily need reforms in the EU market, where we are aligned—possibly until 2026—and that we can do enough in our domestic market to meet the needs of the United Kingdom energy market?

**Neil Kenward:** The primary determinant for the effective operation of the GB market must, obviously, be GB reforms. We will respond and, through interconnectors and other mechanisms, try to make sure that we have the most efficient connections with the other bits of the market, which, of course, includes Ireland as well as continental Europe.

**Fiona Hyslop:** Thank you.

**The Convener:** That brings us to the end of our allocated time. I thank both witnesses for giving evidence to the committee this morning. It was very much appreciated.

The committee's scrutiny will continue tomorrow, when we will hear from Greg Hands MP, Minister of State in the Department for Business, Energy and Industrial Strategy. Next week, our final evidence session as part of the inquiry will be with the Cabinet Secretary for Net Zero, Energy and Transport.

I thank members and our guests. That brings us to the end of the public part of the meeting.

10:45

*Meeting continued in private until 12:01.*

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