The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 1 May 2013

Session 4

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ECONOMY, ENERGY AND TOURISM COMMITTEE
13th Meeting 2013, Session 4

CONVENER

*Murdo Fraser (Mid Scotland and Fife) (Con)

DEPUTY CONVENER

*Dennis Robertson (Aberdeenshire West) (SNP)

COMMITTEE MEMBERS

*Marco Biagi (Edinburgh Central) (SNP)
*Chic Brodie (South Scotland) (SNP)
*Rhoda Grant (Highlands and Islands) (Lab)
*Alison Johnstone (Lothian) (Green)
*Mike MacKenzie (Highlands and Islands) (SNP)
*Margaret McDougall (West Scotland) (Lab)
David Torrance (Kirkcaldy) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Joan McAlpine (South Scotland) (SNP) (Committee Substitute)
Andrew Wright (Office of Gas and Electricity Markets)

CLERK TO THE COMMITTEE

Jane Williams

LOCATION

Committee Room 4

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 1 May 2013

[The Convener *opened the meeting at 10:00*]

Decision on Taking Business in Private

The Convener (Murdo Fraser): Good morning, ladies and gentlemen. Welcome to the 13th meeting in 2013 of the Economy, Energy and Tourism Committee. I remind everyone to turn off all mobile phones and electronic devices—or, at least, to switch them to silent mode so that they do not interfere with the committee's work.

We have received apologies from David Torrance; I welcome Joan McAlpine as his substitute.

Item 1 on the agenda is to seek the committee's agreement to take item 4 in private and to consider in private our future work programme at our meeting next week, on 8 May. Is that agreed?

Members *indicated agreement.*

Office of Gas and Electricity Markets (Pricing Review)

10:00

The Convener: Item 2 is evidence from the Office of Gas and Electricity Markets on the pricing review. I am delighted to welcome Andrew Wright, who is senior partner markets at Ofgem. Before we move to questions, he will make some introductory comments.

Andrew Wright (Office of Gas and Electricity Markets): First, I thank the committee for the opportunity to appear. I know that there are relatively few such one-off sessions, so we are grateful that you are dedicating one of them to consideration of our energy market reforms.

Ofgem is strongly committed to Scotland and to engaging with the Scottish Parliament and other stakeholders on the particular issues and opportunities in the energy market in Scotland. We are continuing to grow our presence here; as you probably know, we now have more than 80 people located in Scotland—up, over the past couple of years, from about 25. We expect that that growth will probably continue.

The retail energy market reforms that we have proposed are the most radical changes to the retail energy market since competition was introduced about 15 years ago. They needed to be radical because we found, when we looked at the markets a couple of years back, that customers were being put off engaging in the market because of the confusing array and complexity of the tariffs that were being offered. Moreover, when customers engaged with the market, they did not have particularly good experiences. We know about instances of misselling, and people were also not always given accurate information. Even when customers signed up to a contract, the terms and conditions were sometimes misleading and confusing, which meant that they were not necessarily getting what they expected.

As a result, trust and confidence in the market was at an all-time low. We feared that we were in a downward spiral of less engagement, which meant that there was less competition and that companies were therefore not being held to account.

All that was despite our already having sent a shot across the bows of the companies through the energy market probe findings that we published in 2009, when we sought to try to improve the information that was provided and the behaviour of the companies through such things as voluntary standards of conduct. That is why we had to act.

Our proposals are intended to introduce a simpler, clearer and fairer market for consumers. The market will be simpler in that we are proposing that companies have no more than four core tariffs, we are banning complex multi-tier tariffs and we are making the tariffs apply to a simple two-part structure. The market will be clearer in that we are requiring suppliers to provide better information in bills and in the annual statements. We are introducing a new annual percentage rate style of metric to help customers to compare tariffs more easily and we are requiring suppliers to tell customers if a cheaper deal is available to them from that same supplier. The market will be fairer in that we are introducing new licence conditions that will require companies to treat customers more fairly. Those conditions could be backed up by fines, if necessary.

A lot of companies have already made positive moves; some have moved to a simple two-part tariff and have reduced the number of tariffs that are available, and some have withdrawn from doorstep selling. Our message to the companies is that the best way to rebuild trust and confidence is to get behind our proposals and help us to implement them and to implement them as soon as possible. I look forward to answering questions.

The Convener: Thank you for that introduction. Through their constituency work, all members around the table will be familiar with people's concerns about the complexity of billing arrangements and the lack of transparency. Therefore, we welcome Ofgem's direction of travel and look forward to exploring some of the detail.

I will start off with a couple of process questions about Ofgem's work. First, what will be the timetable for implementing the changes?

Andrew Wright: We have just finished a consultation on the detailed rules and the licence drafting, and we are now considering the responses to that. We expect to go out to consultation on the next stage, which is the statutory consultation, later this month—that is a 28-day process. At the end of those 28 days we will enter the last stage of the process, which is a 56-day period in which companies may appeal against the proposals. Assuming that none of the companies lodges an appeal, we expect the proposals to be in place by the end of the summer, which means late August or early September.

Some of our other proposals—for example, the enforceable standards of conduct—will come into effect immediately, whereas for the changes to tariffs the companies will have until the end of the calendar year. For the proposals that require detailed systems changes, including the information on bills and annual statements, our current implementation timetable gives the companies until the end of March 2014. All the changes should be in place by 2014—provided that the companies do not appeal to the Competition Commission.

The Convener: Thank you. That is helpful.

What work has Ofgem done to model the difference that the changes will make to the future retail market? For example, what can customers expect to save as a result of the changes?

Andrew Wright: Our main concern is to increase the engagement of consumers. We have done a lot of market research asking consumers why they do not engage with the market now, what factors hold them back and whether the sort of changes that we have proposed will make a difference. You can never tell in the real world, but certainly in our focus groups and surveys consumers tell us that the sort of changes that we have proposed will make a significant difference to their intention to engage.

Probably even harder to predict is the impact that the changes will have on trust and confidence. We know that the complexity of the market, the poor outcomes that people experience and the behaviour of some suppliers have undermined trust and confidence. That lack of trust and confidence holds people back from engaging. We will monitor how people will react to see whether the changes make a difference. Clearly, our view is that if customers engage and do so more successfully, that will turn the vicious circle that I spoke about into a virtuous circle and enable customers to begin to hold companies to account.

The Convener: Do you, although it is difficult to predict the outcome, expect that more transparency will lead to more switching, which should save customers money?

Andrew Wright: There are two big unknowns. The first is how the companies will respond. Certainly, we learned a bit of a lesson with the energy market probe, in that companies sometimes respond to the letter rather than to the spirit of our proposals. That is why we have introduced new enforceable standards of conduct, which will fill the gaps, if you like, and make it difficult for companies not to adhere to the spirit of what we are trying to do.

The second big unknown is how consumers will respond. There is a lot of science behind how consumers respond to prices and to prompts and we can make prudential predictions, but we can never say for certain how consumers in the real world will respond until things happen in practice. Clearly, we will monitor the market and, if things are not going as we hoped or expected, we will react to that.

Marco Biagi (Edinburgh Central) (SNP): In developing the reforms—you have hinted at this—

how positive have your relations with the energy companies been?

Andrew Wright: Relations certainly hit a low when we published our initial proposals. Our view is that we were angry with how the companies had failed to respond to the challenge that we set them in the energy market probe, and we said that very clearly. I think that some of the companies were upset by the strength of the language that we used at that time.

Since then, things have got better. Most of the companies appear to have accepted the agenda that we have proposed. Most of them say that their priorities are to build trust and confidence among consumers and to rebuild their relationship with consumers. Many have started on positive things including reducing the numbers of tariffs, removing the most complex forms of tariff and stopping the misselling of products on the doorstep. They also have various forms of customer charter, and so on.

We are seeing real improvement on the ground, but it is a little bit inconsistent and patchy at the moment. I think that comparability between companies is also important. Each company might be doing good things independently, but customers need to be able to compare between companies as well.

The companies continue to challenge our proposals—we have received many responses to our consultation on the detailed rules. However, everything that we hear suggests that the companies want to grasp the nettle, accept our proposed programme and see the real improvement that we think the changes will bring to consumers. I am optimistic that we are seeing a good way forward and that the companies will fall in behind what we are trying to do.

Marco Biagi: Do you sense any difference in companies' acceptance of switching? From my constituency casework, I am aware of one or two examples of companies that have taken steps—for example, through installation of specific hardware—to make switching a little less easy for customers who wish to move to another supplier.

Andrew Wright: Yes—we need to be careful and we need to be watchful. There are a number of ways in which companies can make it difficult for customers to switch. A thing such as a loyalty discount can, on the face of it, appear to be benign, but the loss of entitlement to the discount obviously acts as a barrier to switching.

I presume that the example that Marco Biagi mentioned involved smart meters. We have put quite a lot of effort into trying to ensure that, where companies install them, smart meters do not act as a barrier to switching. We have introduced a new set of licence conditions that require companies to facilitate switching where a smart meter is involved so that the new company can take on the smart meter.

There are still issues with smart meters. For example, at the moment consumers need to accept that not all companies will provide smart capability or smart features, so they may not be able to get the cheapest price and the smart functionality that they value. However, as smart meters continue to be rolled out, we expect that they will be offered by all companies. We are aware of the concerns and we are doing all that we can to ensure that there are no undue barriers to switching.

Marco Biagi: Is there an evolving technological standard for smart meters to ensure that the same hardware can be used by all suppliers?

Andrew Wright: Yes. The Westminster Government's Department of Energy and Climate Change has put in place technical standards for smart meters—I think that we are now in the second round of those—so we expect all suppliers to install to the same technical standard.

However, the real facilitator of easy switching will be the central Data and Communications Company—known as the DCC—which will be responsible for licensing. All smart meter data will go through the DCC, so that will also enable significantly easier switching than is possible today. We have a programme in place to try to ensure that the benefits of switching are realised and that smart meters facilitate quicker, easier and more reliable switching than is available today. There is no reason why switching could not be done within a few days, if not less than that.

10:15

Dennis Robertson (Aberdeenshire West) (SNP): Good morning. What can be done to try to ensure that consumers who live in remote and rural areas get the same deal as consumers who live in urban areas? There is a perception that if you live in a remote area you will be disadvantaged.

Andrew Wright: First and foremost, the products that will be on offer to customers will be clear and transparent. There will be four simple tariffs and a few simple options, for example dual-fuel deals, that relate to those. The options are likely to be available to all the customers whom a company supplies, which will help to build confidence that customers in rural areas are not being disadvantaged.

There are a number of ways in which rural customers might be disadvantaged. One is the potentially higher network charges in, for example, the north of Scotland. Another disadvantage might be that customers who are off the gas grid will not necessarily have access to some of the cheaper dual-fuel deals that will be available. It is fair to say, however, that although a dual-fuel discount looks good on the face of it, we have evidence that dual-fuel products do not necessarily offer the best value in the market, so I am not sure that lack of access to dual-fuel discounts is the disadvantage that it appears to be.

Further, the more that rural customers engage in the market, the more likely it is that they will have access to some of the cheaper and more competitive deals. We would be concerned if it remained the case that the cheapest deals were available only to dual-fuel customers or to direct-debit customers. We want the cheapest deals to be available across the whole market and see no reason why they should not be so.

Dennis Robertson: So, you will be monitoring that quite closely, perhaps with special emphasis on remote and rural areas.

Do you think that fewer companies will engage with consumers in remote and rural areas, with the result that those consumers will have less choice?

Andrew Wright: That was certainly the case when doorstep selling was one of the main ways that companies engaged with consumers. The economics and the practicality of doorstep selling in remote areas obviously make those areas less of a target for companies. None of the companies now engages in doorstep selling; most of their selling is done through the internet or over the telephone. There is no particular reason why they should engage less with people in rural areas than with people in urban areas.

One particular concern might be that the companies are looking for dual-fuel customers, but I know that that is not the case. Many companies offer deals that are as competitive for single-fuel customers as for dual-fuel customers. If those customers were to seek out the best deals, I hope that they would find plenty of offers available to them.

Dennis Robertson: Is there a basic acceptance that some customers—for example, those who do not get mains gas but rely on bottle gas or oil—could be disadvantaged? Are you going to keep a close eye on that?

Andrew Wright: It is true for anyone who is off the gas grid that, if the emphasis of competition is on dual-fuel products, they might be disadvantaged. Our concern is to ensure that the competition for people who are just taking electricity is as effective as that for people who are taking both electricity and gas. We want that, as the sign of a healthy and competitive market. By our own admission, it is certainly the case that there is not a healthy and competitive market out there today.

The Convener: In your exchange with Dennis Robertson you touched on transmission charging in the north of Scotland. Rhoda Grant wants to come in on that.

Rhoda Grant (Highlands and Islands) (Lab): There has been for generators higher transmission charging in the north of Scotland, but that has been dealt with by project transmit; the anomalies are being sorted. Higher charges also apply to the customer base.

However, now that we are generating huge amounts of renewable energy in the north of Scotland, the electricity is not being transmitted very far, but we are seeing higher charges in bills. Are you looking at that issue?

Andrew Wright: I think that those are two separate issues. This is slightly outside my core area, but my understanding is that the higher transmission charges to generators in the north of Scotland are offset, or matched, by lower transmission charges to customers in the north of Scotland.

The part where the charges are higher is the distribution charges, which relate to the local distribution network, because the low population density means that the cost of serving customers is much higher. Even after taking into account the cross-subsidy that exists, those distribution charges are still higher. As transmission charges account for about 4 per cent of the bill and distribution charges account for more like 20 per cent of the bill, the total network charges in the north of Scotland are likely to be somewhat higher. Generally, that is a consequence of the higher cost of serving customers in remote and rural areas. As far as I understand it, the difference is less than £20 per customer on average for electricity, and that applies to only a portion of the bill.

For the other aspects of the bill, there is no reason why prices should be higher for customers in the north of Scotland than for customers elsewhere in the country, with the possible exception of some of the competition issues that we discussed earlier.

Rhoda Grant: Are there plans to look at the distribution charges, given that the distribution charges should be less for very local generation? That has been reflected in the charges to generators, so surely that must come back to the customers. Otherwise, there is an imbalance in the system.

Andrew Wright: If generators connect to the distribution network, they avoid some of the higher charges that are associated with connecting to the transmission system. That will potentially come as higher profits to developers. If developers want to pass some of those costs through to customers, that is really for them to do.

The development of community energy schemes is being explored and focused on. Generally speaking, the development of generation and transmission feeds into the way that charging takes place and will have a potential impact on both distribution and transmission charges.

Another point is that we are just starting the process for the next round of price controls for electricity distribution. We have published our initial strategy document proposals, which relate to prices from 2015 onwards. That provides an opportunity for engagement on all those issues.

Rhoda Grant: Could the initial strategy document be a vehicle to deal with the distribution charges?

Andrew Wright: Our RIIO-ED1 consultation—RIIO stands for revenue equals incentives plus innovation plus outputs, and ED stands for electricity distribution—will address some of the issues around connection of embedded generation, intermittent generation and smart grids. We will examine and assess the proposals in the companies' business plans, and those will all feed into the price controls for 2015 onwards.

The Convener: Mike MacKenzie also has a question on transmission charging.

Mike MacKenzie (Highlands and Islands) (SNP): I hope that you can give us a written explanation of this, because I must admit that I am struggling to understand the rationale behind what you have said.

You may be aware that Orkney and Shetland suffer a grid constraint. Although Orkney is doing some innovative work to increase grid capacity, both communities are still heavily constrained. The idea has been floated that if they could encourage more use of locally generated power, the grid could accept more generation.

One idea that seems to be technically competent is that if people were encouraged to install storage heaters, it would increase power use and therefore ease the constraint on the grid. However, in order to make that a feasible proposition, a special lower tariff, which would make that an economical form of heating, would have to be applied. I understand that there have been conversations with Ofgem, which is the sticking point. Bearing it in mind that Scotland's islands suffer from fuel poverty at around 50 per cent, is that something that you would look at in the process that you just described to Rhoda Grant?

Andrew Wright: The RIIO-ED1 process will consider a range of factors. It will consider the role of smart grids and how smart grids could be developed and integrated into the system and it will, potentially, look at the drivers of costs, which might well include connection of local generation. It is the appropriate forum for such discussions and debates.

It is worth mentioning how transmission charging works at the moment. Because transmission charging for demand is lower in areas such as the north of Scotland, there are incentives to build load in order potentially to absorb some of the generation that might be constrained in being exported out of the area.

This is a debate—

Mike MacKenzie: If I can interrupt you there, that is the point that I am really struggling to understand. This committee has been led to believe that the last time you looked at project transmit, it was still indicating transmission charges for Scotland's islands that are several times higher than those for adjacent sites on the mainland.

Andrew Wright: Yes—that is the case for generation.

Mike MacKenzie: From what you told Rhoda Grant, it seems that not only are generators charged more to transmit and feed into the grid, but users are charged more for the cost of distribution in the north of Scotland and on Scotland's islands. Surely that cannot be correct.

The Convener: I appreciate that that may not be your area of expertise, Mr Wright.

Andrew Wright: No.

The Convener: You might prefer to give us a written response.

Andrew Wright: It would be a good idea to give you a written response in any case.

Once again, it is worth separating out the local distribution charges, which are driven by the geography of the area and the population density, and the transmission charges, which have different drivers. Project transmit is dealing with the transmission charging issue. RIIO-ED1 is dealing with electricity distribution charging and we will deal with many issues relating to local collection of generation into the distribution network, smart grids and whether there are any undue barriers to the realisation of innovative solutions, such as those that have been described.

Mike MacKenzie: Do you agree that what you have just described is a double whammy for the north of Scotland and Scotland's islands?

Andrew Wright: No, I would not describe it as that. The parallel is that the transmission charging for demand would be lower for customers in Scotland. Transmission charges are a lower part of the overall bill than distribution charges.

Mike MacKenzie: If I could put it another way and think in terms of outcomes, fuel poverty in England is about 20 per cent; in Scotland it is about 30 per cent; and in Scotland's islands it is 50 per cent. Earlier, you described your various proposals to regulate the market more effectively, but will any of the measures have any impact whatever on redressing that situation, which to me looks like a market failure?

10:30

Andrew Wright: The retail market proposals are designed to ensure that no customer pays more than they need to for their energy. Many customers today could save money by switching to better deals with the same supplier or with a different supplier. We want to make that as easy and as simple as possible.

Mike MacKenzie: With respect, you are not answering my question, which was about redressing the imbalance. In what way will the measures that you described ameliorate or mitigate the disproportionate fuel poverty that is suffered in Scotland's islands and in Scotland, in comparison with England?

Andrew Wright: Energy prices are one significant contributor to fuel poverty. Our retail market proposals will, by making the market as effective as possible, ensure that customers can hold suppliers to account, which we hope will mean that they pay no more than they need to, which will drive efficiencies in those companies and ensure that people get the best deal possible. That is what we are aiming to do through the retail market review.

Alison Johnstone (Lothian) (Green): You said that the reforms seek to ensure that

"no customer pays more than they need to",

but a report by Consumer Focus suggests that the wealthiest customers are three times more likely to use a price comparison website than the poorest groups. Have the proposals been designed to target the parts of the market, such as the lower end or vulnerable customers, in which people are still not getting a good deal? What is being done to address that issue?

Andrew Wright: That is a good question. You are absolutely right that vulnerable customers are more likely to be disengaged from the market. The levels of trust and confidence are lower and the barriers to getting access to good information are greater. Therefore, our proposals will in themselves improve the way in which the market functions for vulnerable customers by addressing the barriers that they face in getting into the market.

We recognise that the current proposals might well not be enough. There is a role in the market for what we call at-a-glance capability or comparisons, through which people can see, simply by looking at a piece of paper or a set of numbers, which deal is best for them, without needing to go through a comparison website.

One way that we propose doing that is through providing customers with information about the cheapest deal for them across the market, taking into account their particular circumstances. However, that is not easy to do. There are many questions about the technology to enable that, data protection issues and whether information is best delivered through suppliers or a trusted third party. We have proposed a trial on that with the suppliers. We have written to all the suppliers and, gladly, all of them have agreed to get together and work out the best way of putting such a trial in place. That will involve considering some of the difficult implementation issues.

We will push ahead with that. We think that there is a need to provide even easier ways to compare prices and tariffs than our retail market review proposals will provide—and ways that are targeted at the stickiest and most vulnerable in society.

Rhoda Grant: I want to go back to the issues of dual fuel in rural areas, which Dennis Robertson touched on. One issue is to do with people who have heat and power coming from electricity. SSE has had different ways of providing that: there is total heating with total control; there is now a new system; and there also used to be a system of dual metering for storage heaters. Constituents tell me that they cannot move supplier because that type of heating is specific to SSE and that, therefore, they cannot get the best deal. What are you doing about that and how are you opening up that market?

Andrew Wright: This is a long-standing difficulty with no easy solution. We have considered it a number of times, but finding an easy workaround has not been easy. There are alternative offers out there, but not many. The only consolation is that, as our studies have shown, the customers who are on the tariffs in question are generally getting a good deal compared with other customers who are more readily able to switch, such as those on standard economy 7.

The long-term solution probably lies in smart metering, which will make it far easier for other companies to offer similar tariffs than it is possible for them to do today. The Westminster Energy and

Climate Change Committee asked a similar question, and we undertook to consider the issue again because of continuing concerns. We expect to report on the matter in the next couple of months—hopefully in June. I will ensure that you get a copy of that report when it comes out.

Rhoda Grant: That will be interesting to see.

You say that smart metering is a potential solution, but I understand that it requires good broadband connectivity in order to work. A lot of the areas that are covered by the type of heating in question have poorer connectivity—if, indeed, they have any at all—so there is almost a dual barrier. Will you take that on board and think about ways in which that issue could be addressed as well?

Andrew Wright: Yes. The smart meter programme is being led by DECC. We work closely with DECC to ensure, as far as we can, that what it is doing meets the needs of consumers. The issue that you raise is potentially an important one.

At the moment, DECC is considering potential suppliers of what it calls the wide area network, which involves the communication links between the smart meter and the central data and communications hub. One of the issues around the consideration of suppliers is the extent to which they can deliver solutions in remote areas that are off the 3G network, for example.

We will continue to apply pressure with regard to the needs of people who are in areas where data communications are not as good, so that they are considered and well provided for. We can do what we can in that regard, but that might be something that you would like to keep a close eye on as the smart meter programme develops.

Margaret McDougall (West Scotland) (Lab): What discussions have you had with companies on the issue of customers who are in arrears and are perhaps paying off their debt by card? Have you discussed the fact that they cannot swap suppliers in the same way that other customers can?

Andrew Wright: We have been concerned about the fact that customers who are in arrears might not be able to change supplier in order to swap to a cheaper deal—a fact which could make it even more difficult for them to get out of debt as they might be paying more than they need to for electricity and gas.

Suppliers are able to block customers who are in debt from switching, but we raised the limit for that from £100 to £200 and we have now raised it to £500 so that it affects as few customers as possible. We have watched with some concern as the numbers of customers in debt and the levels of debt have risen. We have a series of rules and requirements on companies to treat those customers fairly and to give them the best opportunity possible to get out of that position.

Margaret McDougall: There is no mention whatsoever of that in your paper. Could you give us some more information on that?

Andrew Wright: Certainly. I am happy to do so. We addressed the matter—I cannot remember exactly when, but it was probably during the past year—by raising the limit to £500. We took action fairly recently.

Margaret McDougall: To make it easier for people to switch.

Andrew Wright: Yes. Perhaps more could be done, by us or by someone else, to publicise that, so that people do not assume that they cannot engage in the market because they are in debt.

Rhoda Grant: I think that SSE is one of the only companies that offers the same tariff to people with meters as it does to people who pay quarterly bills. Most other companies charge more if someone has a meter, which seems a bit perverse. Someone who gets metered electricity and pays by card or whatever is obviously less able to pay, so it seems morally wrong to make their power more expensive. Are you taking steps to protect people on meters from excessive charges?

Andrew Wright: We must be clear about where our powers and responsibilities end and where those of Government begin. We have done all that we can do to ensure that there is not excessive charging of people on prepayment meters, because those customers might engage less in the market and companies might think that they can get away with charging them more because they are in debt or for whatever reason.

As part of the energy supply probe we introduced a new licence condition to require the charges on meter types to be cost reflective. As a result, a number of companies brought down their prepayment premiums. There has been significant benefit through that.

We want to ensure that such customers engage in the market. Although there are many good things about companies' withdrawal from doorstep selling, I am aware that many prepayment customers engaged in the market through that route, so I hope that our proposals will encourage more such customers to get into the market and will bring prices down. However, we are not in a position to require companies to cross-subsidise between one group of customers and another. That is a matter of policy, which is for Governments to address.

Mike MacKenzie: Surely the whole approach is based on the delusion that all consumers secretly harbour the desire to be amateur energy traders. Was David Cameron correct when he said that the obligation should be on the energy supplier automatically to transfer people to the most cost-effective tariff?

Andrew Wright: I agree that what you described would be a delusion. In the current proposals and in the probe, we abandoned that delusion and tried to construct a market that fits with the real world, recognising that people probably have better things to do with their lives than stare at price comparison websites.

It should be as easy as possible for people to compare. Our proposals include not just better information and simplification but prompts that alert people when they might be paying more than they need to pay. For example, we propose the tariff comparison rate, with its APR-type metric, and we propose that people should be provided with information about how much they are paying and should be prompted about their right to switch on their bill and annual statement—introducing the annual statement was our proposal, too.

We are thinking about introducing other measures. The market cheapest deal proposal would mean that customers who did not engage in the market for a time would get a letter telling them the best deal for them across the whole market. If we can get a trial under way and make the proposal work, we will go further.

For better or for worse, we are responsible for a system of competition in retail markets that must hold companies to account and control prices. That is potentially a matter for legitimate political debate, but our job in the meantime is to ensure that competition works well. We are doing that by reflecting how people behave in the real world.

10:45

Mike MacKenzie: Have you considered developing sniper software that would automatically buy the best energy deal on the market on any given day for consumers? As you will know, the prices often change day to day or week to week.

Andrew Wright: There is no reason why such proposals could not be developed commercially by someone if there is a market for it. As a regulator, that would not be a role for us. However, our proposals will simplify the market to such an extent that such comparisons and tools and technologies become more feasible. Up until now, tariffs have been so complex that I doubt that any simple piece of technology could make an effective decision on behalf of consumers. Perhaps now they will be able to.

Alison Johnstone: On the subject of engaging those who are far away from thinking about switching to a more economical tariff, it has been suggested that collective switching might be a way to engage such people, who might feel more confident if the scheme was run by a local authority or a third sector organisation. Perhaps even a neighbourhood group of flats might get together to switch. That approach might provide more information and reassurance and give people who are not switching more confidence. Are there any barriers to collective switching? If so, are there any proposals to remove them? Are there any proposals to raise awareness of collective switching as an option?

Andrew Wright: That is a good point, and I should probably have referred to that issue in relation to the previous question on how we can develop proposals to address fuel poverty.

Collective switching has significant potential, particularly in engaging the parts of the community that have not previously engaged readily with the markets and in making decisions easier. Our proposals will not stand in the way of collective switching—I think that there was concern in some quarters that they would. When entering into a collective switching process, the limits on the number of tariffs will not apply. That derogation will enable companies to engage without using up one of their four tariff slots, so we are helping in that sense.

We are also beginning a work programme that is looking at third-party intermediaries to ensure that there are no barriers not only to collective switching but to other forms of agent operating in the market. It will also look to ensure that where those intermediaries operate they do so in the consumer’s interest, because we have certainly had a lot of concerns in the non-domestic market about the functioning and operation of agents who have not always worked in the consumer’s interest.

We are looking at a number of things, but we do not think that there are significant barriers to collective switching. The number of schemes that have taken off over the past year or two has shown that. However, if there are any barriers, we ask people to point them out to us.

Alison Johnstone: Another way to reduce bills is to be energy efficient. It is fair to say that the two-tier tariff set-up that rewarded people for using more energy sent out the wrong signal, so I am pleased to see the proposal for single tiers. What consideration has been given to designing tariffs to encourage energy efficiency in customers?

Andrew Wright: First of all, the question on tariff design and the impact on consumer behaviour is complicated. With current technology, things such as rising block tariffs that have been proposed to encourage energy efficiency could easily have adverse consequences that would lead to customers paying more than they would otherwise do without necessarily impacting on people's behaviour.

Unless there is real-time feedback on what block of the tariff consumers are on, it is difficult to know how they will change their behaviour—they will understand that they were paying too much only when they get the bill three months after they have taken the action. Smart technology is almost a necessary precursor to such tariffs and arrangements working.

Once smart technology is available, all sorts of things could be done to make energy use more efficient through, for example, using less of it, using it at the right time of day to address some of the congestion concerns that we have discussed, the better use of transmission and distribution networks, and so on. All sorts of possibilities open up with smart technology.

Alison Johnstone: Thank you.

Chic Brodie (South Scotland) (SNP): Good morning, Mr Wright. You have already said in evidence this morning that proposals going through just now are not enough and that more could be done to alert people who are in debt to switching. We are just tinkering, aren't we?

Andrew Wright: No, I do not think so. The change is radical and a marked difference from what we had before. We are almost unique among economic regulators in taking active measures to simplify the market, to prevent companies from putting in place more complex and confusing products, and to limit the number of products. Those are quite radical measures for a regulator to take, although they are absolutely proportionate.

Of course, we could go further—

Chic Brodie: Why are you not going further?

Andrew Wright: Because we as a regulator have a duty to ensure that what we do is evidence based, necessary and proportionate. Breaching that might leave us open to challenge. Moreover, companies might not accept the proposals and might persuade the Competition Commission that we have gone too far.

That is not to say that we are afraid to put forward proposals and do what we think is necessary, but what we are doing strikes a good balance between, on the one hand, providing enough commercial freedom for the companies to innovate and compete and, on the other, protecting consumers against complex and confusing tariffs. That is a difficult balance to strike. If we go too far, companies will not be able to develop and innovate with regard to, say, smart tariffs and we might end up in a situation in which everyone can have any tariff as long as it is black. In other words, there would be the same sort of tariff and no real effective competition. That is the concern that we need to be wary of.

Chic Brodie: Let me tell you the concern that I am wary of. We might talk about the various tariffs as products, but at the end of the day we are talking about only one main retail product. With gas, for example, a recent study called "The gas game" that *The Guardian* carried out suggested that there was a cartel on wholesale pricing. Do you believe that? What are you doing to investigate or make your own determination of wholesale gas prices? Why would all the gas companies wish to trade at the same time, thereby increasing demand? Obviously, with the manifest effect on the wholesale price, that is manna from heaven for a supplier. Why do we not determine what is going on at the wholesale end before we start working our way through what you call "the products"?

Andrew Wright: We are doing that. Although I have been focusing on retail in my evidence, I should point out that I am responsible for wholesale and retail markets and that we are carrying out a lot of work on the wholesale market.

Before I go any further, I want to make it clear that there is no evidence of a cartel in wholesale gas markets. Anyone who has such evidence should bring it to us, and we will act on it.

Chic Brodie: Are you not surprised that they buy at the same time?

Andrew Wright: In what sense do you mean "buy at the same time"?

Chic Brodie: According to the report in question, trading took place on 28 September.

Andrew Wright: Right. There are a number of specific allegations about trading on 28 September and a number of broader allegations about the integrity of the wholesale gas markets and the functioning of price reporting agencies. An investigation on the allegations about pricing on 28 September is on-going—

Chic Brodie: Can you tell me when that investigation will report?

Andrew Wright: No. As a matter of policy, we do not comment on on-going investigations.

Chic Brodie: You said that you are responsible for wholesale and retail markets. Recently, there was a Government inquiry into the banking system and proposals to break the banks up into wholesale and retail elements. Is it not time that we did the same thing with the energy companies?

Andrew Wright: To some extent, my answer will be similar to my previous response about whether it is right to focus on competition in retail as the best way to control retail prices and hold energy companies to account. It would be a profound decision for us to say that we require the vertically integrated companies to split up into upstream and downstream. If we took that decision, it would inevitably be challenged and considered at the Competition Commission.

We think that we can make the market work with the various liquidity reform proposals that we are putting forward. When we combine those proposals with some of the UK Government's energy market reform proposals, we see that a lot is changing and that there will be an increasing ability for new entrants to come into the market and gain access to liquidity—as we would hope to see in a good competitive market.

Chic Brodie: To come back to competition—to the Competition Commission and indeed to European competition laws—can you share with us exactly where it says that companies can block switching because of the debt of end users?

Andrew Wright: As I mentioned before, we have raised the limit below which companies are not able to debt block.

Chic Brodie: No, my question is: where does it say under European competition law or under Competition Commission guidance that the energy companies can block switching because of the level of debt of an end user?

Andrew Wright: Sorry, I am not sufficiently familiar with that. I will come back to you on that question.

Chic Brodie: I have a quick question before we talk about tariffs. As regards the companies themselves, I had an experience the other evening because I disputed some of the charges that were applied to gas in my Edinburgh flat. I got a call and, when I returned the call, I was switched through to Delhi—which is fine—and I was told that the number I got from the incoming call was from the call centre out and the Delhi call centre was the call centre in. I have challenged the administration of a particular gas company on various other issues. I do not believe that that company is unique.

What investigation has gone into the operational efficiencies of the gas companies? Everyone keeps saying that the price is going up because of wholesale prices, but when I look at the financial reports of the six major utility companies I look at marketing costs, the costs of the salaries of executives and the dividends of major shareholders. What do you do in terms of looking at how efficient those companies are?

Andrew Wright: The first thing is that, with the system of competition that we have in Great Britain, it is primarily the actions of customers switching that hold the companies to account. We do all that we can to make that competitive process work well, and I hope that I have described what we are doing in that regard.

We also monitor the effectiveness of the market. One of the things that we look at is the cost of the companies and whether competition is driving energy efficiency. Certainly when we looked at the retail market review, the evidence was very mixed, which suggests that there was not a massive competitive constraint on the operating costs of the companies. That is a matter of concern and it is why we are taking action. We are not apologists for the competition in the energy market. That is why we are taking what we consider to be radical steps to increase competition in it.

The companies are not price regulated. We look at those issues in great detail in relation to the distribution companies. It would not be appropriate to do that for companies that are competing in the competitive market.

Chic Brodie: I understand that the companies are not price regulated, but we look to you to help guide them through that. Can I ask—

Andrew Wright: I am sorry to interrupt, but we do an awful lot to increase transparency about the costs and prices of the companies in the market. We are responsible for requiring the companies to publish segmental statements on an annual basis, separating out the various businesses and breaking down the costs into fuel purchase costs, operating costs and so on. We have done a lot to get some of that information into the public domain and, as I mentioned before, we are also doing everything we can to make the market work more effectively, recognising that it is not at the moment.

11:00

Chic Brodie: I do not want to demean the work that you do—I compliment, in particular, the group in Scotland—but the harsh reality is that you do not really have the teeth to make the recommendations bite.

Andrew Wright: I think that we have the teeth to make these recommendations bite. Our willingness to enforce was demonstrated only a few weeks ago, when we announced the £10.5 million fine against SSE for misselling. That is only one of a number of enforcement cases that we have taken, both in general and on the probe remedies. If the companies think that they can get away with flouting the licence conditions that we have put in place as part of the retail market review, they will find us investigating them and enforcing the conditions as vigorously as we always have. I think that, for the current proposals, we certainly do have the teeth.

The question is whether we ought to move more towards a price-regulated model in retail energy. That is a matter for political debate. We operate to make the system that we have work as effectively as possible, and that is what we are trying to do.

Chic Brodie: I am sure that you do. It is the system that we have a problem with. Thank you.

Dennis Robertson: I have a brief supplementary question on enforcement. Companies did not engage with you when we had the voluntary code and guidance, which is why you have taken radical steps now. What are the next steps if the companies do not engage?

Andrew Wright: If the companies do not comply with the standards of conduct that we have set out, we will have the option of taking enforcement action against them. We have a variety of tools that we use for enforcement, ranging from writing letters of gentle encouragement to full-blown enforcement and fines. We will continue to use that range of tools to get the best outcomes for consumers.

Dennis Robertson: You regard that as sufficient enforcement. What would be your next steps after that? I suppose that you hope that engagement will be forthcoming.

Andrew Wright: Yes, I am confident that it will be. If it is not, we will continue to use the full range of enforcement powers that are available to us. The idea of the standards of conduct is to get companies thinking carefully about how to run their business in a way that aligns with those standards of conduct. We certainly want to see companies embedding those standards in their business processes in the way that they deal with customers.

Marco Biagi: You mentioned the £10.5 million fine for SSE. Can you remind us what its profit was last year?

Andrew Wright: I do not have the figures to hand, but it was clearly quite a lot more than that.

Marco Biagi: It was several billion pounds, was it not?

Andrew Wright: For the group as a whole, it was billions. However, that includes a wide range of generation network businesses and businesses outside the UK.

Joan McAlpine (South Scotland) (SNP): I am a substitute member of the committee, so you will forgive me if my questions are not as technically informed as those of my colleagues who are on the committee every week. How much is Ofgem driven by ethical considerations?

Andrew Wright: We are a statutory body with duties, objectives and functions, and we operate within a statutory framework. Many of those statutory duties are driven by ethical considerations such as the duty to have regard to the interests of vulnerable customers.

In general, our primary objective of promoting the interests of consumers has a strong ethical element to it. We are not a political organisation, so there are limits to that. However, we operate ethically and, if we feel that the arrangements that we are responsible for are not delivering in the interests of consumers, we are prepared to stand up and say so to Government or anyone else who may have the powers to do something about it. It is important that we retain our impartiality.

Joan McAlpine: Do you think that the power companies that you regulate operate ethically?

Andrew Wright: We propose to introduce a set of standards of conduct reflecting how we think that power companies ought to treat customers in the marketplace, which includes a requirement to treat them fairly. We think that they should treat their customers well and fairly, and we are willing to take action to ensure that they do so.

Joan McAlpine: Do you think that they do?

Andrew Wright: If we thought that they did in all circumstances, we would not have thought it necessary to introduce a statutory licence condition. The rhetoric around the enforcement action that we took against SSE shows that we were not entirely comfortable with what it was doing. However, it would be unfair to pick on only that company. That is one instance, but there are a number of instances in which we think that customers have not been treated well.

Joan McAlpine: Let us return to the question that Mike MacKenzie asked about island customers and fuel poverty. Do you think that it is ethical that people in areas where the natural resources generate energy for the rest of the UK pay higher bills, even for all the reasons that you outlined concerning the market? Do you think that that is ethical?

Andrew Wright: We are responsible for regulating the electricity system, and we seek for that to be done in a way that is as fair as possible and that does not discriminate against any particular group of customers. If the rules or arrangements do not deliver that, we are interested in addressing the situation. If we do not have the powers to address it or if we are working within a statutory framework that does not allow us to do that, we have shown that we are comfortable with engaging with the politicians who might have the powers to do that. I will leave the question there.

Joan McAlpine: Thank you.

The Convener: Okay. That concludes all the questions that we wanted to cover with you, Mr

Wright. Thank you very much for a very interesting and helpful session.

11:07

Meeting continued in private until 11:41.

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e-format first available
ISBN 978-1-78307-929-2

Revised e-format available
ISBN 978-1-78307-945-2

Printed in Scotland by APS Group Scotland