

# Pre-legislative scrutiny of the draft Domestic Gas and Electricity (Tariff Cap) Bill inquiry

## Energy UK written submission

29<sup>th</sup> November 2017

### 1. Introduction

1. 1. Energy UK is the trade association for the GB energy industry with a membership of over 90 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership encompasses the truly diverse nature of the UK's energy industry from established FTSE 100 companies' right through to new, growing suppliers and generators, which now make up over half of our membership.
1. 2. Energy UK strongly believes in promoting competitive energy markets that produce good outcomes for consumers. In this context, we are committed to working with Government, regulators, consumer groups and our members to develop reforms which enhance consumer trust and effective engagement. At the same time, Energy UK believes in a stable and predictable regulatory regime that fosters innovation, market entry and growth, bringing benefits to consumers and helping provide the certainty that is needed to encourage investment and enhance the competitiveness of the UK economy.
1. 3. These high-level principles underpin Energy UK's written submission to the BEIS Select Committee's Pre-legislative scrutiny of the draft Domestic Gas and Electricity (Tariff Cap) Bill inquiry. This is a high-level industry view; Energy UK's members may hold different views on particular issues. We would be happy to discuss any of the points made in further detail with the Committee or any other interested party if this is considered to be beneficial.

### 2. Energy UK's comments

2. 1. Energy UK would like to make the following comments in relation to the proposed clauses set out in the draft legislation:
2. 2. **Appeals rights to expert economists (the CMA):** Given the scale of the proposed intervention in the competitive retail market, Energy UK is concerned that the draft legislation proposes to place a duty on Ofgem to set a price cap for standard variable and default tariffs without the ability to refer the level at which the cap is set to independent experts. In the absence of the ability to refer Ofgem's decision to an expert body (the CMA), there is a risk that the cap will be set at the wrong level, which could be detrimental to consumers and competition.
2. 3. In particular, Energy UK has concerns about the lack of appeal rights to the CMA in relation to how Ofgem constructs any cap. Energy UK believes that interested parties such as suppliers and consumer groups should retain the right to appeal Ofgem decisions on substantive grounds.
2. 4. Should Parliament pass a bill requiring Ofgem to implement a price cap, then this is the will of Parliament and if CMA appeals were provided parties would not be able to appeal Ofgem discharging its duties (i.e. they would not be able to stop a cap coming in). Government and Parliament should not, however, assume that when discharging its duty to implement a cap, despite all parties' best intentions, Ofgem will deliver a cap that will guarantee the best outcomes for consumers. For example, despite Ofgem carrying out extensive consultation, Ofgem's 2013/14 Retail Market Review (RMR) reforms resulted in some sub-optimal policy outcomes, as

demonstrated by the findings and remedies published by the CMA last summer. The RMR issue shows that consultation and impact assessment by one body does not substitute the ability to ask a second independent expert to review the decision.

2. 5. We note that in the absence of appeals to the CMA, Judicial Review (JR) will still be an available appeal option for interested parties. An appeal route to the High Court (JR) is, however, not a reliable protection against a cap being set against the wrong level because High Court judges are not reliable experts in the economics of setting energy price controls. JR will not, therefore, assist in creating a stable or predictable environment as the substance of a policy decision cannot be scrutinised effectively by an expert appeal court.
2. 6. A merits-based review by an independent expert body like the CMA is a faster and more effective appeal mechanism than JR and will mean that any potential appeals are treated in a consistent manner with other price controls. This will help the sector as a whole achieve better outcomes for consumers and investors.
2. 7. The need for effective appeal rights for regulatory decisions, particularly with regards to price controls, is widely accepted. The CMA is the arbiter on price control in all other utility sectors (water companies, electricity and gas networks, OpenReach) and as the competent expert body it should also be the arbiter for price controls for retail energy supply.
2. 8. **Clause 1(6):** The duties set out in this Clause differ from Ofgem's existing regulatory duties. It is important that any differences do not create conflicts or regulatory uncertainty. In particular we would highlight:
  - a. 1.(6)(e) currently states that in setting the cap the Authority must have regard to "the need to ensure that the holders of supply licences who operate efficiently are able to finance activities authorised by the licence". The draft bill is, however, silent on how the benchmark for an efficient supplier will be set. It is also already implicit in Ofgem's current duties to incentivise suppliers to operate efficiently. This is reiterated in 1.(6)(b) which explicitly requires Ofgem to "create incentives for holder of supply licences to improve their efficiency". 1(6)(e) should, therefore, be changed to reflect Ofgem's current statutory duties, so as to ensure regulatory predictability and stability. The wording should be "*the need to secure that licence holders are able to finance the activities which are the subject of obligations imposed by the licence or legislation*".
  - b. Ofgem should be given a duty in setting the level of the cap to have regard to decarbonisation objectives, to help minimise any unintended consequences for confidence in investment upstream and to give consideration to the Government's long-term aims, as set out in the recently published Clean Growth Strategy.
2. 9. **Clause 2:** Based on learnings from the existing PPM price cap, we believe that in devising any cap it is important Ofgem has the flexibility to adjust the cap as required in line with cost and regulatory changes and developments.
2. 10. **Clause 3:** We would like clarification on whether it is Government's intention that green gas tariffs that a customer has actively chosen would be captured by the cap. We note that while there is an exemption for electricity tariffs with environmental benefits, no similar exemption is made for green gas tariffs.
2. 11. **Clause 4(2):** As per its existing approach to consultation, and in the interest of transparency, Ofgem should also be required to set out its rationale for making any modifications.
2. 12. **Clause 6 & 7:** Energy UK notes that the criteria that Ofgem will use for its assessment for whether the cap should lapse in 2020 are unsatisfactory. It is unclear what Government means by "*conditions for effective competition*". There is a risk that the cap could become self-perpetuating if this clause is interpreted to include the extent of consumer engagement, for example. Current metrics for measuring retail energy market competition, such as levels of (external and internal) switching and number of active suppliers, may be negatively impacted by the introduction of a market wide price cap.

2. 13. In light of this and in the absence of a clear and realistic definition of the “*conditions for effective competition*”, as a minimum Energy UK believes the decision as to whether any cap should be extended beyond 2020, should sit with the independent regulator, rather than the Secretary of State, based on the analysis undertaken in line with 6(1). This will ensure that any decision is based on a robust evidence and analysis as opposed to political expediency. We welcome the inclusion of the 2023 hard-stop end date for the cap.
2. 14. **Clause 8:** Energy UK is concerned that the proposed powers – “*the Authority may make such modifications of any standard supply licence conditions as it considers necessary or expedient in consequence of the tariff cap conditions ceasing to have effect as provided by section 7*”- is very broadly drafted and could be interpreted and utilised more widely by Ofgem than originally intended over their lifetime. It is important that any new powers granted to the Authority are limited in both time and scope to only where required to deliver the specific outcomes. We also note that currently, no case has been made in the draft bill or the explanatory note as to why Ofgem require such additional powers, over and above their existing powers to modify the supply licence.

**For further information or to discuss our response in more detail please contact Daniel Alchin on 020 7747 2965 or at [daniel.alchin@energy-uk.org.uk](mailto:daniel.alchin@energy-uk.org.uk).**