House of Commons
Committee of Public Accounts

The new electricity trading arrangements in England and Wales

Second Report of Session 2003–04

Report, together with formal minutes, oral and written evidence

Ordered by The House of Commons to be printed 1 December 2003

HC 63
Incorporating HC 835-i, Session 2002–03
Published on 16 December 2003
by authority of the House of Commons
London: The Stationery Office Limited
£10.20

The Committee of Public Accounts

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Mr David Rendel MP (*Liberal Democrat, Newbury*)

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Committee staff

The current staff of the Committee is Nick Wright (Clerk), Christine Randall (Committee Assistant), Leslie Young (Committee Assistant), and Ronnie Jefferson (Secretary).

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Summary

Introduction

The wholesale market for electricity is an essential link between the generators who produce electricity and suppliers who sell it to consumers. The electricity industry was restructured in 1990, most of it privatised, and an arrangement for the wholesale trading of electricity, known as the Pool, was set up. The Pool was criticised by customers and other stakeholders as a mechanism for setting prices. Following a review in 1998, the Department of Trade and Industry introduced the New Electricity Trading Arrangements (NETA) in March 2001 which changed the trading arrangements to make the market more competitive and encourage a fall in prices.

Under the Utilities Act 2000, the Office of Electricity Regulation and the Office of Gas Regulation were merged to form the Gas and Electricity Markets Authority, supported by the Office of Gas and Electricity Markets (Ofgem). Ofgem's main objective is to protect the interests of electricity consumers, by promoting effective competition, while all reasonable demands for electricity are met and the businesses concerned can finance their regulated activities.[1] Ofgem and the Department of Trade and Industry shared responsibility for the implementation of NETA.

On the basis of a Report from the Comptroller and Auditor General,[2] we took evidence from Ofgem, on the benefits for consumers of the electricity market, the competitiveness of the market and the security of supply.

1 Section 13 of the Utilities Act 2000

2 C&AG's Report, *The New Electricity Trading Arrangements in England and Wales* (HC 624, Session 2002–03)

Conclusions and recommendations

1. **Electricity prices have fallen, but by much less for domestic customers than for industrial and commercial customers.** Wholesale prices have fallen by around 40% since 1998 and reductions for industrial and commercial customers have been consistent with this fall. But domestic reductions have been much smaller and only 1% to 3% since NETA was implemented in 2001.

2. **Customer loyalty is penalised**. Since the market was opened to competition in 1998, only some 40% of domestic consumers have switched supplier, with a lower proportion for the elderly and those who live in rural areas. Customers who have stayed loyal have benefited much less from competition and pay much more than those who have switched.

3. **Some customers who might have liked to switch supplier have not done so because they have not had the necessary information**. Others may always be resistant to the idea of "shopping around" for a service where their interests have traditionally been protected in other ways—for instance switching rates are lower amongst the elderly. Ofgem, working with *energywatch*, should increase consumer awareness of the information already available to assist the switching process including price and quality comparison services, for instance by requiring these to be signposted more visibly on customer bills.

4. **The domestic retail market has been less competitive than that for industrial and commercial consumers**, who have seen much greater price reductions since NETA was implemented. Ofgem should carry out a review to determine whether the suppliers are acting in an anti-competitive manner to the detriment of domestic consumers and Ofgem should take action such as fines or price caps as appropriate.

5. **Ofgem has very limited information on suppliers' profit margins,** an important indicator of market conditions. To enable Ofgem to form a clearer judgement of the competitiveness of the market Ofgem should start to collect information from the suppliers on their profit margins from domestic supply.

6. **Over recent years, the level of vertical integration has increased in the electricity market.** In Ofgem's view vertical integration in the industry should not be a problem so long as both the wholesale and retail markets are competitive. Nevertheless, Ofgem should take seriously the risk that vertically integrated companies may exploit their position and Ofgem should adapt its competition analysis of the wholesale market and retail markets to reflect the new reality of the market.

7. **Whether the system can meet future increases in electricity demand in severe winter weather is uncertain.** At present, the electricity system has more capacity to generate electricity than required. Ofgem appears confident that market mechanisms will ensure that companies have sufficient generating plants to produce enough electricity to meet all reasonable demands. But the margin of spare capacity over expected demand has been falling continuously since the introduction of NETA when it was nearly 30%, and currently stands at around 17%. Ofgem takes confidence from the potential for "mothballed" power stations (those taken out of

service by their owners) to meet rising electricity demand. Ofgem has, however no formal powers to ensure that, if a power station is mothballed or a generating company goes into receivership, these assets are kept in a serviceable condition for future needs.

8. **The system operator (National Grid Company) may not know the condition of generating capacity that is taken out of service.** We recommend that Ofgem, with the Department, introduce obligations on administrators of generating companies, and owners of mothballed plant, to ensure that the condition of generating capacity is clearly communicated to enable the National Grid Company to understand better the availability of power stations to meet demand.

1 Consumer benefits from competition

Falling wholesale prices

1. The changes to the trading of electricity brought about by NETA were part of a wider programme to protect the interests of electricity consumers by promoting effective competition. In the 1990s the electricity regulator progressively opened up to competition the market for supplying electricity to consumers, culminating in 1998 with the domestic market. The next stage in improving competition came with NETA in March 2001.[3] The wholesale market has an annual turnover of around £7.5 billion, complex IT systems and a large number of suppliers, traders and generators, so that introducing NETA[4] cost Ofgem £39 million. In addition Ofgem estimated that businesses in the electricity industry could incur additional costs of up to £580 million.[5] The Department of Trade and Industry and Ofgem had estimated, however, that NETA and other changes could lead to reductions of 10% in consumer prices.[6]

2. Wholesale prices have fallen by 20% since NETA was implemented and 40% since 1998. In Ofgem's view, this was due to a combination of changes in the structure of the generating market, the spread of competition through all the relevant markets and NETA.[7] In Ofgem's view NETA has therefore delivered benefits in excess of £1.5 billion, much more than the programme cost.[8] This calculation is based on the assumption that NETA causes prices in the wholesale electricity market to fall to the price that a new entrant would charge in generating electricity to recover its costs, rather than earning a set price above this level as under the old arrangements. On this basis, Ofgem estimated that the benefits of NETA would be of the order of £1.5 billion, in terms of lower electricity prices.[9]

The prices charged to different types of customer

3. The prices for industrial and commercial customers, who take two thirds of the electricity generated, have fallen by over a quarter since 1998, and 18% since NETA was implemented. These falls have been in line with the trend in wholesale prices. By comparison, since 1998 domestic customers, who consume one third of electricity generated, have seen an average reduction of only 8% for those who have not switched supplier and 17% for those who have.[10] Most of these reductions have occurred before 2001. Since the start of NETA, in March 2001, average prices have fallen only 1% to 3%.[11]

3 11th Report from the Committee of Public Accounts, *Giving domestic customers a choice of electricity supplier*, para 9 (HC 446, Session 2001–02)

4 Q 7

5 C&AG's Report, para 4

6 *ibid*

7 Q 23

8 C&AG's Report, para 3.2; Qq 7, 22

9 *ibid*, para 4.30

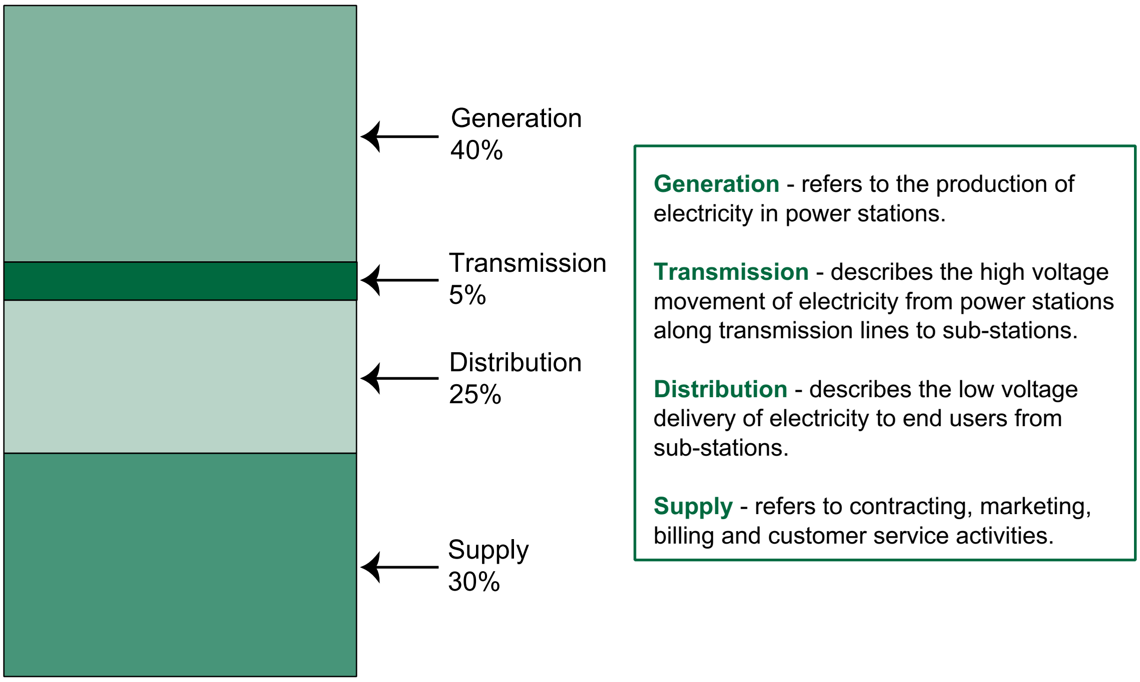
10 Q 22

11 C&AG's Report, para 3.7

4. Ofgem gave several reasons why prices for industrial and commercial customers had fallen more than those for domestic customers:

- energy prices were a much higher proportion of the costs of supplying the former but represented less than half the costs of supplying a domestic customer (**Figure 1**);
- the domestic market was still a relatively immature market, having been opened up for only four years, while competition was introduced earlier for industrial and commercial customers and was further advanced;[12]
- some electricity was still being sold on older contracts at higher prices; and
- suppliers had marketing and environmental costs that they did not have before.[13]

Figure 1: The breakdown of a typical energy bill[14]



Switching electricity suppliers

5. Since 2001, Ofgem has replaced price controls by encouraging competition and consumers to exercise choice. Around 150,000 domestic customers switch their electricity supplier every week; and 39% of customers have switched supplier at least once since the market was opened up. Ofgem said that this represented a better performance than in any other privatised utility or retail banks.[15]

12 Qq 68, 90

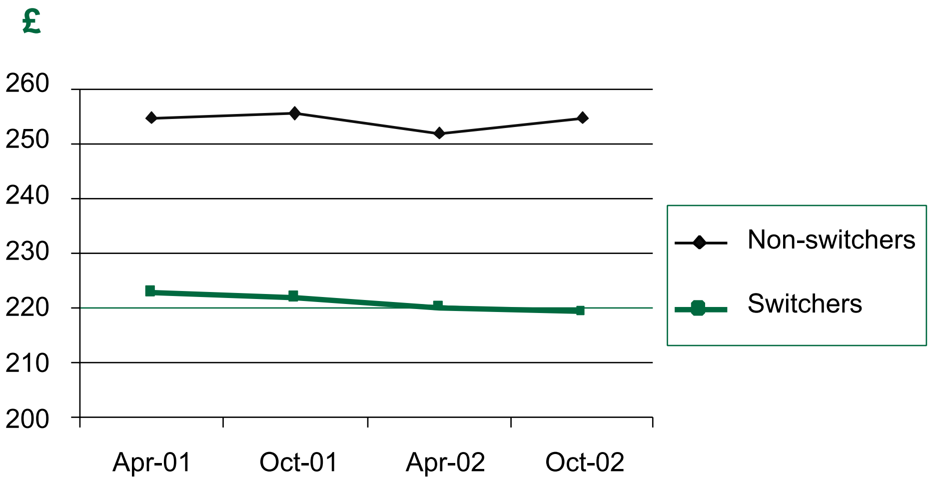
13 Q 53

14 C&AG's Report, p20

15 Qq 4,18, 64, 70

6. In January 2002, we reported that a quarter of domestic customers had switched supplier in the first 18 months of competition, thereby saving around £140 million a year, but that those who had not switched were worse off. We asked Ofgem to ensure that the market was operating in the interests of consumers and that all consumers were adequately informed of the choices available to them.[16] The differential tariff changes between switchers and non switchers are shown in **Figure 2**. This shows that consumers can only obtain the keenest price by switching supplier, and consumers who have not switched continue to pay more for the same energy than their neighbours who have done so.

Figure 2: Changes in the average annual electricity bill for customers since April 2001 on standard credit terms, showing a relatively small fall in prices during the period.[17]



7. Ofgem expects that the difference between the prices charged to consumers who have switched and those who have not switched will decrease, citing academic modelling to show when this might happen. The incumbent suppliers of customers who have not switched have been losing market share at 5% a year. This research suggested that they might change the rates offered to non-switching customers once they had lost half or more of their original customers.[18]

Consumer information

8. The responsibility for disseminating information to help consumers choose between competing suppliers passed from Ofgem to *energywatch*, the watchdog for energy consumers, who revised and improved the price comparison information available to consumers. It provides this in the form of leaflets and on the internet. Ofgem also started validating commercial comparison websites which *energywatch* now administers and spreading the message that switching is simple in other ways, for instance through educational programmes in schools.[19]

16 11th Report from the Committee of Public Accounts, *Giving domestic customers a choice of electricity supplier* (HC 446, Session 2001–02)

17 Based on C&AG's Report, Figures 6–7, p 21

18 Qq 93–94

19 Qq 61, 111

9. Information to help consumers choose is of little benefit if they are not aware of it. The *energywatch* telephone number is printed on the back of every electricity bill but whether consumers understand its significance is a different matter. In deciding whether to ask companies to display information about choice more prominently on the bill, Ofgem said it had to strike a balance between doing so and the risk of limiting the display of other types of information.[20]

10. There has been little difference in the switching figures for different socio-economic groups, but the proportion has been lower for some categories of consumer such as the elderly and those who live in rural areas. Ofgem has therefore been working with Age Concern and various countryside bodies to try and reduce this differential.[21]

20 Qq 112–115

21 Q 18

2 The competitiveness of the electricity markets

11. There are separate markets for generators to sell electricity to suppliers (the wholesale market under NETA) and for suppliers to sell to consumers (the retail market). Ofgem has been concerned to ensure competition in both markets.[22]

The wholesale market

12. One of the objectives of NETA was to promote competition in wholesale markets. Ofgem considered that under the previous arrangement there had been market manipulation on a number of occasions and that NETA had reduced this and the risks of market abuse.[23]

13. The wholesale electricity market is, however, a special market where generating companies can have market power for very short, but critical, periods. Ofgem monitors the market carefully to watch for such abuse and sought in 2000 to obtain an additional power to facilitate action against companies found abusing the market. It said that the Competition Commission, however, had struck down this power. Ofgem did not believe that there had been transient abuse. Their purpose in seeking a market abuse licence condition had been to demonstrate to those who might be tempted to abuse the market that Ofgem regarded it as a serious issue.[24]

The retail market

14. *Energywatch* has called on Ofgem to investigate why electricity suppliers' margins have increased. Ofgem recognised that the margins are currently higher than in the past but it only had actual figures for the two companies that have published margins for their retail operations (Centrica and Powergen) with 4.2% and 4.3% respectively on turnover. These were higher than when there had been price controls on the retail market, although even under price controls companies often out-performed their targets and earned significantly higher profits than the 1.5% allowed.[25] Ofgem consider that the business is now riskier, so that investors might expect higher returns, and it did not believe that a 4% margin indicates undue or improper market power. There is not enough evidence to show whether customers are being exploited.[26]

Vertical integration between the markets

15. When it was privatised, the England and Wales electricity market was based on vertical separation—that is, different companies being involved in generating electricity and in

22 Q 26

23 C&AG's Report, para 1.11, 4.21

24 Qq 27, 82

25 Ev 14

26 C&AG's Report, paras 3.10–3.11; Q 6

supplying it to consumers. This vertical separation has gradually given way to a more integrated structure, and the C&AG's report showed how there are now six large vertically integrated companies operating in England and Wales.[27]

16. There have been concerns within the electricity industry about the increasing vertical integration in the industry. Europe Economics, advisers to the National Audit Office, suggested that vertically integrated generating companies could oblige independent generators or suppliers to take out contracts to cover unexpected changes in supply or demand at an unfair price.[28]

17. Ofgem recognised the risk of market abuse in the wholesale market and, as indicated in paragraph 15 above, that the domestic market was still relatively immature. But if it thought that either the generating market or the retail market was subject to collusion between companies in either market it said that it would take action under the Competition Act.[29] It would be very concerned about vertical integration if it thought that either market was uncompetitive but it could accept the current level if there was sufficient competition.[30]

27 C&AG Report, para 1.5

28 *ibid*, para 4.23

29 Q 78

30 Q 26

3 Security of Supply

18. Ofgem has a legal duty to make sure that all reasonable demands for electricity are met, while the National Grid Company is responsible for the day-to-day balancing of electricity supply and demand. There is, however, no equivalent in NETA to the previous Pool arrangements whereby suppliers made payments to generators for making capacity available. Instead the aim is to balance the supply and demand for electricity through market mechanisms. When a shortage of generating capacity is forecast, the relevant market price should rise to give an incentive to invest or make more plant available, and Ofgem said that it had seen evidence of this.[31]

19. The demand for electricity is growing at a fairly steady rate of 1.5% a year. The Government has provided strong financial incentives to encourage the development of renewable sources of electricity which are intended to meet about 1% of the increased demand a year.[32] The remaining 0.5% will need to be met from other sources. At the same time the excess of capacity over peak demand (the safety margin) has fallen significantly below the 20% benchmark that the Department of Trade and Industry considers to be a healthy level.[33] It now stands at 17.7%, well below the levels of close to 30% seen at the start of NETA.[34]

20. On the other hand the safety margin has increased if allowance is made for the plant that generating companies have taken out of active service (mothballed) in response to low wholesale prices. In addition to the benchmark, Ofgem estimates that this could generate 7.5 Gigawatts of electricity or 14% of the peak demand. This plant could be brought back into production—some 2 Gigawatts of it within less than three months—to meet increased demand. Ofgem said that some capacity had been brought back when the supply margin fell.[35]

21. Ofgem is increasingly relying on mothballed plant to help meet demand if there were unexpected closures of power stations (for example, if a nuclear power station needs to be closed quickly for safety reasons) or sudden increases in demand. But the mothballed plant must be in a fit state if it is to return to service quickly. Ofgem and the National Grid Company are therefore seeking to obtain and publish a fuller picture of the state of mothballed plant so that it and the market can judge what plant is generally available. They will have to rely on the owners of the plant to tell them about its condition. Ofgem cannot at present oblige owners to keep their plant in good condition so that it can be brought into use at short notice.[36]

22. We explored with Ofgem the possibility that generators might manipulate the availability of mothballed power stations so as to help inflate short-term prices. Ofgem said that it could take action under the Competition Act if it could prove that a company

31 C&AG's Report, paras 4.2–4.3; Qq 48, 73

32 Qq 31–32

33 Q 33

34 Ofgem Factsheet, *Securing Britain's Energy Supply*, 10 September 2003

35 Qq 36, 48–50

36 Qq 37–43, 52

abused its dominant position by artificially withholding capacity. It might however be hard to prove that plant was deliberately held back to manipulate prices.[37]

23. A number of companies owning generating plant, including British Energy, have experienced financial problems and some have gone into administration, raising doubts about security of supply. Neither Ofgem nor any other body has the power to step in to run plant where the owner is in financial difficulties and the security of supply is at risk, although Ofgem do have powers in the retail market to prevent customers' supply being interrupted. Ofgem have made it clear that they would use these powers, and in the case of TXU Europe this precipitated the early sale of that business. Ofgem has also been pressing the Government for powers to take over networks where their operations are in financial difficulties.[38]

24. Ofgem said that generators have very large capital costs and relatively small marginal costs so that it is worthwhile for the existing company or the administrator to keep running the plant. This had happened in practice in the majority of cases to date, and Ofgem would expect it to happen in future.[39]

37 Qq 42–43, 46

38 C&AG's Report, paras 3.14 and 4.7; Qq 101–102

39 Q 29

Formal minutes

Monday 1 December 2003

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Allan
Mr Richard Bacon
Jon Cruddas
Mr Frank Field
Mr Brian Jenkins
Mr Nigel Jones
Jim Sheridan
Jon Trickett
Mr Alan Williams

The Committee deliberated.

Draft Report (The new electricity trading arrangements in England and Wales), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 24 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Second Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

Adjourned until Wednesday 3 December at 3.30 pm

Witnesses

List of written evidence

Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 18 June 2003

Members present:

Mr Ian Davidson

Geraint Davies	Mr David Rendel
Mr Brian Jenkins	Mr Gerry Steinberg
Mr George Osborne	Mr Alan Williams

In the absence of the Chairman, Mr Alan Williams was called to the Chair

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Mr Tim Burr, Deputy Comptroller and Auditor General, further examined.

Mr Rob Molan, Second Treasury Officer of Accounts, HM Treasury, further examined.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL:

The New Electricity Trading Arrangements in England and Wales (HC 624)

Witnesses: **Mr Callum McCarthy,** Chairman of the Gas and Electricity Markets Authority and Chief Executive, **Mr John Neilson,** Managing Director, Customers and Supply, and **Dr Boaz Moselle,** Managing Director, Competition and Trading Arrangements, Office of Gas and Electricity Markets (Ofgem), examined.

Q1 Mr Williams: May I, before we start, welcome two visitors—Senator The Honourable Christine Sahadeo, Third Minister in the Ministry of Finance, Trinidad and Tobago, and Mrs Sandra McIntyre-Trotman, the Acting High Commissioner. You are very welcome. Our hearing today is on The New Electricity Trading Arrangements in England and Wales. Our witness is Mr Callum McCarthy. Welcome, Mr McCarthy. Would you like to introduce your two colleagues to the Committee?
Mr McCarthy: Yes, Mr Williams. On my right I have John Neilson, who is the Managing Director responsible for customers and supply within OFGEM, and on my left is Boaz Moselle, the Managing Director responsible for Competition and Trading Arrangements.

Q2 Mr Williams: Thank you. We are in the days of loyalty cards and loyalty points and consumers generally seem to expect that loyalty is something to be rewarded. Why is it that in the electricity industry, as with bank customers, loyalty is something that the customer pays for rather than the company? Why do we have such a strange situation?
Mr McCarthy: In what sense, Mr Williams?

Q3 Mr Williams: If you stay with a company you end up paying higher prices than your neighbour who has the sense to move to another company. Why should that be?
Mr McCarthy: It is entirely a matter of choice for the companies how they price their electricity product. We had a choice between establishing and continuing a process of price controls, which is the way that we would have to establish the same price in different areas, or establishing competition and, for reasons which I can explain which we set out at the time and which we believe events have fully justified, we have chosen to encourage competition and encourage people to exercise their right of choice, and I am glad to say nearly 40% of existing customers of the original electricity suppliers have actually exercised that choice.

Q4 Mr Williams: But it does seem to the outside view somewhat unjust that you have a situation where you pay more to stay with the one company. They, like the banks with their interest, have become modern pickpockets, have they not? They rely on inertia amongst the consumers to keep their profits high.
Mr McCarthy: One of the things that we have been much concerned to do is to make switching as easy as possible. One of the things which is a reassurance in this is that 85% of those people who have switched in electricity have found it either very easy, the majority of that 85%, or easy. We are spending a lot of time and effort to make the transaction costs of switching as low as possible and to give people confidence in the switching process. One of the things I would point out is that the switching in electricity, and also in gas, only four years after the market was fully opened up, is a multiple of the switching that occurs between bank accounts after probably 50 years of in theory being able to switch bank accounts.

Q5 Mr Williams: I understand that. It is just a matter of which level of roguery you prefer. You brought in a new regime because it was felt that prices were higher than economically justifiable at that time, yet, according to paragraph 8 of the

document, right in the very last sentence, it says, "The margins of some suppliers seem to have increased as the differential between their costs and some of the retail prices they charge has widened". How does that come about?
Mr McCarthy: I am not sure whether we believe that statement to be entirely true.

Q6 Mr Williams: I am sorry, but you have signed up to this document. Let us be clear. In order to ensure that we do not waste our time haggling about facts these documents are cleared by the NAO for factual accuracy before they are presented to the Public Accounts Committee. That is our tradition and it has facilitated our working. Therefore, anything that is in here, unless it carries a reservation stated by you, is something you have signed up to.
Mr McCarthy: Mr Williams, I absolutely understand that convention. I am merely pointing out that although some people have claimed that margins have widened, one has to look at the facts as we are aware of them. There are two companies which have published margins for their retail operations. One is Centrica and the other is Powergen. One showed margins on their retail operations of 4.2% and the other of 4.3%. That is a higher margin than when you had a controlled business with price controls and a very different risk profile from the position that existed before. It is true that in the previous price controls we had allowed a much smaller figure as the margin in price controls but we do not believe that a 4% retail margin at operating level is an indication of people exercising undue or improper market power.[1]

Q7 Mr Williams: The changes you introduced incurred costs of £580 million as a ball park figure for the industry. Why did it cost so much to achieve so little?
Mr McCarthy: I would not accept the formulation of the question, if I may say so, because, if I may point out, the reduction in prices for industrial and commercial customers has actually produced benefits which are well in excess of £1.5 billion already, so I would not accept a characterisation of NETA as having produced so little. Let me turn to the question of why it costs the industry so much. This is a wholesale market which is measured in billions, approximately £7.5 billion. It is a market which involves complex systems and a large number of players in it—suppliers, traders, generators. They all have to have their own IT systems to do it; there are significant costs in that, and there were significant costs in establishing the Pool in the first instance.

Q8 Mr Williams: With experience is it still regarded as essential that you have to have this half-hourly notification of information? Is that something you could revisit and would it make much difference?
Mr McCarthy: There are some trading systems elsewhere in the world which have even shorter periods. The Australian system, for example, has very short periods. There is an essential problem of the physics of electricity, that you have to balance the supply and demand of electrons second by second and because of that you need a specific detailed balancing mechanism. That is where a great deal of the effort and skill and complexity arises.

Q9 Mr Williams: When it comes then to persuading people to make what are very long term investments, what would be the average time to bring on significant extra capacity? What would the lead time be?
Mr McCarthy: It depends very much on what is the technology. The technology is longest for nuclear build, partly because of the planning dimension involved in that. It is relatively short for combined cycle gas turbine plants which could be a question of two years.

Q10 Mr Williams: As short as that? Are you satisfied that at current wholesale prices you are going to be able to attract enough new investment for new capacity on time and that we are not going to be left with a shortage situation?
Mr McCarthy: I think it is essential that at some stage prices will rise in order to attract new investment because prices at the moment are below new entry costs and that is, I think, generally accepted, but the more general question is, do we believe that the market and forward prices will give an indication that would be sufficient to incentivise people to invest? I think the answer to that is yes.

Q11 Mr Williams: You say that it is generally accepted that at present it is below. To what extent is it regarded as being under the optimum level?
Mr McCarthy: For example, the estimates that are current for new entry prices are something around £21 per megawatt hour. The price yesterday for the winter 2003 base load price was just under £20, so that gives you an order of the difference at the moment.

Q12 Mr Williams: Do these price levels fluctuate very widely over, say, an operating year? What would be the parameters within which you would expect them to operate?
Mr McCarthy: I think you have to distinguish, Mr Williams, between the spot price at any moment, which can vary very considerably, just as under the Pool it varied from zero to high prices, and under NETA where the spot price can also change significantly. However, that is not the relevant question for investment, which is based on long term contract and will be based on the long term forward price level, and that has not varied by more than, I would say, one or two pounds going forward.

Q13 Mr Williams: The law of the stability of large numbers tends to operate to some extent here.
Mr McCarthy: Yes.

Q14 Mr Jenkins: I was fascinated by your answer. I was thinking about the system you have described now. It is totally different from the system as I

[1] Ev 14

remember it. Can you tell me, in your opinion is this super grid going to remain viable over, say, the next ten years?
Mr McCarthy: The super grid being the NGC's transmission system?

Q15 Mr Jenkins: Yes.
Mr McCarthy: Yes, absolutely. The investment in NGC, and also in the equivalent for gas in Transco, is not directly affected by NETA but is subject to different arrangements. It is not a competitive market. It is a regulated market and we regulate it in such a way that I am very confident that it will.

Q16 Mr Jenkins: I am just trying to determine its continued use because if you have got locally generated, locally distributed power stations, there is no need for a super grid, is there?
Mr McCarthy: There will undoubtedly be a huge shift in the nature of transmission and distribution in Britain. What we have called the re-wiring of Britain is undoubtedly going to happen but, equally, if, for example, as is proposed by many people, there is extensive investment in renewables in the north of Scotland, there will undoubtedly be a requirement for a significant grid component to take that power to where it is needed further south in Britain.

Q17 Mr Jenkins: An extension of the grid in effect?
Mr McCarthy: Some reinforcement. One of the things which is happening literally at the moment, this year, is the strengthening of the North Yorkshire line which is going to make a lot more of the Scottish power, where there is a very considerable surplus of generating capacity, available to where the demand is in the south.

Q18 Mr Jenkins: You answered Mr Williams with regard to his first comment about loyalty and how loyalty is not rewarded in this existing system, and I think that is quite right. The concern that I have is that if you are a very able individual and you are very sharp and you can switch companies, you might benefit, but what protection do the less able in our society have from being, if not exploited, placed at a disadvantage? What do you do to protect their interests?
Mr McCarthy: One of our concerns throughout the opening up of the retail market to competition is that the competition should not be the preserve of the well off or the savvy, and we have done repeated surveys to test whether the benefits of competition are spreading throughout society. We published last week the most recent of those. If you take electricity domestic retail markets, on average 39% of people have moved away from the traditional supplier. The figure for social group C2 is marginally higher. The figure for D is marginally lower, but they are all within 1% or 2%. If you look at the figures for single parent families, they have switched more than the average. There are two areas which cause us concern and have caused us some concern for more than two years. One is pensioners, who tend not to switch as much, and the second is those in rural areas. We have done work both with Age Concern and with various bodies in the countryside to try and deal with that.

Q19 Mr Jenkins: As you say, switching was made easier. In fact, it was made so easy the agreement switched after you had died and there are cases where people have had their signature forged on documents by lying, cheating salesmen in this industry. Do you think that has had an effect in causing concern for pensioners in why they do not take up these switching arrangements?
Mr McCarthy: Absolutely, which is why, as soon as the Government gave us the power to impose financial penalties, which was not until last year, we investigated the most egregious and dreadful examples of the sort of behaviour that you have just described, which was the behaviour of London Electricity and Virgin, and fined London Electricity two million pounds, which has had a very salutary effect. We are deeply concerned about any instances of mis-selling of that sort.

Q20 Mr Jenkins: Did you use that two million pounds to allay the fears of pensioners in switching their contracts? Did you have a specific programme to try and overcome that fear, or did the two millions just get swallowed up?
Mr McCarthy: I have no choice under the law but to give it to the Treasury.

Q21 Mr Jenkins: The Treasury? Gordon?
Mr McCarthy: It is not my choice. That is what the law says.

Q22 Mr Jenkins: We should ask him for it back, should we not, and then we can spend it on overcoming pensioners' fears? The Chairman touched on the costs of NETA. Do you think this has an impact on consumers as far as where the cost is passed on to consumers? Do you think it is justified, the cost of setting NETA up?
Mr McCarthy: If I look at the overall effect of the new arrangement, I think it is important to remember that two out of every three electrons generated go to the industrial and commercial market and, since we started this programme, the costs in that market have fallen by over a quarter, and that is a huge benefit to hospitals, to businesses, to factories. In the residual one-in-three electrons that go to the domestic market prices have fallen between 8% and 17%, depending on whether you have switched or not. Our concern is to ensure that people have the maximum confidence in the system, can switch and do so believing that if they do so they will do it relatively easily and make it through.

Q23 Mr Jenkins: With falling prices, is that (a) down to you and the marvellous market place you have set up, or (b) down to technology and the switch that we have made in this country into burning a primary source and converting that into a secondary source and squandering our natural resources in our dash for gas? Which one is it?

Mr McCarthy: Since NETA was introduced, if anything, there has been a slight move in the direction of increased coal burn, so the price reduction I do not think comes through because of increased use of gas. I would also say that during that period gas prices have risen, not fallen, so I think it is through a genuine change. It came about through a combination of a change in the structure of generating to break up what was basically an oligopoly, a spread of competition through all retail markets, industrial, commercial and domestic, and through NETA.

Q24 Mr Jenkins: If we are going to break up the large conglomerates and bring in more producers, why is it that the smaller producers tend to say that the costs of NETA fall upon them disproportionately because they have the same paperwork and they have the same costs to bear as the larger producers? Why is the cost of NETA not proportionate on the generation, for instance?
Mr McCarthy: In many businesses—and this is no way confined to electricity—if you have to do a task, filling in your tax returns, making sure that you abide by Health and Safety Executive rules, that tends to be the same cost and if you can spread it over a bigger output it is less per unit amount, and that is no different here.

Q25 Mr Jenkins: But we would try to encourage the small generators, new entrants into the industry, to increase competition and therefore you are in a position to be able to allay your costs, not on just per producer but on the amount of production you take off producers, are you not?
Mr McCarthy: We are very concerned to ensure that there is a genuinely competitive market in generation. I do not think that anybody has claimed that the present market is not strongly competitive and nobody has claimed that it is failing to produce low prices.

Q26 Mr Jenkins: If you are totally committed to competition, and I accept you are, what is your position in regard to the degree of vertical integration that is taking place within the industry where we have companies owning both generation and supply? Surely that is anti-competitive, is it not?[2]
Mr McCarthy: There are two things which have to be recognised. One is that you can have the same economic effect through contract as you have through ownership and there has always been—and I would argue that it is not a bad thing—the ability for suppliers to offset their risk through contract with generators and vice versa. The other thing is that we have always been concerned to ensure that there is competition at both generating level and supply level. Nobody at all is claiming that there is absence of competition at the generating level, and at the supply level we have six large competing suppliers and, typically, for any domestic household in the country, between 11 and 20 suppliers of energy in total. I would be much concerned about vertical integration if I thought either of these markets was uncompetitive but, provided they are both competitive, I think we can accept the degree of vertical integration that we have.[3]

Q27 Mr Jenkins: At what point do you get concerned about the ownership of the generation? Is it a matter of the number of companies or the size of a particular company?
Mr McCarthy: It is both the share that any company has, and particularly the ability of any company to exercise power within the market, and the electricity market is a special market where it is possible for people to have market power for very short periods which can be critical periods. We watch and monitor that very carefully indeed and, as you will know, we tried to get an additional power, called the Market Abuse Licence Commission, which the Competition Commission struck out and refused to give us.[4]

Q28 Mr Jenkins: One last clarification. Given the fact that we need to encourage new entrants into generation, given the fact that you have got this standard set of paperwork which you are going to send out to each generator irrespective of size, is there any other way you can look favourably upon and give an advantage to a small new entrant into generation?
Mr McCarthy: There are a number of things that we have done for smaller generators which were built into NETA from the very beginning, including a process called consolidation, and we are trying all the time to build that up.

Q29 Mr Rendel: I understand that a number of generators are having problems and there have been concerns about price levels and whether they can remain in existence. What would happen if the Government allowed British Energy to go into liquidation? Would that solve the generators' problems at a stroke?
Mr McCarthy: No. I think you have to recognise that the economics of generation, for all generators and particularly for nuclear generators, are that they have very large capital costs and typically rather small marginal costs. That means that, whether in administration or being run by the existing company, running the generating set is cash generative and therefore, when a company goes into administration, other than some transitional problems which can sometimes occur, we expect (and have found this expectation to be correct) that the administrator will keep on running the plant. Therefore, in terms of, if the plant goes into administration do I expect it to continue to be run and to generate electrons?, the answer is yes and that is what we have found.

Q30 Mr Rendel: I would have thought that British Energy's difficulty might be slightly different from that in that they may be able to make an operating profit in terms of year by year operations, but, of

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course, a lot of their difficulties are the liabilities that they are facing which would still be there even if they were transferred to different ownership. Does that not mean that there is a possibility that if the Government allowed them to go into liquidation they would simply cease to operate? Nobody would be prepared to take them on?
Mr McCarthy: I do not believe that that is likely.

Q31 Mr Rendel: You say you want to encourage—everybody wants to encourage—generation from renewable sources, but there is, I understand, a difficulty in that the renewables are likely to be small to begin with and you have talked yourself this afternoon about the difficulty of encouraging new entrants, so how are we going to overcome that, particularly with NETA in place?
Mr McCarthy: It is very important to recognise that from the very beginning of the programme it was recognised that lower prices would have some dampening and deleterious effect on both renewables and CHP. The Government set out in October 1999 a very careful environmental impact assessment on NETA which specifically said that that would happen. It also said that the way of countering that was by specific action where the Government judged it was suitable, and in terms of renewables you have a very successful programme at the moment, which is the Renewables Obligation Programme. The Renewables Obligation Programme has a nominal value per megawatt hour of £30. In fact, Renewable Obligation certificates are trading at between £45 and £50. The latest price I saw was £47 and, on top of that, a renewable generator gets the income from the energy that he sells, so renewables are undoubtedly highly profitable at the moment.

Q32 Mr Rendel: And therefore you would expect any new generation capacity when it is needed to be mainly in renewables, would you?
Mr McCarthy: We at the moment have demand which is growing by something like 1.5% a year pretty steadily because that is the nature of the economy and changes in the economy, and we have a Government policy to bring on to the system about 1% per annum of new renewables. That policy is broadly proving successful, so I do expect the present position to continue, subject only to people retiring some of the other plant, either mothballing it or scrapping it.

Q33 Mr Rendel: There is some indication in paragraph 4.6 of the Report that the capacity margin is expected to drop during this decade and may indeed get below the 20% which is normally expected for safety reasons by the end of the decade. Are you saying that the rate of increase of renewable resources is likely to mean that that will not actually happen, that we will remain above our safety margin because the rate of introduction of renewables will increase?
Mr McCarthy: No, because I think that at the moment the margin in England and Wales is below 20%. That is something which is a matter of public knowledge. It has been interesting since that was stated that there have been new plant in the sense of existing plant that was mothballed which has been brought back on to the system, and that is what I would expect to happen.

Q34 Mr Rendel: So at the moment you are not expecting more renewables to come in? You are expecting mothballed plant to take up the spare need?
Mr McCarthy: No; I am expecting both. I am sorry if I did not make that clear. Both are happening.

Q35 Mr Rendel: How sure are you about the mothballed plant? How can you be sure that that is ready to be brought back into operation at a moment's notice or at least at fairly short notice?
Mr McCarthy: I think it is a matter of fact, the scale of mothballed plant. We have had two plants brought back and there are—[5]

Q36 Mr Rendel: I am not saying what has happened. I am saying how sure are we that the mothballed plant which is currently mothballed could be brought back into operation? Do you have any control over the state of that mothballed plant?
Mr McCarthy: No, we do not control that. We know that there are around two gigawatts of capacity which could be brought back within relatively short periods, and by "relatively short periods" I mean, say, three months.

Q37 Mr Rendel: How do you know that? How do you know the state that the plant is in, for example, that when it is brought back into action it will not suddenly explode because it has gone rusty or something?
Mr McCarthy: One of the things that we are doing at the moment is making sure that we get a fuller picture and also put that fuller picture into the public domain so that people generally can have the fuller picture of the state of mothballed plant, to deal with exactly the point that you are raising.

Q38 Mr Rendel: Can we go into that a little further? You say you are making sure that you are getting a fuller picture. What are you doing to ensure that you have a fuller picture?
Mr McCarthy: With NGC we are getting the information from the companies about the state of their different mothballed plant.

Q39 Mr Rendel: So it is entirely up to them to tell you what state their mothballed plant is in?
Mr McCarthy: They are the people who run the plant, yes, not us.

Q40 Mr Rendel: My worry about this is that it seems to me that it could be in the company's interest to pretend to you that their plant is more ready to bring back into action than it really is, and then when you start saying, "Come on, chaps, we need a bit more capacity now", and they turn on the switch, they say,

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"Oh, terribly sorry. This plant is actually very dangerous. We cannot bring it on line after all", at which point they are then able to charge rather more for the rest of their capacity because suddenly you are in great need and there is no more capacity available.
Mr McCarthy: I am very conscious of that.

Q41 Mr Rendel: So what are you doing to make sure that that is not the case?
Mr McCarthy: We are doing things to make sure that people do not artificially withhold plant which would be a breach of competition law.

Q42 Mr Rendel: But it is not artificially withholding it if it is dangerous. How can you be sure that it is not going to be dangerous when they bring it back into action and you suddenly say to them, "We need this plant"?
Mr McCarthy: They have a responsibility under health and safety legislation not to run dangerous plant.

Q43 Mr Rendel: Not to run it, but do they have a responsibility to keep it in such good condition that it could be brought back into action at short notice if you need it?
Mr McCarthy: No, they do not have that specific responsibility. There is no licence condition compelling people to do that.

Q44 Mr Rendel: So you are simply having to rely on the company's reassurance to you that their plant is able to be brought back into action at short notice?
Mr McCarthy: Yes, and I also rely on the interests of companies to make money by running plant.

Q45 Mr Rendel: It seems to me that it might well in their better interests not to have the plant ready, to tell you at the last moment it is not ready, and then to be able to run the plant they are running now at a much higher profit because they can put the price up.
Mr McCarthy: Which is exactly why we have competition laws to deal with such positions.

Q46 Mr Rendel: How would the competition powers work?
Mr McCarthy: We would regard that as an abuse of a dominant market position if it were to arise and we would seek to prosecute any company which behaved in that way.

Q47 Mr Rendel: What rights do you have to prosecute them, if suddenly you discover that the country does not have the capacity to generate all the electricity it needs and they all say, "Terribly sorry. We can run our plants harder or we can work our people harder, but actually there is not enough capacity and we think we need to raise prices"?
Mr McCarthy: Can I distinguish between two positions? One is that if someone were to artificially withhold capacity—

Q48 Mr Rendel: I am not talking about artificially withholding it. I am talking about actually allowing that plant, without telling you they are doing it, to get rusty, to become dangerous, to be unusable, but pretending to you that it is still ready and available at a moment's notice and you do not know this because you are trusting them to tell you.
Mr McCarthy: The other thing is that I would expect, and there is good evidence to show that that is actually happening, is that when there is a shortage of power, when there is a shortage of capacity, the forward price moves to give people an incentive to invest or to bring back new plant.

Q49 Mr Rendel: Now you are starting on a completely different line of argument. Now you are trying to say that actually you are not depending on the mothballed stuff because you are depending on the price going up which will encourage people to invest, whereas if you look at what the Report says, it is that you are to some extent dependent on the mothballed stuff and until this very moment that is what you have been saying and you have suddenly changed your mind.
Mr McCarthy: I am sorry. I did say that one of the things that had happened as a result of NGC saying that margins had tightened was that there had been a return of mothballed plant which had already happened. I am also saying that if there is a continuing shortage of capacity, or a continuing tightening of capacity margin, I would expect that to be reflected in the price curve and, as it was reflected in the price curve, people would take decisions either to invest anew or to bring plant which is now mothballed back into production.

Q50 Mr Williams: In relation to this, what percentage is the mothballed capacity of the operational capacity?
Mr McCarthy: I think the total that has been mothballed is 7.5 gigawatts, of which just under 3.5 gigawatts has been mothballed since 2001. To a rough approximation, the maximum peak demand is 55 gigawatts. I am afraid I cannot do the sums in my head. I t would be something like 13% or 14%.

Q51 Mr Williams: It would be 15%, so with an annual growth rate of 1.5% in demand, if I have heard correctly, the mothballed capacity actually gives us considerable protection for some years ahead on current growth rates. Is that correct?
Mr McCarthy: Demand is growing by 1.5% but, because of the environmental policy, renewables are also being brought on to the system at a rate of about 1% per annum.

Q52 Mr Williams: So there is a shortfall there of 0.5% so really the mothballed capacity gives us a very considerable protection against future shortages?
Mr McCarthy: It gives us a cushion. It is important to recognise that when we talk about capacity margins, that is the margin of the maximum demand, but also you have to take into account that there are days when there are unexpected outages.

Sometimes those unexpected outages can be severe; for example, if you have a problem at a nuclear plant, it tends to take out quite a chunk of capacity, sometimes very quickly.

Q53 Mr Osborne: Are you disappointed that since the introduction of NETA the price falls in wholesale prices have not been passed on to domestic consumers?
Mr McCarthy: If you look at it you have to look at a number of factors as you go through. First of all, you have to recognise that energy costs make up about just under 40% of prices, so if the wholesale price reduction had come through in full it would be 40% of 40% (i.e. 16%). There are some things which have also produced reductions, such as the reduction in distribution charges, which we regulate, which come through with something like another 9%. You have to make allowances for the fact that not everybody is on present prices. There are quite a lot of legacy contracts at higher prices, which has the effect of pushing costs of supplies up. There are some costs which have gone up because the suppliers now have some marketing costs that they did not have before, and also you have to recognise that the Government's environmental policies have added between 2% and 3% to end prices as well.

Q54 Mr Osborne: So, to return to my question, are you disappointed? You have given me some reasons why it has not happened but are you disappointed it has not happened?
Mr McCarthy: I am all in favour of competition working strongly and hard and the way in which we think it will happen is by making competition work, and that is why we are working very hard to ensure that competition, which is already strong, continues to be strong.

Q55 Mr Osborne: But, of course, when OFGEM was selling the NETA arrangements to the public and Parliament and so on, you were predicting a 14% fall in domestic prices. That has not happened, has it?
Mr McCarthy: We have had falls in domestic prices of between 8% and 17%, so I do not think we were badly wrong.

Q56 Mr Osborne: Those, of course, are only for some people who have shopped around.
Mr McCarthy: No. The 8% is for those people who have not shopped around. The 17% is for those who have.

Q57 Mr Osborne: Maybe I am wrong here, but in this Report at paragraph 3.8 it says that there has been little reduction in the bills of those who remained with their incumbent supplier and that OFGEM have obtained a figure of an average of 1%, eight times less than the figure you gave me.
Mr McCarthy: The figure that I gave was the figure, as all the figures I have given, since 1998, which was the beginning of the NETA programme and the point at which wholesale prices started to fall. This 1% is the figure since 2001.

Q58 Mr Osborne: So you take 1998 as the benchmark because, as you say, the electricity industry was anticipating changes, even though there have been all sorts of other things like over-capacity, general fall in the fuel prices and so on?
Mr McCarthy: There was over-capacity in the Pool, mounting over-capacity in the Pool, without any reduction in the wholesale prices, and I do not think that anything I am saying is contrary to the Report because I think that I am merely quoting the figures which are in paragraph 3.6.

Q59 Mr Osborne: What are you going to do to try and persuade the two-thirds of us, myself included, who have not switched?
Mr McCarthy: The 60% who have not switched.

Q60 Mr Osborne: I was rounding up.
Mr McCarthy: That is a percentage which, I am glad to say, is falling at around 5% per annum. I am not going to persuade you because there are some people, and manifestly you are one, who do not get out of bed for £60 a year even though it takes ten minutes to do so.

Q61 Mr Osborne: I get out of bed for far less than that.
Mr McCarthy: What we are doing is trying to demonstrate all the time that it is a simple process. For example, recently we ran a programme at a school where we took 13-year olds and got the permission of parents for them to bring to school their energy bills and ran a very simple programme for them to see whether they could save money. That class of 13-year olds saved some £2,000 for their parents' bills and we are going to roll that out in schools across the country.

Q62 Mr Osborne: Can the same supplier offer a better package to someone coming to them as they do to their existing customers?
Mr McCarthy: They can but not in the same physical district.

Q63 Mr Osborne: So you prevent that happening?
Mr McCarthy: The competition law prevents it happening.[6]

Q64 Mr Osborne: And you monitor that?
Mr McCarthy: Yes. Could I just go back to your question because the other thing that we do is that we try very hard to make the process as clean as possible. That is why we took some decisive, I think is the fair word to use, action against London Electricity; that is why we are in the process, because formally we have proposed it, of imposing a fine of £200,000 for Centrica for abuse of a particular objection to switching right that they have. It is the reason why we are changing and improving the transfer process, to make it a better, cleaner process, and it is why we are also encouraging the companies to have a better process. If you transfer 150,000 households a week, which is the population approximately of Oxford,

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you will make some mistakes and we need a process so that when mistakes are made they are corrected very quickly without hassle, and we are doing all those things to give people greater confidence in the competitive process.

Q65 Mr Osborne: But it is still the case that electricity suppliers' profit margins are currently higher than they have been historically, is it not?
Mr McCarthy: I attempted to explain to Mr Williams that for the only two companies that quote figures for their retail supply business, which is both gas and electricity (and both figures are just above 4%), it is a different position from acting in a controlled market, but it is also the fact that since 1998 we have brought prices down by between 8% and 17%.

Q66 Mr Osborne: It is still a strange situation where producers are going bust or having to be bailed out and there is huge over-supply, and yet profit margins remain high for the suppliers and bills have fallen for a handful of domestic customers. Is there not a failure of the market mechanism here somewhere?
Mr McCarthy: Remember that two-thirds of electrons go to the industrial and commercial market.

Q67 Mr Osborne: They have seen their prices come down.
Mr McCarthy: They have seen their prices fall by more than 25%

Q68 Mr Osborne: That would suggest that there is a failure in the market mechanism for domestic consumers.
Mr McCarthy: We have always acknowledged that the domestic market is still a relatively immature market. It is after all only four years ago that it was opened up. I would claim that it is, for example, relative to banks, as I said to Mr Williams, immeasurably more competitive and easier to switch and we are working all the time to make that market grow more mature.

Q69 Mr Osborne: Do you do comparisons with other utilities, for example, switching with telephones and so on?
Mr McCarthy: Yes.

Q70 Mr Osborne: How does electricity fare?
Mr McCarthy: We have a better record than any other privatised utility in Britain and we have a better record than any other energy competitive market elsewhere in the world.

Q71 Mr Osborne: Could I turn now to the nuclear industry and, if I have time, to renewables? Are you in a position to take a view on the future of the nuclear industry? Do you have a view about whether new nuclear power stations should be built or not?
Mr McCarthy: No, sir. I am paid not to have a view on that. It is what is politely called above my pay level.

Q72 Mr Osborne: You do not have a personal view?
Mr McCarthy: If I have a personal view I express it only when I go to the ballot box.

Q73 Mr Osborne: Is there a danger that the problems at the moment in nuclear, and indeed in other producers, are going to mean that we do have problems of security of supply down the track as there is not the capital investment going in and there are not the power stations being built and so on, particularly in some of these areas such as the nuclear industry where there is a very long lead time? Is there a danger that the present shakeout perhaps brought on by NETA is going to cause us problems down the track?
Mr McCarthy: I should make it clear that the authority has a legal duty colloquially to keep the lights on, more formally to make sure that all reasonable demands for electricity can be met (and the same for gas), so we take this question extraordinarily seriously. For reasons I tried to explain before, I do not think the problem of some of the generators now being owned by banks and being in administration is a short-term threat. It makes sense for those administrators to keep on running the plants, and they are doing so. There is a question which absolutely has exercised us, as you would expect it to, whether the market system that we have is providing appropriate signals for new investment, and so far we believe that the response of the market to the signals has been appropriate. We do not think there is a problem but we are very vigilant about it because we have a legal responsibility.

Q74 Mr Osborne: Finally, just purely as a matter of personal interest, are we increasing the use of electricity in this country? Does it increase year-on-year pretty much? Do you have predictions that stretch 20, 30, 50 years into the future? Are we going to become greater and greater consumers of electricity?
Mr McCarthy: I should make clear that OFGEM is not a *commisariat au plan*—we do not do projections like that. The history is that demand has grown pretty steadily at about 1.5% and that reflects rundown in some very heavy energy using industries, increased demands in the home for appliances, increased use of IT equipment—and for what it is worth I cannot see that changing in the short term.

Q75 Mr Osborne: You do not do predict and supply?
Mr McCarthy: No.

Q76 Geraint Davies: At the beginning of the hearing Mr Williams was making the point about loyalists subsidising triallists in the market place, and you made the point that the terms were between 4.2% and 4.3%. Was that as a percentage of revenue or a return on capital value?
Mr McCarthy: It was defined as "operating margin", and I am afraid that I would have to go back and look at the accounts of the two companies to give you a specific answer. If I may I will send the answer to you.[7]

Q77 Geraint Davies: I was trying to work out whether it was reasonable or not. Obviously a lot of industry—for instance, the tourist industry—might make 2% on revenue. Obviously if it was 4% on

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capital that would be reasonable but it seems to me that this industry is making twice other industries. I do not mean to simplify it too much but a lot of this is about switching on and switching off supply obviously and trading commodities. I just wonder whether you feel that the price reductions we have seen which you quoted, and you mentioned that the loyalists have basically got an 8% price reduction and the triallists 17% but they have not really enjoyed much since 2001 from the OFGEM figures, are due to technology, as it were, and that the players are now beginning to increase their margins as they do not allow any access to the market, partly for this reason we have heard—namely, they keep a plant in mothballs and any prospective entrant knows there is a mothballed plant waiting to come in so they are deterred from entering.

Mr McCarthy: I think it would be helpful to distinguish between the retail market and the generating market. The retail market remains significantly competitive. Any market in which 150,000 customers switch every week is showing signs of a competitive market, a market in which the recent survey we did showed that just under 15% of customers gave an indication that they intended to switch in the next twelve months, where in the last 12 months the incumbents had lost 5% of the market share. All that shows genuine competitiveness and we constantly survey that market and take steps, which I tried to describe a moment ago, to ensure that that market remains competitive and grows in competitiveness. It is important to recognise, therefore, that that is a genuinely competitive market, and also I think it important to recognise that generation is a highly competitive market in which some people have suffered very badly from being sent—

Q78 Geraint Davies: I understand what you are saying. My understanding is that the price is higher than price control. They are making 4.2%, 4.3% which they think is good. The sort of prices you mention in the market place of £20 a megawatt are enabling the players to compete, yes, but within a price banding that enables them all collectively to make a reasonable margin in an industry, as I think you said, where even if you are not trading so as to make a profit at the margin at any point, you keep on generating. What is basically happening, therefore, is a group of players are playing a game within a price band where they can make a significant margin of over 4% offering a cost of £20 per megawatt in the knowledge that entry costs £21 and in the knowledge that they have got 15%, 7.5 gigawatts, of spare capacity behind them to gain entry from prospective entrants. It seems to me that is a very clever way to tie up the market.

Mr McCarthy: If we thought that either the generating market or the retail market was subject to collusion we would act using our powers as a competition authority. You have markets where there is very significant change between suppliers: you have a market in which there are significant differences in prices being offered: I do not believe that this is a market which is subject to the sort of collusion or organisation you are suggesting.

Q79 Geraint Davies: In terms of the concentration of ownership, and you mentioned six competing suppliers, how many will there be in two years' time, do you think? Will it go up or down?

Mr McCarthy: I do not know. All I do know is that we have been able, up to now, to be relatively relaxed about proposals for mergers between supply companies because we had six large supply companies and we had a number of other smaller supply companies. We have made it clear that if there were a proposal for a merger within those six we would not be relaxed about it and would want to examine it very carefully insofar as it was our decision, and we would strongly counsel that to the OFT whose decision it is.

Q80 Geraint Davies: On this issue of using mothballed plants as a barrier to market entry, is there a case for taking mothballed plant away from certain suppliers or providing it for prospective entrants so it cannot be abusively used in that way?

Mr McCarthy: I do not see any case for doing so.

Q81 Geraint Davies: You mentioned that the market abuse licence condition was not allowed by the Competition Commission. Can you explain to the Committee what the market abuse licence condition is, again?

Mr McCarthy: The market abuse licence condition was an attempt to reinforce the powers we have under competition law to deal with some particular transient positions in electricity which occur because market players can have market power restricted to very short periods, but that market power can be significant. We, I much regret to say, failed to convince the Competition Commission that that was a proper increase in our powers and therefore do not have this power.

Q82 Geraint Davies: And are you finding, as a result of that, that you are seeing transient abuse of market power in the market?

Mr McCarthy: No, I do not believe we are, and I suppose the justification of having spent the time working so hard in front of the Competition Commission even though we failed was that it showed the determination that we had to tackle these problems, and I think the people who might be tempted to abuse their market power recognise that we regard this as a really serious problem.

Q83 Geraint Davies: And that you might run back to Competition Commission and say, "Told you so, it is happening; if only you had given us the power we would have sorted them out. Give me that gun"—that sort of thing?

Mr McCarthy: We would use all legal means to achieve our objective!

Q84 Geraint Davies: Exactly. Finally, how did the situation in California where they had to switch the lights off happen, and could it happen here?
Mr McCarthy: It happened in California because there were restrictions over a number of years preventing investment in generation. There was a requirement that everybody had to trade spot in the wholesale market, and there was a cap put on retail prices. We, I am glad to say, have had open access in generation—what one of your colleagues described as "Dash for gas". We very carefully, in designing NETA, allowed a whole series of contracts to be able to take place and did not confine people to the spot market and we have taken off all retail price controls, so none of the three essential mistakes in California occurs in Britain.

Q85 Geraint Davies: And in terms of the technological innovation which drives down costs and therefore hopefully prices for consumers, do you think that has been held back by the fact that there is a lot of this mothballed plant hanging about so people think, "Why invest in other plant: we can wind up this old machine if we need it"?
Mr McCarthy: I do not think this is an industry which has been marked by much technological innovation. It is not one of those hugely fast-changing industries. The central reason why people are not investing is one which is not economically stupid at all—it is that we have had a very large plant margin: we have had as a consequence quite predictably low prices: and there are good economic reasons not reasons of collusion for not investing.

Q86 Geraint Davies: In terms of the sustainable long-term energy strategy for the country, as it were, as you know the price of oil globally has halved in recent months. It peaked at about $40 and went down to about $20 a barrel. Given that, if one is on the one hand reducing electricity from oil and on the other hand producing it from gas or whatever, or nuclear, that creates enormous uncertainties, does it not, over whether as a company trading you are not in danger of at some point going out of business? Do you think anything should be done to provide more stability as opposed to more free-for-all competition? I am thinking on a slightly different tack because I have been arguing there is not enough competition. Let's assume for a moment there is a lot. Is there a danger of being there being too much tied into these uncertainties of energy costs?
Mr McCarthy: One of the things we have been trying very hard to do is give people a framework so they can conclude long-term contracts, and we have seen, particularly in gas, a number of long-term contracts extending at least a dozen years forward. We in OFGEM have made our contribution to that by, for example, changing the way in which people can get access to the landing ports of gas, the entry points to the national transmission system, to give them certainty over periods that go forward for nearly fifteen years. So the solution to the problem that you pose is the ability to have long-term contracts. One of the essential features of NETA and one of the original objectives was to allow people to conclude long-term contracts in that way and in that respect NETA has been successful.

Q87 Geraint Davies: And in terms of responsibilities, do you feel there is a tendency for some of these companies to do all they can, individually and collectively, to increase unduly the consumption of energy to make money? I know you said there is only 1% a year but people are continuously being encouraged to run all sorts of electronic machinery in their homes, often on stand-by on a continuous basis and all sorts of things, and the energy people say, "Oh, well, if they are being provided lower cost energy, you can afford to do even more consumption". Is there a problem there?
Mr McCarthy: I think it is undoubtedly the case that if you reduce the price of almost any commodity you get increased demand, and electricity is no different from that.

Q88 Geraint Davies: So is there a case for tax, then?
Mr McCarthy: That, I am afraid, is one of those questions that I regard as above my pay level.
Mr Davies: Good. Thank you very much.

Q89 Mr Williams: You said you were giving forward advice on gas contracts. In the present context are you giving any advice at all forward on oil contracts?
Mr McCarthy: No. Oil is basically not us.

Q90 Mr Rendel: I will restrict the subject of my first questions merely to a passing remark. I hope there will be ways found to assure yourselves in the future that the mothball capacity is ready to be brought back on because I think we are in danger that somebody might try and pull a fast one over us if we are not careful. I would like to come back to the difference between domestic and industrial customers. Firstly, given that the industrial customers appear to have had a bigger drop in their pricing than domestic, why has that happened?
Mr McCarthy: There are two reasons for it. One is you have to recognise that energy costs are a much higher proportion of the industrial and commercial end-bill than they are for domestic customers, because the sales costs of selling to only a small number of large customers is less as a proportion of their bill, so you would expect 40% reduction in wholesale prices to feed through as a higher proportion of the end-bill for industrial and commercial. Secondly, quite simply, the competition which opened up in the industrial and commercial markets in the mid-90s is much better and further advanced.

Q91 Mr Rendel: So you would expect the price to domestic customers to continue to fall for some time to come given that you expect competition to reduce prices more as it takes greater effect?
Mr McCarthy: Other things being equal, and I say that quite carefully because if, for example, gas prices increase very markedly that will feed through. If, for example—

Q92 Mr Rendel: Let me put it another way: you would expect the difference between the drop that has taken place between industrial and domestic customers to reduce?
Mr McCarthy: Yes, absolutely.

Q93 Mr Rendel: And clearly there is a difference at present between the prices charged to domestic customers who have switched and those who have not—you kept insisting on the difference between the 8% and the 17%. What will happen as more and more switch? Are you expecting the prices of those who have not switched to come much closer in line to those who have not?
Mr McCarthy: Yes, I think that will happen. There are quite interesting bits of modelling that have been done by various universities showing the point at which for companies the loss of customers is such that they will begin to shrink those margins between the stayers and the leavers.

Q94 Mr Rendel: But that loss of customers is likely to reduce over time rather than increase. If that position has not been reached for companies up to now it probably will not be reached in the future?
Mr McCarthy: I think it will because it depends on the percentage. If you have 60% on one and 40% on another, the financing of the company is very different than if you have 50/50 or 40/60, and the incumbents are still losing market share at a rate of around 5% per annum.

Q95 Mr Rendel: I am sure they are at present but you seem to think that eventually some point will come at which the companies all say, "Hey, hang on a second, we are losing too many customers so we have to reduce the price to our current customers so we do not lose any more". I would have thought as time goes on and they have already lost most of the customers they had in the original system they would be less likely to lose more customers, not more. If they have not reached the point at which they give up and say, "Hey, hang on, we have to hold on to our current customers" yet, they are not going to do so in future as they will lose fewer of them.
Mr McCarthy: I do not think that is the way it works but it would take quite a lot of explanation which I cannot do off-the-cuff to explain it.

Q96 Mr Rendel: It would take a lot of explanation, yes.
Mr McCarthy: I would say, however, that as we get more and more people on to the switch tariffs, the problem that you very properly are aware of and we are is, of course, a diminishing problem.

Q97 Mr Rendel: I think you said a moment ago that in any one district they have to retain the same pricing, so presumably in the districts where, for example, Southern Electricity used to work, ie across the south of the country they have stopped one price for all those people who used to be all their incoming customers, and they are going to have to keep those because they cannot suddenly reduce for some—they are going to have to keep their original priced customers pricing at the same level.
Mr McCarthy: There are quite a lot of things being done by companies to try and win back customers as well—not just price but a whole variety of other things, so there is an interesting scope for increasing competition developing.

Q98 Mr Rendel: But in practice, on price at least, if they want to compete with the other companies moving into their area, they are going to have to move that pricing down to, so to speak, new customer prices?
Mr McCarthy: They are going to move their prices down.
Mr Neilson: Or offer a wider variety of tariffs to their existing customers. For example, the choice that has been offered to many domestic customers has been to move away from having to pay a standing charge, so there are a number of ways in which choice allowed innovation and a wider range of tariffs for customers. Some of these incumbents may well try and seek to persuade their existing customers to move to new tariffs. What we are saying is the one old tariff is steadily whittling away as people exercise choice.

Q99 Mr Rendel: Effectively what you seem to be saying is that although you are told you have to keep your charges in one district exactly in line for all customers, what you are going to be able to do is say, "If you want not to switch, fine, we will leave you on the old higher prices and that is good for us because we will make more profit out of you, but if you want to then we will offer you something else which is the equivalent of a new price for a different company in order to try and retain you, so effectively you will be getting your 17% discount but you are just getting it because you are being charged a different sort of tariff".
Mr McCarthy: I think there will be a variety of offerings, and we do not want to discourage a variety of offerings.

Q100 Mr Rendel: It seems to me in a sense what you are saying is that you will find ways around the difficulty they have to keep under competition or the same prices for all their people in one district, so their current customers can be charged in different ways with different tariffs and therefore some of their current customers, the clever ones, will get the 17% discount?
Mr McCarthy: Over time there will be a shrinking between the stayers and the leavers because that is what has happened in other markets.
Mr Rendel: I am glad to hear that because it seems to me that otherwise, Mr Williams, we are going to get all the customers in the south buying electricity from Northern Electricity and all the customers in the north will be buying it from Southern Electricity, and we will be getting a very confusing system in which nobody is buying their electricity from the company which is named after that part of the country. It seems rather odd.

Mr Williams: Thank you.

Q101 Mr Jenkins: Clarifying one or two parts in my own mind, in answer to Mr Rendel you mentioned that, if a company goes out of business, you would expect the administrators to run the plant. I do not like the term "expect". I want to know there is a security of supply. On page 27 at 4.12 it says: "The Government undertook . . . to monitor security of supply through the DTI/OFGEM Joint Energy Security of Supply Working Group . . .". There must be some mechanism in place where, if a major company goes out of business and the administrator says, "We are not running the plant because this company is broke, it is not viable", someone has to step in, take over and run the plant until we can stabilise the industry. Whose job is that?
Mr McCarthy: At the moment nobody has that job. I would say that in terms of generating plant that has been taken over by an administrator, in the overwhelming majority of cases the administrator has kept the plant running. Could I also say that we do have powers in relation to the retail market to ensure that domestic customers' supply is not interrupted: we have made it clear that we would use those powers and both in relation to the administration of Enron and in relation to TXU Europe, where TXU Europe provided more than 10% of the households in Britain with electricity and gas, we made it clear that we would use those powers which was the reason why the sale of that business took place so quickly. So we do have it in the retail market; we do not have it in the generating plant; there is an interesting question in terms of the bit in the middle, the networks, where we think there is a need for the electricity and gas sectors to have powers equivalent to powers that exist in railways, and have been pressing the government to give us those powers.

Q102 Mr Jenkins: Thank you. That is why I needed to make it extremely clear that there is no security of supply in this country since at the end no one is empowered to step in and take over the plant and run it until we can restabilise the system.
Mr McCarthy: I am saying we do not have that power.

Q103 Mr Jenkins: I think that is the point I had to stress. The other point I want to make is that I think you said, and I have probably got you down slightly wrong here, "We would consider the withholding of supply due to any reason to be a breach of competition law under their dominant position". If a company has mothballed plant and wishes to bring it back on itself but, due to lack of funds or low prices the maintenance of that plant was poor and it could not bring it back on, the company would not be and is not in a dominant position in the market and therefore would breach no competition law and we would have no claim on it, because we do not pay to maintain it, do we?
Mr McCarthy: The circumstance where we would be able to use competition law would be that if you had a company that owned a fleet of generators, a number, and it withdrew one of them in order to push up the price available for all the others, we would certainly seek to use competition law against that company.

Q104 Mr Jenkins: Lastly, in the Report it is indicated that you reject the idea that electricity markets are cyclical. I know in Britain we have had a steady increase in electricity demand over the last fifty years and I know that consumer demand is continually going up and we have daily peaks and seasonal peaks, and we have also had a cyclical peak insofar as industry and the demands of industry are concerned, and if we have a recession there is less demand for electricity. So there is a cyclical nature on the demand for electricity in Britain.
Mr McCarthy: I think the context in which we were discussing the question of the cyclical nature of an industry is there are some people who argue that generation would be like what is claimed to be the position in the aluminium industry where you have, as it were, nine years of low prices and a tenth year of very high prices, and we were advancing arguments why we believe that, through long-term contracts, that degree of spikiness would not occur.
Mr Jenkins: I understand.

Q105 Mr Williams: You indicated earlier that, of 1.5% growth in demand during a year, 1% or two thirds is met from renewables, if I remember correctly. Do you think that figure would be higher or lower if NETA did not exist?
Mr McCarthy: I do not think that NETA is affecting that very much one way or the other. The biggest constraint on renewables at the moment is getting planning permission. The combination of energy prices plus renewable obligation makes investment in renewables a profitable activity. The particular problems that renewables had in the early days of NETA which were associated with the dual cash out prices and the scale between the top and bottom of those dual cash out prices has largely been eliminated, whereas the average difference at the beginning of NETA between what is known as the system buy and the system sell price was around £70 and has now fallen to below £10. The fact that we have reduced the period of gate closure from 3.5 hours to one hour has also significantly alleviated the problems that were seen to be associated with NETA for renewables, so I do not think that NETA is having a deleterious effect on renewables.

Q106 Mr Williams: Do you have any evidence to substantiate what you are saying of the extent to which planning problems are constraining the development of renewables?
Mr McCarthy: There are statistics which I am afraid I do not have to hand.

Q107 Mr Williams: No, but do you have them?
Mr McCarthy: Yes.

Q108 Mr Williams: If you do, I think it would be very helpful to the Committee if you would let us have them.

Mr McCarthy: Certainly. It is, I think, a matter of public knowledge.[8]

Q109 Mr Williams: It probably is; it is a lazy way of not looking for it myself!

Mr McCarthy: Of course we will send it to you. The biggest objector is I believe the MoD, for very good reasons associated with radar.

Q110 Mr Williams: That is interesting as well. Thank you. Secondly, have we, as was implied by George Osborne earlier, an emerging obsolescence problem? The problem with a nuclear plant is, when it goes out, a great chunk of capability goes out. Are you concerned about the obsolescence problem facing the industry?

Mr McCarthy: There was this huge investment in gas fired plant in the 1990s. If you go back to 1990, I think it is correct that in 1990 gas contributed 0%, certainly less than 5%, towards electricity generation so we have had this huge investment there. The fact that the nuclear plant is ageing is well known and some of the coal plant was also invested in some time ago, although I think you have to be quite careful because for a lot of this plant people reinvest as part of maintenance, and the fact that a plant has an accounting life of thirty years needs not show that it is the same as the real life.

Mr Williams: That is right. That is always confusing when we talk about the life of nuclear plants.

Q111 Geraint Davies: Quickly, on possible consumer confusion over prices, as you know what tends to happen these days is that one provider provides both gas and electric and they say, "If you have gas for one supplier and electric for the other we will provide both for less", and someone else comes along and says "We can provide it for less" and it is all very confusing. I know I have been confused on this—it depends on the balance of prospective gas and electricity consumption. A simple example is the gas supplier, or the person who normally supplies gas, probably is more expensive at supplying gas than the electric people, in fact, so there is that confusion already. Do you think that is possibly a growing problem, in particular if conceivably we might have a situation where suppliers of other products come along and say, "Look, if you get gas, electric and your Virgin bank account your global costs will be less, and, for that matter, if you then have your broadband, telephone, etc, etc"—so things that we all consume as products are being bundled together. Do you think there may be an emerging problem in terms of enabling "unbundling", as it were, and what can you do to help the consumer in terms of guidance or possibly market restrictions in terms of excessive bundling to protect people so they have rational choices?

Mr McCarthy: The problem as I understand it at the moment is associated with gas and electricity being bundled. About 80% of people who switch do so, as you have suggested, on a dual fuel basis. The responsibility for the dissemination of price information which we used to have was under the Utilities Act passed across to *energywatch* and we have been pleased that they have revised and improved the price display information that people get. There is a tension which is a difficult tension between encouraging a variety of tariffs which is good, so there are special tariffs for couples who are not at home during the day, elderly people, tariffs with and without standing charges, all of which we in principle encourage, and against that getting the clarity of pricing comparison, which is quite difficult.

Mr Neilson: But there are several commercial websites and we started a process of validating for accuracy a number of those. There is a kitemark system. *energywatch* have taken that over from us so that customers can go to the *energywatch* website and then move on to any of these commercial price comparison services. So that is all quite helpful. Customers can also ring up *energywatch* if they do not have access to the internet and be sent these leaflets, so there is quite a lot of consumer information available.

Q112 Geraint Davies: Yes, but the issue really is what proportion of the switching market accesses that information. I know I did not look up *energywatch* when I was bombarded with glossy leaflets. The idea is spend two minutes and you will save £100,000 or whatever it is, and the tendency is if you do make a saving you think, "Oh, well, I have done that now" and then somebody else comes in and says, "Give it to us and you will achieve lower prices", and you say, "Oh, well, I have just changed so I will not". As you mentioned *energywatch*, I think we heard earlier that 40% of the market had switched. Do you know what proportion of those people would have accessed *energywatch*?

Mr Neilson: On the back of everybody's quarterly bill is the *energywatch* phone number so it is a question of how well publicised it is, but every customer has access to that phone number quite straightforwardly.

Q113 Geraint Davies: I have obviously seen it many times yet never seen it at all!

Mr Neilson: The research that we published last week did survey what proportion of customers said they had carefully examined prices before switching, and around half the customers who have switched think they have done quite a detailed comparison.

Q114 Geraint Davies: If you change your bank account I have seen on some forms you have to sign a contract and it says, "We advise you to show this to your legal adviser before signing". Would it not be possible to say more boldly on all these bills or whatever or these propositions in big bold letters "We strongly advise people to look up *energywatch*", rather than to be hidden somewhat, do you not think?

[8] Ev 14

Mr Neilson: I think you have to have a balance about what consumer information is likely to be read on a bill. There are all sorts of things that it might be very helpful to put on a bill. There is always a balance to be struck between how much you regulate and what things you require to be—

Q115 Geraint Davies: I was wondering how bold it should be. We have a situation where on cigarettes we now have "Smoking kills"—

Mr Neilson: Indeed, and I think that is a very legitimate question.

Mr McCarthy: What we have been concerned to do is stop the terrible practice of people pretending that they were not asking a customer to sign a contract by making it very clear on all contracts, "This is a contract". We thought that was more important to get right to stop the instances of forgery and deception that had happened before.

Q116 Geraint Davies: But you could do both, I guess. Just to get the statistic, how does the number of people accessing *energywatch* compare with the number of people switching accounts?

Mr Neilson: I do not know. I fear *energywatch* would have to provide that for you.

Geraint Davies: If it is significant then it is not of concern. If it is insignificant, with all this bundling perhaps you should think about flagging it up a bit more.

Mr Williams: Thank you, Mr McCarthy, for an impressively lucid presentation. I do not normally make that sort of comment, and we have enjoyed the talents of your two colleagues. Thank you.

Supplementary memorandum submitted by the Office of Gas and Electricity Markets (Ofgem)

Questions 6 (Mr Williams) and 76 (Geraint Davies):

In Q6 and Q76 there was a discussion on rates of return. The rate of return Mr McCarthy quoted was a return on sales. In assessing the significance of this number, it might be misleading to adopt a comparison with profitability under price controls, where suppliers often out-performed the targets set for them. For example, electricity suppliers' last price controls allowed a 1.5% return on sales, but suppliers also beat targets relating to generation and supply costs, and so earned significantly higher profits than 1.5%. Ofgem believes that electricity profitability is above historic levels, but that this profitability is permitting suppliers to maintain gas prices which allow very little margin.

Question 26 (Mr Jenkins):

In Q26 there was a discussion on the extent of retail competition. Mr McCarthy stressed that all customers can benefit from competition, as a number of suppliers are seeking their business. Twelve electricity suppliers are active in the market nationally and 13 gas suppliers. The number of suppliers offering a cheaper price than the incumbent varies by geography, payment type and consumption level; as an example, however, there are between nine and 11 suppliers (depending on region) discounting against incumbent prices to medium-consumption standard credit electricity customers, and the maximum discount is between 9–16%, depending on the region involved. For gas, 12 suppliers are offering discounts to these customers, with a maximum discount of 19%.

Questions 26, 27 (Mr Jenkins) and 63 (Mr Osborne):

In Q26, Q27 and Q63 there was a discussion about prices charged to in-area customers. Mr McCarthy pointed out that competition law governs to what extent suppliers can target in-area customers with better offers. Ofgem has indicated that it will pay particular attention to initiatives aimed at prospective or past switchers which aim to reduce switching in the incumbent's favour and hence may foreclose the market. However, as with all competition law matters, how a particular case is treated will depend on empirical assessment of the effects on competition. There are no absolute prohibitions on this sort of price discrimination under competition law. As the subsequent discussion (Q98 onwards) makes clear, Ofgem expects suppliers to start to offer a wider variety of tariffs to their domestic customers.

Question 35 (Mr Rendel):

In Q35 there was a discussion about the scope for mothballed plant to be brought back into operation. Mr McCarthy mentioned that two plants have been brought back. Since April 2003 two plants have come onto the system—one a newly commissioned plant, the other returned from mothballing.

3 July 2003

Supplementary memorandum submitted by the Department of Trade and Industry

Statistical Information on Renewables Planning in the UK

1. In line with its Energy White Paper commitment, Government is working to improve the collection and presentation of statistical information about renewables planning in the UK. There are currently two main sources of Government statistics on the status of planning applications for renewables projects: information collected as part of the DTI's renewables programmes scheme and information collected by the DTI and the Scottish Executive on consents given under Section 36 of the Electricity Act and the Transport and Works Act 1992.

2. The information from the DTI's renewables programmes scheme is collected under two main categories—NFFO and non-NFFO. The Non Fossil Fuel Obligation preceded the Renewables Obligation Order as the main Government support mechanism for renewables in England and Wales. The Scottish Renewables Obligation (SRO) preceded the Renewables Obligation (Scotland) Order in Scotland and the Northern Ireland NFFO (NI-NFFO) applied in Northern Ireland. These categories cover most of the applications made under planning procedures for **onshore** renewable technologies. Total figures given in Table A below show the current status (approved, refused, withdrawn or to be determined) of onshore applications made in the years 2001, 2002 and 2003 in the UK.

3. Applications for onshore developments of over 50 MW are considered by the DTI and the Scottish Executive as appropriate under Section 36 of the Electricity Act 1989. Offshore developments over 1 MW require consent under either Section 36 of the above Act or the Transport and Works Act 1992. Information on the progress of applications for **all offshore** and **some onshore** technologies is categorised under Section 36 Onshore, Section 36 Offshore and Transport and Works Act 1992. Table B below gives information on the current status of applications made under these Acts.

4. For the three years in question, the success rate for NFFO (SRO & NI-NFFO) projects is highest in Scotland (73.33%), followed by England (60%), Wales (42.86%) then Northern Ireland (0%). The percentages for refusals are 8% (England), 0% (Scotland), 42.85% (Wales) and 0% (Northern Ireland).

5. When considering application success/failure over the past 2–3 years, it should be borne in mind that we are effectively in a transition from NFFO to non-NFFO (in effect, to the Renewables Obligation in England Wales and Renewables Obligation Scotland in Scotland. Northern Ireland does not yet have a Renewables Obligation in place). Many of the applications submitted for non-NFFO projects have yet to be determined.

TABLE A

INFORMATION FOR THE THREE-YEAR PERIOD, 2001, 2002 and 2003

Scheme under which project funded	*No. of planning applications submitted*	*Applications approved*	*Applications refused*	*Applications withdrawn*	*Applications to be determined*
NFFO, SRO & NI-NFFO	47	29 (61.7%)	5 (10.6%)	Nil	13 (27.7%)
Non-NFFO, Non-SRO & NI-NFFO	158	62 (39.24%)	16 (10.13%)	4 (2.53%)	76 (48.10%)

TABLE B

INFORMATION FOR THE THREE-YEAR PERIOD, 2001, 2002 and 2003

Consenting authority	*No. applications submitted*	*Applications approved*	*Applications refused*	*Applications withdrawn*	*Applications to be determined*
S36 Onshore	4	1 (25%)	1 (25%)	Nil	2 (50%)
S36 Offshore	7 incl. 1 in Scotland	7 (100%)	Nil	Nil	Nil
Transport and Works Act 1992 Offshore	6 incl. 1 in Wales	Nil	Nil	Nil	100%

6. Table C below gives a longer-term view, covering NFFO and non-NFFO projects, for the period from 1990 to 2003.

7. For NFFO (SRO & NI-NFFO) projects, the success rate of applications is highest in Northern Ireland (95%) followed by England (82%), Scotland (74%) and Wales (61%). The percentages for refusals follow a similar trend (0%, 10%, 9%, 23%).

TABLE C

INFORMATION FOR THE PERIOD FROM 1990 TO 2003

Scheme	*Submitted*	*Approved*	*Refused*	*Withdrawn*	*To be determined*
NFFO, SRO & NI-NFFO	480	374 (78%)	56 (12%)	19 (4%)	32 (7%)
Non-NFFO, non- SRO & non- NI-NFFO	190	83 (44%)	24 (13%)	4 (2%)	79 (42%)

7 November 2003

Printed in the United Kingdom by The Stationery Office Limited
12/2003 877893 19585