Written evidence submitted by npower (DGEB07)

1. npower, part of innogy SE's retail business division, is a major retail energy supplier in Great Britain, serving approximately 4.6 million domestic customer accounts (2.8 million households) and over 400,000 business (I&C and SME) accounts and employing over 6,500 direct staff.

2. npower welcomes the opportunity to respond to the Committee's call for evidence on the Domestic Gas and Electricity (Tariff Cap) Bill. npower's views on price caps are well documented and are not repeated in detail here. Suffice is to say, we believe that the evidence clearly shows that competition in the energy market has grown significantly since the conclusion of the Competition and Market Authority (CMA) investigation in 2016**;** that a SVT/default tariff cap is a disproportionate intervention (as concluded by the CMA majority); and that the unintended consequences of the intervention – for competition, for innovation, for service quality and ultimately for both engaged and less engaged consumers – has been dismissed too lightly in the debate to date.

3. We have been disappointed by the lack of analysis to support the government's decision to introduce a SVT/default tariff wide cap which is contrary to the conclusions of the CMA's 2014-16 investigation into the market. We note that the Regulatory Policy Committee itself concludes that 'in general, the evidence the Department presents in support of its rationale and selected option is weak, and even confused …' and that 'the Department provides a reasonably clear qualitative assessment of the costs and benefits of the measure, though it tends to downplay the costs to business and emphasises the benefits to consumers. Its monetised assessments and SaMBA fall short of the standard that would normally be expected, even taking account of the dependencies on *Ofgem's* work.' In particular, we note that the RPC concludes that it can only assess the Impact Assessment as fit for purposes on the understanding that:

   (a) *Ofgem* will present specific monetary estimates of direct cost and benefits during its preparatory work and

   (b) the Department will publish (or ensure that *Ofgem* publishes) a clear estimate of the costs and benefits once the level of the cap is known, regardless of the eventual business impact target status of the measure.

4. We welcome the assurances provided to the RPC from both the Department and *Ofgem* that it will do so and would encourage Parliament to ensure that the concerns raised in the RPC assessment are adequately addressed through the consultation process on the price cap.

5. We acknowledge the intent to confer a duty on Ofgem and the power to impose a price cap for domestic standard variable and default tariffs as soon as practicably possible after Royal Assent of the Bill and our commentary is limited to the technical aspects of the Bill.

Regulatory governance and the right of merits based appeal

6. Unlike the licence modification procedures set out in the Electricity Act 1989 and the Gas Act 1986 (as modified), the licence modification procedure set out in the Bill does not set out the arrangements regarding appeal. As has been made known to Parliament during pre-legislative scrutiny of the draft Bill, this has the effect of limiting the ability to appeal to judicial review, which only provides appeal on the grounds of failure to observe process, and means that the matter cannot be referred to the Competition and Markets Authority (CMA). It is our understanding that the exclusion of the right to appeal to the CMA on the basis of merit was deliberate as government were concerned that the inclusion of the right to appeal to the CMA could delay the implementation of the cap. The BEIS Select Committee concurred with this view in their Pre-Legislative Scrutiny of the draft Bill.

7. The existence of a strong and robust appeals process enhances both the regulatory decisions and legal and regulatory certainty for all market actors; and the right of merits based appeal to an independent expert body, such as the CMA, is a central feature of the UK's regulatory governance system. Removal of the right of appeal to the CMA sets a concerning precedent.

8. Given the significance of the intervention proposed and the inherent complexity in constructing and setting accurate, cost-reflective retail energy price caps, it is crucial that a robust regulatory process is in place and that the Bill retains the right of merits based appeal to an expert body. In this regard:

    - We believe that the CMA is the right body to form judgements on highly complex and technical issues inherent in setting the level of a cap.
    - We note that in their submissions to the pre-legislative scrutiny of the draft Bill, others have drawn attention to the fact that in its consultations leading up to the Enterprise and Regulatory Reform Act 2013, and its consideration of who should undertake price control and licence modification appeals, the Government concluded the competition authority 'should continue to hear **all** appeals on price control and licence modification decisions.' In coming to this view, the government concluded that it 'is well-placed to undertake complex economic, legal and financial analysis required to support these types of decisions and appeals and has strong project management skills enabling it to adhere to tight time limits for decision-making'
    - We would note that the CMA provides the route of merits based appeal for price controls in the energy and other utility sectors, including airports, water, energy networks , and therefore to exclude this route is inconsistent with other regulated markets.
    - We do not believe that appeal to the CMA on the basis of merit inherently builds delay into the system. To the contrary, the CMA has a strict, six-month timeline (with the possibility of a month's extension), unlike a judicial review challenge which is at the discretion of the Court and can be much longer than this.

9. In this context, we would emphasise that at the beginning of the CMA market investigation, npower committed to positive engagement in the debate, a high threshold for appeal, and full commitment without delay to all remedies not appealed. We made good on these commitments.

10. This was not just the realpolitik of a tactical approach to the situation but instead a positive approach to the formation of policy. Our general approach is to have the debates, win some, lose some, and move on, but do not interminably drag them on.

11. It is therefore wrong to intimate that the absence of appeal should be construed to mean that we agreed with all the conclusions and remedies, or indeed that appeals would not have been successful

    "*In the absence of any appeal against the Competition and Markets Authority's findings and after review of the Authority's methodology, we were unconvinced by criticisms of the £1.4 billion annual customer detriment figure. We found no valid reason to question this figure*."[1]

12. Indeed such a statement actually puts pressure on us to appeal, simply not to let statements pass that we believe to be incorrect.

13. Here is not the place to re-open the debate about the merits of this figure. We do refer the Committee to CMA's own analysis of the total earnings of the six large energy firms. Over the eight years shown, the average earnings are below £1.4bn and the final year of 2014 is shown at £1.6bn on a turnover of £43.1bn[2]. Using simply the CMA's own analysis at a headline level there does indeed seem to be a reason to question this figure if new policy (i.e. policy not recommended by the CMA) is to be formed on the basis of it.

14. The investigation did in fact provide a good example of the importance of merits based appeals. Having failed previously to convince Ofgem on grounds of merit, Judicial Review was taken in relation to locational losses in power transmission. This appeal failed. The *CMA* decided to re-open this debate and found against Ofgem on grounds of merit and in their remedy overturned Ofgem's decision.

15. Nor should any appeal be regarded as "silly"[3]. An appeal on Judicial Review would only be won if the processes associated with our democracy were not followed. A reasonable interpretation is that there may be some desire not to follow these processes.

16. This is the concern to us. It is much wider than the price cap. Indeed at the moment where the will of the people is to take back our laws after Brexit, and the removal of a level of appeal in European court, the need to observe governance within the UK becomes more rather than less. History and the world will judge all of us on how we manage justice post Brexit.

17. Npower has not stood in the way of the prepayment cap, the vulnerable customer safeguard tariff, the legislative cap, social tariffs, the warm homes discount or indeed any prior price limits imposed under licence conditions.

18. We have encouraged, in the matter of price caps and otherwise[4], Ofgem to consider the lawfulness of their interventions, and/or their statutory powers, and/or the proper exercise of their duties in these interventions. An example is in our open response to the prepayment cap. Our questions, which were directly germane to the execution of the cap, were never answered. This is a cause for concern.

19. A fundamental aspect of the UK constitution, before the EEC, during the period of the European Union, and after Brexit, is the separation of the powers of legislature, executive and judiciary.

---

[1] https://www.parliament.uk/business/committees/committees-a-z/commons-select/business-energy-industrial-strategy/inquiries/parliament-2017/pre-legislative-scrutiny-of-draft-tariff-cap-bill-inquiry/

[2] Appendix 9.13: Retail Profit margins

[3] Greg Clark – Statement to the House 26 Feb 2018

[4] https://www.ofgem.gov.uk/system/files/docs/2017/12/npower_-_whd_safeguard_tariff_response.pdf

The concentration of power in any body is a matter of serous democratic concern. For an unelected body, such as Ofgem, to take on all three powers, is of still greater concern.

20. To dismantle further the appeals process for a single tactical end feels to us a significant venture in the UK constitution, and not a decision to be taken lightly

21. **<u>Recommendation:</u> Replicate the licence modification appeal routes set out in the Electricity Act 1989 and Gas Act 1986 and permit appeal to the CMA of the setting of the cap.**

Clause 1(6)d

22. Clause 1(6)(d) states that the Authority must have regard to 'the need to ensure that the holders of supply licences **<u>who operate efficiently</u>** are able to finance activities authorised by the licence'. We note that it is already implicit in Ofgem's duties to incentivise suppliers to operate efficiently and that Clause 1(6)(a) reiterates this requirement for Ofgem to 'create incentives for holders of supply licences to improve their efficiency', arguably making the inclusion of 'who operate efficiently' in Clause 1(6)(d) unnecessary. Moreover, the legislation is silent on how the benchmark for an efficient supplier will be set, which will be for the regulator to determine – further reinforcing the need for a robust appeals process. Our comments to the CMA on the competitive benchmark used to determine the level of consumer detriment and set the level of the PPM are a matter of public record. It is inappropriate and flawed to benchmark smaller or mid-tier suppliers in a growth phase (with high levels of newly acquired direct debit customers on heavily discounted short term tariff products and facing lower policy obligation costs) with larger suppliers (with a range of different types of customers, paying by different methods and facing the full costs of delivering the government's social and environmental obligations). Any efficiency benchmark should include all obligations and all customer types, taking into account payment type differentials.

Clause 7 & 8

23. We welcome the inclusion of the 2023 hard stop end date for the price cap in the legislation, but more clarity is required on the criteria that Ofgem should use to assess annually from 2020 whether the *"conditions for effective competition"* have been met to warrant removal of the cap. The current metrics for measuring retail energy market competition, such as levels of (external and internal switching) and number of active suppliers, will in our view be detrimentally impacted by the introduction of a market wide price cap, creating a risk that the cap could become self-perpetuating if this clause is interpreted to include or be overly biased towards the extent of consumer engagement. In light of this, the decision to remove the price cap should be more concretely linked to enabling programmes which will facilitate consumer engagement such as progress on smart meter deployment and reliable switching. Ofgem should be required to consult on this criteria.

March 2018