

## Ofgem: Retail Market Review Consultation

### Written response submitted on behalf of the Government's Fuel Poverty Advisory Group for England (FPAG)

The Fuel Poverty Advisory Group is a non-departmental advisory body, which consists of a chairman and senior representatives from the energy industry, charities and consumer bodies. Each member represents their organisation, but is expected to take an impartial view. The role of the Group is to:

- Consider and report on the effectiveness of current policies aiming to reduce fuel poverty;
- Consider and report on the case for greater co-ordination;
- Identify barriers to reducing fuel poverty and to developing effective partnerships and to propose solutions;
- Consider and report on any additional policies needed to achieve the Government's targets;
- Encourage key organisations to tackle fuel poverty, and to consider and report on the results of work to monitor fuel poverty.

**Note:** In view of the very specific nature of the Retail Markets Review subject matter the following is submitted **on behalf of the FPAG Non-Supplier membership**.

#### Context

1. The Government has a legally binding target to eradicate fuel poverty by 2016<sup>1</sup>. FPAG, as the Government's statutory advisory body on fuel poverty, want to ensure that Government policies are doing all that is reasonably practicable to meet this target.
2. The Government's own estimate indicates that in 2011 there were 4.1 million households in England in fuel poverty; however some members of FPAG have estimated that with the energy price rises in 2011 this could now be as high as 5 million.<sup>2</sup> Almost 50% are pensioners and overall some 80% can be categorised as vulnerable.
3. The recent Marmot Review Team report<sup>3</sup> presented evidence on how cold homes lead to multiple health problems. Cold homes and fuel poverty contribute to excess winter deaths, respiratory health problems and mental health problems as well as an increased likelihood of poor educational attainment among children.
4. High energy prices have been the biggest driver in the increase in fuel poverty and the long term trend is for prices to continue rising. With every one per cent increase

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<sup>1</sup> Fuel Poverty Strategy 2001

<sup>2</sup> NEA estimate November 2011

<sup>3</sup> The Health Impacts of Cold Homes and Fuel Poverty, written by the Marmot Review Team for Friends of the Earth, published in May 2011

in energy prices, another 60-70,000 households are added to the number of homes in fuel poverty<sup>4</sup>.

5. The recession, unemployment, plus the industry's investment plans estimated at c. £200 Billion to 2020<sup>5</sup> and uncertainty over new generating capacity and energy prices will exacerbate the problem. FPAG remains deeply concerned that the costs and implications of the UK's transition to a low carbon economy, have yet to be sufficiently explored. Meanwhile, the regressive means of collecting costs added to fuel bills to fund a range of related environmental and energy costs creates consumer inequity should these costs continue to be recovered in this way and not funded via general taxation. A more equitable attribution would be for recovery on a per kWh basis and not per customer as some are at present. Initial research undertaken by FPAG reveals that 85% of fuel poor consumers would benefit from a move to consumption-based cost recovery mechanism. The attribution of these and other costs on consumers bills to fund decarbonisation of energy production and its end use requires much greater exploration and transparency.

## **Response**

### **CHAPTER: Two**

**Question 1:** Do stakeholders agree that we should introduce the RMR core proposal?

FPAG have long argued that there should be more to encourage consumers to engage with the energy market and subsequently promote more competition across the market. We welcome Ofgem's RMR proposal as the first steps to achieving these aims. However, there remain concerns that it is very unlikely to assist those who are excluded through poor literacy, language, age, illness, technology etc. Of the estimated 4.1 million fuel poor households in England, approximately 50% are pensioners and 80% vulnerable in some way. Further safeguards are therefore still required for the fuel poor, low income and vulnerable consumer.

**Question 2:** Which cost elements should be included in the standardised element of standard tariffs?

FPAG welcome the standardisation of the standing charge to avoid 'sticky' customers being penalised by paying a higher proportion of costs. However, we remain concerned that if the standing charge is too high it will make the tariff less attractive to consumers, particularly on the standard tariff.

We agree with the more equitable proposals suggested in the January document "The Standardised Element of Standard Tariffs under the Retail Market Review" not to include transmission and distribution in the standing charge and to include this in the unit rate. As low users tend to be on a lower income, it is right that higher users pay a higher proportion of the costs.

However, we would also like to see the costs associated with Green policies, such as the new Energy Company Obligation recovered on a per unit basis rather than per household basis in the standing charge. Continuing payment for environment policies on a per

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<sup>4</sup> DECC fuel poverty impact assessments 2010

<sup>5</sup> Ofgem Project Discovery

household basis would be a significant backward step on both social and environmental grounds. It would be inconsistent with polluter pays principles, because all households would pay the same towards decarbonisation regardless of their carbon footprint. It also disproportionately loads the cost burden on to the poorest in society, because (in broad terms) there is a correlation between income and energy usage. FPAG have completed some analysis into this area and a paper is attached at Annex A.

For fuel poor customers in particular, we would like to see a household allotted a number of units free of the standing charge before having to pay, with the cost being recouped from high users, typically on higher incomes.

**Question 3:** Do stakeholders agree that our information remedies would help consumers engage effectively? If not, what would be more appropriate remedies?

Whilst we agree that some consumers will be helped by the proposed changes to the tariffs and encouraged to engage with the market, and in addition that it is hoped that if more people can be encouraged to engage with the market and switch supplier, this will have a knock on effect across the market and reduce tariffs for all households, providing a benefit to all consumers.

However, there remains concern that customers who are currently disengaged will remain disengaged, particularly the elderly and the vulnerable, those in fuel poverty or where a household is in debt to their supplier. Also, those without access to access to the internet and switching websites will still find it difficult to identify the best tariff for their household.

**Question 4:** Do stakeholders consider that the price comparison guide should be presented in a p/kWh figure, a £ per month figure or both?

FPAG consider that this should be presented in both p/kWh and £ per month, the p/kWh provides a useful comparison for tariffs whilst the monetary value shows the impacts on the customer's budget.

**Question 5:** Do stakeholders agree that the proposed exceptions for legacy social tariffs and extremely high consumption domestic consumers are appropriate?

We agree that those on social tariffs from the previous voluntary programme should be protected until the tariffs come to an end, in line with the Government's Warm Home Discount scheme.

Extremely high users should also be exempt from these proposals where they are on a low income. As it is now proposed that transmission and distribution charges will be included in the unit price of the tariff, we would argue that high income, high users should not be excluded from the changes and should pay a higher proportion of these costs.

**Question 6:** Do stakeholders agree that we should not allow an exception for suppliers to offer a green standard tariff in addition to an "ordinary" standard tariff?

Whilst FPAG agree with the principle and want to keep the standard tariffs as simple as possible, we would not want to see incentives removed for green policies that offer paperless billing. Most fuel poor households will probably opt to receive paper statements, however, we would not want this choice to be removed, where the household could receive a discount for choosing a green policy.

**Question 7:** Do stakeholders believe it would be appropriate to introduce a six-month price guarantee for standard tariffs, or do you consider that this would undermine the simplicity of the RMR core proposal?

Yes. We consider that a six month price fix would promote certainty for consumers who are considering switching supplier. It would also help to create trust in the market, and that the best tariff at the time of switching would not be changed soon after.

### **CHAPTER: Three**

**Question 8:** Do stakeholders agree with our recommended proposal of Option 3 (“Introduce more prescriptive rules” ) for bills and annual statements?

Yes. As well as the amendments to SLC 31A, FPAG welcome the use of standardised language on bills across the industry which will be particularly beneficial for vulnerable households when comparing tariffs. In addition, the standardised summary box will provide clear information about their current tariff and information people need to be able to switch more readily available.

FPAG agree that there should be a clear difference between a customer’s bill and their annual statement, a customer must be able to recognise an annual statement if it is to be of use to them. Again, we would be particularly keen so see a common set of terms used across the industry for the annual statement and the information presented in a clear format, this is essential if a customer is expected to utilise the annual statement and act upon it.

**Question 9:** Do stakeholders agree with our recommended proposal for SLC 23 notifications including price increase notifications of option 3 (“Additional information plus prescribed format” ) and option 4 (“Tighten and clarify policy intent” )?

Yes, FPAG agree with the recommended proposals for SLC 23, when a supplier increases prices, these changes to price should be clear to the consumer, particularly as to the estimated monthly increase to a customer’s bill. By setting out the impacts to customers’ bills on a monthly and annual basis, it is more likely to prompt a customer to investigate switching tariffs if they think they can find a better deal. In addition, if the customer feels that the letter is personalised to them, they are also more likely to read the letter rather than discard it.

**Question 10:** We seek views from stakeholders on the additional requirements outlined in option 3 (“Additional information plus prescribed format” ) for SLC 23 notices including price increase notifications.

As stated above, FPAG agree with the proposals to make the information clearer, especially for vulnerable consumers.

**Question 11:** We seek views on any proposals to restrict the inclusion of additional materials (e.g. marketing material) along with SLC 23 notifications.

As stated above, FPAG are in favour of this proposal, as it is more likely to encourage people to read their letters if there is less marketing material and more personalised information to the consumer, thus encouraging further trust and confidence in the mail customers receive from their supplier.

**Question 12:** We seek views along with any supporting data or evidence for our proposals for information signposted to consumers in option 4 (“Tighten and clarify policy intent”) for SLC 23 notifications including price increase notifications.

FPAG agree with the proposals set out in option 4, we find these recommendations to be common sense.

**Question 13:** We seek views on any additional recommendations which stakeholders consider relevant for bills, annual statements and SLC 23 notifications.

At this stage FPAG consider the recommendations to be full and complete, but would welcome the opportunity to review and feedback to Ofgem after a period of reflection.

**Question 14:** We intend to consult on the content of the Confidence Code separately if and when we take over the governance responsibility for it. However at this stage we welcome any early views on developing the Confidence Code.

FPAG would welcome greater scrutiny of the switching websites to ensure that the information they are providing to customers is accurate, if Ofgem were to govern a Confidence Code for these sites it would promote further trust in the market and a method of redress if the information was found to be incorrect.

**Question 15:** We welcome views from stakeholders on our proposals for enhanced monitoring.

FPAG would welcome a greater awareness of which energy suppliers had the best customer service records and complaints handling procedures, again this would promote trust and confidence in the market, it may be that some customers value better customer service over cheaper tariffs and providing additional information would enable customers to make a more informed choice and the best suitable tariff for them.

**Question 16:** We invite specific views on costs and other implications if we were to introduce our proposals. Please provide details and cost estimates where appropriate broken down by each proposal.

FPAG do not take a view on this question.

#### **CHAPTER: Four**

**Question 17:** Do you consider the revised SOC's will help achieve our objectives?

FPAG agree that the Standards of Conduct would support the amendments to the licence conditions and help achieve Ofgem's objectives. Having a stronger Standard of Conduct, which can hold the suppliers to account where a breach occurs, will reinforce that the customer should be able to have trust in their supplier.

**Question 18:** Do you agree the revised SOC's should apply to all interactions between suppliers and consumers?

Yes.

**Question 19:** Do you agree that the SOC's should be introduced as an overarching, enforceable licence condition?

Yes, as has been seen under the current Standards of Conduct without the licence condition being enforceable with a form of redress if breached, there is no guarantee that the energy suppliers will abide by the Standards of Conduct.

**Question 20:** Do you have information regarding potential costs this may impose on suppliers?

FPAG do not take a view on this question.

#### **CHAPTER: Five**

**Question 21:** Do you agree with our analysis of the impact on vulnerable consumers?

FPAG understand the ambition that all customers will benefit from the RMR proposals either directly or indirectly, however those benefiting indirectly will be dependent on a greater number of customers engaging with the market and switching tariffs and suppliers.

FPAG would like to see a review of these proposals 12 months post implementation, to evaluate if more people have engaged with the market and subsequently provided a knock on effect for 'stickier' customers who are typically vulnerable or fuel poor.

**Question 22:** What are your views on the need for further intervention?

Again, we would like to see how much engagement there is with the market across the board by all customers with the new tariffs and if customers see a benefit before considering if further intervention is required.

**Question 23:** Who in particular should any additional support be targeted at?

As stated above, we would like to see a period of reflection before further intervention is targeted at vulnerable households. However, FPAG, considers the Cold Weather Payment Group as a useful mechanism for identifying those most at risk of fuel poverty as they are on a low income and have an additional factor that makes them a vulnerable household.

Derek Lickorish  
Chair of Fuel poverty Advisory Group  
22<sup>nd</sup> February 2012

## Appendix A

### FPAG Paper - Supplier Obligation Costs and the Energy Company Obligation

#### The Case For Reform – Jonathan Stearn and William Baker

This paper is the result of a series of research reports prepared by the Centre for Sustainable Energy, the Association for the Conservation of Energy (ACE), and papers from an FPAG working group with representatives from Centrica, EDF Energy, SSE, Ofgem, ACE, Age UK and Consumer Focus with additional research information from E.ON Energy

The Energy Company Obligation (ECO) is to replace the Carbon Emissions Reduction Target (CERT) in 2013. All the members of the working group agree on the basic principle outlined in this paper that, if costs of ECO, like CERT, are to be recovered from energy consumers, the recovery should be according to the amount of energy consumed rather than as a flat rate on households. Recovering the costs of ECO on a consumption, or 'per unit' basis, rather than a flat rate per gas and electricity consumer, is more progressive because people on higher incomes tend to use more energy than those on lower incomes.

This paper outlines the argument for that change.

This paper also details policy proposals for those consumers on low incomes who heat their homes with electricity and face particular detriment. It also indicates possible solutions for the small percentage of low income high energy users who would be adversely affected by the change to collection by energy used.

#### Summary

- The government is proposing a new Energy Company Obligation (ECO) to help make homes more energy efficient, particularly those occupied by low income households. From 2013, ECO will take over from the Carbon Efficiency Reduction Target (CERT) and Community Energy Savings Programme (CESP). Like CERT, it is proposed that energy companies will recover the costs of ECO from consumers.
- The statutory instrument for CERT dictates how Ofgem apportions the overall target between suppliers. This is done in relation to a supplier's number of gas and electricity customers. Moving to a per unit recovery will mean amending statutory instrument for ECO to apportion the overall target between suppliers and the energy used by suppliers' customers.
- Department for Energy and Climate Change (DECC) estimates that the CERT target costs most consumers some £46 per year (£23 per household for electricity and £23 for gas). This is expected to rise to £61 for dual fuel customers in 2012 and £75 when ECO starts in 2013. By contrast, suppliers recover other carbon saving policies, such as the Feed In Tariff and Renewables Obligation, according to the amount of energy consumed.
- Recovering the costs of ECO on a consumption, or 'per unit' basis, rather than a flat rate per gas and electricity consumer, is more progressive because people on higher incomes tend to use more energy than those on lower incomes.
- Recovering costs on a 'per unit' basis would also meet the 'polluter pays' principle.



- Assuming a typical consumption profile per income decile, about eighty five per cent of low income consumers would benefit from the 'per unit' recovery of ECO. Instead of paying the estimated flat rate of £46, 6 million consumers on the lowest incomes (the lowest three deciles) with gas heating would contribute between £32 to £39 per year - saving up to £15 per year. Those with gas heating in the three highest income deciles would contribute between £49 to £54 per year - paying up to £8 extra.
- However, a small minority of low income consumers will lose out, mainly those who use electricity to heat their homes and those who are, for various reasons, high energy users.

### **Electrically Heated Homes**

- Households that use electricity for heating and have no gas supply (about 2.5 million consumers) currently are assumed to pay £23 pa towards CERT – one million of these consumers are concentrated in the lowest income deciles. A 'per unit' recovery method would increase their contribution for ECO to around £46 per year. This group will get limited benefit from the ECO scheme and it is worth noting that other carbon saving policies are concentrated only on electricity consumption.
- There are two options that could be adopted for protecting these electricity-only consumers:
  - provide a contribution free allowance on electricity bills to those with electric heating and a lower value allowance to those with gas heating
  - apportion the majority of the costs of ECO onto gas consumers.

### **The contribution free allowance option**

- The provision of a contribution free allowance could be one option to offset some of the costs collected by suppliers. If that contribution allowance was set at say 25% of the total costs of ECO it would imply a £56 contribution free allowance on electricity bills to those with electric heating and a £6.50 allowance on the electricity bills of those with gas heating. In combination with a 'per unit' cost recovery method, it has the following impact:
  - consumers with electric heating would benefit, compared to the current 'per household' approach and to a non-adjusted 'per unit' approach
  - the level of benefit increases the further down the income scale
  - the lowest income decile electric heating consumers would be, on average, £21 pa better off
  - the lowest income decile gas heating consumers would be, on average, £14 pa better off
  - higher income gas heating consumers would pay more than under the current approach.

### **Focusing the ECO contribution on gas consumers**

- The case for transferring the full or the majority of the costs of ECO to gas consumers is based on the fact that the carbon savings from installing insulation are generally made from gas not electricity. The modelling here is based on the full cost being passed on to gas consumers.
- However, those off the gas grid may get measures and it could be argued, should contribute something to the cost. As the policy for ECO is being developed, DECC may want to consider how much of the energy savings will be made in electricity and how much would be made in gas.
- And it may also consider a simple 'per kWh' basis across all gas and electric. kWhs sold would create a split of around 62 per cent on gas and 38 per cent on electric.

- There is however a second consideration that argues ECO collection should focus on gas. Electricity consumers currently bear a much higher level of carbon policy costs than gas consumers and this discrepancy will continue to rise as current carbon policies progress. By 2013, electricity consumers will pay a higher contribution towards the EU Emissions Trading Scheme (ETS) and the Renewable Obligation (RO) than is currently the case. They also bear the costs of the Feed In Tariff (FIT) obligation. These obligations do not apply to gas consumers. Therefore the focus on gas for ECO considers environmental and social costs 'in the round'.
- Modelling the transfer of the cost of ECO to gas consumers, combined with a 'per unit' method of cost recovery, shows the following effects:
  - it will lead to a more equal balance of costs between gas and electricity consumers, although electricity heating consumers will still pay significantly more towards costs of all policies than gas heating consumers (an average of between £18 and £28 pa more, depending on income)
  - the electricity bills of electric heating consumers at all income levels will reduce by £23 pa (assuming ECO is set at the same level as the current level of CERT and CESP)
  - electricity heating consumers in the lowest income decile would on average pay £108 pa towards carbon reduction policies, compared to £131 on a 'per household' method; those in the highest incomes would pay £197 pa, compared to £174
  - gas heating consumers in the lowest income decile are still £8 pa better off (on average) than under the 'per household' method, paying £99 pa for carbon reduction policies. The second lowest decile is £4 pa better off with very little difference for the third lowest decile. Those on the highest incomes pay £146 pa compared to £127 under the 'per household' method.

### **Low income high users**

- A minority (1.4 million out of 4.8m) of low income consumers (those in the lowest two income deciles) have higher than average energy consumption, although 0.4m of these are only slightly higher. Many of these consumers would not benefit from the move to a straight 'per unit' cost recovery approach. Households that fall into the category of 'low income high users' include:
  - retired couples and single elderly households without gas
  - retired couples and single elderly in larger than average homes with gas central heating
  - working age families and multi-adult households (in HMOs) with gas central heating.

The provision of a contribution free allowance on electricity bills will help the first group as will focusing the majority of the charges on gas consumers for ECO. ECO policy should be designed with the needs of these group of vulnerable consumers in mind so that they get a fair share of the benefits. The Warm Home Discount can be targeted towards households most affected,

But there also needs to be a recognition that the cause of these issues may lie outside the energy sector. The needs of older and disabled people whose health requires a higher ambient temperature in the home and those who need a need a large amount of hot water for medical reasons should be addressed through the health service and benefit system.

Under-occupiers will normally be long-standing occupiers who because of bereavement or because of the outward migration of their family are now left as single occupiers of properties they bought as family homes. If they are on low incomes, they will struggle to afford the running costs of these homes. There are answers:

- To ensure that there is provision in the locality of more appropriate housing,
- To grow the equity release market so that people who choose to stay put can modernise and improve the energy efficiency of their homes at a sensible cost. If, like student loan accounts, they could draw on a repayment scheme which pooled and even subsidised the risk factors and reduced the uncertainty costs there would be a much greater public appetite for equity release.

## 1. Introduction

Energy companies are responsible for delivering a range of Government climate change and social policy objectives. They currently include the:

- Renewable Obligation (RO)
- Feed in Tariff (FIT)
- European Union Emissions Trading Scheme (ETS)
- Warm Home Discount (WHD)
- Community Energy Support Programme (CESP)
- Carbon Emissions Reduction Target (CERT).

Companies pass on the costs of delivering these policies to energy consumers. The costs of all of the above programmes are passed through to electricity consumers, whereas only the costs of CESP and CERT are shared with gas consumers.

The method by which companies recover the costs of these policies from consumers varies due to the way in which Government requires companies to meet the policy objectives.

Costs of the RO, FIT and ETS fall upon companies based on the amount of energy consumed by their customers. As such, it is expected that companies pass the costs of meeting these policies through in each unit consumed.

By contrast, the costs of the WHD, CERT and CESP fall on companies based on the number of customers they have. As such, it is assumed that they pass costs on equally to each customer, regardless of the level of energy consumption. This means all consumers make the same contribution towards the costs of these programmes regardless of level of energy consumption.<sup>6</sup> The Department for Energy and Climate Change (DECC) estimates that the CERT target costs most consumers some £46 per year (£23 per household per fuel from electricity and gas consumers). This is expected to rise to £61 to dual fuel customers in 2012 and £75 when ECO starts in 2013. The Government is about to consult upon the design of the new Energy Company Obligation (ECO), which will replace CERT and CESP in 2013. This provides an opportunity to reform the method by which companies recover the costs of ECO. There is a strong case for recovering the cost of ECO on a 'per unit' basis rather than the current 'per household' approach used for CERT and CESP. The majority of low income consumers would benefit from such a reform, since there is a close correlation between income and energy consumption – see table A1 and fig. A1 in the appendix.

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<sup>6</sup> See Preston & White (2011), *Reviewing the evidence for a fairer recovery of climate change policy costs*, Consumer Focus and Croft (2011), *Costs of the ECO: the impact on low income households*, Eaga CT for further discussion of fuel companies' recovery of climate change and social policies.

The reform also better meets the ‘polluter pays’ principle than the current ‘per household’ approach.

This paper provides data on the distributional impact of the proposed reform according to a range of possible options. It summarises data culled from a range of reports<sup>7</sup>.

How targets are set can dictate how equitable they are on consumers. The costs of social and environmental programmes on consumers are relatively small compared to the assistance provided to the beneficiaries. But only a small number of consumers actually receive these benefits. Therefore it is imperative that policies are designed to deliver the benefits to those who need them the most.

## **2. The legislative context**

The primary legislation for the ECO comes from the Gas and Electricity Acts, the Utilities Act 2000, and will come from the Energy Bill. The relevant section of the Utilities Act 2000 is section 103<sup>8</sup>:

*‘Overall energy efficiency targets.*

*(2)Where an overall target applies in relation to both sections mentioned in subsection (1), the order specifying the target may make provision for the Authority to apportion the target between—*

*(a)persons who are gas transporters or gas suppliers (for the purposes of section 33BC of the 1986 Act and any order under that section); and*

*(b)persons who are electricity distributors or electricity suppliers (for the purposes of section 41A of the 1989 Act and any order under that section),*

*by reference to such criteria as may be specified in the order.*

*(3)The Authority shall exercise its functions under the provisions mentioned in subsection (1) in relation to which an overall target applies (and in particular its functions relating to the determination of energy efficiency targets) in the manner it considers best calculated to result in the achievement of the overall target.*

When the Statutory Instrument is drafted for the ECO it can dictate how the target is apportioned between suppliers which in turn provides an indication for how the costs should be collected. The statutory instrument for ECO could apportion the overall target between suppliers and the energy used by supplier’s customers

## **3. Recovering supplier obligation costs on a ‘per unit’ basis from gas and electricity consumers**

Tables 1 and 2 below show the impact of moving recovery of current CERT costs from a ‘per household’ approach to a ‘per unit’ approach, using 2010 data. This illustrates the effect such a change would have if ECO is recovered on the same basis although the costs recovered are expected to be higher.

The tables consider the impact of the reform on the 2½ million consumers that heat their home by electricity and the 20½ million consumers that heat their home by gas. Consumers that heat their homes by other means, e.g. heating oil or LPG, are not included in the analysis. It also does not include consumers that have a gas supply but do not use gas for heating (about ½m consumers in

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<sup>7</sup> In particular, Preston (2011), *A fairer distribution of costs?*, Centre for Sustainable Energy. Tables 1-6 in this report summarise the data provided in Preston’s report.

<sup>8</sup> <http://www.legislation.gov.uk/ukpga/2000/27/section/103>

England). The analysis is based on the average level of consumption of each fuel by income decile, using data from the ONS Living Costs and Food Survey (see Table A1 in the Appendix).

It is important to note that some consumers will consume less and some more than that shown within each decile, i.e. there is considerable variation in energy use within deciles (see Fig. 1 in the Appendix). This has an important bearing on the likely impact of the reform on the relatively small number of low income high energy users. The paper will address this issue later.

**Table 1: Electric heating consumers – CERT on gas and electricity**

| Income Deciles | No. of hhds      | Annual CERT costs: per unit (average) | Annual CERT costs: per hhd | Difference |
|----------------|------------------|---------------------------------------|----------------------------|------------|
| 1              | 399,420          | £39.57                                | £23.41                     | £16.16     |
| 2              | 346,995          | £43.68                                | £23.41                     | £20.27     |
| 3              | 326,672          | £46.45                                | £23.41                     | £23.04     |
| 4              | 301,623          | £46.82                                | £23.41                     | £23.41     |
| 5              | 283,282          | £48.62                                | £23.41                     | £25.21     |
| 6              | 239,141          | £50.51                                | £23.41                     | £27.10     |
| 7              | 205,752          | £51.39                                | £23.41                     | £27.98     |
| 8              | 193,158          | £54.44                                | £23.41                     | £31.03     |
| 9              | 158,984          | £59.99                                | £23.41                     | £36.58     |
| 10             | 137,790          | £64.37                                | £23.41                     | £40.96     |
| <b>Total</b>   | <b>2,592,817</b> |                                       |                            |            |

**Table 2: Gas heating consumers – CERT on gas and electricity**

| Income Deciles | No. of hhds       | Annual CERT costs: per unit (average) | Annual CERT costs: per hhd | Difference |
|----------------|-------------------|---------------------------------------|----------------------------|------------|
| 1              | 1,935,547         | £ 31.79                               | £46.82                     | -£15.03    |
| 2              | 1,960,714         | £ 34.89                               | £46.82                     | -£11.93    |
| 3              | 1,988,243         | £ 38.92                               | £46.82                     | -£7.90     |
| 4              | 1,998,518         | £ 40.80                               | £46.82                     | -£6.02     |
| 5              | 2,023,139         | £ 43.04                               | £46.82                     | -£3.78     |
| 6              | 2,071,498         | £ 45.19                               | £46.82                     | -£1.63     |
| 7              | 2,094,848         | £ 46.73                               | £46.82                     | -£0.09     |
| 8              | 2,107,808         | £ 48.95                               | £46.82                     | £2.13      |
| 9              | 2,123,850         | £ 50.05                               | £46.82                     | £3.23      |
| 10             | 2,105,170         | £ 54.42                               | £46.82                     | £7.60      |
| <b>Total</b>   | <b>20,409,335</b> |                                       |                            |            |

Table 1 shows that electric heating consumers at all income levels will generally lose out from the move to a 'per unit' method of cost recovery. This is because under the current 'per household' approach, it is assumed that electricity-only consumers pay only half the CERT costs that consumers with both gas and electricity pay. The use of a 'per unit' approach would increase the cost of CERT for those with electric heating, given the higher level of electricity used by these consumers. This is of particular concern given that electric heating is more common among low income consumers than higher income consumers – see Fig. 2 and Table A3 in the Appendix.

Table 2 shows that the move to a 'per unit' basis would benefit most gas consumers<sup>9</sup>, apart from those in the three higher income deciles. Furthermore, the average level of benefit increases the further down the income scale. Given that most consumers use gas for heating, large numbers of consumers would benefit from the proposed reform.

#### 4. Reducing the impact of the 'per unit' approach on consumers with electric heating

The negative impact of the 'per unit' approach on electricity-only consumers could be addressed by providing consumers with a 'contribution free allowance'. The policy costs are then recovered at a higher 'per unit' rate for consumption above this level. Two options for doing this are:

1. the provision of a free equal sized allowance to all electricity consumers (including those with gas)
2. the provision of a higher value free allowance credit to consumers who use electricity to heat their homes (for example, by applying it to the Economy 7 tariff) and a lower value free credit to those who use gas.

The first option is administratively simple but results in even higher costs for electric heating consumers than the standard 'per unit' approach. This paper therefore only considers the second option. For illustrative purposes only, a notional allowance was calculated based on 25% of the total costs of the current policies. The value of the free allowance is estimated at £147m for those with electric heating and £147m for those with gas heating. The value of the credit to each individual consumer within the second group is much lower because there are a much larger number. Tables 3 and 4 show the impact of the free allowance approach on consumers by income decile. An 'free from contribution' allowance of 25 per cent of costs would mean £56.84 is applied to electric heating consumers while a credit of £6.52 is applied to gas heating consumers.

**Table 3: Electric heating consumers – free £56 allowance on electricity bills**

| Income deciles | No. of hhds      | Annual CERT costs per unit (average) | Annual CERT costs per hhd | Difference |
|----------------|------------------|--------------------------------------|---------------------------|------------|
| 1              | 399,420          | £2.51                                | £23.41                    | -£20.90    |
| 2              | 346,995          | £8.67                                | £23.41                    | -£14.74    |
| 3              | 326,672          | £12.84                               | £23.41                    | -£10.57    |
| 4              | 301,623          | £13.38                               | £23.41                    | -£10.03    |
| 5              | 283,282          | £16.08                               | £23.41                    | -£7.33     |
| 6              | 239,141          | £18.93                               | £23.41                    | -£4.48     |
| 7              | 205,752          | £20.25                               | £23.41                    | -£3.16     |
| 8              | 193,158          | £24.81                               | £23.41                    | £1.40      |
| 9              | 158,984          | £33.14                               | £23.41                    | £9.73      |
| 10             | 137,790          | £39.72                               | £23.41                    | £16.31     |
| <b>Total</b>   | <b>2,592,817</b> |                                      |                           |            |

<sup>9</sup> Although note that the assessment is based on average consumption. Some consumers with high levels of consumption may lose out under the 'per unit' approach.

**Table 4: Gas heating consumers – free £6 credit on electricity bills**

| Income deciles | No. of hhds       | Annual CERT costs per unit (average) | Annual CERT costs per hhd | Difference |
|----------------|-------------------|--------------------------------------|---------------------------|------------|
| 1              | 1,935,547         | £32.49                               | £46.82                    | -£14.33    |
| 2              | 1,960,714         | £36.19                               | £46.82                    | -£10.63    |
| 3              | 1,988,243         | £41.26                               | £46.82                    | -£5.56     |
| 4              | 1,998,518         | £43.67                               | £46.82                    | -£3.15     |
| 5              | 2,023,139         | £46.54                               | £46.82                    | -£0.28     |
| 6              | 2,071,498         | £49.25                               | £46.82                    | £2.43      |
| 7              | 2,094,848         | £51.20                               | £46.82                    | £4.38      |
| 8              | 2,107,808         | £53.99                               | £46.82                    | £7.17      |
| 9              | 2,123,850         | £55.29                               | £46.82                    | £8.47      |
| 10             | 2,105,170         | £60.50                               | £46.82                    | £13.68     |
| <b>Total</b>   | <b>20,409,335</b> |                                      |                           |            |

Table 3 shows that the combined ‘free allowance’ and ‘per unit’ approach would help protect lower income consumers with electric heating, with the level of benefit increasing the further down the income scale. Table 4 shows that lower income gas consumers are still ‘better off’ under this approach, with higher income gas consumers slightly ‘worse off’ than under the straight ‘per unit’ approach.

The main disadvantages are:

1. Potential administrative complexity
2. The concern that the Treasury is more likely to deem the policy as ‘tax and spend’ and thus bring it into its ‘levy control framework’.

The first issue could be addressed by aligning the contribution credit with the Economy 7 tariff – although the regulator would need to keep a close eye on the per unit cost of Economy 7 to make sure tariffs were not being increased as a result of the policy. A similar time of day tariffs that might emerge once smart meters are commonplace. With respect to the second issue, many fuel poverty advocates argue there should be a cap on the amount raised through energy bill levies<sup>10</sup>. This is because policies funded through levies (even those funded on a ‘per unit’ basis) are more regressive than policies funded out of public expenditure (see Fig. A3 in the Appendix). If ECO is maintained at a similar level to the current scale of CERT and CESP and the total allowable amount with the control framework is adjusted to take account of these additional costs, bringing ECO into the remit of the control framework should not be an issue.

## 5. Focusing the ECO contribution on gas consumers

The final option considered for reducing the ‘per unit’ approach on electric heating consumers is to transfer all or some of the costs of the ECO programme onto gas consumers so that electricity consumers do not make a high, or any, contribution. Putting more costs onto gas is more in line with how the policy is developed and the outcomes - most of the savings to the consumers who benefit will have gas heating. There is also an argument that there are strong grounds for adopting

<sup>10</sup> For example, Boardman (2010), *Fixing fuel poverty*, Earthscan

such a policy, given that a higher level of climate change policies are paid for by electricity consumers (FIT, ETS, RO, WHD, CERT, CESP) than gas consumers (WHD, CERT and CESP). Also some electricity levies will increase in the near future, e.g. ETS (particularly given the likely introduction of the carbon floor price) and the RO and possible changes from the Electricity Market Reform.

Tables 5 and 6 below show the impact of all climate change and social policies, including ECO, on consumers in 2013. This year was selected on the basis that ECO will have come into effect, WHD is also in place and higher levels of ETS and RO will apply than is currently the case. The tables assume that ECO is set at a similar level to current CERT and CESP.

**Table 5: Electric heating consumers – all policy costs, 2013**

| Income deciles | No. of Hhds      | Projected policy costs <sup>1</sup>  |                                          | Difference |
|----------------|------------------|--------------------------------------|------------------------------------------|------------|
|                |                  | Current recovery method <sup>2</sup> | ECO recovered from gas only <sup>3</sup> |            |
| 1              | 399,420          | £131.45                              | £108.41                                  | -£23.04    |
| 2              | 346,995          | £141.43                              | £118.39                                  | -£23.04    |
| 3              | 326,672          | £150.03                              | £126.99                                  | -£23.04    |
| 4              | 301,623          | £150.78                              | £127.74                                  | -£23.04    |
| 5              | 283,282          | £155.38                              | £132.34                                  | -£23.04    |
| 6              | 239,141          | £160.33                              | £137.29                                  | -£23.04    |
| 7              | 205,752          | £163.50                              | £140.46                                  | -£23.04    |
| 8              | 193,158          | £171.74                              | £148.70                                  | -£23.04    |
| 9              | 158,984          | £185.87                              | £162.83                                  | -£23.04    |
| 10             | 137,790          | £196.84                              | £173.81                                  | -£23.03    |
| <b>Total</b>   | <b>2,592,817</b> |                                      |                                          |            |

<sup>1</sup> Includes ETS, RO, FIT, WHD, ECO; WHD is recovered on a 'per household' basis <sup>2</sup> Assumes ECO recovered on a 'per household' basis from gas and electricity consumers <sup>3</sup> Assumes ECO recovered on a 'per unit' basis from gas consumers only

**Table 6: Gas heating consumers – all policy costs, 2013**

| Income deciles | No of hhds        | Projected policy costs  |                             | Difference |
|----------------|-------------------|-------------------------|-----------------------------|------------|
|                |                   | Current recovery method | ECO recovered from gas only |            |
| 1              | 1,935,547         | £98.89                  | £90.72                      | -£8.17     |
| 2              | 1,960,714         | £102.09                 | £97.70                      | -£4.39     |
| 3              | 1,988,243         | £107.43                 | £107.64                     | £0.21      |
| 4              | 1,998,518         | £110.27                 | £112.42                     | £2.15      |
| 5              | 2,023,139         | £113.61                 | £118.00                     | £4.39      |
| 6              | 2,071,498         | £116.55                 | £123.30                     | £6.75      |
| 7              | 2,094,848         | £118.65                 | £127.13                     | £8.48      |
| 8              | 2,107,808         | £121.63                 | £132.71                     | £11.08     |
| 9              | 2,123,850         | £122.74                 | £135.34                     | £12.60     |
| 10             | 2,105,170         | £127.14                 | £145.65                     | £18.51     |
| <b>Total</b>   | <b>20,409,335</b> |                         |                             |            |



Table 5 shows that moving ECO to gas consumers would benefit all electric heating consumers by the same amount. The lowest two income deciles of gas heating consumers are still better off (due to the 'per unit' cost recovery method), with the third income decile only paying marginally more.

Even if ECO is transferred to gas consumers, a comparison of Tables 5 and 6 shows that electric heating consumers will still pay more towards environmental and social policy costs than gas heating consumers. The difference exists at all income levels. Electric heating consumers in the lowest decile pay £18 pa more towards policies than gas heating consumers in the lowest decile and those in the highest decile pay £28 pa more.

However, some argue that shifting the entire costs of ECO onto gas would reduce the size of the consumer base from which the cost of ECO is recovered and may lead to unintended distortions to competition and does not recognise that some – all be it a minority – of electricity heated homes may benefit from ECO. A possible alternative would be for gas consumers to bear, for example, 70 per cent of the costs and electricity consumers 30 per cent of the cost, with the option of the application of a free contribution allowance to those with electric heating. If, for example, there was split simply on a 'per kWh' basis across all gas and electric kWhs sold, there would be a split of around 62% on gas and 38% on electric. However, the distributional impact of such an option, or the relation to potential beneficiaries was not modelled.

## **6. Protecting low income high users**

The above analysis is based on average levels of energy consumption by income decile. Assuming an energy consumption typical of the households income, the 'per unit' method of cost recovery is likely to benefit between 80 and 85% of low income consumers (those in the lowest three deciles)<sup>11</sup>.

However, there are about 1.4m low income high energy users who will lose out from moving to a 'per unit' approach. Research by the Centre for Sustainable Energy for Ofgem provides information on who these households are<sup>12</sup>. In summary, the research found that three broad factors (either in isolation or in combination) contributed to high energy use among low income consumers:

- high occupancy – in terms of number of occupants or time spent in the house (or both), thus resulting in an extended heating regime and power consumption;
- property type – larger dwellings that have a higher heating and power demand;
- off-gas and/or reliance on electricity for heating, resulting in higher than average electricity consumption (relative to non-electric heated households).

The type and number of households identified as low income high users are given in Table 7 below:

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<sup>11</sup> See Croft (2011), *Costs of the ECO: the impact on low income households*, Eaga CT

<sup>12</sup> White, Roberts and Preston (2010), *Understanding 'High Use Low Income' Energy Consumers*, Ofgem

**Table 7: Low income high energy users**

|                                                                                                                                                |                  |
|------------------------------------------------------------------------------------------------------------------------------------------------|------------------|
| <b>Households with high electricity consumption</b>                                                                                            |                  |
| retired couples living in large properties off the gas network                                                                                 | 380,000          |
| single elderly occupants in smaller, electrically heated properties                                                                            | 262,000          |
| <b>Households with high electricity and gas consumption</b>                                                                                    |                  |
| retired households (couples and single) living in larger than average properties (especially for this income bracket) with gas central heating | 530,000          |
| working age families or multi-person households (HMOs) in larger than average, gas centrally-heated properties                                 | 258,000          |
| <b>Total</b>                                                                                                                                   | <b>1,430,000</b> |

The proposals to reduce the impact of a ‘per unit’ approach on electric heating consumers will help low income high electricity use consumers. The following measures can also help reduce the impact of a ‘per unit’ approach on all the above groups:

- Target ECO measures on households with high energy use – this will require intervening in the design of the ECO programme, e.g. through uplifts
- Target WHD (or introduce a differential rate of WHD) on households with high energy use – this will require information on income or benefit status of such households
- Develop equity release schemes for asset-rich, income-poor consumers in large homes that consumers can trust.
- A recognition that some of the may be outside the energy sector. For example older people whose health requires a higher ambient temperature in their own home or a large amount of hot water is also a health issue. For more details of improvements to equity release and these health vs energy issues see note by Mervyn Kohler in appendix two.

## Appendix one

Figure A1 below shows how energy consumption generally increases with income. However, it also illustrates the fact that some low income consumers have relatively high energy use and similarly some higher income consumers have relatively low energy use.

**Figure A.1: Energy consumption by income decile**

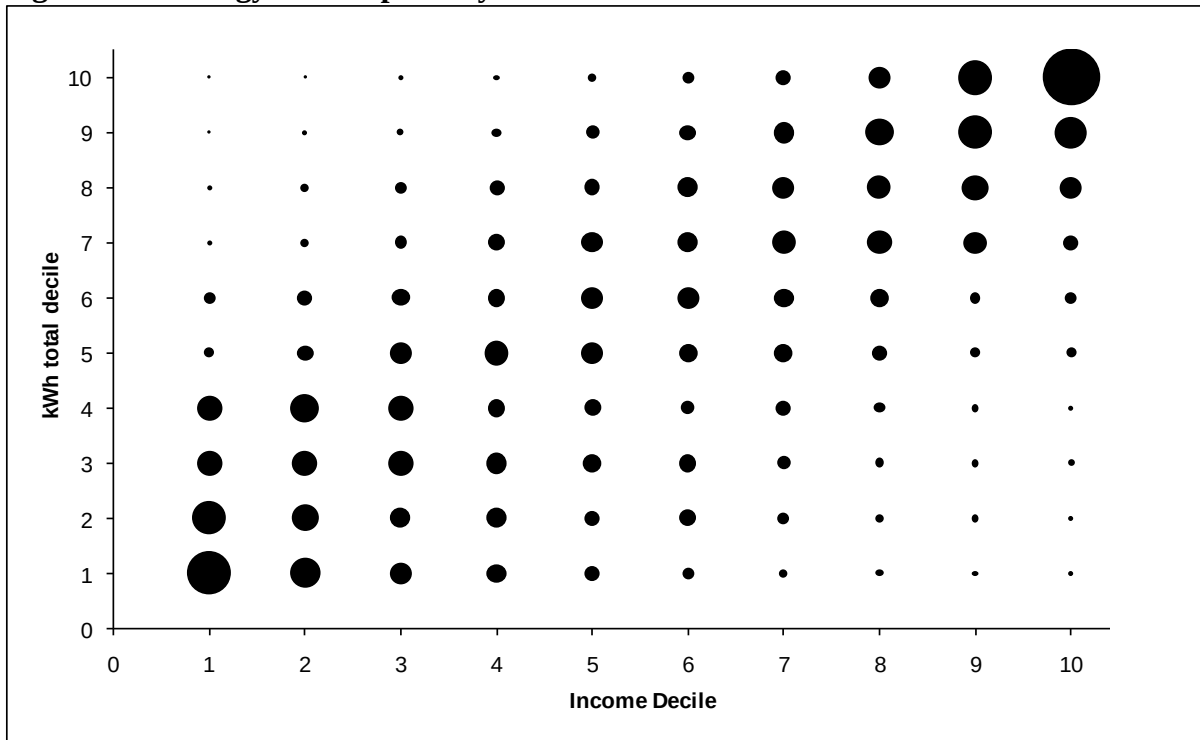


Table A1 below gives the average level of energy consumption by income decile.

**Table A1: Average energy consumption by income decile**

| Income decile | Electric heating consumers | Gas heating consumers |             |
|---------------|----------------------------|-----------------------|-------------|
|               | Electricity use            | Electricity use kWh   | Gas use kWh |
| 1             | 7,381                      | 2,695                 | 12,433      |
| 2             | 8,148                      | 2,921                 | 13,788      |
| 3             | 8,665                      | 3,303                 | 15,214      |
| 4             | 8,733                      | 3,504                 | 15,788      |
| 5             | 9,069                      | 3,741                 | 16,481      |
| 6             | 9,423                      | 3,950                 | 17,218      |
| 7             | 9,587                      | 4,100                 | 17,752      |
| 8             | 10,154                     | 4,313                 | 18,523      |
| 9             | 11,191                     | 4,389                 | 19,019      |
| 10            | 12,008                     | 4,703                 | 20,941      |

Figure A2 illustrates how access to gas is generally lower for lower income deciles. Thus, these consumers are more reliant on electricity and other heating fuels to heat their homes.

**Figure A2: Access to gas by income decile**

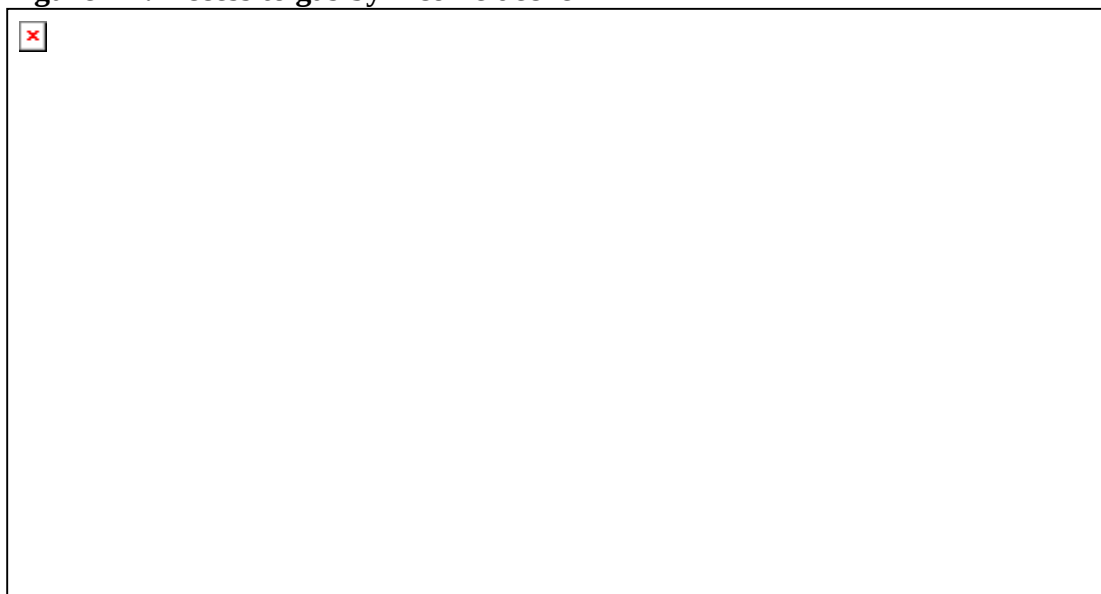


Table A3 below shows that households without mains gas heating are more likely to live in fuel poverty than those with gas heating (based on an analysis of English Housing Survey, Welsh Living in Wales Survey and Scottish House Condition Survey carried out for Consumer Focus by Dr Richard Moore – publication forthcoming).

**Table A3: Heating fuel by fuel poverty status, Great Britain 2008**

Thousand households/ row percentage/ column percentage

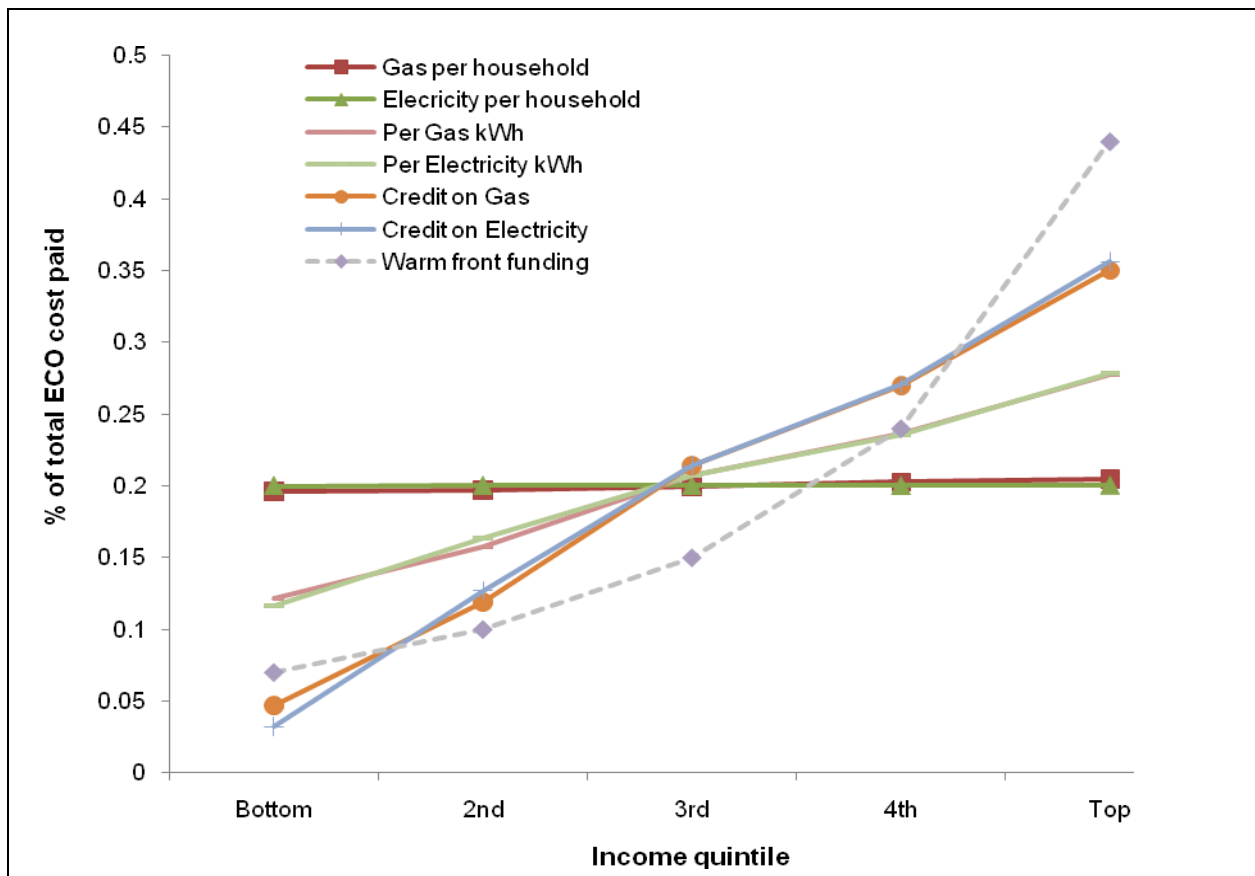
| <b>Fuel poverty target definitions<sup>1</sup></b> | <b>Mains gas</b>        | <b>LPG &amp; Bot gas</b> | <b>Heating Oil</b>    | <b>Solid fuel</b>   | <b>Electric heating</b> | <b>Com-munal</b>    | <b>Total</b>             |
|----------------------------------------------------|-------------------------|--------------------------|-----------------------|---------------------|-------------------------|---------------------|--------------------------|
| Not in fuel poverty                                | 17,732<br>85.8<br>85.3  | 82<br>0.4<br>48.0        | 742<br>3.6<br>67.1    | 170<br>0.8<br>54.8  | 1,677<br>8.1<br>71.8    | 253<br>1.2<br>89.4  | 20,656<br>100.0<br>82.6  |
| In moderate fuel poverty (10 – 20%)                | 2,543<br>72.5<br>12.2   | 60<br>1.7<br>35.1        | 269<br>7.7<br>24.3    | 98<br>2.8<br>31.6   | 512<br>14.6<br>21.9     | 24<br>0.7<br>8.5    | 3,507<br>100.0<br>14.0   |
| In severe fuel poverty (> 20%)                     | 502<br>62.4<br>2.4      | 30<br>3.7<br>17.5        | 91<br>11.3<br>8.2     | 39<br>4.8<br>12.6   | 138<br>17.1<br>5.9      | 5<br>0.6<br>1.8     | 805<br>100.0<br>3.2      |
| Total in fuel poverty <sup>2</sup>                 | 3,046<br>70.6<br>14.6   | 90<br>2.1<br>52.6        | 360<br>8.3<br>32.5    | 139<br>3.2<br>44.8  | 649<br>15.0<br>27.8     | 30<br>0.7<br>10.6   | 4,313<br>100.0<br>17.2   |
| <b>Total households</b>                            | 20,799<br>83.2<br>100.0 | 171<br>0.7<br>100.0      | 1,106<br>4.4<br>100.0 | 310<br>1.2<br>100.0 | 2,336<br>9.3<br>100.0   | 283<br>1.1<br>100.0 | 25,005<br>100.0<br>100.0 |

<sup>1</sup>Definition of fuel poverty significantly different in Scotland than in England and Wales. The preferred target definition in each country is combined in this table.

<sup>2</sup> Fuel poverty status of 37 thousand households in Scotland not known.

Figure A3 below shows the proportion of total policy costs paid by income quintile. It compares the costs of recovering ECO on a ‘per household’ basis, straight ‘per unit’ basis and on a ‘per unit plus free credit’ basis. It also shows the relative tax contribution to Warm Front by income quintile. The graph shows that the ‘per household approach’ represents the most regressive method of paying the costs, while Warm Front cost recovery is the most progressive.

**Figure A3: ECO and Warm Front costs by income quintile**



**Source:** Croft (2011), *Costs of the ECO: impact on low income households*, Eaga CT

**Note:** The analysis illustrated in the graph above applied a slightly higher credit (£80 on electricity bills) than that described in this report. It also applied a credit to gas, which was not considered in this report.

## **Appendix two**

### **Energy Consumers**

#### **High usage, low income**

Amongst the older population, there are at least three groups which characteristically need to use higher volumes of energy to keep themselves and their houses adequately functional and warm, despite being poor, and who would suffer if the growing raft of 'standing charges' was shifted wholesale to a calibration based on energy consumption - a p/KWh basis.

The issue is whether the energy supply companies should adjust their tariffs to support these groups, or whether other expenditure streams should pick up the special needs of disadvantaged groups. Our starting point is that the energy suppliers are not in the business of welfare support, and inviting them to amass further information about their customers which could be intrusive and resented (and for both those reasons might not be responded to), and which would also be an expensive reduplication of knowledge which was already being gathered and logged elsewhere, is not the right way forward. Rather the people who are disadvantaged because they are high users of energy but on low incomes should be supported by other measures.

The three major groups of older consumers affected, extrapolated from the CSE research, are:

Older people whose health requires a higher ambient temperature in their own home, particularly since they are occupying it on a 24/7 basis, and may be suffering mobility problems which constrain their ability to keep warm by being physically active. These people have a health need, and that should be addressed through the health system. Their GP needs to prescribe energy costs as part of their general health care, and the NHS budget should be taking the strain.

People who are incontinent and need loads of hot water to keep clean. The same as above. This is a health issue, and requires a response which is supported by health providing agencies. There are more ways of tackling incontinence with medical and pharmaceutical interventions than with simple damage-limitation strategies, such as incontinence pads, and if health agencies were mandated to make a contribution the costs of frequently washing quantities of clothes and bedding, it would be a welcome call to them to take a more interventionist and innovative approach to the issue of incontinence more seriously. Alternatively, these costs could be met by enhanced disability payments through the DWP budget.

Then there are the under-occupiers - people living in houses which on the current definition of under-occupation (which is incredibly tightly drawn, assumes that a one person household needs only one bedroom, and totally fails to recognise that grandparents have a growing role to play in the care and support of their grandchildren). Under-occupiers will normally be home-owners, will normally be long-standing occupiers who because of bereavement or because of the outward migration of their family are now left as single occupiers of properties they bought as family homes. If they are on low incomes, they will struggle to keep these homes going. There are answers:

- To ensure that there is provision in the locality of more appropriate housing, and schemes which assist older residents to find them and move into them. This is a

- planning duty the local authority needs to take responsibility for, and it too could facilitate the removal schemes and support.
- To grow the equity release market so that people who choose to stay put can modernise and improve the energy efficiency of their homes at a sensible cost. Equity release is seen as the solution to many problems - Andrew Dilnot noted it in relation to the funding of social care, and the Centre for Social Justice commented on it in its report on social exclusion and isolation - but it does have salience given the high equity levels locked up in the homes of many millions of people. The problem is that the equity release providers have to calculate their costs against the huge uncertainty of longevity, so tend to price the product at rates which look frankly unattractive. If, like student loan accounts, they could draw on a repayment scheme which pooled and even subsidised the risk factors and thus reduced the uncertainty costs (understanding that people looking after themselves better would be less likely to cause costs to arise in other state spending areas), there would be a much greater public appetite for equity release. The Government needs to grasp this issue with enthusiasm.

Winter Fuel Payments are paid at a flat rate to every household, as a kind of pension supplement. This is not unreasonable and not without merit. But as the database grows from EPCs, and as people join the queue for Green Deal interventions, there is a case for raising the Winter Fuel Payment for households which need, but have not had, an energy refurbishment makeover. This would give central government a strong incentive to ensure that energy efficiency programmes really ran at speed.

The fundamental point underpinning all these suggestions was well spelt out in the recent report from the Marmot team: cold homes equals poor health equals poor performance as citizens. Because we ignore the legitimate needs of fuel poor households, we stack up other social problems and health needs. But front-loading the problem onto the energy supply industry is not the way forward: not only is it inappropriate and unreasonable to ask the energy supply companies to address endemic social problems, but it distracts attention from the public sector providers who need to recognise their responsibilities and adjust their service offerings.

Appendix two was prepared by Mervyn Kohler at Age UK.