Response to Ofgem Consultation: "Addressing unfair price differentials"

ENERGY ACTION SCOTLAND
Suite 4a
Ingram House
227 Ingram Street
Glasgow G1 1DA
Tel: 0141-226 3064
Fax: 0141-221 2788
Email: eas@eas.org.uk
www.eas.org.uk

Introduction

Energy Action Scotland (EAS) is the Scottish charity with the remit of ending fuel poverty. EAS has been working with this remit since its inception in 1983 and has campaigned on the issue of fuel poverty and delivered many practical and research projects to tackle the problems of cold, damp homes. EAS works with both the Scottish and the UK Governments on energy efficiency programme design and implementation.

EAS welcomes the opportunity to respond to Ofgem's Consultation on "Addressing unfair price differentials". EAS is more concerned about the impact of unfair price differentials on vulnerable consumers than on the risks to competition and innovation and this response concentrates mainly on the aspects of the consultation which relate to fuel poverty.

Fuel Poverty in Scotland

The Scottish Government is required by the Housing (Scotland) Act 2001 to end fuel poverty, as far as is practicable, by 2016 and plans to do this are set out in the Scottish Fuel Poverty Statement. The number of Scottish households living in fuel poverty dropped from 756,000 (35.6%) in 1996 to 293,000 (13.4%) in 2002. Half the reduction was due to increases in household income, 35% to reduced fuel prices and 15% to improved energy efficiency of housing[1]. The most recent 2007 figures[2] from the Scottish House Condition Survey Key Findings Report show that there were 586,000 households living in fuel poverty in Scotland in 2006/07, representing 25.3% of the total.

According to figures produced by Scottish Government[3] early in 2008, for every 1% rise in fuel prices an estimated 8,000 more households would go into fuel poverty. Based on these figures EAS estimates that there are currently 850,000 households, around one in three, in fuel poverty in Scotland. This significant increase in fuel poverty is widely accepted to be due to the dramatic increases in domestic energy prices and EAS is very concerned about the negative impact of high energy prices on vulnerable consumers. EAS is pleased that Ofgem is investigating this matter and strongly recommends that the issue should be referred to the Competition Commission for investigation if agreement on proposed remedies cannot be reached with suppliers within a reasonable timescale.

General comments about unfair price differentials

The Ofgem consultation document acknowledges that "a significant number of consumers remain disadvantaged by persistent unfair price differentials and that vulnerable consumers are disproportionately affected". The "Energy Supply Probe – Initial Findings Report" stated that competition is not working for vulnerable customers. EAS does not believe that the competitive market is working well for vulnerable and low income customers and this is supported by research carried out by Ofgem[4] and by Mori[5]. The Ofgem research showed that PPM customers are less likely to switch suppliers than consumers who pay by other methods and Ofgem acknowledges that the competitive market has not worked for these customers.

[1] Fuel Poverty in Scotland: Further Analysis of the Scottish House Condition Survey 2002
[2] Revised Scottish House Conditions Scotland Key Findings Report 2007
[3] Estimate of Fuel Poverty Households in Scotland: Scottish House Condition Survey March 2008
[4] Ofgem Factsheet 67: "Prepayment meter customers and Fuel Poverty" June 2007
[5] "Switching Rates for Vulnerable Customers": Mori, March 2008

The current differential between prepayment meter tariffs and direct debit tariffs is between £80 and £125. EAS was pleased to note that the Chancellor of the Exchequer's statement in the 2008 Budget about PPM customers urged Ofgem and the energy suppliers to bring forward proposals for treating prepayment customers more fairly and also stated that Government will take statutory action if there is insufficient progress on this issue.

Ofgem has also indicated that it is concerned with the impact of unfair price differentials on vulnerable consumers and EAS suggests that any possible adverse impact on competition and innovation should be of secondary concern particularly at this time of high energy prices. It is encouraging to note that the six main energy suppliers have already taken some steps to address the issue of unfair price differentials but there is still concern about the speed of implementing these changes and the fact that some customers are still experiencing significant detriment.

In its response to the BERR Committee Inquiry into possible anti-competitive behaviour in the UK's energy market, EAS asked the BERR committee to consider whether the current duties of Ofgem should be changed to ensure that there is a stronger focus on the needs of vulnerable consumers, until such time as fuel poverty has been eradicated in Britain.

Response to specific proposals in the consultation

CHAPTER: Two

Question 1: In proposing action, are the overall aims we set out appropriate? Are there other issues we should focus on in taking a decision on the best way to proceed in this matter?

EAS would like to stress the importance of prioritising the interests of vulnerable consumers and suggests that the development of competition and innovation in the energy market should be a secondary consideration until Ofgem is satisfied that vulnerable consumers are not adversely affected by the way the domestic energy market is operating.

EAS agrees with Ofgem's general approach, strongly supports the need to take action to address unfair price differentials and urges Ofgem to act quickly to resolve this issue. However, EAS does not support the proposals to introduce cost reflective pricing and would only be prepared to support the introduction of relative price controls if there were sufficient safeguards for vulnerable customers.

Question 2: What is the appropriate approach to cost allocation?

Ofgem suggests that costs that are directly attributable to the characteristics of a particular product should be reflected in the pricing of that product. This argument is currently used to justify the higher charges for PPM tariffs but it is generally accepted that this has a disproportionate impact on vulnerable and fuel poor customers and therefore EAS does not support this proposal.

The proposals to prohibit undue discrimination and cross subsidy between electricity and gas supply are certainly worth considering and EAS reiterates that the primary consideration in relation to any changes should be the protection of vulnerable customers.

Question 3: Are social or environmental issues appropriate to consider in relation to objective justification? How might these exceptions be captured in either licence conditions or guidelines?

Consideration of social and environmental issues is absolutely essential and EAS recommends that Ofgem should adopt a holistic approach when considering the issue of price differentials.

Energy is fundamental to people's lives and well being and therefore should not be treated in the same way as other commodities.

Question 4: Would it be beneficial to give a clear indication of materiality thresholds either on the face of any licence conditions or in guidance?

EAS does not support cost reflective pricing and therefore the issue of materiality thresholds is not relevant.

Question 5: Would it be beneficial to introduce a new enforcement process? If so, should this process be of the form set out in this document? Are there any other considerations in relation to the detail of how such arrangements might work?

EAS believes that it is essential to have a robust enforcement process in place to ensure that any breaches of the new licence conditions are dealt with. It is disappointing to note that Ofgem appears to be reluctant to impose penalties for breaches of licence conditions and EAS recommends that Ofgem should reconsider its approach to this issue. The "multi-stage" approach set out in the consultation document appears to be quite vague and EAS is particularly concerned that there is no timescale set out in the document for energy companies to comply with notices of objection.

Question 6: Should the proposals for licence requirements set out in this document apply to all suppliers active in the market for domestic consumers - or only to a subset of these suppliers, such as the Big 6?

EAS cannot see any obvious reason why the proposals should not apply to all suppliers active in the domestic energy market.

Question 7: Would a sunset clause be appropriate for any licence conditions? What would be a suitable time period before any review of the market?

EAS agrees with the proposal that changes to the licence document should remain in place for a specified period of time and accepts that a period of between three and five years is reasonable but EAS recommends that these conditions should not be removed without further consultation.

Response to specific proposals in the consultation

Proposal A: Cost-reflective pricing between payment methods

It is generally accepted that some element of cross subsidy is unavoidable in any industry. Given that the retail side of the energy industry represents less than 10 per cent of the total costs to customers, it seems unreasonable to impose an even greater burden on the most vulnerable people in our society by introducing cost reflective pricing into the retail side of the industry. Competition is not currently working for vulnerable and fuel poor customers and therefore Ofgem should not seek to justify higher tariffs by introducing cost reflective pricing into the energy market.

The issue of regulatory uncertainty and risks to competition and innovation are not of primary concern to EAS but there is a real danger that cost reflective pricing would allow companies to continue to justify the practice of imposing higher tariffs on PPMs and this would do nothing to address the current unfair situation. It is acknowledged by Ofgem in the consultation document that "vulnerable consumers are disproportionately represented among PPM customers" and therefore EAS does not support any proposals that might lead to further detriment for these consumers.

EAS believes that all suppliers should equalise their PPM tariffs with other tariffs, e.g. standard or direct debit tariffs, and can see no obvious barriers to this. This view is supported by the fact that Ofgem has agreed that suppliers are now allowed to include PPM tariff equalisation in their Corporate and Social Responsibility expenditure.

According to the consultation document the introduction of cost reflective pricing is likely to result in price increases for standard credit customers, many of whom may also be classed as vulnerable. Ofgem also acknowledges that this proposal may also lead to an increase in prices for some direct debit customers.

EAS is very concerned about the possible negative impact of cost reflective pricing on vulnerable and fuel poor consumers and strongly recommends that Ofgem gives careful consideration to this issue before any changes are implemented. In view of all of these factors EAS does not support cost reflective pricing between payment methods.

Proposal B: Prohibition of undue price discrimination

EAS supports Proposal B, which would prohibit undue price discrimination and believes that this would address situations where consumers are unable to access better deals because they have no bank account or because they are unable to switch supplier or access a better payment method. EAS notes that Ofgem proposes to publish guidance on how this obligation would be interpreted and EAS believes that this should remove any concerns about regulatory uncertainty.

Customers who are locked into a particular method of payment, and who have no access to competition should also be protected against unfair price differentials. Figures[6] produced by energywatch stated that there are 228,000 households with dynamic teleswitching meters in Scotland. Consumers with these meters find it difficult to switch suppliers as most suppliers' systems are not able to incorporate data from these meters and so we are an example of a group which would require such protection.

Question 5: Could this sort of prohibition be used to address instances of cross subsidy between gas and electricity supply – or would an additional condition, such as an explicit prohibition on cross subsidy, be needed to address this issue?

EAS can think of no obvious reason why this sort of prohibition could not be introduced to prohibit instances of cross subsidy between gas and electricity.

Proposal C: Relative price controls

As this proposal could result in setting a limit on the premiums for PPMs and "in area/out of area" consumers but would not remove them altogether. EAS is concerned about the unintended consequences arising from it. For example, the consultation document accepts that introducing relative price controls, which relate to different payment methods, would result in premiums for PPMs being greater than for standard credit and direct debit. In addition to this the issue of unfair price differentials for in area/out of area customers would continue and therefore EAS is very sceptical about supporting this proposal.

[6] "Working for Scottish Consumers" Factsheet - energywatch

The consultation document also acknowledges that imposing a revenue cap might lead to further unintended consequences for vulnerable consumers and therefore EAS does not support the introduction of a revenue cap or relative price controls as a means of addressing unfair price differentials.

Proposal D: Prohibition of "cross subsidy" between gas & electricity

The market probe identified "that the five former incumbent electricity suppliers have consistently earned higher margins on electricity supply then on gas". This has an ongoing detrimental effect on households that are not connected to the mains gas network and who have no choice of fuel. In Scotland 33 per cent of households have no access to mains gas and are therefore unable to benefit from dual fuel deals, which are usually cheaper than single fuel arrangements.

According to the consultation document, "if in area margins earned in gas and electricity were equalised, electricity prices would need to fall by around 14 per cent and gas prices by 6 per cent". Ofgem has also acknowledged that this measure would be of greater benefit to vulnerable consumers particularly those who are electricity only customers, many of whom are likely to be fuel poor. The introduction of a reciprocal condition to deal with potential cross subsidy of electricity supply from gas supply would also seem to be desirable.

In view of all of these circumstances, therefore, EAS supports the proposal to prohibit "cross subsidy" between gas and electricity and that Ofgem should set out clear and unambiguous guidelines on what it means by "significant implicit cross subsidy".

APPENDIX: Two

Question 1: What are the potential impacts of the proposals set out in this document? Where possible, please indicate the magnitude of any impacts.

There is a significant danger that the introduction of cost reflective pricing and relative price controls could result in the continuation of unfair price differentials for PPM and "in area/out of area consumers" many of whom are experiencing significant detriment under the current arrangements.

Question 2: What are the potential impacts on consumers of these proposals?

The impact of Proposals A and C would result in higher prices for some vulnerable customers and therefore EAS does not support these proposals.

Question 3: What are the potential impacts on competition of these proposals? What are the potential impacts on small suppliers?

EAS is not primarily concerned about the impact on competition or on small suppliers and believes that this is a matter for Ofgem. The National Audit Office (NAO) Review stated that there is a lack of easily accessible, trustworthy, relevant, understandable and comparable information for customers wanting to switch suppliers. Tim Burr, head of NAO said "Ofcom, Ofgem and Postcom need to be vigilant, and be prepared to use their powers when necessary, to ensure genuine competition is present and that it is working to serve consumers".

In its "Consumer First" research[7] into vulnerable consumers' engagement with the energy market Ofgem stated that "historically, levels of switching supplier have been lowest amongst these less

[7] Ofgem Research Report on Vulnerable Consumers' Engagement with the Energy Market: March 2008

affluent and more disadvantaged groups, and research has consistently shown that it is the higher social grades (ABC1 and C2s) who are more likely to take full advantage of the gains to be made from switching supplier". The research also concluded that many vulnerable customers do not have access to the internet and that there is also a widespread belief that switching is difficult and may lead to problems of double billing, leading them to conclude that it is safer to remain with their existing supplier. These findings are supported by the recent Mori Research[8] commissioned by Ofgem which stated that the AB social group are more likely to switch than social groups D and E and therefore EAS believes that vulnerable groups still need regulatory protection.

Question 4: Would these proposals have a significant impact on sustainable development? In particular, is there anything in the proposals that would preclude the development of green tariffs, energy services offerings and similar innovations?

EAS sees no reason why Proposals B and D would have any adverse impact on sustainable development or on the development of innovative green products. In August 2007 Ofgem removed the 28 day rule in order to clear the way for energy suppliers to offer more innovative products that could bring better deals to customers and environmental benefits. EAS is unaware of any real progress in this area and would urge Ofgem to reinstate the 28 day rule if suppliers do not make relevant progress in the development of innovative and environmentally friendly products.

Question 6: What are the risks and potential unintended consequences of these proposals?

There is a real danger of unintended consequences arising from Proposals A and C, which could result in higher tariffs for some vulnerable and fuel poor customers and therefore EAS urges Ofgem to use all its powers to ensure that any changes to the licence do not result in more difficulties for vulnerable customers.

EAS would not support any changes that would undermine the provision of social tariffs to vulnerable customers as these are currently providing an essential level of protection for fuel poor customers.

Conclusion

It seems clear from all the research that has been carried out that the energy market is not working well for all consumer groups and that vulnerable and fuel poor customers are not being well served by the current arrangements.

EAS supports the prohibition of undue price differentials and the prohibition of "cross subsidy" between gas and electricity as these proposals would remove some of the disadvantages currently experienced by PPM and electricity only customers.

EAS does not support the introduction of cross reflective pricing between payment methods or the introduction of relative price controls or revenue caps mainly because these might lead to unintended consequences for vulnerable and fuel poor consumers. It is imperative that Ofgem does not allow any changes to the existing licence conditions without first ensuring that fuel poor customers are not adversely affected and EAS suggests that any proposed changes should only be considered if Ofgem is satisfied that they will not result in new or continued detriment to fuel poor customers.

[8] "Switching Rates for Vulnerable Customers": Mori, March 2008