

Ofgem's Retail Market Review

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**. The response does not cover all aspects of the review; it seeks to focus on the main areas of FPAG concern and technical expertise.

1 Response in summary

1.1 Broad support for the majority of the proposals, some clarification required as follows, and the need to go further The non-supplier membership is particularly keen to understand:

- how a supplier's price for one standard variable tariff will be efficiently and competitively incurred,
- can competitive pressures be maintained in this context,
- how a distortion over time can be prevented through being effectively monitored,
- what the distributional impacts would be if the tariff is applied,
- what are the implications for pre-payment and 3 rate tele-switch consumers,
- why standing charges are viewed by Ofgem as an appropriate mechanism to collect environmental charges compared to a more equitable consumption based mechanism.

A major concern is that by having a defined standing charge and single unit rate promulgated in a prescribed manner may well assist more consumers to participate in the market, it is still very unlikely to assist those who are excluded through poor literacy, language, age, illness, technology etc. Of the estimated 4 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.

- 1.2 Communicating with the hard to reach** Suppliers have demonstrated the ability to communicate targeted messages in a mass market. This is clearly demonstrated by the growth in the number of consumers on fixed priced deals, Internet tariffs and those paying by direct debit. Meanwhile, there does not appear to have been a similar success with low income, vulnerable and fuel poor consumers. Suppliers should now be required through licence conditions to have well-developed and specific plans to communicate with the significant hard to reach community. This could include tailored and simplified bills, key facts etc and greater use of different languages. With the advent of the Green Deal and the Minister of State, Greg Barker MP's declared ambition for the fuel poor to benefit greatly from this initiative, should in itself drive a requirement for excellence in all mass market communications to a range of target sectors. This could potentially build on the data sharing initiatives underway to target the Warm Homes Discount.
- 1.3 Meanwhile explore a regulated 'fair trade' tariff solution with energy efficiency measures.** All consumers pay for the competitive market irrespective of their participation. The best energy deals go to the well informed, computer literate and broadband connected consumer. A further option that builds on the RMR's radical and creative proposal would be to explore a regulated tariff, priced relative to a basket of other products available on the market, plus a package of Green Deal energy efficiency measures, but as an alternative to participating in the competitive energy market for certain categories of the most vulnerable and excluded households. The principles behind it would be cost reflective transparency, excellent value for money to consumers and a fair return on supplier's investment. For suppliers, realistic marketing costs, reduced need for churning with lower transaction costs once the initial changeover had occurred and a high degree of assurance that the most vulnerable households were not being disproportionately disadvantaged by being unable to access the market.
- 1.4 Costs to decarbonise energy should be recovered on a per kWh consumption based mechanism.** FPAG remains deeply concerned that the costs and implication of the UK's transition to a low carbon economy, has yet to be sufficiently explored and the consumer implications understood. Meanwhile, costs continue to be added to energy bills to fund a range of related environmental and energy costs on an inequitable basis. Continuing payment for environment policies on a per 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.

- 1.5 A more equitable attribution of these environmental and energy costs would appear to be cost recovery on a per kWh basis and not per consumer (See Appendix). Initial analysis and research undertaken by FPAG reveals that at least 85% of low income consumers benefit from the Energy Company Obligation costs being applied on a consumption-based cost recovery mechanism. It is unclear where responsibility resides for the exploration and instigation of such a more equitable cost recovery initiative.
- 1.6 **Green Deal, capital provision and consumer equity** Without Treasury funding, the provision of capital is the most elusive element required to eradicate fuel poverty. The latest Green Deal proposals anticipate private capital provision plus a new Energy Company Obligation (ECO). However, as yet, the ECO quantum, the mechanism by which its cost will be recovered, and the extent to which the fuel poor will benefit are yet to be determined. It is important that Ofgem seeks to build on its drive for fairness and consumer equity to engage both DECC and other stakeholders in these fundamental points of this new policy instrument.
- 1.7 **The Green Deal and regulatory oversight; going further** An issue of growing concern is the scope of Ofgem's role in relation to the wider energy services market per se. The Green Deal programme will encourage the uptake of significant energy efficiency measures paid for through the anticipated savings from consumer energy bills. The collective sums involved will potentially be £billions. There is, therefore, a need for a very robust consumer protection regime at the outset. Ofgem is currently responsible for regulating the energy suppliers in relation to the provision of energy but the sale of energy efficiency products is currently covered by the OFT (although this will in turn be affected by the proposed consumer landscape changes). This split of responsibilities risks leaving consumers confused and **prevents a coherent approach** being taken to some of these issues especially, if as anticipated, energy suppliers are involved in the sale of Green Deal or, indeed if the Green Deal ends up being 'bundled' with energy provision. FPAG would therefore recommend Ofgem's powers be extended to ensure that a holistic approach can be taken to these issues as the energy services and Green Deal market evolves.

2. Background and context

- 2.1 **The number of fuel poor households continues to increase** In 2004 there were 1.2 million households, in England, in fuel poverty; the Government's own estimate for England indicates that there are now some 4 million households. High energy prices have been the biggest driver. With every one per cent increase in energy prices, another 60-70,000 households are added to the number of homes in fuel poverty¹. The recession, plus the industries investment plans estimated at c. £200B to 2020 and uncertainty over new generating capacity will exacerbate the problem. The drastic reduction in funding for Warm Front, and the scheme's complete termination in 2013, is particularly disappointing given that heating and insulation improvements represent the most rational and sustainable approach in addressing fuel poverty.

¹ DECC Fuel Poverty Impact Assessments 2010

2.2 Poverty and Fuel Poverty Fuel poverty is fundamentally different from other aspects of poverty and financial inequality. Within fairly narrow parameters, and subject to certain lifestyle choices, essential goods and services including food and clothing can be acquired at a comparable cost across all households – this is not the case with domestic fuel. Fuel poverty also differs significantly from general poverty in that appropriate levels of capital investment can deliver, in many cases, a permanent and sustainable solution.

2.3 The table below illustrates the fundamental difficulties faced by fuel-poor households; not only are they economically disadvantaged, they also need to spend more on fuel, in absolute terms, to achieve a warm and healthy living environment *i.e.* those who need to spend most on fuel are those least able to do so.

Expenditure as % of income	% of housing stock	Number households	Average income	Average fuel costs (£)	Average SAP
Up to 5%	49.9%	10,890,000	£39,718	£1,124	55
5% to 10%	34.5%	7,383,000	£17,887	£1,203	51
10% to 15%	10.0%	2,145,000	£11,350	£1,351	45
15% to 20%	3.0%	635,000	£9,131	£1,567	38
Over 20%	2.6%	550,000	£5,495	£1,662	37
Total	100.0%	21,407,000	£27,554	£1,201	52

2.4 The Health Impacts of Cold Homes and Fuel Poverty The Marmot Review Team was commissioned by Friends of the Earth to write a report which reviews the existing evidence of the direct and indirect health impacts suffered by those living in fuel poverty and cold housing. It makes the case for aligning the environmental and health benefits of reducing fuel poverty and improving the thermal efficiency of the existing housing stock.

2.5 The inability to heat a home to a healthy temperature, as a result of poor quality housing and/or sufficient income to cover the required energy costs, impacts directly and indirectly on the physical and psychological health of the occupants, and can lead to death. The Marmot team did not use Fuel Poverty as an indicator because of its imprecision in identifying particular households, but the concept stands alongside the indicators that were used, which included the low thermal efficiency of housing and low indoor temperatures.

2.6 On excess winter deaths, the Marmot team noted:

- that countries with more energy efficient housing have lower rates of excess winter deaths;
- there is a relationship between excess winter deaths, low thermal efficiency of housing and low indoor temperature;
- there is a strong relationship between cold temperatures and cardio-vascular and respiratory diseases (see attachment 1);
- around 40% of excess winter deaths are attributable to cardio-vascular diseases;
- around 33% of excess winter deaths are attributable to respiratory diseases;

- excess winter deaths are almost three times higher in the coldest quarter of housing than in the warmest
- children living in cold homes are more than twice as likely to suffer from a variety of respiratory problems than children living in warm homes;
- cold housing negatively affects children's educational attainment, emotional well-being and resilience;

2.7The report also noted that:

- children in cold homes face significant negative effects such as infants' weight gain, hospital admission rates, developmental status and the severity and frequency of asthmatic symptoms;
- mental health is affected by living in cold homes across all age groups;
- there are clear negative effects of cold housing and fuel poverty on the mental health of adolescents;
- more than 1 in 4 adolescents living in cold housing are at risk of multiple mental health problems compared to 1 in 20 adolescents who have always lived in warm housing;
- for adults of all ages, but particularly older people, there are clear measurable effects of cold housing on adults' physical health, well-being and self-assessed general health, in particular for vulnerable adults and those with existing health conditions;
- for older people, there were measurable effects from cold housing in terms of higher mortality risk, physical health, and mental health;
- cold housing increases the level of minor illnesses such as colds and flu, and exacerbates existing conditions such as arthritis and rheumatism.

2.8The report shows that long-term acute physical and psychological health effects and death can be avoided by interventions which improve the fabric of the property, reduce its energy requirements and so the cost of keeping it appropriately warm and heated to an adequate temperature.

For the full report please use the following link:

http://www.foe.co.uk/resource/reports/cold_homes_health.pdf

Derek Lickorish
 FPAG Chair
 5th June 2011

Proposal to base supplier obligations on kWh volumes

FPAG is keen to ensure that all the creative opportunities to aid the pursuit of consumer equity are explored and particularly so at this time of Ofgem's Retail Market Review. The following is an approach FPAG is exploring with the Big 6 suppliers. Such a model could also be deployed as other policies such as the new ECO evolves:

Current system

Currently CERT and the Warm Home Discount place obligations upon the supply companies which are apportioned according to their share of total domestic customer numbers as reported at the end of December each year. Electricity accounts, of which there is a national total of c.27m, are given the same weight in the calculation as gas accounts of which there are c. 22m. In other words, a supplier's share of the obligation is the sum of all their domestic energy accounts divided by the national total (c. 49m).

This arrangement has some merits

- Simple, transparent in some aspects with a relatively predictable outcome
- Little scope for gaming
- Suppliers have accepted the resulting apportionment as "fair" in the sense that competition is not distorted.

On the other hand, there are a number of criticisms that can be made.

- It adds perhaps to suppliers customer related costs increasing upward pressure on standing charges which are both unpopular and regressive.
- It misses the opportunity to incentivise lower usage in accord with environmental objectives.
- It is increasingly out of alignment with the pattern of benefits from the obligations which are designed to reduce usage particularly with regard to heating. This also means that the equal weighting of gas and electricity customers is problematic.

As we approach the end of CERT and the introduction of a new scheme in the form of ECO (perhaps carbon floor also), it is a good time to consider whether we should operate with an improved method of apportionment and in particular whether it should be shifted to a volume basis.

A Possible System based on kWh

This proposal attempts to keep the beneficial features of the current system in place but simply adjust the measurement criterion to a volume basis taken from the existing system of data collection for production of official statistics. Each month suppliers submit a return to DECC showing their sales of domestic electricity and

each quarter a similar return is done for gas. These data could therefore be used to apportion CERT and other obligations in proportion to kWh supplied.

The key advantages of this system would be

- It relieves some of the upward pressure on standing charges and increases the scope for suppliers to shift charges towards unit rates.
- It incentivises suppliers to achieve lower usage from their customers in accord with environmental objectives.
- It improves the alignment of the cost to suppliers with the pattern of benefits from the obligations.

There appears to be a reasonable prospect of devising a system for apportioning supplier obligations which retains the main benefits of the existing system but eliminates the problems associated with a customer number basis for the calculation and some of the consumer inequity it drives.