

# Ofgem Consultation on revisions to its Guidance on Impact Assessments

## 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

The diverse nature of the Group's membership may, on some occasions, prevent unanimity on some of the following points.

### The Fuel Poverty Context

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 in energy prices, another 50-60,000 households are added to the numbers in fuel poverty<sup>1</sup>. The average domestic dual fuel bill is now at a record high of £1,365 per annum<sup>2</sup> creating severe additional hardship for some six million UK fuel poor households<sup>3</sup>. The problem is even more acute for many living off the gas grid using Oil or LPG, where average fuel bills are circa £2,100 per annum<sup>4</sup>. The Government's Energy Market Reform (EMR) has no beneficial impact on bills between now and 2016 and adds costs from 2016 onwards.

The recession, unemployment plus the industries overall and longer term 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 implication of the UK's transition to a low carbon

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<sup>1</sup> DECC fuel poverty impact assessments 2010

<sup>2</sup> Ofgem: Electricity and Gas Supply Market Indicators updated 22 November 2012

<sup>3</sup> Consumer Focus 2012

<sup>4</sup> DECC, Fuel Poverty Detailed Tables 2010

<sup>5</sup> Ofgem Project Discovery

economy, has 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.

Professor John Hills, at the request of Government, undertook an independent review of the fuel poverty definition and measurement which completed in April 2012. Professor Hills' 'interim findings' and conclusion that fuel poverty is a: 'distinct and serious problem; that it deserves and requires attention as recognised by Parliament in adopting the Warm Homes and Energy Conservation Act, were welcomed by FPAG. We also noted and strongly endorsed Professor Hills' emphasis on the detrimental physical and mental health consequences of living in a cold home.

As part of the Review's conclusions, they established a 'Fuel Poverty Gap' which measures the average and aggregate depth of fuel poverty expressed as the difference between costs faced by the fuel poor and typical costs of achieving a warm home. The Review found that fuel poor households are paying £1.1 billion more for their fuel compared to typical households across England. The fuel poverty gap clearly demonstrates the enormous scale of the problem. In his final report Professor John Hills stated: "It is essential that we improve the energy efficiency of the whole housing stock. But those on low incomes and in the worst housing can neither afford the immediate investment needed nor afford later repayments without additional help." FPAG unequivocally agrees with Professor Hills.

It remains very clear that irrespective of how fuel poverty is to be eventually defined and measured, the number of households and occupants will still remain in the millions. Consequently, a robust strategy delivering serious measures will be required if the Government is to meet the legally binding target to eradicate fuel poverty by 2016.

Under the current definition of fuel poverty nearly 50 per cent of households are pensioners (10 percent contain a person over the age of 75 or over), 34 per cent contain someone with a disability or long-term illness, 20 per cent have a child aged 5 or under<sup>6</sup>. Hence the plight of the ever increasing numbers of fuel poor households has never been more serious than it is today. High energy bills cause stress and misery for many and often ill health as well for those living in a damp and poorly insulated property.

Those with the lowest incomes are the least able to absorb price rises, as fuel makes up a much more significant proportion of their incomes than is the case for those on higher incomes. The mean annual income of fuel poor households in the UK in 2010 was £11,000 compared to an average income of £32,000 for non-fuel poor households<sup>7</sup>. In addition, those on the lowest incomes typically pay more for their energy with households with an average income of £6,500 paying £1,954 for their energy, compared to those earning around £42,000 paying £1,244 per annum<sup>8</sup>. It is clear that a major step change in the energy efficiency of our housing stock is the only viable and long term solution if we are to have any hope of reducing the financial, physical and psychological health impacts of the ever increasing cost of

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<sup>6</sup> Hills Review 2011 2012

<sup>7</sup> DECC (2012) *Annual Report on Fuel Poverty Statistics 2012*

<sup>8</sup> DECC Fuel Poverty Detailed Tables 2010

energy bills. Such a change will cost money; more money than any government has been able to commit thus far.

Meanwhile, FPAG notes the Chancellor's recent decision to recycle some £300m of the sums to be received from the carbon price floor (c. £1.4billion to be paid by all consumers) to only industrial energy users of electricity to soften its impact, yet will not do something similar to protect the most financially disadvantaged fuel poor consumer in this context. FPAG further notes that consultation will now take place to explore the extension of compensation to cover Contracts for Differences.

At the same time as the energy Industry sets course for a low carbon transformation and EMR, the future of fuel poverty, its measurement, definition, mitigation schemes and the welfare benefits system will **all** change. For the first time since 1978 there will no longer be a government funded fuel poverty programme in England. The devolved assemblies of Scotland and Wales, however, will keep their funded schemes which will be in **addition** to a GB wide new energy supplier obligation.

The Green Deal and ECO could offer a new opportunity to assist both those households off the gas grid. However, most FPAG members believe that the Energy Company Obligation (ECO) must be dedicated to the alleviation of fuel poverty and not used to subsidise expensive measures on behalf of 'Able-to-Pay' households whilst so many fuel poor household still require measures to be fully funded upfront.

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 least able to do so and live in the most thermally inefficient properties

Fuel expenditure as a % of income	Number of households (thousands)	% of whole stock	Average full income (£)	Average fuel costs (£)	Average SAP
<5%	9,900	45.8%	41,963	1,244	59.1
5-10%	8,164	37.8%	19,832	1,338	54.0
10-15%	2,275	10.5%	12,549	1,497	47.0
15-20%	641	3.0%	9,649	1,644	42.0
>20%	620	2.9%	6,567	1,954	36.0
Total	21,600	100.0%	28,526	1,338	54.7

Source: Detailed Tables published by DECC in 2012

## Consultation Question 2:

Our proposed approach to assessing impact, costs and benefits is to develop an iteration of options between three aspects. These are: monetised, aggregate cost-benefit analysis; distributional effects; and long-term, hard-to-monetise considerations. These assessments are informed by a consideration of our principal objective to protect consumers (existing and future) and our other statutory and EU duties, including considerations of competition (EU and domestic). Do you agree with our approach to assessing impacts? We welcome any views on this approach, and the specific content within each category.

## Consultation Response

FPAG will limit its response to the issue of distributional impacts only.

The regressive means of collecting costs added to fuel bills to fund a range of related environmental and energy costs creates consumer inequity. FPAG, therefore, welcomes and fully supports Ofgem's approach and intention to assess the impact of distributional effects.

In order to give greater perspective of distributional impacts and 'underline its importance', FPAG wishes to cite the following research<sup>9</sup> and conclusions drawn, commissioned by Consumer Focus as part of its commitment to support the work of FPAG on the distributional impacts of energy tariffs. The study was designed to first assess the impact of the Energy Bill and other social and environmental policies on household energy bills, with particular attention to **those not likely to benefit from ameliorative measures**; and second explore potential solutions to off-set those worst affected.

### The hardest hit

A core objective of this research was the identification of households 'hardest hit' by the energy policies.

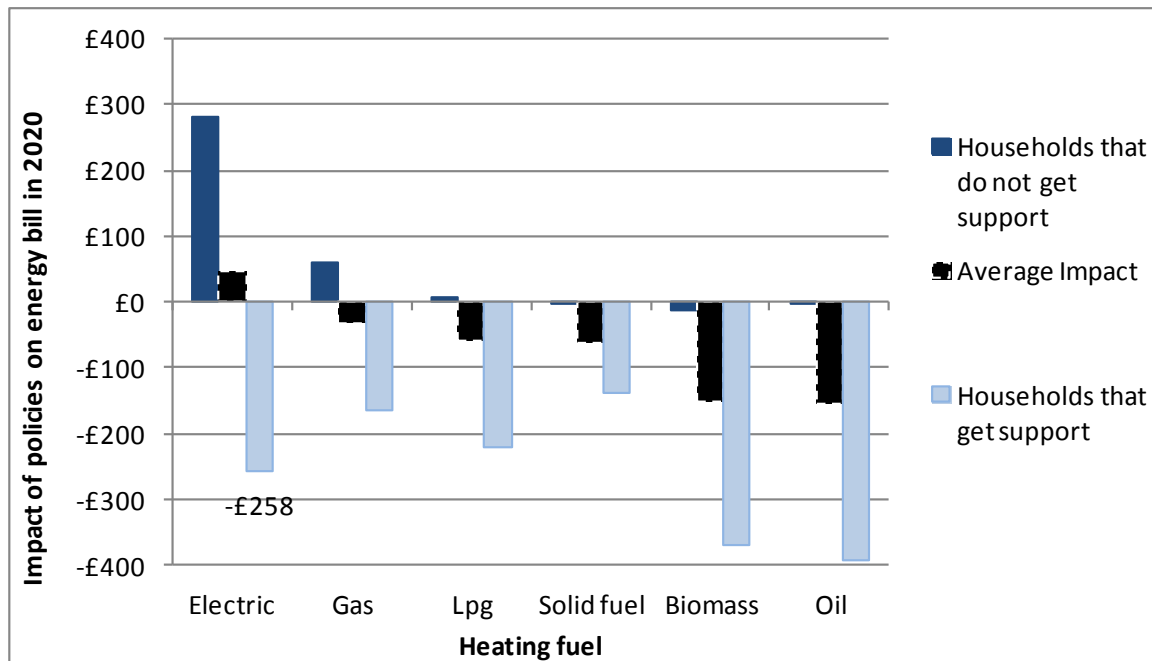
Electricity is subject to the majority of policy costs. Households reliant on electricity for heating are likely to have higher than average levels of electricity consumption, compared to the rest of the population, and therefore bear a disproportionate share of policy costs. These households might expect to receive measures to offset the particularly high costs they face, but this does not appear to be the case. The research found that a lower proportion of electrically-heated households (27%) benefit directly from policies when compared to all households (40%). Consumers that use electricity to heat their homes see an average increase in their bill relative to the 'no policy' bill, while all other consumers see a decrease on average. Furthermore, the difference between electrically-heated 'winners' (defined as households that 'get support' and benefit from policy) and electrically-heated 'losers' (households that do not get any support) is stark, at over £500.

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<sup>9</sup> The hardest hit – Going beyond the mean. Centre for Sustainable Energy Bristol, April 2013

The graph below shows the impact of policies on 2020 household energy bills by household heating fuel for DECC's 'central policy scenario'.

Figure A.1. Impact of policies on energy bill by heating fuel and those who do and do not receive support



Across all households that do not benefit from energy policy, electrically-heated homes are subject to the largest increase of £282, whilst households using non-metered fuels experience a decrease (regardless of whether or not they benefit from policy). This is because the benefits of products policy outweigh the total policy costs for this group of consumers.

In 2020, electrically-heated households:

- represent 10.5 per cent of the total share of heating fuel by type
- pay 18.9 per cent of the total cost of domestic energy policy
- receive 6.8 per cent of all measures deployed.

Furthermore, these householders contribute a significant amount towards large scale infrastructure projects designed to deliver energy security and renewable energy. When combined, the EMR and historical legacy of the Renewables Obligation represent the largest share – some 35% - of total policy costs of £4.8 billion in 2020.

### Identifying the hardest hit

The analysis of the impact of Government policies on domestic energy bills by different socio-demographic characteristics highlighted some important distributional issues, not least the implications for low-income households with electric heating. Chi-squared Automatic Interaction Detector (CHAID) was used to further explore and identify the characteristics of those 'hardest hit'.

The analysis found that of the five groups 'hardest hit' by policy costs, four use electricity to heat their home and hence have above average electricity consumption, compared to the population as a whole.

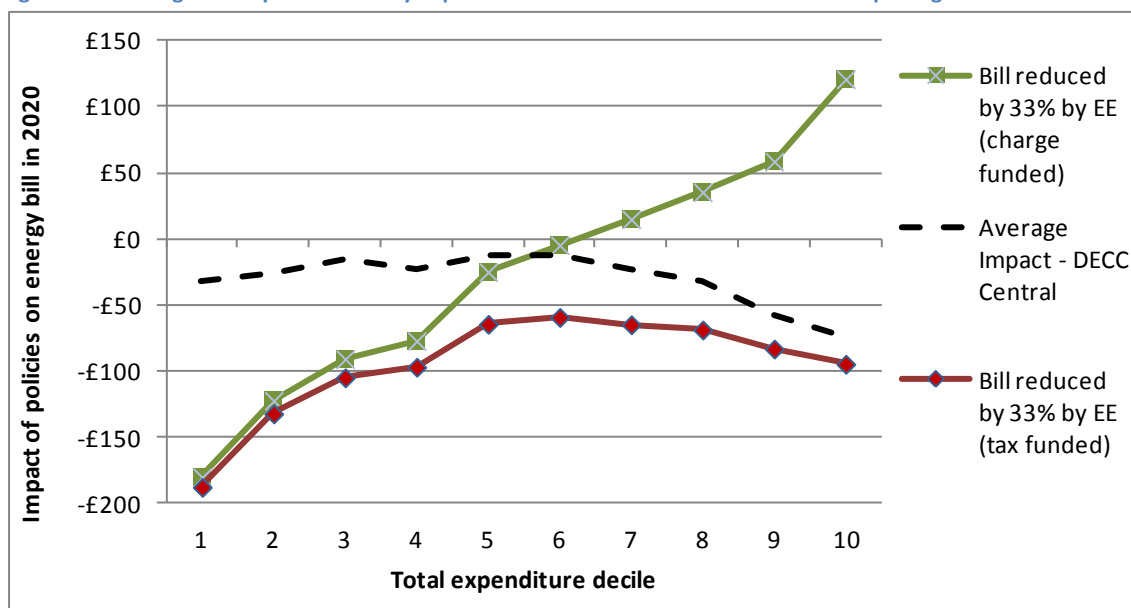
### Compensating the hardest hit

The research explored a range of approaches for off-setting the impact of policies on those worst affected and produce a more progressive distributional impact – that is, ensure lower income households are proportionally better off compared to higher income households. The application of an 'equity charge' in which a fixed credit is given to all consumers and the cost of this is recovered through raising the unit cost of energy above the median consumption threshold, provides a fairly effective form of compensation. However, the changes to tariff design under this approach do not protect the hardest hit as these are typically low-income households with above average electricity consumption.

A different approach to compensating those worst affected involves targeting electrically-heated purpose-built flats and households with occupants who are over 65. There are 1.1m households in electrically-heated purpose built flats. This group are worse off on average by over £100 as a result of policy costs, yet they have lower than average income and expenditure. Similarly households with occupants that are over 65 are typically lower income, especially those that use electricity for heating.

One approach to compensating these households involves allocating them a lump sum payment. However, the scale of payments required to ensure these households become **better off on average** is considerable (ranging from £500 to £1,000). Therefore, an alternative approach involves reducing their energy costs by an average of 33 per cent through energy efficiency measures. The distributional impact of this approach is shown in the graph below.

Figure A.2. Average bill impact in 2020 by expenditure decile for the demand reduction packages



Further work is needed to quantify the cost of measures required to deliver the savings across the 1.68 million households identified for targeting. However, the 'consumer credit' package investigated as part of this study generated revenue of £1.1 billion per year from consumer bills, which is similar in scale to the current Energy Company Obligation.

### **Policy implications**

The research explored a number of options for targeting the hardest hit households. It identified two groups that would benefit from targeting; households in purpose built flats with electric heating and all properties with electric heating containing at least one pensioner. The final stage of this research explored options for compensating these households. The research found that providing sustainable energy measures to reduce household energy costs provided the most successful approach to protecting these households and was the most progressive option in terms of distributional impact.

### **Conclusion**

The review of policy options and their distributional impacts of the above have shown that there remains a significant gap for the hardest hit by energy policy. In FPAG's opinion amendments to the current Energy Bill to compensate these households should now be considered.

Furthermore, since the above research, further analysis reveals that towards 30% of the off-peak element of a typical electric heating tariff is now required to cover the costs associated with government policy; and with further increases likely it is not unrealistic to foresee this increasing to 50% of off peak unit costs.

Government needs to make sure that its forthcoming Fuel Poverty Strategy and Heat Strategy develop policies for compensating these households, for example by installing solid wall insulation, heat pumps and/or gas district heating a priority. In terms of future funding for these measures, FPAG recommends further consideration of the use of existing carbon revenues or revenues from perhaps an EE FiT. The EE FiT may be an appropriate route for homes heated by electricity, helping these households to offset the steep increases in costs they face.

FPAG looks forwards to learning how Ofgem will promulgate their distributional impact findings following the introduction of their new approach to impact assessments.

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9<sup>th</sup> June 2013