

Ofgem: Response to Ofgem's Draft Consumer Vulnerability Strategy 2025

Consultation response from the

Centre for Competition Policy

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Response to Ofgem’s Draft Consumer Vulnerability Strategy 2025

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We welcome Ofgem’s carefully researched approach to the draft vulnerability strategy, in particular in identifying measures of outcomes. However, we suggest that regulators need to distinguish between those forms of vulnerability which are practicable and desirable to identify (which might include affordability) and those where identification may be either impracticable or potentially undesirable (for example bereavement). The appropriate policy responses are unlikely to be the same for these two cases. We present relevant evidence from research at the Centre for Competition Policy and elsewhere. We address the questions asked, but not in numerical order, so that we discuss conceptual issues first.

Question 4: Do you agree with our proposals for the first year of the strategy?

4A Create an analytical framework...

We agree that identifying an analytical framework is an important first step, but we are concerned that inherent challenges will limit its usefulness, precisely because, as acknowledged on page 5, “Vulnerability is a complex issue to tackle and one where all policy makers, consumer bodies and industry must come together to address consumer risks.” While consumer archetypes can help understand who is most at risk in the energy market, bundling together different characteristics may blur the boundaries between types of vulnerability, and identification of whether and how they should be addressed through energy markets.

The desire by Ofgem to ensure that vulnerable members of society are not adversely impacted upon through the ever-changing energy market should, of course, be a core principle to identify and, where appropriate, avoid detrimental welfare effects for sectors of society who are most at risk. However, the decision to try and judge this against ‘vulnerable situations’ may not only be misleading but could even create quite perverse outcomes.

One significant problem is finding an appropriate definition of vulnerability. This has vexed many academics and led to a raft of programmes – Emory Law School’s Vulnerability and the Human Condition is an illustration. The work of Martha Fineman (e.g. Fineman and Gear, 2015) makes it plain that vulnerability functions at both individual and institutional levels and is a lens from which to view the human situation. In short, all humans are vulnerable but some are more so. From this perspective, vulnerability is *the* universal human condition as it affects us all in varying degrees. It is important, therefore, to disaggregate consumers in vulnerable situations and vulnerability per se. For the former, the legal response is to identify the characteristics that might make some more susceptible to adverse effects and act accordingly. Economic, health and social factors are important variables but vulnerability can be viewed from both an objective and subjective perspective. This has an interesting echo in the discussion and evidence about objective and subjective measures of affordability – see question 2 below. The objective risk of detriment definition used as a focus for regulatory intervention may not necessarily align with self-perception. This is particularly so with regard

to generalizations relating to age or disability e.g. those with health problems may not see themselves as particularly vulnerable whereas the objective bystander might. Perhaps the definition of vulnerability requires an “or” instead of an “and”.

We define vulnerability as when a consumer’s personal circumstances *and* characteristics combine with aspects of the market to create situations where he or she is:

Personal circumstances might not align with characteristics e.g. mental impairment can lead to a risk of enhanced vulnerability but does the definition require impairment? In short, are circumstances or characteristics independently necessary but not sufficient in themselves?

Distinction between vulnerable situations and Vulnerability per se

Again, the two are not the same. For example, while in Ofgem’s (figure 2) not having used the internet is measurable, it is not the same as not having access to it, or indeed not wishing to do so. The same could be said of “people living with cancer” – this could cover a wide range of situations, from end of life, terminal to being treated in remission, etc. Other categories cover similarly broad circumstances for individual consumers, which makes them difficult as identifiers of those in need.

Evidence specific to the energy market indicates why using residential criteria might be an inefficient mechanism for helping truly vulnerable consumers, even using apparently uncontroversial criteria.

Knowing the characteristics of the buildings people reside in, alongside their demographic traits such as age, gender, and environmental preferences would appear to be a sound foundation from which to judge estimations on energy usage. However, in a study conducted at the University of East Anglia (UEA), researchers found that those living in identical buildings and holding near-identical personal characteristics use starkly different levels of energy (Brock, 2015; Brock & Borzino, 2016). Indeed, some residences consistently used treble the energy of their adjacent neighbours on a weekly basis. Furthermore, this was after being provided with explicit information on their relative and absolute usage. This means that, even with a reference point from which to judge behaviour, people’s energy consumption can be hugely disparate.

The study above found even more striking results when it combined energy usage with attitudes to the environment. Specifically, those students who had self-selected to live in a ‘green flat’ (i.e. a sustainable environment) actually consumed above-average levels of energy throughout the period of the trial, showing that information on residents may not always coincide with their actions. This is akin to the famous intention-behaviour gap (Sheeran & Webb, 2016).

Whilst the study of UEA students does not pertain to vulnerability explicitly, it is easy to envisage how basing vulnerability criteria upon the visible or factual information of individuals

might create a false indicator as to whether they are actually vulnerable. Indeed, being situated in a 'vulnerable condition' does not inherently mean that consumers do feel 'at risk' and thus there is a difficult balance to tread regarding how such information should be used to improve overall wellbeing. Perhaps more crucially, this also works in reverse – there could be 'vulnerable' consumers who, on paper, would not live under conditions that would suggest this is so. Thus, through proposing an abstract index one fails to access the vulnerable who are actually in real need of help.

A related point here is that truly vulnerable people may react differently to being identified as so. In just the same way that the aforementioned students responded very differently to being given information on relative energy usage, a study by Longhurst & Hargreaves (2019) identify that people in 'vulnerable circumstances' exhibit very different sets of attitudes, both in terms of their living situation and in their strategies for coping with this.

Overall, our response here is not that Ofgem is wrong in wishing to actively pursue the desire to improve the welfare of vulnerable consumers, but using 'vulnerability conditions' as a system to achieve this is likely to create many cases which invite incorrect predictions on who are deemed vulnerable. Given the tools at Ofgem's disposal, in terms of price we encourage them to pursue strategies for the market and its regulation, which can make domestic energy more universally affordable, because of the difficulties of pinpointing people who lose out through a flawed market process. Moreover, some of the remedies suggested in the draft strategy may be inconsistent with lowering prices through the market, as the next section suggests.

4b Implications for the future retail market

Effective action on the vulnerability issue is difficult to reconcile with Ofgem's long-held vision of how a competitive retail energy market should work. To some extent, any cross-subsidy is inconsistent with a fully competitive market, but there are specific contradictory key features of Ofgem's approach, for example:

- the focus on encouraging switching, based on price (not, of course, an intrinsically unreasonable thing to do with such a homogenous product as energy), when switching is less prevalent among vulnerable groups;
- the focus on encouraging (small) new entrants (again, not intrinsically unreasonable in the context of what might otherwise have been seen as a rather cosy oligopoly);
- the supplier hub principle.

Each of these features of the Ofgem vision makes it more difficult for Ofgem to take effective action on the vulnerability issue without significant qualification of its usual stance:

- the focus on price competition makes suppliers particularly reluctant to do anything which increases their costs, as well as weakening the incentive to acquire information on customers who may soon be someone else's responsibility;
- this is even more of an issue for small suppliers which do not have the capacity to spread costs of addressing vulnerability over a large number of units;

- the supplier hub principle (and the informing philosophy that network monopolies are inherently incapable of doing anything better than competitive suppliers, whether it be installing smart meters or accumulating information about energy consumers) means that it is unclear how networks play a role on the vulnerability issue, even when, as here, they have the advantage of not being subject to the intensity of the cost pressures on suppliers and when, at least in principle, they have an easier task of accumulating relevant information about network users because of the relatively static nature of their user base.

Although there are various points in the consultation where some of these issues are recognised (the stiffer requirements for new entrants, the acknowledgement of a role for networks), it is not clear how the aspirations of the vulnerability strategy are to be reconciled with Ofgem’s vision of the retail market. Applying Ofgem’s experiments with collective auctions may provide one compromise through competition for the market to supply identified vulnerable groups (Deller et al., 2017).

Question 1: Do you agree with the five priority themes and the outcomes we will aim for (as set out in chapter 3-7 and annex 2)?

Much of the strategy involves the collection of data, which raises issues of both data privacy and its potential use for less benign purposes. For example, since many of the suggestions are likely to raise costs for retailers to supply consumers identified as being in vulnerable situations, information may be used to avoid supply to such consumers, or at least not recruit them so enthusiastically, which might lead to worse outcomes for such consumers.

We welcome the recognition that vulnerability has both a subjective and objective element, both in the general sense discussed under question 4 and the particular issue of affordability as discussed in respond to the next question.

Question 2: Do you agree with our approach on affordability? While we recognise this is a concern for many consumers in vulnerable situations, we think addressing wider affordability pressures is mainly a matter for government to address.

Outcome 2A – wanting consumers to have access to affordable energy – is not well defined, though the proposed measurements will provide a general guide to trends. Many studies show the difference between externally assessed and self-reported measures of affordability pressures, which emphasise the difference between subjective and objective measures discussed above (for example Waddams Price the al., 2012 and Deller and Waddams Price for the UK; Waddams and Deller, 2015 for the EU). These and other publications emphasise that while there is a positive correlation, the levels of affordability issues measured by these different approaches vary, and that a large number of households which are ‘fuel poor’ by one measure are not deemed to be so by the other. Moreover, even within a single ‘objective’ measure of fuel poverty, issues arise over measurement, for example how to deal with missing data; and the question of whether using actual consumption/expenditure or modelled required energy use to reach a pre-determined temperature level is more

appropriate when households' underlying temperature preferences are largely unknown (chapter 6 of Deller and Waddams Price, 2018). While such formal definitions of fuel poverty are likely to be useful in assessing the extent, and perhaps overall trend, of affordability issues, the many nuances mean they may not be helpful in identifying individuals with affordability problems.

On page 24 Ofgem expresses concern at the number of people self-disconnecting through a prepayment meter. An important dimension of such activity is the length of the disconnection: research has shown that the majority of self-disconnection incidents are often for a very short length of time, and it is important to identify those for whom self disconnection arises from affordability or other capability issues, and is sufficiently long to cause major disruption of energy services in the home. Evidence from the Centre for Management under Regulation and the Centre for Competition and Regulation provides some historical evidence (Cooke et al., 2001).

Similarly, at paragraph 4.19 the paper expresses concern that consumers will ration more energy than is good for them. Again, this is difficult to define in practice. We agree with Ofgem that affordability issues are intrinsically household wide, and that energy affordability issues are part of a wider budget constraint. Where such a household is allocating limited income, some restriction of energy consumption below an 'ideal' level may be 'better for them' than, say, constraining food intake. Because affordability involves such trade-offs, it is difficult to identify ideal levels of consumption for particular households. In this context, it is not quite clear what is meant by self-rationing, and when this goes beyond the expectation that many households will have to make difficult choices about how to spend their limited income. While the potential harm of cold homes is known, not all economies on heating are undesirable, and, as noted above, they may be less harmful than other ways of saving money. Moreover, it is difficult to see how any such rationing could be identified from company data.

Consequently, we also agree with Ofgem that more general issues of affordability should be dealt with at government level, both because they have a general responsibility for distribution and the most effective tools (primarily through the benefits system) to address them. However, governments have shown both reluctance to operate on this basis and enthusiasm for sector-specific measures, such as the winter fuel payments, often introduced at a time when affordability pressures seem relatively low (Deller and Waddams Price, 2018). We welcome the CMA's recommendation in 2016 and that of the NAO the following year, to clarify decision making with respect to policies with significant distributional impacts. Ofgem's proposals to work with government on common consumer challenges seems an appropriate division of labour, and the regulators should retain a role in identifying major distributional effects of policies (their own and others') in their own sectors. Assessing any trade-offs between adverse effects and average benefits should remain a government decision for the regulator to implement when appropriate.

Affordability seems a particularly relevant aspect, over which regulators can share and collaborate, and we welcome the UKRN proposed work in this area, since, as noted, difficulty in affording energy is almost by definition part of a wider affordability (low-income) challenge for that household. Regulatory collaboration can result both in more holistic understanding and potential policy solutions and, perhaps more importantly for the households concerned,

a better interface for them in addressing their issues. Experience of water and energy companies collaborating on priority registers shows a promising approach to such households.

Moreover, the household's own 'optimum' may not be that of an externally assessed ideal. One striking feature of the relationship between formal measures of affordability, such as fuel poverty, and perception-based measures is that older respondents are less likely (relative to objective measures) to report that they have affordability issues than their younger counterparts (Deller and Waddams Price, 2018). This may reflect a preference for colder homes, or a reluctance to self-identify, but it underlines the difficulty in basing a policy on a single measure of affordability need.

While innovation to help vulnerable consumers is to be welcomed, many innovations may have the opposite effect if vulnerable consumers are less likely to access them. One stark example has been with self-generation, where it is mainly homeowners who have been able to take advantage of photo voltaic cells and feed in tariffs. Energy prices are higher than they would otherwise be to provide the necessary subsidies, imposing a regressive charge since lower-income households, on average, spend a higher proportion of their income on energy than richer households do. Such innovation has also raised the question of distribution tariffs, which might otherwise disadvantage those who had not accessed the innovation (see for example Lu and Waddams Price, 2019). Even if they have equal access to innovations, vulnerable consumers may be reluctant to adopt them because their circumstances render them more risk-averse.

However, innovation may be able to help directly in one aspect of measuring fuel poverty, namely identifying the temperatures achieved in homes. Since fuel poverty is based on ideal temperatures, thermometers could be installed alongside smart meters to monitor achieved temperature, and how far these align with either the World Health Organisations recommendations or consumers own preferences. In this way, the direct harm that might result from affordability and other issues could be directly measured to inform policies (Deller and Waddams Price (ed) 2018 chapter 6).

Question 3: What more could be done through energy regulation to assist consumers in vulnerable situations in the longer term? How should any such further measures be funded?

Our responses above indicate that we believe that Ofgem's main role in the short term is to encourage companies to remove any barriers that prevent consumers in vulnerable situations from receiving the support that they should reasonably expect. This may be related to consumer protection as much as competition/regulatory duties. Some of the measures which have been proposed will raise the costs for companies, and these will be recovered from consumers as a whole (either through the market or via allowed costs under a price cap). Where there are large benefits and small costs for other consumers, this is less controversial than when the converse applies. Given the political sensitivity of the energy market and its feature in political decisions, major policy interventions should be determined by government.

As we have noted in our previous research, the complexity of the statutory duties assigned to the energy regulator has increased considerably since the original privatisation statutes, moving beyond pure economic regulation to incorporate expanded social and environmental objectives (see chapter 3 of Deller and Waddams Price, 2018; a diagram from that book is provided below). A greater number and complexity of duties raises the potential for conflicts between duties, creates ambiguities around how Ofgem should prioritise them, and raises the need for greater government-regulator communication. That research also confirmed that there was a consensus among those in the regulatory community that decisions with significant distributional implications should be the responsibility primarily of government.

As our comments above suggest, it is important to recall that a well-functioning energy market which keeps prices down for all consumers makes a major contribution to affordability. We hope that Ofgem will be able to apply the lessons it has learnt about making such markets work best for all consumers, alongside both public preferences for fairness and any distributional rulings from government.

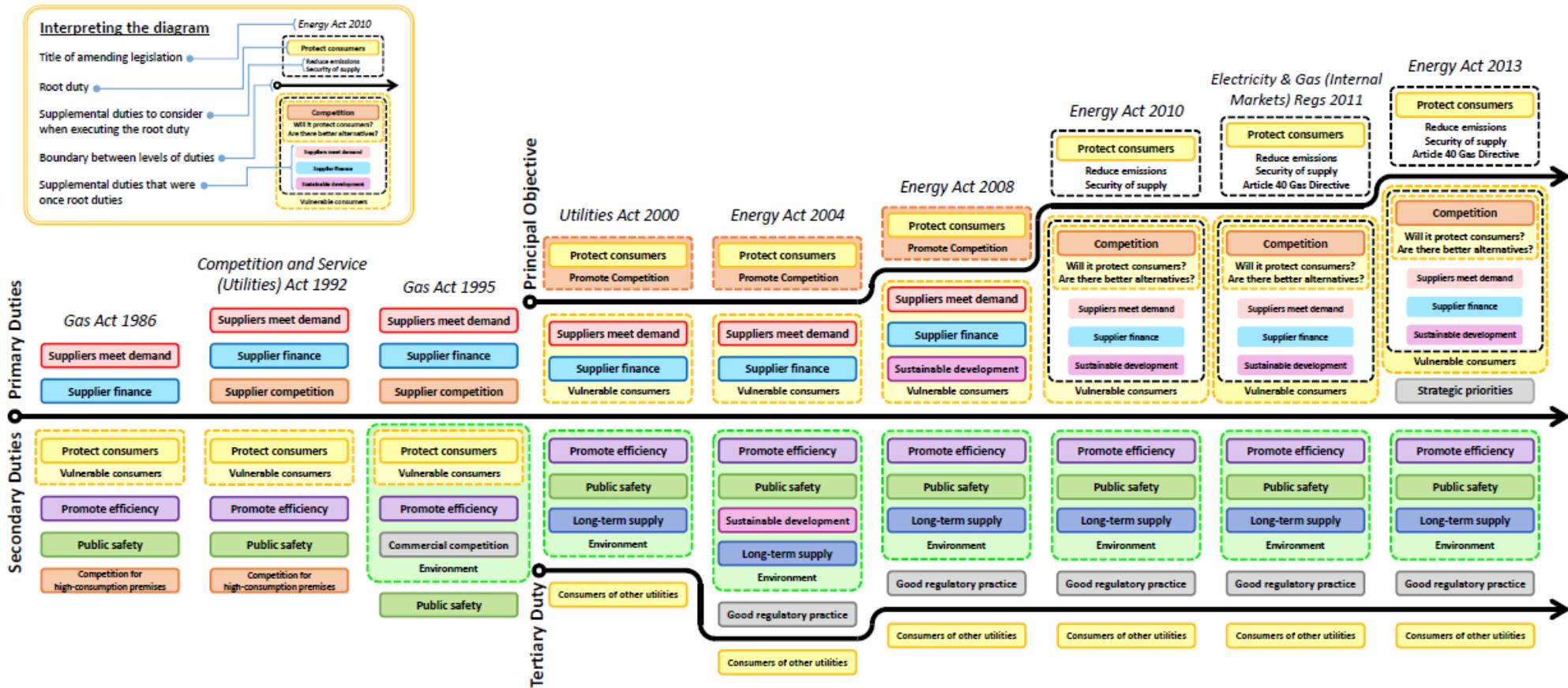


Figure 1 from Deller and Waddams Price (eds) 2018., p. 36

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