

## **Energy Retail Association response to an energywatch consultation on the nature of social tariffs in the energy market**

This response to energywatch's consultation on the nature of social tariffs in the energy market has been prepared by the Energy Retail Association and represents the collective views of: British Gas, Scottish & Southern Energy, RWE npower, E.ON Powergen, EDF Energy and Scottish Power.

As requested we have not answered specific questions but have categorized the key issues under sub-headings. This response may be supplemented by comments from individual energy suppliers, which will be submitted separately.

### Introduction

The ERA is concerned that the debate on social tariffs and subsequent calls for a national fixed rate are a reaction to a wider phenomenon linked to a global shift in energy markets. Britain is no longer an energy island and we must compete globally for our energy supply. The proposition to impose a national social tariff is a short-term fix to the more complex challenge of social equity for all customers in a world of higher prices and the deep-rooted problem of social exclusion. Average fuel prices remain lower than the EU 15 states (Eurostat, Nov 2006) but in the future are likely to remain closer to European prices than the exceptional low prices consumers have enjoyed over the last decade. We remain concerned about the rising burden of energy costs on consumers with the increase EEC2 to EEC3 more than doubling the effective customer contribution, a social tariff could further increase this burden against a backdrop of 18 months of rising energy prices. The ERA advocates full liberalisation across European markets so that competitive pressures ensure prices converge towards the lower, rather than the upper level of European retail pricing.

### **Defining social tariffs**

- 1 As a principle the ERA does not support a national social tariff as identified in the consultation document. The term social tariff is not in our view appropriate to define the range of social support schemes that suppliers provide.
- 2 We do not believe this is something that suppliers should be striving to provide and neither do we advocate the concept of an automatic right to lower priced energy for certain social groups. This would merely be an extremely complex intervention in the benefits system and restrict rather than promote innovative and sustainable schemes to help vulnerable households.
- 3 The ERA is concerned that the debate around social tariffs is a distraction from the more pertinent decisions that are required to address fuel poverty. As an economic instrument social tariffs are of limited benefit. The imposition of a social tariff or any

mandated pricing regime would undermine the successful competitive energy market that is evolving in Britain.

- 4 We believe that tariffs should have a time limit on how long customers may stay on lower payment schemes. Otherwise this leads to a dependency culture whereby, instead of creating financial independence, low income and vulnerable people are encouraged to remain dependent on social support with no incentive to achieve financial independence through reduced energy use. This contradicts the Government's financial inclusion policy.
- 5 Given the higher average prices that are likely to be a part of Britain's energy market fuel poverty must be addressed by improving income through more targeted means. Suppliers do not support the concept of a national social tariff, but are willing to assist the Government in helping people develop sustainable solutions to fuel poverty. We do not believe that social tariffs would have any discernible effect on reducing fuel poverty without an integrated strategy that addresses the three elements of fuel poverty – low income, poor housing stock and energy costs.
- 6 Furthermore, a compulsory national social tariff is likely to see suppliers withdraw from other CSR based schemes in order to fund the tariff. For the reasons given this could redirect funds away from the most effective solutions.

#### **Impact on vulnerable households**

- 7 In order to meet the challenge posed by fuel poverty it is imperative that Government tackle the short as well as long-term implications of fuel poverty and challenges itself to be bold, innovative and imaginative in the development of policies. It has become increasingly clear that a "one size fits all" approach does not adequately address the entrenched socio-economic problems faced by many of those suffering from fuel poverty. Factors such as benefits maximisation, future demographic shifts and the performance of dedicated Government fuel poverty programmes all need to be viewed holistically in order for a coordinated and target-driven framework to be established and executed. The DTI has attributed 60% of previous reductions in fuel poverty figures to an increase in income, 20% as a result of falling fuel prices and 20% due to energy efficiency improvements in consumers' homes. This is a clear indication of the need for a whole house approach.
- 8 The Government's fuel poverty strategy to 2018 should engage the full range of government departments (e.g. DTI, DEFRA, DWP, DOH, DCLG and the Treasury) as well as the many agencies that also have a role to play in the eradication of fuel poverty. It should encompass and bring together the wealth of existing information to target those on low incomes, in poor quality housing and claiming benefits. In addition, the reality of whether such programmes can be more appropriately delivered by third party organisations with the expertise to provide front line support services and engage on a community and local level should also be explored.
- 9 For its part the industry is committed to supporting vulnerable customers and will continue to invest in the range of social welfare programmes and other initiatives it has developed. In the past year the energy suppliers collective discretionary spend on alleviating fuel poor customers was almost £100m. This is in addition to the obligation to fund Energy Efficiency Commitment and Priority Service Register

(PSR) measures. However, the fact cannot be ignored that the root of fuel poverty is, at its most simplistic, poverty, and although many stakeholders and the industry have a legitimate role to play, it is ultimately Government who is responsible for developing, delivering and sustaining a financially inclusive, socially conscious society which provides help for those who require it the most.

### **Identifying eligibility**

- 10 The challenge of identifying eligible households is well documented. Suppliers continue to incur high costs to target hard to reach homes. Previous attempts at means testing have been contentious. In the case of a national social tariff it would not be possible to differentiate between consumer needs. For example, a fixed price for eligible customers would not take into account individual circumstances of housing standard, regional location, tenure and number of people in property. Suppliers existing schemes are more closely tailored to need to achieve maximum advantage for customers.
- 11 Furthermore, some customers require higher energy use for health reasons and the proposal for a minimum level of free energy would not meet the needs of these people. Similarly, hard to heat homes such as off mains and solid wall properties would require more fuel use to keep warm than other types of property.
- 12 Evidence from the Energy Efficiency Commitment shows that targeting fuel poor and hard to reach homes incurs high additional costs. Recent trials with the Department for Work and Pensions have highlighted that there is more work to be done to develop ways to use data held about households. The Government should take the lead in helping to identify potential recipients of fuel poverty alleviation measures, given that it has access to incomes data which is key element to identifying those most in need

### **Choice for all**

- 13 A national tariff restricts the benefits available to vulnerable households by taking away the advantages of choice that are enjoyed by all other consumers. We believe that this fundamentally undermines the competitive market. Therefore, the industry should continue to be incentivised to develop products that distinguish them from their competitors.
- 14 The proposal for a common understanding that is advanced by energywatch is anti-competitive. Suppliers already offer a minimum level of service through PSR, but the market enables them to extend and tailor these services for maximum benefit to eligible customers. However, the ERA would welcome further examination of Age Concern's proposal for a universal service obligation as an alternative to the PSR.

### **Changing the pricing policy**

- 15 It would be possible for the UK market to develop in a different way such that the domestic retail customer has available to them different products that would be more similar to those offered to industrial and commercial customers. This would involve the price paid by the customer being more closely linked to the wholesale price. However, this needs careful consideration for a number of reasons.

- 16 The advantage of this would be that the customer would see any fall in the wholesale market price more quickly but equally would have experienced significantly higher and more rapid price rises over the last few years of at least double the current increase. There would be no “cushioning effect”, such as that experienced by consumers this winter, whereby suppliers could absorb some of the increased cost. Some suppliers have explored this approach and some have investigated the possibility by means of “focus group” discussions with their customers. This option would be reflective of the Scandinavian model where the market works with a much greater mix of contract types where some customers choose to be on a tariff which is more closely linked to current wholesale prices whilst others select long term contracts that may be at a fixed price. This operates in a similar manner to the mortgage market here in the UK.
- 17 However, it is not easy to draw direct comparisons with the British market where energy suppliers have cushioned the impact of wholesale prices by absorbing some of the increase. The wholesale price increase in the last three years is 170% compared to the retail price increase of 100%.
- 18 The ERA would be concerned that potentially vulnerable customers are the least likely to understand the market complexities of falling and rising prices and could not take advantage of such a scheme. Research to date seems to indicate that the vast majority of customers would not find a spot price tracking approach to pricing attractive. It is also most important to stress that the impact of this approach could have been even more acute to those who are in or close to fuel poverty. Instead, in response to customer demand, many suppliers have introduced a range of fixed and capped price products, which are designed to protect customers from the full impact of price rises.

### **Controlling costs**

- 19 The ERA does not advocate a role for Ofgem in setting price controls. Suppliers will continue to set tariffs appropriate to the cost savings achievable balanced against the risk of losing customers. For example, some suppliers have set higher pre-payment tariffs to account for the higher cost to serve. Suppliers already work closely with consumer groups and more importantly directly with their customers to understand best way to help vulnerable customers. Therefore, they are best placed to create products that reflect customer need.
- 20 Suppliers must be able to impose restrictions on the support they provide e.g. time limited tariffs. Any supplementary payment scheme must be needs tested. The cost of designing and marketing schemes for vulnerable customers is significant. Consequently, any proposals to widen the customer base of customers eligible for assistance will impact on the level of contribution available to each customer. The ERA advocates better targeting by using data held by Government on individuals’ circumstances.
- 21 The ERA has joined a campaign with energywatch to increase the availability of third party payment schemes, such as Fuel Direct. Suppliers’ experience of Fuel Direct is that the process can be bureaucratic and complex for some consumers. On this basis the proposal in the consultation document for a Government mechanism to administer social tariffs should consider the failings of the Fuel Direct

processes. Equally, suppliers are not set up to administer such a scheme. The costs of integrating a Government system with suppliers' individual payment systems needs further investigation.

### **Improving existing payment support schemes**

- 22 On the principle that whilst suppliers are opposed to a national social tariff they are willing to play their part in supporting vulnerable households, the ERA is developing proposals for integrated policy solutions. We shall be considering the shortfalls of existing measures with a view to identifying options for improvement. For example, the Winter Fuel Payment and Cold Weather Payments are one-off payments designed to help at times of greatest need. Suppliers anticipate spending in the region of 1.2bn on the Energy Efficiency Commitment from 2008. On previous experience at least 65% of this will be in the vulnerable household sector. We believe that such schemes can be better targeted and enhanced through a public/private partnership between Government and industry. We shall be presenting our findings to Government next year.

### **Access to tariff information**

- 23 The consultation document asks for views on how customers can access information about the tariffs available to them from all suppliers. This is a sensitive area for the ERA to comment on because this information is a matter of competitive advantage. Energy suppliers provide details of their schemes to comparison sites and this is currently supervised by energywatch. However, recent investigation has undermined consumer confidence in such services, which may adversely affect vulnerable customers in particular. The provision of information about pricing across all suppliers cannot be met by industry or the ERA. We are not party to individual corporate decisions or discussions on pricing policy. However, it would be legitimate for the regulator or a Government funded body to provide genuinely impartial advice service free of charge to vulnerable customers.