

Energy

“ Ironically, if energy markets were working as efficient markets should, the requirement for all consumers to continuously monitor prices, switching whenever necessary, would not exist. Companies would know that if their prices were above the best on offer, they would lose more of their market than they could afford to and would be forced to match the best prices on offer. ”

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1. Introduction

For many decades in Britain, access to an affordable and reliable supply of electricity has been essential to provide lighting and, in some cases, meet heating and cooking needs. The reliability aspect has become increasingly important as advances in electronics and information technology make functions that rely on electricity ever more pervasive. An efficient space-heating system is also a necessity and, over the past 30 years, natural gas has taken a dominant share of this market with now more than 80 per cent of homes heated by natural gas, with no ready alternative.

The way in which electricity and gas are supplied in Britain was transformed 20 years ago when the companies were privatised and regional monopolies in electricity and a national monopoly in gas were replaced by competitive markets wherever possible.¹ This reform became the model for many countries and provides the basis for the European Union's (EU) Directives on electricity and gas (Thomas, 2006A). The Directives require Member States to implement similar reforms to those introduced in Britain excluding requiring privatisation. Requiring privatisation would exceed the powers of the EU and, for example, the EU can exert no pressure on Sweden to privatise its state-owned electric utility, Vattenfall.

The British reforms have generally been seen as successful and were accompanied by real price reductions up to 2002. However, for this period, fossil fuel markets were benign with world prices falling in real and sometimes absolute terms. How far, if at all, the price reductions that occurred up to 2002 were the result of the benefits brought by this new model and how far they were the result of other factors is a moot point (see Thomas, 2006B). However, it is clear that this benign background meant that important aspects of the model are only now being tested for the first time.

The challenge facing the competitive model is not just how well it can deal with unpredictable fossil fuel markets, but also how it can cope with a need for the major changes required to reduce emissions of greenhouse gases. It seems clear that the market alone will not produce the changes required, whether they are increased use of renewables, nuclear power or energy efficiency measures. It cannot be assumed that energy prices will see sustained falls much below their present high level – they could well go higher.² By the end of 2008, these high prices could mean that a fifth or more of British households would, under the government's definition of fuel poverty, be classed as fuel poor; in other words, they would need to spend more than 10 per cent of household income on energy to maintain a satisfactory heating regime.

This situation is exacerbated by the price differential that has emerged between the methods of payment used by most low-income households, prepayment meters or standard credit terms (bills paid quarterly in arrears), which are on average 20-25 per cent more expensive than the cheapest form of payment: Direct Debit on-line accounts. In certain areas of the country this differential can be as much as 40 per cent higher. This latter method of payment is often not feasible for low-income households, for example if they do not have access to an internet connection, or they do not even have a bank account which allows them Direct Debits. Those that do have the scope to use Direct Debits may be concerned that their finances are not stable enough to commit to a Direct Debit without risking high overdraft charges. The government's target to ensure no vulnerable households are fuel poor by 2010 cannot now be met and the target that no households at all are fuel poor by 2016 looks increasingly unlikely to be met.

The questions that arise, therefore, are: How well has transforming energy from a monopoly to a market served low-income groups? Are they worse off than they would have been under a regulated monopoly? Can changes be made to the system that will alleviate the problems without seriously compromising energy markets, and are there lessons to be learnt from how low-income households are protected for other major purchases of essential services?

2. Purchasing electricity and gas

2.1 Product characteristics

While electricity and gas are especially important purchases for low-income households, their characteristics make purchasing them a very different process to most other purchases. Arguably, it is more difficult for consumers to get the best deal available than it is for most other purchases they make.

2.1.1 Demand for energy is a 'derived demand'

Demand for energy is a 'derived demand'. In other words, consumers do not want a kWh of electricity or gas, they want the service that this energy will provide, for example heat, light, cooking etc. The amount of energy needed to meet the service required is determined not only by the service requirement but also by the efficiency of the appliances used and, for space heating, by the size and thermal qualities of their housing. Therefore, consumers can receive the same level of energy service, but with significantly lower energy consumption if their appliances, especially cookers, fridges and light bulbs, are energy efficient and the building is well insulated.

For low-income consumers, this is a particularly important issue and means that those that suffer from 'fuel poverty', in other words not being able to afford to buy enough energy to meet reasonable standards of comfort, are not necessarily the same as those that suffer from 'poverty' in general. The fuel poor may not have incomes that place them in the lowest income bracket but, if their housing is poor quality, their bills could be difficult to afford. We return to the issue of fuel poverty and its definition later.

2.1.2 Standard product

Gas and electricity supplied by the public network are entirely standard products. The quality and reliability of supply is entirely determined by the quality and reliability of the supply system, and consumers do not have the opportunity to choose between a higher or lower quality of gas or electricity, or between product variants, except for the little used 'green tariffs' and the now relatively little used off-peak (Economy 7, etc.) tariffs. Opting for a 'green tariff' should provide guarantees that the supplier has sourced an equivalent amount of energy from sources that are certified as 'renewable'. However, as argued below, given that all retailers must source a given percentage of their electricity from green sources and the market for green electricity is considerably less than this percentage, consumers buying green power from the large retailers will not cause any more green power to be generated than if they had opted for a normal tariff. The Department for Food and Rural Affairs (DEFRA) has become concerned about this issue and, in June 2008, asked Ofgem to strengthen guidelines on green tariffs. The Minister, Hilary Benn said:³

It is increasingly difficult to demonstrate that buying a renewable electricity tariff is offering additional carbon emissions reductions compared with what suppliers are required to source to meet the Renewables Obligation.

A month later, Ofgem published proposals for a new accreditation scheme that would assure consumers that opting for green tariffs would bring additional environmental benefits.⁴

energywatch has also been critical of the amount of information the companies give out on the sources for their power and which markets that power is sold to.⁵

The standard nature of the product means that the only relevant criteria, apart from environmental issues, for choosing one of the six major suppliers are price and service quality. However, the main interface between supplier and consumer is the meter reading and billing process. This should be an entirely routine process

where there is little scope for one supplier to offer significantly better service than another. Despite this, billing and meter-reading complaints constitute the largest area of complaint to energywatch. Efficiency of complaint handling could also be a criterion for choice, but given that meter-reading and billing should be such a simple process, it is hard to understand how a large enough number of complaints could arise for this to be an issue (faults in the network are not the responsibility of the retailer).

So, at least in theory, service quality should not be a determining issue. All large suppliers are required to offer the full range of payment methods, so price should be the only criterion on which consumers choose their supplier. Ofgem research backs this up by showing that 78 per cent of people who switch do so to save money.⁶ Given that there is effectively only one product, pricing schemes should be very simple, based on the rate per unit of energy. The decision by Ofgem to allow 'fixed' and 'capped' rates does somewhat complicate choice for consumers, but the take-up of these has been low and consumers do not seem confident enough yet to 'gamble' on whether rates will rise or fall. Opting for a fixed rate at what could be the top of the market could lock consumers into very high prices.

There are a number of problems that can arise when consumers try to compare suppliers' offerings. For example, the consumer might not know the terms and conditions under which they are currently supplied, nor have an accurate picture of how much energy they use over a given time period. Consumers could also be confused by the ways in which different suppliers apply discounts and use different consumption bands for different pricing levels. Some price comparison sites seek to make offers more comprehensible, making it easier for those consumers with ready access to the internet to make informed decisions about what deal is best for them. Certain consumers, such as Economy 7 users, can find it difficult to make an accurate comparison even with the aid of internet sites.

2.1.3 Availability of substitutes

For many products, there are substitutes available that provide a comparable service. For example, if a particular food product becomes expensive, consumers can switch to a different food stuff that will perform much the same function. This will reduce demand for the product that has become expensive and will tend to force the market to reduce prices for that product. For most electricity and gas applications, there are no easy substitutes and, even where there are substitutes, these require significant investment in new equipment. For example, switching from gas cooking to electric cooking would require a minimum of a new cooker. This lack of ability to switch demand to substitutes removes one of the weapons consumers would otherwise have available to impose discipline on their suppliers. In the future, this might change if technologies become commercial which would allow consumers to produce their own power; for example, small scale wind turbines or micro combined heat and power where a conventional boiler is replaced by equipment that supplies hot water and power.

2.1.4 Frequency of choice and ease of switching

The more frequently consumers are able to choose their supplier, the less significance to overall budgets each purchase has. For example, if someone purchases their weekly food shopping from a shop that proves expensive they can, generally, buy elsewhere next week. By contrast, some high cost products, such as insurance, are generally bought annually and choosing an expensive supplier is a mistake that cannot generally be corrected for a year once the statutory cooling-off period has finished. Some products, such as certain financial services like bank accounts which are subject to an ongoing implicit contract, can, in theory, be switched readily at no charge. In practice, because the choice criteria are not straightforward, consumers change such services infrequently. Choosing an energy supplier is a decision that, in practice, is an infrequent one. Unless the consumer has chosen a fixed term contract (few have so far), consumers can, in theory, switch supplier every 28 days with no charge from either the previous or the new supplier. In fact, a switch of energy

supplier can take up to 6 weeks or, in some cases, even longer, so being able in theory to switch every four weeks is of limited value.

As argued later, while switching energy supplier should be simple and cost-free, in practice switches can go wrong at considerable inconvenience to the consumer, and choosing a supplier may take a considerable amount of research that is realistically only possible for those able to use the internet. In addition, there can be significant problems in switching for consumers that use prepayment meters or who have accumulated debt with their existing supplier, or who have to use Dynamic Teleswitch Meters. Like other services purchased on an open-ended contract, consumers cannot generally know in advance what the relative price of their chosen supplier is compared to other suppliers. At best, the consumer can know that when the choice is made, their chosen supplier is offering the best terms, although by the time the switch has been completed, this information could easily be out of date.

2.1.5 Location

For some products, the effective market may be quite localised. For example, consumers in rural locations (and some urban locations) may have a very limited practical choice (if any) of supplier, for example, of food or petrol. The British energy market is regional in scope and there are relatively moderate price variations between the 14 regions. However, there is no evidence that consumers in isolated or disadvantaged communities are charged more than those in cities. Some rural consumers may not have the option of a natural gas supply and may be forced to use expensive bottled gas or fuel oil.

2.1.6 Do residential consumers compete with bulk purchasers?

For most household purchases, residential consumers do not compete directly with large consumers for the same product. Bulk purchasers have much greater buying power and should be able to force suppliers to reduce their margins to a minimum, although the Business and Enterprise Committee (Business & Enterprise Committee, 2008) found that this buying power did not seem as strong as might have been expected. Electricity demand is split reasonably equally between residential consumers, industrial consumers and commercial consumers (e.g. offices). The larger consumers have the skills and the incentive to negotiate hard for attractive prices using specialist staff to research the market. There have been suggestions that household consumers should find ways to combine their demands, for example via the local council, a trade union or a housing association, so that they are buying in bulk, but this has not happened to any extent yet. Unless it does, residential consumers will have no scope to negotiate and are generally not aware of whether they are purchasing their energy on the best terms available. Suppliers may take advantage of this 'inertia' to offer disproportionately low rates to industrial consumers, who they can be sure will switch if their terms are not competitive, and much higher rates to residential consumers who are much less likely to know whether the rate they are being charged is a competitive one.

2.1.7 Demand cannot easily be postponed & consumers cannot store energy

Consumers generally have little discretion over when they consume energy. They need energy when they are cold, when it is dark or when they are hungry. Consumers cannot therefore choose to postpone demand to a time when prices are lower or they have more money available. In other sectors, consumers can also reduce the impact of short-term high-prices by keeping stocks of goods that can be used if a product is unavailable or high-priced. For gas and electricity, storage is impossible for a householder. This issue will need careful attention if proposals to install smart meters and time-of-day pricing for households are implemented. These issues are discussed in more detail in Section 4.

2.2 The 2007 Supply License Review

Since 1996-99 (depending on the region) household consumers have been able to choose their retail suppliers of electricity and gas. Initially, companies were required to allow consumers to switch supplier with 28 days notice without penalty and were required to offer terms to any consumer requesting them under a variety of payment methods. In July 2007, Ofgem (Ofgem, 2007) completed a review of supply licenses that led to significant changes in the obligations placed on retail suppliers of gas and electricity.

The main changes, implemented in August 2007, were⁷:

- The so-called '28 day rule', whereby consumers could in theory change supplier every 28 days was abolished. This allows companies to offer long-term fixed rate or capped prices to those prepared to sign long-term contracts;
- Suppliers with fewer than 50,000 consumers are no longer required to offer a wide range of payment methods. Ofgem hopes this will make it easier for new companies to enter the retail market to break up the market power of the six major companies.

3. Legal requirements

The increasing reliance modern societies have on a reliable energy supply and the issues raised by the 'marketisation' of energy services have led to an increase in the responsibilities governments have had to assume to ensure that the consequences of any 'market failures' do not impinge too heavily on consumers. In particular, the European Union has introduced a number of significant requirements in parallel with its Directives requiring the opening of energy markets to competition (this legislation is discussed in detail in Annex 1).

3.1 EU legislation

Electricity and gas are network-supplied energy products categorised by the European Commission as Services of General Economic Interest (SGEI). Under EU policy, this means that the service should be made available to all consumers of a Member State with a specified quality and at an affordable price, including, for electricity, complete territorial coverage.

The EU Electricity (2003/54) and Gas (2003/55) Directives contain provisions on public service obligations and consumer protection. These require Member States to take measures to protect vulnerable consumers. For electricity, the Directive (paragraph 3) states that all consumers have 'the right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable and transparent prices'.

Gas is not categorised as a 'Universal Service' and the requirements in the Directive on coverage of the network are not so extensive. The new draft Directives on electricity and gas do not reduce these obligations.

A Directive on energy end-use efficiency and energy services was passed in 2006 that placed some further obligations on government. It requires the installation of 'smart meters' (meters that measure and transmit consumption data on a half-hourly basis) provided cost tests are met. In October 2007, energywatch strongly supported the introduction of 'smart meters' for all consumers within 10 years.⁸ The government's Energy Bill that was being debated in July 2008 gave powers to Parliament to mandate 'smart meters' within five years.

European legislation also requires that consumers be provided with very extensive cost and consumption information. For example, bills should include: current actual prices and actual consumption of energy;

comparisons of the final customer's current energy consumption with consumption for the same period in the previous year, preferably in graphic form; wherever possible and useful, comparisons with an average normalised or benchmarked user of energy in the same user category. The extent to which these requirements have been implemented in the UK is questionable.

3.2 National legislation

Member States are required to translate Directives into national law so all provisions of the EU's Directives should be embodied in UK law within the specified period, or else the Commission will take action against the UK government.

The main legislation relevant to the EU's Directives is the 'Utilities Act' of 2000. The Utilities Act required the setting up of a Gas and Electricity Consumer Council (energywatch) and details the duties this body has. It also changed the primary duty of the regulatory body for gas and electricity from promoting competition to protecting the interests of consumers. For gas, the primary duty of the Authority, still jointly held with the Secretary of State, is:⁹

to protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas so conveyed.

And for electricity:

to protect the interests of consumers in relation to electricity conveyed by distribution systems, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity.

However, for both gas and electricity, there is a secondary duty:

In performing that duty, the Secretary of State or the Authority shall have regard to the interests of—

- (a) individuals who are disabled or chronically sick;
- (b) individuals of pensionable age;
- (c) individuals with low incomes; and
- (d) individuals residing in rural areas;

but that is not to be taken as implying that regard may not be had to the interests of other descriptions of consumer.

In 2004, the Minister of State for Energy, e Commerce and Postal Services issued Guidance to the Ofgem board under the Utilities Act legislation. This Guidance was more explicit on social issues and the role Ofgem was expected to play in meeting the government's objectives. It stated:

- The Utilities Act 2000 gives the Authority the principal objective of protecting the interests of consumers, wherever appropriate by promoting competition. It also places duties on the Authority in respect of a number of groups within society, namely the disabled or chronically sick, pensioners, those on low incomes and those living in rural areas.
- The Government considers that the Authority has a wide responsibility in relation to social issues, including equal access for all consumers to competitive markets and the desirability of lower levels of disconnection and arrears. It also believes consumers' interests include the quality of service provided and the size of energy bills. The Authority has a duty under the Sustainable Energy Act 2003 to produce impact assessments. These should include cost/benefit analyses of the social as well as the environmental impacts of the decisions.

- Within the context of protecting and helping vulnerable consumers, the Government is committed to achieving its fuel poverty target that, as far as practicable, no household should be living in fuel poverty by 2016-18, and no vulnerable household should be in fuel poverty by 2010.
- The Government expects the Authority, within its sphere of responsibility, to put in place measures which will help achieve these targets.

The government also passed the Warm Homes and Energy Conservation Act in 2000, which required it to set out a 'Fuel Poverty Strategy'. This was published in November 2001. On 9 April 2008, a UK charity, Help the Aged and an environmental group, Friends of the Earth, launched a legal challenge to the Government to ensure it is held to its legal obligation under Fuel Poverty Strategy to eradicate fuel poverty by 2016.¹⁰

The 1998 Competition Act, which came into force in March 2000, gave new powers to regulatory bodies in relation to anti-competitive practices; for example, it gave regulators the ability to impose fines of up to 10 per cent of company turnover for three years for breaching the prohibitions of the Act.

The Office of Fair Trading and Ofgem are responsible for enforcement of the Competition Act 1998. Concurrency arrangements cover the gas and electricity industries, which mean that Ofgem is the competition authority that will deal with most cases in these areas.¹¹ The Enterprise Act (2002) gives Ofgem market study duties and power of referral to the Competition Commission. Ofgem also has a role in merger and takeover cases in the energy sector.¹²

4 The Market structure

4.1 The companies

The electricity market has evolved substantially since energy consumers were given a choice of supplier. Prior to the opening up of the gas market for residential consumers, the national monopoly retail supplier was Centrica, a company spun off from the privatised company, British Gas PLC. Centrica trades as British Gas in the UK even though it now has no connection with its former parent company, BG plc (outside Britain it is allowed to trade as British Gas).

For electricity, prior to the opening of the market, there were 14 regional electricity retail companies with regional monopolies. Twelve of these companies were in England and Wales and at that time also operated the monopoly low-voltage distribution system.¹³ But these companies had few interests in generation. In Scotland, there were two companies, Scottish Power and Scottish Hydro, which were fully integrated companies owning almost all the generation in their region, as well as owning and operating the transmission and distribution networks and retailing electricity to final consumers.

When the gas and electricity markets opened, Centrica began to offer electricity in a package with gas (a so-called dual fuel offer) and the regional electricity companies became national in scope and began to offer gas as well as electricity. There was a rapid process of consolidation of suppliers and, by 2003, the 14 electricity retailers were owned by only five companies. Three of these were foreign-owned by the French company, EDF and by two German companies, RWE and E.ON, which took over the two largest generation companies, Npower and Powergen respectively. The other two companies were based on the integrated Scottish companies, which had expanded into England and Wales. Subsequently, Scottish Power was taken over by a Spanish company, Iberdrola.

Table 1 Structure of the British gas and electricity market	
Electricity and gas companies	Former national/regional companies
EDF Energy	London Seeboard SWEB
E.ON/Powergen	East Midlands Eastern Norweb
RWE/NPower	Midlands Yorkshire Northern
Iberdrola/Scottish Power	South of Scotland, Manweb
Scottish & Southern Energy	North of Scotland Hydro Electricity Southern SWALEC
Centrica	British Gas Scottish Gas

Source: *Author's research*

New entrants to the electricity and gas markets for residential consumers have had only limited success in gaining market share and the market is now composed of the five electricity companies and Centrica/British Gas (see Table 1). The only exceptions are the handful of small companies. Three of these companies offer only green tariffs while the others (one of which buys all its power from SSE) offer a range of tariffs. The market share of these small companies was less than 1 per cent in March 2007¹⁴ and the retail market is dominated by the big six companies.

4.2 Regulation

Autonomous sectoral regulators for gas, the Office of Gas Regulation (Ofgas), and electricity, the Office of Electricity Regulation (Offer), were set up when the industries were privatised in 1987 and 1990 respectively. These were headed by a Director General who, jointly with the relevant government minister, was responsible for the decisions made.

The government's Utilities Act 2000 required the merger of Ofgas and Offer to form the Office of Gas and Electricity Markets (Ofgem) in 2001. The single person regulator was replaced by a board, the Gas and Electricity Market Authority, comprising a Chair, Chief Executive, three Directors and six non-executive members. Its net operating cost in 2007/08 was about £40m and it employed about 300 people. Its budget far exceeds that of any other energy regulatory body in Europe.

4.3 Barriers to entry

An important characteristic of any market, particularly a relatively concentrated one, is how large the 'barriers to entry' for new companies are. Low barriers to entry mean it would be easy for a new company to enter the market. From a competition point of view, this is desirable especially if the market is concentrated. If barriers to entry are low and the existing companies charge prices that are higher than necessary, a new entrant could come into the market and take market share from the existing companies. However, if barriers are high, existing suppliers may believe that they can maintain high margins because they and their competitors will know it is probably not in their interests to start a price war.

For energy, entry barriers are extremely high for a number of reasons:

- The electricity market is dominated by generator-retailer companies who have a strong incentive to buy from their own sources and not sell wholesale power to the open market as this would make it much easier for new retailers to enter the market;
- Information asymmetry in favour of the dominant players;
- Complexity of the market rules and the regulatory regime;
- Energy wholesale supplies are generally available only in large quantities, contracted long-term and new entrants would not be sure enough of their market share to be able to contract long-term for large quantities of energy;
- All experience since opening of the market suggests that household consumers are only comfortable buying from companies with a strong brand name, with a record of operation in the energy sector and one which they have dealt with before. Even supermarkets with a strong brand name such as Sainsbury and Tesco both abandoned moves in 1997 to enter the market before their attempt had even been launched.¹⁵

Bizzenergy, a small electricity supplier to businesses, told the Business & Enterprise Committee that the attitude of the big six towards it was ‘we do not want to deal with you because all you are going to do is compete against our supply business’¹⁶.

4.4 Pricing mechanism and cost structure

Consumer bills for energy are made up of six main components - wholesale, retail, metering, transmission, distribution and environmental costs - each of which is set by a separate pricing mechanism. Table 2 shows a breakdown of gas and electricity bills by main costs. This Table was based on information at the beginning of January 2008 before the large price increases of 10-15 per cent that were imposed that month, which the companies blamed on higher wholesale prices. Updated figures would therefore show a higher percentage of the bill attributable to ‘energy, supply costs and margin’.

Table 2 Breakdown of household energy bills ex VAT by cost category (%)		
	Gas	Electricity
Energy, supply costs & margin	72	69
Distribution	21	18
Transmission	2	4
Environmental	3	8
Meter provision	2	1

Source: <http://www.ofgem.gov.uk/Media/FactSheets/Documents1/energy%20prices%20jan08.pdf>

Notes

1. This table reflects gas and electricity prices as of January 2008 except for the environmental costs, which have been updated to reflect the additional charges consumers will have to pay.
2. VAT is added to these costs at a rate of 5 per cent.

The main component of the environmental costs is the Carbon Emissions Reduction Target (CERT) programme which was launched in April 2008. This was expected to add, on average, £38 to the energy bill of a consumer using gas and electricity. The Renewables Obligation, whereby electricity suppliers have to source an annually increasing amount of electricity from renewable sources (10 per cent by 2010), adds around £10 per year to electricity bills and this is expected to rise to £20 by 2015 when the target will be about 15 per cent.

However, this table is not very revealing because it does not split the main cost, ‘energy, supply cost and margin’, now probably more than 75 per cent of total cost, into its components. The largest element of energy, supply cost and margin is ‘energy’; in other words, the wholesale price of gas or electricity. This should be set in a competitive market. However, as little of the wholesale trade is conducted in the open and visible market, little is known about the actual cost retailers pay for their wholesale supplies. For gas, a significant proportion of supplies are contracted long-term for supplies from gas producers. For electricity, most power is generated in retailers’ own plants and internally transferred to the retail division. Most of the rest is contracted long-term, at prices known only to the two parties to the contract, from independent generating companies, of which much the largest is British Energy, the privatised nuclear generation company, with about 12 per cent of Britain’s generating capacity but about 18 per cent of generation.¹⁷ However, in 2008, this company was for sale and, if

the sale goes through, the most likely buyers would be one or more of the big six energy companies. This would leave only about a quarter of electricity generation not owned by the six integrated companies.

The retail element should also be set by a competitive market and it is hard to determine how large the retail element is. When electricity and gas were monopoly markets, it was about 5-10 per cent. Competition has introduced extra costs, such as advertising or the cost of switching consumers etc., and some estimates, for example by the regulator, Ofgem, have suggested retail might account for up to 35 per cent of the final bill.

The transmission element, the fee to use the monopoly high voltage national electricity network or the monopoly high pressure national gas network, is set by the regulator, Ofgem. It accounts for about 2-4 per cent of the bill. The distribution element, the fee to use the monopoly low voltage regional electricity network or the monopoly low pressure regional gas network, is also set by the regulator, Ofgem and accounts for about 20 per cent of the bill. In theory, metering is a competitive business, i.e. consumers should be able to choose their meter supplier and operator, but for residential consumers this is a choice that is of little or no value to them.¹⁸

Unlike some countries, retailers in Britain do not provide consumers with a break-down of their energy bills into these component parts. One interpretation of the transparency requirements of Paragraph 24 of the Electricity Directive is that such a break-down would be required (see Section 4). The Directive states: 'Member States should ensure that household customers enjoy the right to be supplied with electricity of a specified quality at clearly comparable, transparent and reasonable prices.'

The marginal cost to a supplier of supplying additional energy is very high. Transmission and distribution services must be supplied by legally separate companies and are charged on a kWh transmitted basis. Generation also has a high marginal cost and only the retail element is largely independent of the quantity of energy supplied. For many other products, the marginal cost of additional consumption is low (i.e. fixed costs are a large proportion of the overall price). For example, with public transport the cost of carrying an additional passenger is very low and, in telecoms, the cost of an additional phone call is minimal. This means the cost to a supplier of offering a concession that allows a consumer to receive at low or zero cost a service they would not otherwise consume is very low. It may be possible, as the government has increasingly sought to do, to negotiate voluntary concession schemes with commercial companies who may believe that the value of the publicity they will gain more than pays any additional costs if the marginal cost is low.

For energy, supplying an additional unit of energy is comparable to the average cost. This means that there is not a natural inclination for commercial companies to offer voluntary schemes to support low-income consumers, because they would be very costly. The option of passing the costs on to other consumers would be risky if the costs were significant and the market was genuinely competitive, because companies would risk losing any competitive advantage they held in the market.

4.5 Market shares

The national electricity retail market for residential consumers appears to be reasonably competitive (see Table 3) with the six dominant companies all having market shares of the same order (Ofgem, 2007). However, the companies all retain a large market share for the electricity market of at least 40 per cent and up to 80 per cent in their former home territory, with the average being around 54 per cent. Market shares of all the suppliers are not given by region as this information is regarded as commercially confidential. Centrica has no home territory for electricity so it is likely that its customers are reasonably evenly distributed across the country. This means it is likely that all regions are largely 'duopolies' with Centrica and the former incumbent holding on average about 75 per cent of the market.

energywatch¹⁹ estimated that the electricity market Herfindahl-Hirschmann Index (HHI)²⁰ for the regions ranged from 2,500 in the regions where there has been most switching from the former incumbent, to 6,500 in the regions where the former monopoly company has retained most of the market. Even in the most competitive regions, the market would still be categorised, according to the HHI, as 'highly concentrated'.

Table 3 Market shares of major suppliers in electricity (%)						
	Centrica	Powergen/ E.ON	Scottish & Southern	Npower/ RWE	EDF	Scottish Power
G Britain	21	19	18	16	14	12
E Midlands		47				
Eastern		49				
Norweb		40				
Scot Hydro			80			
Southern			62			
SWALEC			70			
Midlands				44		
Northern				45		
Yorkshire				47		
London					57	
Seaboard					51	
SWEB					54	
South Scot						61
MANWEB						48

Source: *Ofgem (2007) 'Domestic Retail Market Report' Ofgem, London.*

For gas, the picture is rather different (see Table 4), with Centrica, the former incumbent, still holding 46 per cent of the national market. As market shares are not given by supplier at a regional level, we can make a simple assumption to see the regional picture. About 40 per cent of gas consumers buy their energy on a 'dual fuel' basis.²¹ If we assume that 40 per cent of electricity consumers that still buy their electricity from their incumbent also buy gas, this means that, on average, the electricity retailers have a market share of about 22 per cent in the gas market of their home territories. On average, nearly 70 per cent of the gas market in each former electricity territory is therefore probably held by the former electricity and gas incumbents. energywatch calculated that the domestic gas retail market has an HHI of around 2,800.²²

While the market shares of some of the incumbents are falling slowly, the regional markets are, by any standards, highly concentrated. In any other sector, if two companies held at least 70 per cent of the market and, in some cases, about 90 per cent (the Scottish Hydro electricity market), these markets would probably be seen as priorities for investigations to determine whether policy action was needed to break up these dominant positions. For example, the Competition Commission's market share test²³ that would be likely to trigger an investigation would be met if a merger led to the creation of a company with a market share of only 25 per cent.

The guidelines were reviewed in 2003, when the Competition Commission issued guidance under the 2002 Enterprise Act. This guidance stated that the test for referral to the Competition Commission would be based on whether the merger or takeover resulted in: ‘a substantial lessening of competition within any market or markets in the UK for goods or services’.²⁴ In April 2008, the Competition Commission and Office of Fair Trading launched a further review expected to be completed by the end of 2008, which would result in new guidance.

Table 4 Market shares of major suppliers in gas (%)						
	Centrica	Powergen/E.ON	Scottish & Southern	Npower/RWE	EDF	Scottish Power
G Britain	46	13	13	12	7	9

Source: *Ofgem (2007) 'Domestic Retail Market Report' Ofgem, London.*

5. Fuel poverty

5.1 What is fuel poverty?

5.1.1 The definition

The definition of fuel poverty adopted by government in the UK Fuel Poverty Strategy 2001 – that a household is in fuel poverty if, in order to maintain a satisfactory heating regime, it would be required to spend more than 10 per cent of its income on all household fuel use²⁵ - has been widely accepted. While ‘fuel poverty’ and ‘poverty’ in general clearly have strong linkages, in the past decade it has increasingly been recognised that it is possible for ‘fuel poverty’ to occur in households that would not be considered to be poor in the wider sense. The measures necessary to deal with poverty in general, e.g. income support, Housing Benefit etc, will not be sufficient to address fuel poverty. A significant proportion of those categorised as suffering from poverty are fuel poor. However, a minority of the fuel poor, at least in 2005 when the number of households that were fuel poor was less than 2 million, would not be categorised as suffering from poverty in the wider sense.

As rising energy prices push a much higher proportion of households into the category of being fuel poor, problems with the 10 per cent definition will become more apparent.²⁶ Even in 2005, when only 1.7 million households were fuel poor, 6 per cent of those in the third income decile (gross weekly earnings of £215-292) were categorised as ‘fuel poor’. By the close of 2008 the number of households living in fuel poverty is likely to be three times the 2005 level. This will mean that some households categorised as fuel poor are likely to be found in the fifth (£384-496) and even sixth (£497-623) income deciles.

The fact that some households in the sixth income decile could, by the end of the year, be spending somewhere in the region of £3000 per year on energy is an appalling indictment of the state of the British housing stock. From an environmental point of view, it must be a priority to put in place policies to ensure their housing is improved so that energy bills and hence ‘carbon footprints’ are much more reasonable. However, from a social policy point of view, it would be hard to justify directing large amounts of public money to households with relatively large incomes.

While there is not a perfect alignment between poverty and fuel poverty, fuel poverty disproportionately afflicts those suffering from poverty in the general sense. There were households in 2005 in the lowest income decile (less than £142 gross per week) who were spending 20 per cent of their income on energy. Energy price rises since 2005 may mean that such a household would now be spending about a third of their income on energy, perhaps leaving less than £100 for all other purchases. Taking such a household out of fuel poverty must surely be a higher social priority than helping someone in the sixth income decile who is paying 10 per cent of their income on energy? However, policies that are led by simple statistical targets do not distinguish such cases. Policymakers should not lose sight of the fact that their priority is to make the greatest welfare gain possible with the resources available, not make the largest improvement to simple statistics.

The statistical details of the 10 per cent definition itself are not without their problems, in particular how income should be measured. In the ‘full income’ definition, income directly related to housing is included, i.e. Housing Benefit, Income Support for Mortgage Interest (ISMI), Mortgage Payment Protection Insurance (MPPI), Council Tax Benefit (CTB) and the payment of council tax. The ‘basic income’ definition excludes income related directly to housing.

For both definitions it is the income, net of income tax and national insurance, of the whole household that is taken into account: that is the income of the Household Reference Person (HRP) and any partner, plus any other adult member. The arguments about which definition is more appropriate are complex. In general, use of the ‘full income’ basis leads to lower estimates of the number of fuel poor but it also changes the incidence of

fuel poverty amongst demographic groups. For example, twice as many single parents are shown to be in fuel poverty under the basic income definition compared to the number under the full income definition.

5.1.2 Factors behind fuel poverty

Boardman (2008) identifies three separate elements that contribute to fuel poverty:

- The cost of fuel (determined by energy prices);
- The amount of fuel needed to heat a property (determined by the energy efficiency of the property) and provide other energy services;
- The ability of the household to afford the necessary fuel (determined by household income).

Traditionally, it has always been the second factor that was seen as the key determinant of whether a household would be fuel poor or not. In terms of actions to help the fuel poor, there is wide agreement that measures to improve the housing stock are the most important because they hold the promise of permanently fuel poverty-proofing buildings at a one-off cost. They also have strong advantages in terms of sustainability. While some of the benefits of energy efficiency measures may be taken as extra comfort, there will still be worthwhile reductions in carbon emissions. The high price environment we are currently witnessing will raise the range and standard of measures that will be seen as sufficient to ensure fuel poverty-proofing. For example, Boardman speculated that the minimum desirable SAP should now be increased from 65 to 80. This issue is examined in detail in Section 6.1.

Measures to artificially reduce the price of fuel or to provide income support are open-ended and potentially expensive commitments, especially if energy prices and the number of households needing support remain high. However, the magnitude of energy price rises since 2005 means that arguments about the cost of energy actually paid by low-income households are becoming more significant. There is a need to ensure not just that costs are as low as possible but also that the prices charged by the companies are justifiable given the costs they incur. There are particular concerns over the widening differential between fuel tariffs for prepayment and standard credit consumers and those that pay by on-line Direct Debit. So, while there is a strong case to argue that energy efficiency measures are by far the most efficient solution to fuel poverty, the rapid rise in energy prices means that energy efficiency measures alone will not be sufficient to eradicate fuel poverty, at least in the short- to medium-term. The process of upgrading the housing stock is inevitably a relatively slow one and measures are needed to protect consumers in the interim until improvements can be implemented. energywatch has sought to focus on the impact that increasing prices are having in driving up levels of fuel poverty. Scorer (energywatch) stated:²⁷

The number of GB households in fuel poverty has almost doubled in the last 5 years. The cause, of course, is a near-doubling in the average household's energy bill over the same period. Incomes have not been slashed and the level of investment in energy efficiency and heating programmes is still higher now than in 2005/6.

However, Ofgem has sought to emphasise the need for action from government on energy efficiency and income measures to address fuel poverty, while seemingly underplaying the need for action on the cost of energy being paid by fuel poor households. At its Fuel Poverty Summit in April 2008, Ofgem stated:²⁸

Fuel poverty is part of a wider problem of poverty and social exclusion caused by a combination of high energy prices, low incomes and poor housing conditions. Given such wider causes, there will inevitably be a limit to the role that the regulator and industry can play in tackling fuel poverty. The main focus must be on raising incomes and improving housing, which are the responsibilities of Government. Ofgem's remit and the focus of the Summit was on tariffs and assistance provided by suppliers.

It is open to question whether such a limited role meets the requirements imposed in the guidance given to Ofgem in 2004 under the Utilities Act, which stated (see Annex 1):²⁹

The Government expects the Authority, within its sphere of responsibility, to put in place measures which will help achieve these targets [no household should be living in fuel poverty by 2016-18, and no vulnerable household should be in fuel poverty by 2010].

The Energy Retail Association has also sought to underplay the impact of rising prices on fuel poverty levels, by emphasising instead the need for action on the dimensions of fuel poverty that are in the government's hands. In May 2008, it stated:³⁰

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.

5.2 Who are the fuel poor?

The government's 2005 Progress Report reported that, for England, the total 'fuel poor number had fallen from 5.1 million in 1996 of whom 4.0 million were classed as vulnerable, to 1.2 million in 2003, of whom 1.0 million were vulnerable.'

The Department for Business, Enterprise and Regulatory Reform publishes, along with its annual progress report (BERR, 2007b, see below), detailed data on the characteristics of the fuel poor in England (BERR, 2007a) on which its annual progress report is based. While the report is dated 2007, the data relate to 2005, before the major price increases began to have an impact. This report has an annex which provides 72 tables showing the characteristics of the fuel poor in England. These tables are generally shown on the two income bases: full income including benefits, and basic income. Both bases are important for a full understanding of the issues. Under the basic income basis, in 2005, nearly 1.8 million households were categorised as living in fuel poverty, of whom 1.4 million (80 per cent) were vulnerable households. For these purposes, 'vulnerable households' are those containing 'older householders, families with children and householders who are disabled or suffering from a long-term illness'.

5.2.1 Payment methods

Of particular concern to this study is payment method (see Tables 5 and 6). Clearly it is not the method of payment as such that determines whether households are fuel poor, rather it is the tariffs charged under these different payment methods. Given that PPM and Standard Credit (SC) tariffs are 20-25 per cent higher on average than the cheapest household tariffs, and given that the cheapest tariffs - online Direct Debit accounts - may not be feasible for many low income households, it is not surprising that many of the fuel poor pay by PPM or SC. Under the basic income definition, 19 per cent of PPM electricity consumers and 17 per cent of PPM gas consumers are fuel poor compared to the overall percentage of households that are fuel poor of 8 per cent. The proportion of SC consumers who are fuel poor is a little above the average. Only about 4 per

cent of Direct Debit consumers are fuel poor and it is highly likely that the percentage of online Direct Debit households that are fuel poor would be much lower.

It should also not be overlooked that those without a gas connection are also particularly at risk of fuel poverty: under the basic income definition, 16 per cent of those without a gas connection are fuel poor. The dramatic increase in the numbers of households that are fuel poor means that updated figures will look very different, but households that were fuel poor in 2005 will be suffering much more than those that have fallen into that condition since.

Table 5 Fuel poor households (2005): payment method – full income basis				
	No (th) who pay for electricity this way	No (th) / % electricity consumers using this payment method in fuel poverty	No (th) who pay for gas this way	No (th) / % gas consumers using this payment method in fuel poverty
Prepayment meter	2996	300 / 10.0	2164	166 / 7.7
Standard credit	6936	696 / 10.0	5943	478 / 8.0
Direct debit	11202	532 / 4.8	10276	434 / 4.2
No gas			2750	451 / 16.4
Total	21134	1529 / 7.2	21134	1529 / 7.2

Source: <http://www.berr.gov.uk/files/file42705.pdf>

Table 6 Fuel poor households 2005: payment method – basic income basis				
	No (th) who pay for electricity this way	No (th) / % electricity consumers using this payment method in fuel poverty	No (th) who pay for gas this way	No (th) / % gas consumers using this payment method in fuel poverty
Prepayment meter	2996	569 / 19.0	2164	372 / 17.2
Standard credit	6936	739 / 10.7	5943	539 / 9.1
Direct debit	11202	467 / 4.2	10276	366 / 3.6
No gas			2750	498 / 18.1
Total	21134	1775 / 8.4	21134	1775 / 8.4

Source: <http://www.berr.gov.uk/files/file42705.pdf>

The issue of which definition to use makes a significant difference to the diagnosis of the extent to which PPMs contribute to the problem. In its Domestic Retail Market Report 2007 (Ofgem, 2007), Ofgem asserts that 80 per cent of PPM customers are not fuel poor. On the full income definition, 19.6 per cent of the fuel poor are electricity PPM users and 11 per cent of the fuel poor are gas PPM users (29 per cent do not have a gas connection). However, on the basic income definition, 32 per cent of the fuel poor are electricity PPM users and 21 per cent of the fuel poor are gas PPM users (28 per cent do not have a gas connection).

5.2.2 Method of heating

The presence or otherwise of central heating and the main type of fuel used for heating are strong determining factors (see Tables 7 and 8). Under the full income basis, those without central heating are four times as likely to be fuel poor as those with, but under the basic income basis, only 3.5 times as likely. Those not using gas for heating are much more likely in all cases to fall into the category of fuel poverty, whether or not they have central heating.

Table 7 Fuel poor households 2005: heating method & fuel – full income basis		
	No of households (th)	No (th) / % of whom fuel poor
Central heating	19918	1288 / 6.5
Gas	17264	886 / 5.1
Oil	834	126 / 15.0
Solid	237	106 / 44.8
Electricity	1580	170 / 10.8
No central heating	912	236 / 25.9
Gas	638	118 / 18.6
Solid	70	37 / 52.6
Electricity	205	81 / 39.6

Source: <http://www.berr.gov.uk/files/file42705.pdf>

Table 8 Fuel poor households 2005: heating method & fuel – basic income basis		
	No of households (th)	No (th) / % of whom fuel poor
Central heating	19918	7.6
Gas	17264	6.1
Oil	834	12.4
Solid	237	46.8
Electricity	1580	15.6
No central heating	912	26.6
Gas	638	20.2
Solid	70	45.7
Electricity	205	40.0

Source: <http://www.berr.gov.uk/files/file42705.pdf>

5.2.3 Tenure

Of the 1.5 million households in England categorised in 2005 as fuel poor under the full income basis, 1.3 million (85 per cent) live in private accommodation (rented or owner-occupier), while 215,000 live in social housing (see Table 9). However, on the basic income basis (see Table 10), nearly a third (0.6m) live in social housing. This shows the impact of Housing Benefit on income for those in social housing.

Table 9 Fuel poverty by tenure 2005: full income basis			
	th households (%)		
	Social housing	Private	All
Vulnerable households	164 (10.7)	1031 (67)	1195 (78)
Non-vulnerable households	51 (3.3)	284 (19)	335 (22)
All	215 (14.0)	1314 (85.4)	1539

Source: <http://www.berr.gov.uk/files/file42705.pdf>

Table 10 Fuel poverty by tenure (2005): basic income basis			
	th households (%)		
	Social housing	Private	All
Vulnerable households	468 (26.4)	937 (52.8)	1405 (79.2)
Non-vulnerable households	108 (6.1)	261 (14.7)	369 (20.8)
All	577 (32.5)	1198 (67.5)	1775

Source: <http://www.berr.gov.uk/files/file42705.pdf>

5.2.4 Income and the thermal properties of housing

Tables 11 and 12 show the very strong relationship between fuel poverty, income and the thermal quality of the property as measured by the government's Standard Assessment Procedure (SAP) rating, a scale running from 0-100. As a reference point, it was assumed that a SAP of 65 would be sufficient to ensure that a property would be 'fuel poverty proofed', although the large rises in energy prices may mean that a much higher target, for example 80, may be needed. These figures show that the standard of British housing is generally well below this reference point.

Table 11 Fuel poverty 2005: income & housing thermal properties – full income basis				
% expenditure on fuel	No of households th / %	Average basic income (£/year)	Fuel costs (£/year)	SAP rating
0-5	13853 (65.6)	31400	780	50.9
5-10	5752 (27.2)	13100	870	45.5
10-15	1112 (5.3)	8700	1020	35.6
15-20	269 (1.3)	7400	1240	28.2
>20	148 (0.7)	5700	1480	20.8
Total	21134	24800	830	48.1

Source: <http://www.berr.gov.uk/files/file42705.pdf>

Table 12 Fuel poverty 2005: income & housing thermal properties – basic income basis				
% expenditure on fuel	No of households th / %	Average basic income (£/year)	Fuel costs (£/year)	SAP rating
0-5	13828 / 65.4	32500	790	50.3
5-10	5531 / 26.2	12900	860	46.2
10-15	1241 / 5.9	8100	950	39.2
15-20	336 / 1.6	6500	1090	34.7
>20	198 / 0.9	5000	1290	24.6
Total	21134	25300	830	48.1

Source: <http://www.berr.gov.uk/files/file42705.pdf>

One of the most worrying aspects of this data is the 26-27 per cent of households in England that spent 5-10 per cent of their income on energy. These households could easily fall into fuel poverty if energy prices increase; in fact many households already have. This figure implies that, all things being equal, if, as seems likely, fuel prices were to nearly double in real terms from their 2005 level, a further 5.5-5.8 million households could fall into fuel poverty, which would mean around a third of households in England would be fuel poor. Whether such a large increase in the numbers of fuel poor would actually happen will depend not only on whether energy prices rise to that extent, but also on increases in income, supplier and government initiatives to assist low-income households with the high cost of energy and whether consumers take steps to improve energy efficiency and save energy, or switch to cheaper payment methods and/or suppliers. Some sources refer to 'extreme fuel poverty' under which more than 20 per cent of income is spent on fuel and, in 2005, 0.7-0.9 per cent of households fell into this category. If energy prices were to double in comparison to the 2005 level, this figure could rise to 7.3-8.4 per cent.

5.2.5 Other factors

As with the factors above, the figures on fuel poverty vary considerably according to whether the full or basic income basis is used.

Of the fuel poor, just under half live in homes that are categorised as 'not decent' using the government's fitness criteria; about 80 per cent of these households fail on the 'thermal comfort' criterion and perhaps other criteria (again for both full and basic categories).

In terms of composition, households with members over 60 years age and single person households are most likely to be fuel poor. On a full income basis, 18 per cent (20 per cent on a basic income basis) of households made up of a single person over 60 are fuel poor, while 16-17 per cent of households where the youngest member is over 75 are fuel poor; and 17-19 per cent of single person households are fuel poor (compared to 7-8 per cent overall). Looked at in a different way, while in only about a quarter of households is the youngest person over 60, such households account for nearly half the fuel poor (on a full income basis). Not surprisingly, the unemployed suffer disproportionately from fuel poverty – 24 per cent on a full income basis but 44 per cent on a basic income basis. The economically inactive – 14-16 per cent – are much more likely to be fuel poor than the employed.

However, the figures on income are more surprising and reinforce the assertion that, while fuel poverty and poverty are strongly linked, they are not the same. Less than half (48 per cent) of those whose income falls in the first decile of income are fuel poor on a full income basis and on the basic criterion, the figure only rises to 55 per cent. Nevertheless, about two thirds of the fuel poor have incomes in the lowest income decile. Six per cent of those in the third decile are fuel poor on either basis.

In terms of the rural/urban split, those living in rural communities (villages, hamlets or isolated buildings) are much more likely to be fuel poor than urban consumers – 13-15 per cent of this category of household are fuel poor, albeit they account for less than 20 per cent of the fuel poor on a full income basis (15 per cent on a basic income basis). There is likely to be some association in this case with the low availability of gas connections for rural consumers as well as the nature of the properties, which may be more difficult to treat, for example if they have solid walls and no potential for mains gas connection.

In terms of location, the areas with the highest rate of fuel poverty are the North East (11.5-14.5 per cent) and the North West (9.2-10.3 per cent), while the areas with the lowest rates are London (3.9-6.4 per cent) and the South East (4.9-5.0 per cent). The higher figures are for the basic income definition. The North West alone accounts for 18 per cent of the fuel poor on a full income basis (17 per cent on a basic income basis) even though only 14 per cent of households are in that region.

The relationship between council tax band and fuel poverty is perhaps not as strong as might be expected on a full income basis. While 10.3 per cent of those in band A, the lowest value houses, are fuel poor, 6.1 per cent in bands F, G and H, the highest value housing, suffer. Nevertheless, on a full income basis, a third of the fuel poor live in band A homes. However, on a basic income basis, 15.4 per cent of those in band A are fuel poor and 40 per cent of the fuel poor live in band A homes, while only 4.2 per cent in bands F, G and H suffer. This perhaps reflects 'under occupancy' of large premises, for example pensioners living alone or as a couple in a large family house.

5.2.6 Summary

These figures show fuel poverty is a complex and multi-faceted phenomenon that, while it is most likely to be present in low-income households, it does affect some households that might not otherwise be thought of as poor. Equally, policies that alleviate poverty in general, e.g. housing benefit and tax reforms, may have a limited impact on fuel poverty because they do not address the main causes, that is, poor housing quality, high energy costs and the use of payment methods that attract a premium. Identifying all the nuances of the factors behind these figures would require a much more comprehensive analysis than is presented here. However, the figures show that there are important linkages to the housing sector. While these figures do not show that the link between fuel poverty and method of payment is causal, i.e. they do not show that households are fuel poor *just because* they use prepayment meters or pay using standard credit terms, the fact that PPM and standard credit tariffs are significantly higher than Direct Debit tariffs does demonstrate that the problem is significantly exacerbated by this price differential between different methods of payment. The issue of payment method is examined in section 6.

5.3 Impact of fuel poverty

The most extreme manifestation of fuel poverty is excess winter deaths. Help the Aged estimate that 25,000 people over the age of 65 die every year as a result of cold-related illnesses. Research (Howieson, 2005) reported in 2004 claimed that:³¹

Poverty is the main cause of premature death among the elderly in Scotland and the chances of premature elderly death are highest in Glasgow. These deaths could be prevented if measures were to be taken to keep pensioners warm in their homes during the winter months.

‘Excess winter mortality’ as defined by the Office of National Statistics³² is calculated as winter deaths (deaths occurring in December to March) minus the average of non-winter deaths (April to July of the current year and August to November of the previous year). However, the figures on ‘excess winter mortality’ are influenced by factors other than fuel poverty. A very cold winter will increase the number of deaths; for example, the number of excess deaths in the very cold winter of 1962/63 was 80 per cent higher than in the following year. Also, a particularly virulent seasonal flu virus will increase the number of deaths. In 1999-2000, when excess winter mortality was the highest since 1985 at 48,440, just fewer than 22,000 were killed by the disease. In 2004-2005, when excess winter mortality was 31,640, there were an estimated 1,268 deaths due to flu. The link between winter deaths and fuel poverty may therefore be obscured. Nevertheless, a 2003 study did find that death rates in the UK were significantly higher than in other affluent Northern European countries (Healy, 2003).³³

However, the impact of fuel poverty runs much deeper than excess winter deaths. Barnardo’s states:³⁴

For those living in fuel poverty, the consequences are misery, discomfort, ill health and debt. It often means choosing between essential household items or living in an adequately heated home. According to the Executive’s Scottish Fuel Poverty Statement, living in a cold, damp environment can cause discomfort and ill health. For example, health problems such as influenza, heart disease, and strokes can be exacerbated, and cold homes can promote the number of dust mites and the growth of fungi, which are often linked to asthma and other similar conditions. Households that need to spend a large part of the family income on fuel often have to spend less on other parts of the family budget. This may lead to a poor diet or reduced participation in leisure activities, both of which can impact quality of life and health, especially for vulnerable people such as children. Children’s education may also be adversely affected. Cold homes can increase the amount of time it takes to recover from an illness, which could result in longer absences from school. Overcrowding in heated areas of the house could be distracting for a child who is trying to do schoolwork.

There is relatively little systematic research on this broader impact of fuel poverty. A small project was undertaken in 2005-07 by Rudge (2007) at the London Metropolitan University Research.³⁵ The conclusions stated:

The results confirm some of the findings by others, while adding to the increasing body of evidence pointing towards health effects of energy inefficient buildings on their inhabitants, over and above their contribution to carbon emissions. The study demonstrates that these effects can be measured in terms of morbidity, as well as mortality, illustrating that the impact of cold homes is even more far-reaching than a proportion of the 40,000 annual excess winter deaths.

5.4 Government policy on fuel poverty

In 2000 Parliament passed the Warm Homes and Energy Conservation Act. The Act required Government to prepare and publish a strategy:

setting out the authority's policies for ensuring, by means including the taking of measures to ensure the efficient use of energy, that as far as reasonably practicable persons do not live in fuel poverty.

In November 2001, government published its 'Fuel Poverty Strategy' (BERR & DEFRA, 2001) as stipulated by the Act. It provided a more precise definition of fuel poverty as follows:

a fuel poor household is one that cannot afford to keep adequately warm at reasonable cost. The most widely accepted definition of a fuel poor household is one which needs to spend more than 10% of its income on all fuel use and to heat its home to an adequate standard of warmth. This is generally defined as 21°C in the living room and 18°C in the other occupied rooms – the temperatures recommended by the World Health Organisation.

This Strategy set a target to end fuel poverty for 'vulnerable households' by 2010 and to end fuel poverty for all households by 2016 so far as reasonably practicable. The two responsible government departments for England are Business Enterprise and Regulatory Reform (BERR, previously Department of Trade & Industry) and Department for Environment, Food & Rural Affairs (DEFRA). For Scotland, Wales and Northern Ireland, the responsibilities are devolved to the Scottish Government, the Welsh Assembly and the Northern Ireland Department for Social Development. These bodies publish an annual report on progress with the Fuel Poverty Strategy (BERR, 2007b).

In 2001, when the Strategy was adopted, government figures estimated that, in England (responsibility for policy on fuel poverty is devolved), 1.7 million households fell into the category fuel poor of which 1.4 million were vulnerable households. Estimates for 2007 suggest the number for that year was 2.9 million, of which 2.3 million were vulnerable households.

In April 2008, National Energy Action (NEA) estimated that 4.5 million households were fuel poor in the UK and that, by the end of 2008, this number could have risen to 5.5 million.³⁶

5.5 Warm Front

A major element of the government's Fuel Poverty Strategy for England is the Warm Front ³⁷ programme (there are devolved equivalents), which was set up in 2000 and provides grants for insulation, draught proofing and heating improvements for householders on benefits who are either owner occupiers or who live in private rented accommodation. In its 2004 action plan, government stated: 'Our main tool for eradicating fuel poverty in England will remain the Warm Front programme.'³⁸ In its 2005 Progress Report, it estimated that:³⁹

61 per cent of the reduction since 1996 can be attributed to improvements in incomes. 22 per cent of the reductions are attributable to energy prices, while 17 per cent of the reduction is attributable to energy efficiency improvements, a sign that initiatives like Warm Front are having a significant impact in taking people out of fuel poverty.

Table 13 shows the annual expenditure under this programme.

In 2007-08, its budget was £350m, although the Fuel Poverty Advisory Group reported that this would be reduced by 25 per cent in the period 2008-11. The government estimated that its package of measures on fuel poverty and home energy efficiency was worth £2.3bn.⁴⁰

Boardman (Boardman, 2008) was not only critical of the reduction in funding for Warm Front, she was also critical of the effectiveness of Warm Front at targeting fuel poverty. Her work backed up a report for the 'Eaga Partnership' by Sefton (Sefton, 2004). Boardman reported that government figures showed that only 16 per cent of households eligible for Warm Front assistance were in fuel poverty and only 60 per cent of the fuel poor were eligible for Warm Front assistance. She also reported that grants paid did not make a large enough difference to the efficiency of buildings. The government rates buildings on the Standard Assessment Procedure (SAP) rating, a scale running from 0-100.

Table 13 Warm Front spend since the scheme's inception	
Scheme year	Approximate total spend/budget (£ million)
2000-01	72
2001-02	197
2002-03	163
2003-04	164
2004-05	166
2005-06	192
2006-07	320
2007-08	350

Source: <http://www.publications.parliament.uk/pa/cm200708/cmhansrd/cm080401/text/80401w0002.htm#08040186000041>

Historically, it has been assumed that a household living in a building rated 65 or higher would not be fuel poor. Boardman stated (Boardman, 2008, p 27):

In 2005 using SAP 2005, more than 98% of fuel poor households lived in a property with a SAP lower than 65 [table 33, BERR and DEFRA 2007]. The households in the most severe fuel poverty (those needing to spend >20% of their income), the property had an average SAP of 21. About a quarter of the fuel poor consistently live in the very worst homes, with a SAP < 20, and around half in a property with a SAP < 35.

She also argued that higher fuel prices meant that a much higher SAP than 65, perhaps 80, would be required for the assumption that a household meeting that level would not fall into fuel poverty by 2016. By comparison, Boardman found that Warm Front lifts a property on average only by 16 SAP points (from 40 to 56).

5.6 The Carbon Emissions Reduction Target

The Carbon Emissions Reduction Target (CERT) is a three year programme that replaced the Energy Efficiency Commitment (EEC) in April 2008. EEC had operated for six years, also in three-year programmes (EEC1 and EEC2). These schemes allowed energy retailers to add a small percentage to the bills of consumers to create a fund to pay for energy efficiency measures that are then delivered in accordance with targets set by Defra and monitored by Ofgem. The objective of CERT is to reduce emissions of carbon dioxide by improving energy efficiency in a cost-effective manner. Consumers' contributions to CERT are approximately double those under EEC and average a total of about £38 for a consumer of electricity and gas. CERT is not specifically aimed at combating fuel poverty, but 40 per cent of the emissions savings (it was 50 per cent under EEC) must be achieved in the 'Priority Group', i.e. those in receipt of specified (mainly income-related) benefits. The qualifying benefits are similar to those which grant access to the Warm Front Scheme, but eligibility extends to social housing tenants. However, Boardman reported that, as with Warm Front, only about 60 per cent of the fuel poor are eligible for CERT assistance and 14.4 per cent of the households who were eligible for EEC were fuel poor.

5.7 Winter fuel payments

The Winter Fuel Payments scheme was introduced in 1997 and is an annual payment made to all pensioners of between £200 and £300. The rates announced in the 2008 Budget were: £200 for households with someone over 60, £300 if over 80, plus an additional one-off payment of £100 to over-80s households and £50 to over-60s households in 2008-09.

Government invariably mentions Winter Fuel Payments when detailing its measures on fuel poverty. However, Winter Fuel Payment is judged by Boardman and the Fuel Poverty Advisory Group to be an inefficient way of dealing with fuel poverty because it is not targeted at the fuel poor. Boardman (Boardman, 2008, p 25) estimates that only '11.6% of the households in receipt of Winter Fuel Payments were in fuel poverty.'

The government's cold weather payments scheme still exists but the amounts of money paid out are small and the cold weather conditions needed to trigger payments are seldom encountered. The group of people that are eligible to receive this payment is also restricted.⁴¹ The payment is:⁴²

£8.50 when the average temperature where you live is recorded as, or forecast to be, zero degrees Celsius or below, over seven consecutive days during the period from 1 November to 31 March.

5.8 Decent homes programme

The Decent Homes Programme (see also the chapter on housing) was launched in 2000 and is intended to raise the overall standard of social housing. The programme is operated by the Department of Communities and Local Government and has a target to ensure that 95 per cent of social housing is 'decent' by 2010. There are four criteria for 'decency':

- It meets the current statutory minimum standard for housing;
- It is in a reasonable state of repair;
- It has reasonably modern facilities and services;
- It provides a reasonable degree of thermal comfort.

So the programme is not specifically targeted at those in fuel poverty and thermal efficiency is only one aspect of its remit. It is not clear how much of the Decent Homes Budget can be attributed to energy efficiency measures and those suffering from fuel poverty. The Select Committee on Communities and Local Government

(2008) found:

The programme is widely seen as worthwhile for what it has achieved but a missed opportunity because of what it never sought to achieve. The Sustainable Development Commission, the Fuel Poverty Advisory Group and National Energy Action all believe the programme underachieved because specific energy improvement standards were omitted.

It recommended:

We recommend that the Government include specific energy performance improvement standards in any social housing improvement programme that follows Decent Homes in 2010. In particular, we recommend that any future programme contain a specific minimum, rather than average, Standard Assessment Procedure target for all social housing. We seek the Government's view on the Local Government Association's suggestion that that minimum SAP rating should be 65.

5.9 Fuel Poverty Advisory Group

The government also set up the Fuel Poverty Advisory Group (FPAG)⁴³ 'to report on the progress of delivery of the Government's Fuel Poverty Strategy and to propose and implement improvements to regional or local mechanisms for its delivery'. This body covers England and there are devolved bodies for the other regions. FPAG is an 'Advisory Non-Departmental Public Body' sponsored by Defra/BERR and acts as an authoritative source of evaluation of the government's Fuel Poverty Strategy. Its 2007 Annual Report (Fuel Poverty Advisory Group, 2008), published in March 2008, expressed concerns on a number of points, particularly the apparent abandonment of the 2010 fuel poverty target. It found that energy prices, from 2003 to March 2008, had increased by 50 per cent⁴⁴ leading to the highest level of fuel poverty for a decade (2.9 million households in England in 2007). It highlighted the increasing differential between payment methods and it was critical of the decision to cut the Warm Front budget and of the rebalancing of CERT to the detriment of low income groups.

It made six recommendations, which can be summarised as follows:

- The Warm Front budget for 2008-11 should be restored to its 2007/08 level over-riding the 25 per cent cut that has been imposed. Several ways of funding this were suggested;
- Progress on reducing the differentials between tariffs should be made, including standard credit terms as well as PPMs;
- Energy companies have been increasing their prices faster than their costs are increasing their margins. FPAG recommended that Ofgem protect the interests of consumers more 'tenaciously' especially low-income households;
- Government should improve benefit take-up;
- Government and the Public Service Agreement should give adequate priority to fuel poverty so that the 2016 target on fuel poverty eradication will be met;
- Information on households should, with appropriate safeguards, be shared – especially by the Department of Work and Pensions – with Local Authorities and energy companies, to help to reach those in need.

6. Payment methods

Tables 14 and 15 show the different payment methods by company. These show that the three main payment methods, Direct Debit, PPM and standard credit (quarterly) account for about 95 per cent of all accounts. There are some differences by company. British Gas has a higher than average proportion of PPM consumers and a lower than average number of Direct Debit consumers. EDF also has a high proportion of PPM consumers. Scottish Power and Scottish & Southern have a high proportion of Direct Debit consumers. Powergen has the lowest proportion of PPM consumers. How far these differences reflect company policies and how far they represent historic or regional differences (for example, culture and income) is not clear.

Table 14 Payment methods for electricity by company (%)						
	Direct debit	PPM	Quarterly	Fuel direct	Budgeting payment schemes	Other
British Gas	43	19	33	0.1	2.8	2.2
EDF Energy	39	17	41	0.1	0.5	3.4
Npower	43	13	39	0.1	2.3	3.5
Powergen	47	9	39	0.1	3.4	2.2
Scottish&SE	50	12	33	0.1	1.0	4.1
Scottish Power	54	14	27	0.2	2.8	2.0
Industry	47	14	35	0.1	2.1	2.9

Source: *Ofgem (2008) 'Monitoring Company Performance of Domestic Suppliers Quarter 3 2007' Ofgem, London Notes*

1. The data for small suppliers is excluded.
2. The data for Npower is an average for their three regions.

Table 15 Payment methods for gas by company (%)						
	Direct debit	PPM	Quarterly	Fuel direct	Budgeting payment schemes	Other
British Gas	40	13	40	0.1	3.2	3.4
EDF Energy	52	15	31	0.1	0.6	2.0
Npower	54	12	27	0.3	3.9	3.5
Powergen	58	6	31	0.1	4.2	1.2
Scottish&SE	59	7	28	0.1	1.4	3.7
Scottish Power	67	7	22	0.1	2.3	0.8
Industry	50	11	33	0.1	2.9	2.7

Source: *Ofgem (2008) 'Monitoring Company Performance of Domestic Suppliers Quarter 3 2007' Ofgem, London Notes*

1. The data for small suppliers is excluded.
2. The data for Npower is an average for their three regions.

Table 16 reproduced from section 5.2 shows that the risk of fuel poverty is strongly influenced by the method of payment. In 2005, the most recent year for which full data is available, more than half of all electricity consumers paid by Direct Debit, which is well-known to offer the cheapest rates, while 33 per cent and 14 per cent paid by standard credit and PPM respectively. For gas, the equivalent figures are 56 per cent paid by Direct Debit, 32 per cent by standard credit and 12 per cent by PPM. The installation rate of PPMs for payment of debt has risen sharply since 2005 (see Table 17). The installation rate for debt was approaching 1000 a day in 2007 (14 per cent higher than 2006) and reflects in part the fall in disconnection levels.

An increasing number of consumers operate their accounts online paying by Direct Debit and receive significant discounts for doing so. Ofgem (Ofgem, 2008) estimated that about 2.5 million consumers now have online accounts, presumably most of which would be 'dual fuel', Direct Debit accounts.

Table 16 Fuel poor households (2005): payment method – full income basis				
	No (th) who pay for electricity this way	No (th) / % electricity consumers using this payment method in fuel poverty	No (th) who pay for gas this way	No (th) / % gas consumers using this payment method in fuel poverty
Prepayment meter	2996	300 / 10.0	2164	166 / 7.7
Standard credit	6936	696 / 10.0	5943	478 / 8.0
Direct debit	11202	532 / 4.8	10276	434 / 4.2
No gas			2750	451 / 16.4
Total	21134	1529 / 7.2	21134	1529 / 7.2

Source: <http://www.berr.gov.uk/files/file42705.pdf>

Table 17 Average daily rate of installation of PPMs for debt							
	2002	2003	2004	2005	2006	2007	2008 Q 1
Electricity	430	422	298	323	452	549	616
Gas	353	299	367	400	463	494	521
Total	784	721	666	723	915	1042	1137

Source: *energywatch*

Note:

Figures for Q1 2008 are estimates based on trend analysis.

6.1 Prepayment meters

The high prices charged to prepayment meter consumers are widely acknowledged as one of the major problems facing gas and electricity consumers who use this payment method. On the high prices paid by PPM consumers, the government's Fuel Poverty Advisory Group stated in its 2007 Annual Report:⁴⁵

The position here is shocking and has been getting worse. Customers with prepayment meters and those paying by cash/cheque are subsidising those paying by Direct Debit and online.

6.1.1 Background

Britain is alone amongst developed countries in having a significant number of consumers that pay their energy bills via prepayment meters (PPMs). These meters are generally electronic meters charged using a 'smart card' rather than the older coin/token meter, although a significant number of the latter still exist (see below). Use of PPMs for electricity increased sharply in 1992 when the number of consumers using electricity PPMs nearly doubled to more than 2 million (Table 18), while the increase in use by gas consumers came somewhat later. Electricity numbers have stayed at about the same level from 1997 onwards, but for gas the numbers have continued to increase.

After the meters were introduced on a large scale in 1992, consumers that had problems paying their bills had little choice but to switch to a prepayment meter if they were ineligible for or unaware of Fuel Direct (see below) and wished to avoid disconnection. These were generally operated by a 'smart card' that contained the individual consumer's account details and money could be added to these cards at a local retail outlet, such as a petrol station or newsagent. The Regulator was persuaded that use of PPMs entailed extra costs compared to normal meters. However, he was able, as the market for small consumers was still then a monopoly and tariffs were regulated, to require the retail companies to limit the premium between prepayment meters and standard credit terms to no more than 5 per cent.

Table 18 Customers on prepayment meters 1991–2007 (million households)		
	Gas	Electricity
1991	0.75	1.15
1992	0.75	2.10
1993	0.80	2.40
1994	0.85	2.70
1995	0.85	3.25
1996	0.95	3.50
1997	1.1	3.6
1998	1.4	3.7
1999	1.6	3.7
2000	1.8	3.5
2001	1.8	3.8
2002	2.0	3.7
2003	2.0	3.7
2004	2.1	3.6
2005	2.2	3.6
2006	2.3	3.5
2007	2.3	3.6

Source: Boardman B & Fawcett T (2002) *Liberalisation of electricity supply and fuel poverty: lessons from Great Britain for Northern Ireland*, Environmental Change Institute, Oxford for 1992-1996; Ofgem (2007) *Domestic suppliers: social obligations annual reporting for 2006* Ofgem, London. <http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Documents1/Monitoring%20Company%20Performance,%20Annual%20Report%202006.pdf> and Ofgem (2008a).

PPMs served a number of purposes for the companies. If there were additional costs over and above the 5 per cent they were allowed to recover in higher tariffs, they simply passed these on to other consumers. The 'smart cards' allowed them to recover debts because a proportion of any energy purchases made by the consumer went to pay off their debt. From a strategic point of view, the political problems caused by disconnecting consumers that did not pay their bills were addressed to a considerable extent. The Bates case of 2003 (see Section 7), when an elderly couple were found dead (one due to hypothermia) in their flat two months after being cut off by British Gas gave an extra impetus for companies to install PPMs for consumers who would otherwise be cut off. With a PPM, the consumer disconnects themselves if they cannot afford their bill. Blame for any harm that results does not rest so squarely on the energy company as it would have done if the company had disconnected them. Jewell (Jewell, 2003) found:

In 1991, 48,000 residential customers were disconnected for debt. By 1998 this had dropped to 400, as prepayment meters replaced disconnection. However, a report published by the Energy Association (a trade group) in 2001 found that 24% of prepayment meter users self-disconnect in a given year, 11% of users for more than 7 hours. With 3.8 million electricity prepayment meters in place, that translates to 912,000 customers being disconnected (410,000 for over 7 hours). The survey found that about 1% of consumers were chronically disconnected (over 20 times in a year). This translates to about 36,500 consumers. In sum, the use of prepayment meters has dramatically increased the number of short term disconnections.

However, from a public welfare point of view, the disadvantages were clear. Jewell found:

Consumer advocates in the UK have pointed out, however, that use of prepayment meters does not block the health and safety hazards associated with disconnection, but rather hides the rate of disconnections because consumers who cannot pay their bills now 'self-disconnect'. Prepayment meters effectively bypass the procedural protections against disconnection.

PPMs are often valued by consumers because of the control they give them over their spending, helping them budget their limited resources. They eliminate the risk that a large, unmanageable bill will be incurred. Any energy used has already been paid, thus reducing the uncertainty consumers might have about whether or not they can afford to heat themselves properly on a cold day. Of course, if they find they cannot afford the energy, they must simply disconnect themselves and try to put up with the discomfort or adopt hazardous coping strategies.

6.1.2 Price differentials

As long as electricity was a monopoly service, the 5 per cent price differential could be maintained because retail companies could recover whatever costs they incur. However, when the residential energy market was opened up, the companies were free to charge whatever the market would bear. Under the monopoly price regime, prices were closely related to costs and were fully determined by the regulator. Under the market regime, cost is just one of the elements determining prices. Companies will have an incentive to set prices at a high level for the consumers that are least likely to switch because the risk of losing their account is low. Companies will also target consumers that they expect to be more profitable (for example, they consume a lot of energy) or easier to serve. Particularly in the first years after market opening, there was a trend for companies to try to become 'multi-utilities' that sold a range of household services from utilities such as telecoms and water to other purchases, such as financial services and car breakdown recovery. This made richer consumers that were more likely to consume a range of services, particularly attractive.

Table 19 Extra cost to supplier of supplying PPM consumers vs. Direct Debit (£/year)

	Direct debit	Standard credit
Prepayment infrastructure provision	40	40
Meter provision and maintenance	30	30
Supply business costs	15	-10
Total	85	60

Source: *Ofgem (2007) 'Domestic Retail Market Report' Ofgem, London.*

Notes

1. Supply business costs include working capital, call centres and billing.
2. It is not clear why the standard credit column does not add up.

Ofgem (Ofgem, 2007) estimates that the additional cost of supplying a PPM electricity or gas consumer compared to a Direct Debit consumer is £85 per year and £60 for a PPM consumer compared to a standard credit consumer (see Table 19). These figures do not take account of any benefits to the company, for example the reduction in exposure to bad debt. However, some of these costs are questionable, while other factors are not included. For example, Ofgem includes as an extra cost: 'token meters require visits to the premises to recalibrate the meter when prices change'. However, given that such meters have been obsolescent since smart card meters were introduced nearly 20 years ago, it is hard to see why companies should be allowed to recover the costs of such an archaic method of payment. However, the analysis neglects the advantage that PPM consumers never incur debt recovery costs and, in a situation where energy prices are rising fast and large numbers of consumers are struggling to be able to pay their energy bills, this would appear a major advantage. Whether the costs are reliable must also be in question. They were given by one supplier and were not open to independent scrutiny.

energywatch stated (energywatch, 2008):

As Ofgem is aware, energywatch wrote to all suppliers seeking their individual views on the £85 estimate. Of the responses received only two suppliers expressed broad agreement with the £85 figure, with the others viewing it as, to varying degrees, an underestimate. This echoes Ofgem's own assertion that suppliers will "have different costs and different methods of allocating costs to separate customer groups" – a recognition that clearly demonstrates the limited usefulness of putting forward an estimated, fixed cost figure of the additional costs associated with PPM provision. The divergent approach of suppliers to PPM pricing demonstrates that the assumed costs are viewed subjectively, reflecting how each supplier chooses to assign these. PPM pricing does not reflect fixed costs that are accommodated in line with a generic, industry-wide approach. The commitment of certain suppliers to maintain equalisation with quarterly credit rates for electricity PPMs further suggests that the scope for flexibility on cost interpretation and assignment does exist.

Even if we assume these figures are accurate and compare this differential with prices charged, the actual price differentials do not seem justified. Ofgem (Ofgem, 2007) states that:

the difference between the best offer on prepayment and the best offer on monthly Direct Debit and standard credit tariffs for a combined gas and electricity customer, since January 2004... has fluctuated within a range of around £50 to £120, with what appears to be a slight upward trend over time; the current difference is however consistent with the estimated difference in costs to serve of approximately £85.

energywatch takes a very different view (energywatch, 2008). It found:

Prepayment meter consumers pay on average £215 and up to £452 more per year for their energy than consumers paying by online Direct Debit.

And:

It is readily apparent that current differentials between payment methods almost always exceed the £85 identified by Ofgem. On average, PPM consumers are paying 13% more for their energy than a consumer on a monthly Direct Debit tariff and 25% more than a consumer who pays by Direct Debit through online tariffs. In cash terms this translates as, on average, a £214 premium over an online Direct Debit tariff and up to £124 more than a consumer using monthly Direct Debit. Extrapolating current differentials shows that PPM consumers are paying an excess of £332 million when compared to online Direct Debit users.

What is more surprising is that there is little difference between PPM and standard credit terms now. This may in part reflect that some companies are seeking to stimulate an increase in the number customers using the 'secure' payment methods of Direct Debit and PPM, as this would improve cash flow and reduce the risk that Standard Credit (SC) poses of customers falling into debt. On average, PPM consumers pay about 4 per cent more than standard credit consumers, but some suppliers charge PPM consumers less than this, despite the extra costs Ofgem believes exist. This may reflect the fact that PPM consumers do not raise any risk that their bills will not be paid and PPM consumers pay in advance. Some companies may also hope that by narrowing the differential between SC and PPM tariffs - typically achieved by raising SC and holding or only marginally increasing PPM prices - they will be able to deflect some of the criticism on price differentials.

Thomas (Thomas, 2008) found that for a household categorised in the standard definitions as a 'medium user' of electricity and gas in London in March 2008 (see Table 20):

- On-line Direct Debit dual-fuel is 27 per cent cheaper than paying by PPM with the incumbent utilities;
- There is little to be saved within PPM suppliers. Now that SSE has increased its prices, the available savings are negligible;⁴⁶
- Standard Credit terms are now generally little if any cheaper than PPMs; for example, if Ms A remains with the same supplier and switches to SC, her bills would actually increase;
- Significant savings are available if Ms A switched to paying by Direct Debit. The savings would be only about 4 per cent if she remained with her existing suppliers, but if she switched to the cheapest, excluding SSE, she would save 8 per cent;
- However, the big pay-offs arise when on-line DD are considered. Switching to the cheapest supplier (excluding SSE) would save 17 per cent;
- Switching to the cheapest supplier with on-line DD and a dual fuel offer would increase savings to 27 per cent;
- Now that SSE has increased its prices from April, anyone following Ofgem's advice in January and February to switch is likely to have found that by the time the switch was complete, SSE was no longer the cheapest supplier and their effort was wasted.

Table 20 Cost of purchasing energy in the London region

	PPM	Standard credit	Direct debit	On-line DD	On-line DD dual-fuel
EDF/B Gas					
Electricity	401	401	393	393*	n/a
Gas	617	656	588	565	n/a
Total	1018	1057	981	968	n/a
Dearest					
Electricity	440 (Npower)	429 (S Power)	402 (Npower)	320 (Npower)	
Gas	676 (E.ON)	656 (B Gas)	633 (Npower)	595 (Npower)	
Total	1116	1085	1035 (Npower)	915 (Npower)	876 (S Power)
Cheapest					
Electricity	353 (SSE)	350 (SSE)	329(SS&E)	285 (Npower)	
Gas	579 (SSE)	535 (SSE)	503 (SS&E)	462 (SSE)	
Total	932	885	832	747	744 (E.ON)
Cheapest ex SSE					
Electricity	393 (E.ON)	393 (E.ON)	357 (S Power)	285 (Npower)	
Gas	617 (B Gas)	642 (E.ON)	580 (S Power)	565 (B Gas)	
Total	1010	1035	937	850	744 (E.ON)

Source: http://www.energywatch.org.uk/uploads/PriceComparison_London_21February2008.pdf

Table 21 Average price differential between different payment methods (£/year)

Annual cost	GB average	Max annual bill	Min annual bill	PPM differential as % of average bill
Online Direct Debit	886	909	845	23
Offline Direct Debit	965	972	956	13
Standard credit	1048	1100	1006	4
Prepayment meter	1089	1144	1037	-

Source: *energywatch*

Notes

1. Based on an average gas consumption of 20,500kWh and electricity consumption of 3,300kWh per annum. Prices include VAT.
2. Prices are average for Great Britain (England, Wales & Scotland) as of 4 July 2008.

In July 2008, the mean PPM bill for a gas and electricity consumer using the average amount of electricity and gas was 23 per cent higher than for the average on-line Direct Debit tariff, 13 per cent higher than the average off-line Direct Debit tariff and 4 per cent higher than the average standard credit terms (see Table 21).

6.1.3 Token meters

The most up-to-date figures from Ofgem⁴⁷ show that in June 2007 approximately 500,000 electricity prepayment meters (1 in 7) are still of the archaic 'token' type. These raise a number of issues examined by energywatch (energywatch, 2008), such as the problem of suppliers being slow to recalibrate the meters to reflect current prices. There are major problems with this type of meter, but the suppliers have now agreed to replace all of them with more modern PPMs by the end of 2009.⁴⁸

6.2 Social tariffs

The government and Ofgem place most emphasis on switching (see Section 7) and, to a lesser extent, use of social tariffs as ways to alleviate fuel poverty. In its Domestic Retail Market Review (Ofgem, 2007), it states:

Suppliers are also playing an important role in delivering help and support to customers who are vulnerable – both those who are financially vulnerable and those who are vulnerable due to age, health or circumstance. Through their actions in this area, suppliers enhance their corporate reputation and brand value by acting in a responsible manner and can make an immediate and significant impact on customers' comfort and finances.

All suppliers currently offer some sort of social tariff and/or rebate to provide cheaper energy to qualifying customers. Qualification criteria vary across suppliers, but often include being eligible for certain means tested benefits. The extent of the rebate or discount offered varies widely between suppliers, from a national average of £15 to £160. Customer numbers on these tariffs or rebates also vary a great deal between suppliers. One supplier – British Gas - offers substantial savings to up to 750,000 customers deemed 'vulnerable' by government.

In fact the latter statement seems to have been premature and, in June 2008, when talking about its Essentials tariff Centrica, told the Business and Enterprise Select Committee:⁴⁹

We have 350,000 customers; we would like to have more customers; and we are hoping to target more with the help of the DWP to actually increase that to 750,000.

In the 2008 Budget, Alistair Darling announced:⁵⁰

And I believe further action is now needed to help vulnerable groups deal with rising energy prices. We want to see the 5 million customers on prepayment meters given a fairer deal and energy companies to increase their support to vulnerable customers. We will work with the companies to take further action on a voluntary and statutory basis - to underpin this as necessary we will legislate. Energy companies currently spend around £50 million a year on social tariffs. I want to see this rising to at least £150 million a year over the period ahead.

In July 2008, Ofgem published its guidance on the measures that could be included in this spend.⁵¹

In April 2008, the resulting deal was announced involving the six large companies pledging an additional £225m over the three year period to 2011. This figure is based on the companies spending £100m in 2008-09, £125m in 2009-10 and £150m in 2010-11 compared to the current spend of £50m per year. This was projected to remove up to 100,000 households from fuel poverty. In their press release announcing this, BERR states:⁵²

The impact of this additional funding on the UK fuel poverty numbers will depend on how it is directed. If it is purely used to offset bills and equally distributed amongst the poorest households, then it could

help to remove up to 100,000 of these from fuel poverty. Other scenarios may bring different benefits - for example, energy efficiency measures may benefit fewer but will be permanent. We will be working with energy companies to ensure those most in need benefit and it is likely that a range of measures will be implemented.

Details subsequently emerged on the elements of the programme. Wicks, the Energy Minister, in a Parliamentary reply to a question on what the companies' contribution would be, stated:⁵³

The individual allocations have been calculated by reference to each company's market share based on customer account numbers. Each supplier has agreed to pay a contribution per customer account. The contribution per customer account is then multiplied by the number of customer accounts 'owned' by a supplier to arrive at each supplier's contribution. A breakdown of suppliers' individual contributions cannot be made available as it contains commercially sensitive information and therefore remains confidential between the Department and the energy supplier.

On the impact of high prices, he stated:

We are concerned about the impact of higher prices on vulnerable people including pensioners and we continue to encourage energy suppliers to adopt initiatives to mitigate their impact. In Budget 2008, the Government said they would like to see the amount energy suppliers spend on social programmes increase to at least £150 million a year over the period ahead. A new voluntary agreement has recently been signed individually with the six major energy suppliers to treble their investment on social programmes in the next three years, reaching collective investment of £150 million by 2010-11. This will take spend to £100 million in 2008-09, £125 million in 2009-10 and £150 million in 2010-11.

In addition, winter fuel payments helped keep 11.7 million people warm in winter 2006-07 and Budget 2008 announced an additional one-off payment of £100 to over-80s households and £50 to over-60s households in 2008-09.

Finally, in the recent Ofgem fuel poverty summit a number of new initiatives were announced to improve the way we identify and target those in fuel poverty, provide support to vulnerable customers to use the competitive market effectively and ensure that tariff differentials are fair and justified.

energywatch and NEA were scathing about the adequacy of these measures. Allan Asher, Chief Executive of energywatch, stated:⁵⁴

We welcome the help to 100,000 fuel poor homes, but 4.4 million homes will remain trapped in fuel poverty. A serious and comprehensive response is needed. This deal is neither - it barely scratches the surface. Consumer groups and charitable organisations working to eradicate fuel poverty have been ignored. There is now no chance of the Government meeting its 2010 poverty reduction goal.

While NEA said:⁵⁵

While we welcome any move that helps those struggling to pay their fuel bills this winter, £100 million looks pretty paltry when you consider the billions made in profits by the major energy suppliers this year. The Government should introduce a simple mandatory social tariff, which guarantees that the most vulnerable customers get the lowest energy price a supplier offers. The Government should stop tinkering around the edges and introduce a more co-ordinated strategy to help over 4 million households in Great Britain that are now in fuel poverty. All six major suppliers have put their prices up

this year forcing more than half a million more households into fuel poverty. The Government estimates that the extra funding unveiled today directed towards social tariffs could take 100,000 households out of fuel poverty. But what about the rest suffering fuel poverty? In England alone there are roughly 3 million fuel poor households – including families with young children and the elderly who are unable to keep warm and healthy. The resources directed towards the problem just aren't adequate.

It is clear that the agreement between the companies and the government does nothing on fuel price differentials, although Ofgem does claim its market probe will cover this issue.

A study on social tariffs commissioned by energywatch and published in January 2008 found the following main points on socially oriented tariffs (Cornwall Energy, 2008). On electricity, the study found that five suppliers had social tariffs and these cost them no more than £7m per year. At that time nearly 150,000 electricity consumers benefited from these tariffs with a benefit of between £23-75 per account for four of the companies, with the costs to the suppliers when expressed as a proportion of their turnover being negligible. The E.ON scheme (Staywarm) was treated separately in the study because it was found to be such an opaque arrangement that like for like comparisons could not be made.

For gas, the picture is similar, with five companies committing about £19m, benefiting about 230,000 consumers by £45-75 per account, again at negligible cost to the companies. The combined gas and electricity schemes cost the companies about £26m benefiting about 365,000 consumers by about £110 per account. Since this report was published, some suppliers such as RWE/NPower have agreed to do more following the March 2008 agreement with government referred to above.

6.2.1 Fuel Direct

Fuel Direct was introduced in 1976 and was designed to protect those families and individuals who found particular difficulty in managing their household finances and in budgeting for their energy bills. National Energy Action (2006) states (note the figures have changed since then):

The current operation of the scheme is outlined in an agreement between the Department for Work and Pensions and energy supply companies licensed by the Office of Gas and Electricity Markets. The purpose of the Statement of Intent is to ensure:

- A domestic fuel supply is retained or restored
- Energy suppliers receive, at four-week intervals, payments towards the cost of ongoing fuel consumption and, where appropriate, debt recovery

Access to the Fuel Direct payment method is restricted to householders in receipt of Income Support, Income-based Jobseeker's Allowance or Pension Credit and whose debt to their energy supplier is at least £56.20. Deductions from benefit will consist of an estimated figure to cover ongoing consumption, determined by a 'Decision Maker' within the Department for Work and Pensions, and a standard fixed weekly charge to defray any outstanding debt – currently £2.85 (£5.70 where arrangements are in place for both gas and electricity). In 1996, the number of households receiving Fuel Direct was 188,000 but, by 2005, the number was only a quarter of this figure or equivalent to less than 2 per cent of the fuel poor. NEA concluded that the decline might be due to:

falling numbers of households eligible for the scheme; the expansion of prepayment meters as a means to manage fuel debt; reluctance on the part of many energy suppliers to promote access to the scheme; and antipathy to Fuel Direct on the part of the Department for Work and Pensions because of the expensive and cumbersome nature of this particular payment method.

Although Fuel Direct benefits only a relatively small number of consumers, the payments made to suppliers are relatively large. For gas, the average weekly payment for each supplier in the year from 1 October 2006 ranged from about £8 to £24.⁵⁶

To summarise, Fuel Direct is a safety net against disconnection for recipients of certain benefits who are in energy debt. It is not, directly, a tool to reduce fuel poverty, although with some modification the scheme has potential to assist in that respect by functioning as a lower cost payment method for low-income consumers.

7. Disconnections and debt

Because of their vital role in modern life, disconnection of vital utilities has for a long time been an important issue. For water, disconnection for non-payment is now illegal, as is payment and arrears collection through prepayment meters.

7.1 Disconnections

Table 22 shows the number of disconnections for electricity and gas, and the number of consumers using PPMs. For electricity, the link seems clear with the very sharp reduction in disconnections following the large-scale introduction of PPMs in 1992. It is not clear whether the large increase in gas disconnections in 1997 was linked to the opening up of the gas market to competition and a more commercial attitude by the retailers to the consumers. For electricity disconnections remain at a low level compared to 1992/93 but have begun to increase from 2004 onwards.

There have been six key events related to disconnections since 2002:

- 2002: Ofgem and energywatch, with other interested parties, produced guidelines aimed at reducing the number of disconnections;⁵⁷
- 2003: 'The Bates case.' An elderly couple, George (89) and Gertrude (84) Bates were found dead in their house, George due to hypothermia, two months after they had been cut off by British Gas over a debt of £140. The furore that followed led to a debate about the extent of powers for companies to disconnect. British Gas imposed a moratorium on disconnections in 2003 although, in 2008, it was reported to be reviewing this policy;
- 2004: In the wake of the Bates case, the Energy Retail Association (the industry body that represents the six major energy suppliers), developed a 'safety net' which was intended to prevent disconnections of vulnerable consumers;⁵⁸
- 2004: A Trade & Industry Select Committee inquiry recommended that if progress was not made in avoiding disconnections of vulnerable consumers, legislation should be enacted to remove gas and electricity suppliers' powers to disconnect;⁵⁹
- 2005: A review (the Sohn review) commissioned by energywatch and Ofgem concluded that while 'substantial effort and progress had been made' there were 'significant variations in approach by suppliers'.⁶⁰
- 2008: Ofgem, in conjunction with energywatch, produced a report reviewing the progress that had been made since the Sohn Review. This found that some suppliers had made better progress than others in dealing with the issues of debt and disconnection.⁶¹

The disconnection rate was rising sharply in 2007. For gas, the level of disconnections was about 50 per cent higher than in 2006, its highest level since 2003. For electricity, the rate was double that of 2006 and would bring the level of disconnections up to levels last seen in 1993. Given that there have been large price rises since then it seems likely that, if nothing is done, the disconnection rate could rise still further. Further, if British Gas, as it has indicated it might, reverses its policy of not disconnecting consumers (it has not disconnected anyone since 2003), the numbers could rise sharply.

In its annual report on domestic suppliers' social obligation, Ofgem found:⁶²

In 2007, a total number of 8,384 customers were disconnected. This is an increase of 64% on the number of disconnections carried out during 2006. The number of electricity disconnections doubled in 2007 (from 1,258 in 2006 to 2,657 in 2007) and in gas they increased by 48% (from 3,859 in 2006 to 5,727 in 2007).

Consistent with previous years, British Gas did not disconnect anyone during 2007. All other suppliers disconnected more customers in 2007 than in 2006, with npower disconnecting significantly more gas customers than any other supplier.

Table 22 Disconnections of electricity and gas (no of PPM consumers)				
	Gas	PPM consumers (m)	Electricity	PPM consumers (m)
1992	15,707	0.75	18,018	1.15
1993	16,068	0.80	3,700	2.10
1994	16,308	0.85	1,200	2.40
1995	14,511	0.85	838	2.70
1996	8,826	0.95	477	3.25
1997	29,771	1.1	466	3.5
1998	29,500	1.4	400	3.6
1999	22,177	1.6	373	3.7
2000	16,500	1.8	300	3.7
2001	26,088	1.8	375	3.8
2002	21,780	2.0	995	3.7
2003	15,973	2.0	1,361	3.7
2004	2,553	2.1	727	3.6
2005	2,309	2.2	604	3.6
2006	3,859	2.3	1,258	3.5
2007	5,727	2.3	2,657	3.6

Source: For 1992-2003, *Parliamentary Warm Homes Group (2004) 'Disconnection from Domestic Gas and Electricity Supply'* http://www.nea.org.uk/downloads/Parliament/Disconnection_from_Domestic_Gas_and_Electricity_Supply.pdf. For 2003-06: <http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Documents1/Monitoring%20Company%20Performance,%20Annual%20Report%202006.pdf>. For 2007: *Ofgem (2008b)*

7.2 Debt

Disconnections are only one manifestation of the larger problem of affordability of supplies, and some disconnections may well result from households who are able to pay their bills but are making a wilful decision not to pay. Tables 23 and 24 show the trends for 2005-2007 on levels of debt and they show how PPMs are being used to deal with debt. The price increases in 2005-06 seem to have marginally increased the number of consumers repaying debt and also the average debt level. Not surprisingly, the majority of consumers in debt use PPMs, especially for electricity. There seems to have been a small increase in the percentage of electricity PPM consumers in debt, but a fall in the number of gas PPM consumers in debt.

The number of PPMs being installed increased markedly from 2006 to 2007 and a larger proportion are being installed as a way to recover debt. A main function of PPMs as far as the companies are concerned is debt recovery. On average about 1,040 PPMs were installed to recover debt every single day of 2007.

The graph directly below shows the numbers of PPMs installed to recover debt using data from Tables 23 and 24.

Table 23 Debt levels for electricity consumers					
	No of consumers repaying debt (millions)	No of PPM consumers repaying debt (millions)	% of PPM consumers in debt	Average debt per consumer £	PPMs installed (of which to recover debt)
Q3 2005	0.8	0.5	14	170	57151 (29974)
Q4 2005	0.8	0.4	13	173	57422 (30864)
Q1 2006	0.8	0.5	13	182	59748 (37030)
Q2 2006	0.9	0.4	13	199	61792 (37636)
Q3 2006	0.8	0.5	13	194	72262 (43099)
Q4 2006	0.7	0.5	13	196	68848 (46915)
Q1 2007	0.8	0.5	15	209	95677 (47893)
Q2 2007	0.8	0.6	16	220	100897 (51175)
Q3 2007	0.7	0.6	17	223	75970 (52783)
Q4 2007	0.6	0.7	18	224	89618 (48382)

Source: *Ofgem (various) 'Monitoring company performance of domestic suppliers' Quarterly reports, Ofgem.*
<http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Pages/SocObMonitor.aspx>
 NB: Ofgem have revised the numbers for Q3 2007 upwards following an update from E.ON.

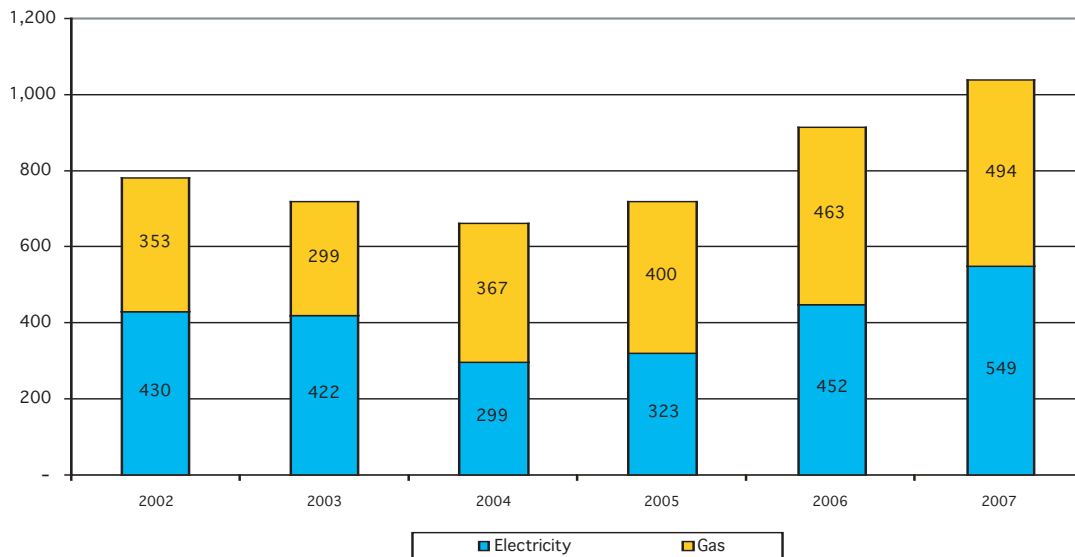
Table 24 Debt levels for gas consumers

	No of consumers repaying debt (millions)	No of PPM consumers repaying debt (millions)	% of PPM consumers in debt	Average debt per consumer £	PPMs installed (of which to recover debt)
Q3 2005	0.5	0.5	23	169	55710 (42396)
Q4 2005	0.5	0.5	23	180	54128 (35600)
Q1 2006	0.5	0.5	21	175	62513 (38950)
Q2 2006	0.7	0.5	20	179	59144 (45527)
Q3 2006	0.6	0.3	15	168	62257 (46653)
Q4 2006	0.5	0.3	14	177	55795 (37390)
Q1 2007	0.6	0.3	13	187	62136 (44126)
Q2 2007	0.7	0.3	15	189	65692 (49110)
Q3 2007	0.6	0.3	15	179	61174 (44982)
Q4 2007	0.4	0.4	16	204	63174 (41954)

Source: *Ofgem (various) 'Monitoring company performance of domestic suppliers' Quarterly reports, Ofgem.*
<http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Pages/SocObMonitor.aspx>

Average Daily Rate of Installation of PPMs for Debt

Historical Data



Source: *Ofgem (various) 'Monitoring company performance of domestic suppliers' Quarterly reports, Ofgem.*
<http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Pages/SocObMonitor.aspx>

energywatch (energywatch, 2008) found (see Table 25 and 26):

All companies recover a higher amount of debt per week from their PPM consumers than from their standard credit customers. This in part reflects the likelihood that a higher level of debt will have led to the installation of a PPM to collect arrears. Despite their obligation under licence condition 27.8 to take into account a consumer's ability to repay a debt, suppliers levy average weekly debt repayment rates of £6.47 per week for electricity, or 81% of the average annual bill for an electricity PPM; and £6.89 per week for gas or 53% of the average annual bill. These rates are more than double the maximum level permitted for weekly Fuel Direct payments. While energywatch accepts that not all consumers paying arrears through a PPM will be in receipt of qualifying benefits, it is clear from the demographics presented above that repayment levels at this level will prove punitive to low income households, especially as they come in addition to the premium that the PPM already attracts. The tendency of some suppliers to calibrate high weekly repayment rates appears to result from a desire to have the debt repaid in least amount of time possible, clearly this does not reflect a fair balance between the interests of the consumer and the interests of the supplier.

Table 25 Debt repayment for electricity				
	Average weekly payment to debt £ (non-PPM)	Average no weeks to recover debt (non-PPM)	Average weekly payment to debt £ (PPM)	Average no weeks to recover debt (PPM)
British Gas	3.50	48	7.19	47
EDF Energy	3.67	53	7.28	83
Npower	6.75	41	5.40	64
Powergen	7.15	39	6.55	103
Scot & Southern	7.00	40	6.46	44
Scottish Power	2.03	52	6.03	69
Average	5.02	45	6.48	68

Source: *Ofgem (2008) 'Monitoring Company Performance of Domestic Suppliers Quarter 3 2007'* Ofgem, London Notes

1. The data for small suppliers is excluded.
2. The data for Npower is an average for their three regions.

Table 26 Debt repayment for gas				
	Average weekly payment to debt £ (non-PPM)	Average no weeks to recover debt (non-PPM)	Average weekly payment to debt £ (PPM)	Average no weeks to recover debt (PPM)
British Gas	3.70	47	7.72	57
EDF Energy	4.17	53	7.42	82
Npower	6.04	39	4.14	108
Powergen	6.92	40	6.46	134
Scot & Southern	5.36	41	5.15	65
Scottish Power	2.09	52	8.38	21
Average	4.71	45	6.54	78

Source: *Ofgem (2008) 'Monitoring Company Performance of Domestic Suppliers Quarter 3 2007'* Ofgem, London
Notes

1. The data for small suppliers is excluded.
2. The data for Npower is an average for their three regions.

8. Switching

Ofgem and the government have consistently claimed large potential benefits for consumers prepared to switch. For example, one of the four main action themes that Ofgem identified as a result of its Energy Summit on Fuel Poverty concerned switching,⁶³ particularly easing practical problems with switching. The 2007 Annual Progress Report on the UK Fuel Poverty Strategy⁶⁴ stated that: 'Those in fuel poverty have much to gain by switching supplier' and 'If all customers were to switch to the best rate, this would take up to 200,000 households out of fuel poverty.' Of course, in the context of there being about 4.5m fuel poor in 2008, the figure of those that could be helped by switching is rather unimpressive. In addition, this does not address the problems that the fuel poor face in switching, especially out of a PPM.

However, as argued in Section 2, the problems with switching run far deeper than just the logistics of carrying out a switch and educating the public about the benefits of switching. The main problems include:

- Consumers do not know the price they will actually pay when they switch, they simply know the price at the time they research the deals. By the time the switch is complete, the prices offered by the competing companies are likely to have changed and the offer chosen will no longer be the best deal;
- The supply company structure is already highly concentrated and likely to see further concentration. The Herfindahl-Hirschmann Index, which measures market concentration, is well above the threshold level for 'highly concentrated markets'. With such a concentrated market, consumers can have little confidence that the companies are behaving competitively;
- By forcing household consumers to buy their energy from a competitive market, the government is placing them in direct competition with industrial energy consumers competing to buy a finite resource. This is a contest that household consumers cannot win and they will inevitably pay disproportionately more for their energy than industrial consumers who have a much stronger negotiating position and skills;
- The cost to the suppliers (both the company losing and the company gaining a consumer) of switching is high and this cost must be passed on to all consumers.⁶⁵ Whether these additional costs are justified by the savings consumers can make by switching is far from clear;
- Switching can be resource intensive. It requires free time, access to up-to-date pricing information and, ideally, internet access and a degree of IT literacy in order to ensure optimal outcomes. Without these the chances of being able to identify the best deal are minimal;
- The record of sales representatives of energy suppliers in helping consumers find the best deal is very poor and consumers relying on sales staff for impartial advice are unlikely to be well served. The companies have continually been found guilty of mis-selling (see below);
- The potential of 'smart meters', which the government and the regulator are now considering, would only be partially realised unless they included time-of-day pricing. If time-of-day pricing was introduced, there is a risk that consumers would not know, until the moment of consumption, how much they would pay for that energy. Depending on the tariff structure implemented, consumers could be left without a basis on which to compare prices and choosing one supplier over another.

These problems may be so fundamental that it becomes questionable whether any amount of fine-tuning of the switching process would result in a system that is more efficient in providing household consumers with a better energy service than they would receive under a well regulated monopoly system.

In January 2008, there were signs that the Energy Minister, Malcolm Wicks, was becoming disillusioned with the switching process. He told the Business & Enterprise Committee (Jan 21):⁶⁶ 'I do not buy the line that switching is universally the way in which our constituents always benefit from competition.' And 'I do recognise that the evidence suggests that when most people switch, they switch to a better deal.'

While the second statement is true, it does gloss over the fact that most consumers who switch do not move to the best deal; indeed, some switch to a worse deal (Waddams Price, 2004) and (Wilson & Waddams Price, 2007). He also identified some of the practical issues for low-income consumers switching:

people who take for granted that everyone has access to a flat-screen computer, can go to the different sites and get the best deal, and has the wherewithal to then revisit and re-switch in x months' time.

In addition, Ofgem (Ofgem, 2008c), in their letter on PPM switching of 30 May 2008, have identified that most PPM customers who switch suppliers actually switch to the three most expensive suppliers:

On the face of it, we would expect to see customers switching away from the relatively expensive suppliers and towards the less expensive suppliers, particularly as 78 per cent of customers say their main reason for switching supplier is to save money. However, information from suppliers about their PPM gains and losses does not show such a perfect relationship. In 2007 63 per cent of electricity and 56 per cent of gas PPM transfers went to the three most expensive suppliers.

However, for these purposes, the issue is whether switching can reduce the inequities that are now apparent. Low income consumers are seriously disadvantaged because of the high rates charged to PPM and Standard Credit consumers, the most likely methods of payment for low income households; switching is difficult for households that do not have free time, and easy access to and competence with the internet; switching is more difficult for consumers that use PPMs and/or have accumulated debt with their energy supplier. The Business & Enterprise Committee (2008) recommended:

Ofgem should also investigate how all customers could benefit from competition, whether they switch or not, for example by preventing energy companies from over-charging their legacy customers.

8.1 Problems for PPM consumers and consumers with debt

In May 2008, as a follow-up to its Fuel Poverty Summit, Ofgem published an open letter on the issue of customers switching to more expensive suppliers. This acknowledged that, in the past, PPM and Standard Credit (SC) consumers were less likely to switch than Direct Debit consumers and that the premiums paid by both prepayment and standard credit customers over Direct Debit have, on average, significantly risen in recent years. In 2007, the switching rate for PPM consumers had risen to about the same rate as Direct Debit (DD) consumers (about 20 per cent per year) and to much more than SC consumers (about 12 per cent). However, in 2007, Ofgem found evidence that some of this switching was to more expensive suppliers. In 2007, 63 per cent of electricity and 56 per cent of gas PPM transfers went to the three most expensive suppliers.⁶⁷ Ofgem's analysis suggested that 70 per cent of PPM switchers did so on the basis of advice from doorstep or telephone sales personnel compared to less than half for those using other payment methods. This should hardly have been a surprise to Ofgem. It would be unrealistic to expect company sales staff to recommend an energy supplier other than the one they worked for unless they were under a specific duty to do so.

The problems of selecting the cheapest supplier are also well-established. In a detailed behavioural study, Waddams-Price (2004) found that, amongst a sample of about 400 consumers who switched supplier, 42 per cent of those switching ended up paying more, 14 per cent were paying the same, while only 44 per cent actually made savings. These percentages were calculated based on the time the choice was made, not when the switch was completed so the issue here was not price movements after the switch had been initiated. In later research, Wilson and Waddams-Price (2007) stated:

that those consumers switching exclusively for price reasons appropriated between a quarter and a half of the maximum gains available. While such outcomes can be explained by high search costs, the observation that at least a fifth of the consumers actually *reduced* their surplus as a result of switching cannot.

In its response to the open letter, energywatch detailed some of the problems and complaints it had dealt with on behalf of PPM consumers. These included:⁶⁸

- PPM users being sold products which are priced for Standard Credit or Direct Debit and explicitly exclude PPM users. Meaning the consumer switches thinking they are going to save money, but are actually defaulted to the much higher PPM tariff which they didn't sign up to.
- PPM users being sold fixed price products which appear to be good deals, only for the consumer to find out later that they also specifically exclude PPM users, meaning that consumers do not get the benefits they were promised.
- PPM users being given wrong, and in some cases we have seen, misleading pricing information as an incentive to transfer.
- PPM users switching supplier to a more expensive deal on the promise of a meter exchange and cheaper energy in the near future only to find out later that it is very difficult to get the PPM removed meaning, again, they are unable to access the cheaper energy that they signed up for.

Table 27 details suppliers' official policies for consumers wishing to switch from a PPM to a credit meter.⁶⁹

The problems for low-income vulnerable consumers with PPMs were particularly clearly illustrated in a letter to the Guardian. The correspondent (who withheld his name) wrote:⁷⁰

As heart patients we have been instructed to stay warm in the winter as the cold thickens the blood. To this end I contacted my gas and electric supplier in a bid to have the prepayment meters taken out of my home as the tariff was too high and my income was so low. I was told it would cost £200. I told the supplier that the meters were in place from a former tenant and I had no credit issues with them. They told me it was not their problem. I went to the ombudsman and now I can have the meters taken out if I pay for the energy by Direct Debit, the rub being that I have to pay in advance, costing me 79% of my income in one month for this to happen. So it can't and they know it.

Table 27 Policies of big 6 suppliers on exchanging a PPM for a credit meter					
British Gas	EDF Energy	Npower	E.ON	Scot Power	SSE
Currently no charge for exchange if debt has been cleared and consumer passes a credit check. This is under review.	No charge for consumers who have used a PPM for more than 12 months or at change of tenancy or shortly after change of supply. Find PPM users like them and don't want to change.	No charge for changing PPM if customer has no debt, and satisfies certain credit checks or has a 12 month payment history with supplier. No charge to people who inherit a PPM and change to this supplier. No charge for 'vulnerable' consumers. Other consumers may be charged £70 for gas and £50 for electricity exchange.	Won't exchange PPM if it still has a debt. No charge for people who inherit a PPM provided they pass a credit check. Supplier may charge others up to £50. Will charge the full cost if have to reinstall a PPM.	No charge if no debt on the meter, but supplier may charge a security deposit for people with a poor payment history.	No charge provided a suitable payment arrangement which minimises chances of building up a debt is secured.

Source: http://www.energywatch.org.uk/uploads/Response_to_Ofgem_Open_Letter_on_PPM_Switching_30_May_20081.pdf

8.2 Mis-selling

The period following the opening of household energy markets was marked by frequent fines on companies for mis-selling practices. These mainly related to 'slamming' or switching a consumer without their informed consent. In recent years, the number of fines has fallen but, in April 2008, Ofgem opened an investigation into the marketing activities of RWE/Npower⁷¹ following a formal referral by energywatch. This was triggered by an undercover investigation by the Sunday Times⁷² which found that sales staff in South London were: 'making customers sign a form without revealing that it was a contract (slamming); exploiting people with poor English; pretending to be officials from the "electricity board"; and lying about standing charges.'⁷³

energywatch had already raised with npower concerns about its agents' behaviour. It found that:⁷⁴

Over a 4-month period, contacts by disgruntled consumers over npower accounted for over a third of all miss-selling cases received by energywatch. The geographical spread of complaints suggests that npower's problems extend far beyond South London.

The companies seem to maintain an ambivalent attitude to direct selling methods. The Chief Executive of E.ON told the Business & Enterprise Committee of his personal dislike of direct selling but justified its continued use, saying it seemed to work in the UK market.⁷⁵

In January 2008, the Energy Minister, Malcolm Wicks, told the Business & Enterprise Committee:⁷⁶

I am also aware, however, that some of our more vulnerable constituents can be subject to mis-selling, and I want to satisfy myself that the codes in place on that are rigorous enough.

The Business & Enterprise Committee took up and strengthened this warning in its report:⁷⁷

Any further significant breach of best practice by any supplier would inevitably lead to calls for this sales technique [direct selling] to be abandoned. The industry must consider itself on notice.

9. Suggested solutions

There is a wide, sometimes grudging, acceptance that the market is not working as efficiently as it should, particularly for low-income consumers. However, the range of solutions offered is wide and often contradictory. The Parliamentary Business & Enterprise Committee announced an Inquiry into energy markets in February 2008, following the spate of price increases.⁷⁸ The issues it decided to consider were:

- Whether the current market structure encourages effective competition in the retail markets for gas and electricity;
- Whether there is effective competition in the wholesale markets for gas and electricity;
- The implications of growing consolidation in the energy market;
- The relationship between the wholesale and retail markets for electricity and gas;
- The interaction between the UK and European energy markets;
- The effectiveness of regulatory oversight of the energy market; and
- Progress in reducing fuel poverty and the appropriate policy instruments for doing so.

Ofgem also hosted a Fuel Poverty Summit which took place on 23 April 2008, attended by government ministers, five of the six major energy company CEO's, charities, campaigners and others.

9.1 Ofgem

Ofgem has shown itself reluctant to acknowledge any failings in the current system. In January 2008, it repeatedly stated that it believed the markets were working well. For example, on 16 January, Ofgem issued a press release that said:⁷⁹

In their meeting today (Tuesday) with the Chancellor, Alistair Darling, Ofgem Chairman Sir John Mogg and Chief Executive Alistair Buchanan confirmed that Britain's competitive market in energy is working.

Yet only a month later, Ofgem announced an inquiry into markets in electricity and gas for households and small businesses. The initial announcement seemed to suggest that its inquiry would focus on international markets and maintained the line that no problems existed with the UK Market. Ofgem chief executive Alistair Buchanan said:⁸⁰

The decision to conduct the probe is in response to public concern about whether the market is working effectively. We are concerned about the increased volatility of wholesale prices and we want to investigate how European and other global energy market developments are affecting energy bills in Britain. We, of course, keep the market under constant surveillance but to date we have seen no clear evidence that the market is failing.

This chimes with the statement on the main 'markets' page on Ofgem's website that says:⁸¹

Increasingly Britain is becoming part of Europe's gas and electricity market and the competitiveness of the GB market depends greatly on what strides forward European countries can make in opening up their own markets to competition.

However, a month later when it published its call for evidence for this inquiry, all references to European and international markets disappeared. The topics covered by the Inquiry stated to be:⁸²

- The customer's perspective and experience of the market including access to information and barriers to switching suppliers;
- Suppliers' market shares, switching rates for different groups of customers (such as online, dual fuel, single fuel and pre-payment);
- The competitiveness of suppliers pricing the different market segments and customer movement between payment types as well as suppliers;
- The relationship between retail and wholesale energy prices; and
- The economics of new entry and the experience of companies trying to enter the energy market.

Whether this represents a withdrawal from the line that the only significant problems are caused by market failings in Europe is hard to tell. Its most recent Domestic Retail Market Report concluded (Ofgem, 2007):

There has been a lot of political and media debate about how competitive the market for domestic gas and electricity is. Concerns include: the size and speed of suppliers' price cuts in response to falling wholesale prices, customer service levels and whether the market adequately protects vulnerable and fuel poor customers. Our analysis shows that all segments of the market remain highly competitive and not just for customers who pay by Direct Debit or online. The key findings are:

- Vigorous price competition between the big six suppliers for all customers - the spread between prices has shrunk and the most expensive suppliers have been forced to become more competitive to stem customers losses
- Suppliers are innovating to retain and win customers - there has been rapid growth in: fixed and capped price deals that shield customers from rising wholesale prices; cheaper online deals; and green tariffs. They now account for roughly 20% of the market
- Customer service is improving: suppliers are investing huge sums to improve their systems and 5 suppliers have cut the number of unresolved complaints
- Annual customer switching rates are at the highest in 4 years
- Customer switching in response to poor service or uncompetitive prices helps to keep the market competitive. We will continue to make sure that all customers - including the vulnerable and fuel poor - have access to good information to enable them to make the right choice for them and switching remains simple and hassle free.

Ofgem's message is spelt out here and in other documents. It is the responsibility of consumers to switch supplier regularly and this will ensure the smooth working of the market.

9.2 energywatch

energywatch takes a dramatically different stance on markets. In its submission to the Business and Enterprise Committee Inquiry into energy markets, it argued strongly that energy markets were dysfunctional. A substantial section looked at the need to ensure the market functions efficiently and effectively so that prices for all are set on the basis of genuinely competitive markets. However, it did not make specific recommendations on reforms to energy markets, leaving this to Ofgem, but committing itself to review any market reform recommendations by the Regulator.

It also focused on fuel poverty and made specific recommendations on PPMs (energywatch, 2008a). It concluded that:

We believe there are reasonable grounds for suspecting that competition is not working effectively in the GB energy markets, most clearly evidenced in the electricity market. Our response focuses on fuel poverty and competition elements of the terms of reference. It outlines the features of the market we believe need to be investigated in a full and independent market investigation by the Competition Commission.

On fuel poverty, energywatch recommended that:

To mitigate the impact of punitive prices on fuel poor households, Government must take the powers necessary to oblige suppliers to offer social tariffs in accordance with minimum standards. Standards should include a stipulation that a supplier's social tariff represents a rate lower than any other rate available to its other customers, regardless of the eligible customer's payment method.

To address the inequities faced by prepayment meter consumers:

- BERR to take steps to abolish prepayment premiums that are shown to be non-legitimate and inefficient.
- Ofgem to reinstate obligation on suppliers to provide annual statements to prepayment meter consumers and to specify that these provide pricing transparency, including: comparison of cost with other payment methods offered by supplier and breakdown of component costs that underpin the differential. The statement should also offer a comparison with competitors' prepayment meter terms.
- 'Health warning' on till receipts at charging points such as shops and post offices, which state that prepayment meter is most expensive payment method, unless supplier can demonstrate otherwise.
- A condition of doorstep acquisition of prepayment meter consumers should be that the acquiring supplier guarantees in the contract a better per unit deal at time of acquisition than their current supplier offers.
- Priority given to prepayment meter consumers in smart meter roll out.
- Provide greater access for prepayment meter consumers to switch through price comparison services.

energywatch provided detailed evidence to the Ofgem inquiry (energywatch, 2008b).

9.3 Energy poverty campaigners

Ofgem's Fuel Poverty Summit was preceded by a coalition of charities, consumer groups and trade unions coming together to express their concerns in relation to fuel poverty. The coalition included: Age Concern, Barnardo's, End Child Poverty, energywatch, Help the Aged, National Consumer Council, National Energy Action, National Housing Federation, RADAR, Save the Children UK, Spinal Injuries Association and Unison.

An agreed Summit Briefing was produced that made recommendations in four areas: social tariffs in accordance with minimum standards; energy efficiency schemes; income measures; and prepayment meters (see Appendix 1 for the full Summit Briefing).

On social tariffs, the coalition was critical of the government's decision to allow the companies yet another opportunity to make the voluntary approach work, despite the government's May 2007 White Paper (Department of Trade and Industry, 2007) appearing to have already issued the suppliers a last chance.⁸³

On energy efficiency schemes, the coalition was critical of the cut in the Warm Front budget and of the lack of targeting of energy efficiency measures on the fuel poor. On income measures, the coalition recommended that the government extend the Winter Fuel Payment to recipients of the Cold Weather Payment, who would not qualify for the age related payment. On PPMs, the coalition challenged the government to: 'set out how it proposes to use statutory powers to abolish non-legitimate and inefficient PPM premiums.'

9.4 Fuel Poverty Advisory Group

The Fuel Poverty Advisory Group made six recommendations in its 2007 annual report. In summary, these were:

- The Warm Front budget for 2008-11 should be restored to its 2007/08 level, over-riding the 25 per cent cut that has been imposed. Several ways of funding this were suggested;
- Progress on reducing the differentials between tariffs should be made, including standard credit terms as well as PPMs;
- Energy companies have been increasing their prices faster than their costs are increasing their margins. FPAG recommended that Ofgem protect the interests of consumers more 'tenaciously', especially low-income households;
- Government should improve benefit take-up;
- Government and the Public Service Agreement should give adequate priority to fuel poverty so that at least the 2016 target on fuel poverty eradication will be met;
- Information on households should, with appropriate safeguards, be shared – especially by the Department of Work and Pensions – with Local Authorities and energy companies, to help to reach those in need.

9.5 The Business and Enterprise Committee

The Business & Enterprise Committee (2008) report was published in July 2008. It represented a very full investigation of the functioning of energy markets. However, it came to limited conclusions, arguing it was best to feed the evidence into the Ofgem Inquiry which was then expected to be published in September 2008. It did express reservations about the scope of the Ofgem Inquiry:

We are concerned that Ofgem's terms of reference suggest it may pay relatively little attention to the wholesale markets, and, in particular, the wholesale gas market.

The Committee clearly believes that these markets are one of the main causes of the problems it identified:

Our overall conclusion on the functioning of both the gas and electricity wholesale markets is that there are significant questions that need to be addressed in the interests of both retail and business consumers.

It was particularly concerned about fuel poverty. On social tariffs it stated:

Energy suppliers' existing social assistance initiatives (which go well beyond specific tariffs) do not reach the vast majority of the fuel-poor. They also vary widely, confusing consumers and providing inconsistent coverage. Irrespective of its broader conclusions on the role of such tariffs, we believe the Government should define the criteria for both the prices charged by suppliers under the banner of social tariffs, and for identifying those customers that qualify for them.

It was critical of the cut in the Warm Front programme and recommended that it be increased and it also had little sympathy for direct selling methods. It recommended:⁸⁴

Any further significant breach of best practice by any supplier would inevitably lead to calls for this sales technique to be abandoned. The industry must consider itself on notice.

On tariff differentials it was especially critical of the differential that has emerged between the more expensive payment methods - PPM and Standard Credit tariffs - and the cheapest Direct Debit tariffs, warning of the need for re-regulation of tariffs if differentials did not reduce:⁸⁵

If, in a year's time, the 'Big 6' have still not narrowed the gap between the different payment types, Ofgem should consider re-introducing some form of price control, limiting the differentials that can be charged.

10. Findings

10.1 Buying energy

Energy purchases are some of the most difficult for households to carry out efficiently, in other words at lowest cost. In part, this is due to the intrinsic properties of energy, e.g. it is impossible to store, has no substitutes, demand cannot be postponed etc. However, the difficulty is also now due to the fact that consumers must compete in the market to buy their energy needs. Introducing competition holds out the promise that consumers will be able to reduce their energy purchase costs by shopping around and switching frequently between suppliers so that they are always with the cheapest supplier.

Achieving this ideal requires free time to research the prices and ensure any switches are carried out correctly; competence and confidence on the internet and an internet connection to do the searches necessary to identify the best deal and to operate the account; and access to financial services, especially a bank account that allows Direct Debits. In practice, even if all these conditions are met, consumers might not get the best deal on offer. For example, switching typically takes four to six weeks to complete, by which time the relative prices may well have changed and the process of switching should, in theory, be instigated again.

Whether consumers are actually better off than they would have been under a regulated monopoly is a moot point. The competitive market as currently constituted has brought with it significant extra costs which inevitably land on consumers. These include the cost of building and operating the systems that allow consumers to switch; advertising and promotion budgets; and sales staff costs. Whether the benefits of the GB model for placing retailers under competitive pressure outweigh these costs overall is far from conclusive.

Competition also raises important equity issues. In a competitive market, the supply companies offer their lowest prices to the consumers who can negotiate hardest and who they value most. This means that, in theory, industrial consumers will be offered lower prices (more than is justified by the lower cost of supply to them) than household consumers. It also means that they will offer lower prices to higher income households who are likely to consume more, will be paying by Direct Debit (possibly online) and who are unlikely to raise issues of debt.

Ironically, if energy markets were working as efficient markets should, the requirement for all consumers to continuously monitor prices, switching whenever necessary, would not exist. Companies would know that if their prices were above the best on offer, they would lose more of their market than they could afford to and would be forced to match the best prices on offer. Consumers would know they were paying the minimum because their supplier was obliged to match the best prices on offer.

10.2 The legal framework

The opening of markets has been accompanied by new legislation at both the national and EU level in an attempt to protect consumers against the risk that markets pose. Whether the letter of these laws, for example on Universal Service in electricity and pricing transparency, is being complied with is a matter for the courts, but it seems clear that the spirit of significant parts of EU law, which the UK is required to embody in national law, is not properly being met.

Under EU law, electricity is classified as a universal service requiring that all consumers have the right to be offered a supply at 'reasonable, easily and clearly comparable and transparent prices'. The government believes it is meeting these requirements by promoting price comparison internet sites and because it requires all suppliers to offer supply terms to any consumer that asks for it. Given that not *all consumers* have access to the internet, the requirement that all consumers be offered 'clearly comparable and transparent prices' is not being met as fully as it might be.⁸⁶

In practice, companies can essentially force consumers who are commercially unattractive to use PPMs. They can require an upfront deposit for those wanting credit terms. While the deposit has to be 'reasonable' it could still be unaffordable for a low income household leaving them with no alternative but a PPM. Whether effectively forcing consumers to use a payment method that is, on average, about 25 per cent more expensive than the cheapest tariffs is offering them 'reasonable prices' is highly doubtful. The information requirements for bills, for example on transparency, data consumption patterns and historical comparisons, certainly do not seem to be met by British suppliers.

From a national point of view, the government committed itself to eradicate fuel poverty amongst vulnerable households by 2010. This target is not going to be met and the government's own Fuel Poverty Advisory Group has said it believes the government had 'given up' on this target. In July 2008, a court case against the government brought by Age Concern and Friends of the Earth on the government's failure was still awaiting judgement.

10.3 The market structure

The market structure itself is so concentrated as to give rise to concern that the companies do not have sufficient incentive to compete vigorously. The market is dominated by just six vertically integrated competing companies in a structure which would, using the normal measures of market concentration, be regarded as 'highly concentrated'. Worse, the barriers to entry for new companies that could offer additional competition in both electricity generation and gas and electricity retail seem insurmountable. There is a strong likelihood that further mergers and takeovers will reduce the field of integrated companies to fewer than six, while the few remaining independent generators may also be absorbed by the 'big six'. The government and the regulator have done nothing to prevent this process of concentration. The regulator is required 'to put in place measures which will help achieve the fuel poverty targets [no household should be living in fuel poverty by 2016-18, and no vulnerable household should be in fuel poverty by 2010]. However, as argued below, the way in which Ofgem discharges this responsibility is limited to monitoring and reporting on suppliers' social obligations and voluntary initiatives, research, and exhorting fuel poor consumers to switch to a cheaper deal. Rather than designing a market that works for consumers, it seems that Ofgem expects consumers to make the market work.

10.4 Fuel poverty

Fuel poverty is a complex and difficult to handle problem composed of three main elements: low income; high energy prices; and poor quality housing. It is the latter factor that distinguishes fuel poverty from poverty in general. Whilst measures to reduce inequality and to ensure that energy prices are not higher than they need be have a part to play, it is tackling the third element, the low quality of housing, which holds the promise of eradicating the problem. It also offers huge additional benefits in environmental terms, by significantly reducing energy demand and hence greenhouse gas emissions.

The thermal quality of British housing is poor. The government measures housing thermal quality with its 'SAP' scale (0-100). A rating of 65 has in the past been regarded as adequate. The average for all British housing is a little less than 50 but, for those that spend more than 20 per cent of their income on energy, the figure is around 20.

The government's analysis of fuel poverty in England is based on data for 2005 when only about 1.8 million consumers were fuel poor. The UK-wide figure was around 3 million at this time and, by mid-2008, the figure was probably 4.5 million and, by the end of 2008, the figure could be anywhere between 5.5 and 7 million depending on what price movements take place between July and the end of 2008.

In July 2008, British Gas raised its gas prices by 35 per cent and its electricity prices by 9 per cent. This might mean that a British Gas consumer in full-time work on the minimum wage would fall into the fuel poor category, even if they paid by Direct Debit and used no more than the average amount of energy.

This potential four-fold increase in fuel poverty means that the analysis of who is fuel poor is no longer valid. Nevertheless, those that were already fuel poor in 2005 will be suffering most from the price rises and efforts to target measures at the most needy should start with those households. It is, however, a priority to update the data so that it reflects the current reality of who is fuel poor.

The high fuel prices are likely to mean that the required level of thermal efficiency for housing will be higher than 65 and may, for example, now be as high as 80. This will mean that measures to improve housing will need to be far more extensive and expensive. Efforts to improve the housing stock will also have to be targeted at a much larger range of households. So budgets for energy efficiency measures will have to be increased, perhaps by an order of magnitude, if this challenge is to be met. It is therefore particularly disturbing that the budget for the government's flagship Warm Front programme was actually cut in 2008. Other measures, such as CERT and the Decent Homes Programme, should be targeted much more carefully to low income households so that they can have a much greater social welfare benefit.

The regulator is required 'to put in place measures which will help achieve these targets (that no household should be living in fuel poverty by 2016-18, and no vulnerable household should be in fuel poverty by 2010). Ofgem seems to rely on encouraging consumers switching from expensive (PPM) to cheaper methods of paying (on-line Direct Debit) to fulfil its statutory obligations in this respect. It is clear that a PPM consumer who has never switched could probably save more than 30 per cent of their energy costs if they switched to the best deal. However, this begs the question why has the regulator allowed these differentials to grow to such an extent when the evidence is that the additional cost of supplying a PPM consumer is far less than this?

As shown in Section 8.1, the practical problems of escaping from PPMs to credit meters are large. This is especially so for consumers with a 'live' debt or a history of debt, who live in a property where a predecessor occupant has had a debt, who do not have an internet connection, or who do not have a bank account that allows them to pay by Direct Debits. As argued above, if the market was working well, consumers would not necessarily have to switch to ensure they are paying little or no more than the cheapest available tariff. The threat that consumers are willing to and can easily switch should be sufficient to maintain keen competition. The price they paid would reflect the costs they impose, not the premium companies think they can charge.

The government seems to be concentrating on private companies voluntarily introducing social tariffs and other initiatives in order to bolster its efforts to meet the targets it set itself. The social tariff schemes that exist so far can be limited in scope, with some offering only small reductions. To lift significant numbers of households out of fuel poverty would require large price reductions to be offered to several million households so that the fuel poor were actually paying less than the lowest commercial tariffs. It seems hopelessly unrealistic to expect profit-led private companies to voluntarily offer concessionary terms, which must be paid for out of profits or passed on to potentially price-sensitive consumers. Such a policy could not be justified to their shareholders. From a moral standpoint, it seems highly questionable that government abdicates responsibility for such an important element of social policy and leaves it to the vagaries of the market.

Annex 1 Legislation on governmental responsibilities for energy supply

A.1 EU legislation

Electricity and gas are network-supplied energy products categorised by the European Commission as Services of General Economic Interest (SGEI). Under the Charter of Fundamental Rights:

the Union recognises and respects access to services of general economic interest as provided for in general law and practices, in accordance with the Treaty establishing the European Community, in order to promote the social and territorial cohesion of the Union.' Electricity is categorised by the European Commission as a 'Universal Service.

Under EU policy, this means that the service should be made available to all consumers of a Member State with a specified quality and at an affordable price, including complete territorial coverage.

In 2003, the Commission published a Green Paper on Services of General Interest, but this did not propose anything specific on energy. The main issue discussed in relation to energy was security of supply from an energy system (not a consumer) point of view.

This was followed in 2004 by a White Paper on Services of General Interest, which again had little specifically on energy. It was suggested that the White Paper would lead to an EU Directive. A Directive is European law that Member States are obliged to transfer into national law within a period (typically about a year) specified in the Directive. A draft services Directive was published in 2004, known generally as the Bolkestein Directive, after the then Internal Market Commissioner that proposed it. The main objective of the Directive was to create a free market in services by removing national barriers to companies. As such it would have little impact on UK energy consumers. After substantial opposition, a significantly revised Directive was approved by the European Parliament in December 2006 and must become national law by the end of 2009.

The EU Electricity Directive (2003/54) contains extensive provisions on public service obligations and consumer protection. Paragraph 24 of the preamble states:

Member States should take the necessary measures to protect vulnerable customers in the context of the internal electricity market. Such measures can differ according to the particular circumstances in the Member States in question and may include specific measures relating to the payment of electricity bills, or more general measures taken in the social security system.

In the main text, Article 3 on 'public service obligations and consumer protection' gives more details. Paragraph 3 states:

Member States shall ensure that all household customers...enjoy universal service, that is, the right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable and transparent prices. To ensure the provision of universal service, Member States may appoint a supplier of last resort.

Paragraph 5 states:

Member States shall take appropriate measures to protect final customers, and shall in particular ensure that there are adequate safeguards to protect vulnerable customers, including measures to help them avoid disconnection. In this context, Member States may take measures to protect final

customers in remote areas. They shall ensure high levels of consumer protection, particularly with respect to transparency regarding contractual terms and conditions, general information and dispute settlement mechanisms. Member States shall ensure that the eligible customer is in fact able to switch to a new supplier.

Paragraph 7 states:

Member States shall implement appropriate measures to achieve the objectives of social and economic cohesion, environmental protection, which may include energy efficiency/demand-side management measures and means to combat climate change, and security of supply. Such measures may include, in particular, the provision of adequate economic incentives, using, where appropriate, all existing national and Community tools, for the maintenance and construction of the necessary network infrastructure, including interconnection capacity.

Gas is not categorised as a 'Universal Service' and the requirements in the Directive are not so extensive. Nevertheless, Article 3 on 'public service obligations and consumer protection' gives more details. Paragraph 3 states:

Member States shall take appropriate measures to protect final customers and to ensure high levels of consumer protection, and shall, in particular, ensure that there are adequate safeguards to protect vulnerable customers, including appropriate measures to help them avoid disconnection. In this context, they may take appropriate measures to protect customers in remote areas who are connected to the gas system. Member States may appoint a supplier of last resort for customers connected to the gas network. They shall ensure high levels of consumer protection, particularly with respect to transparency regarding general contractual terms and conditions, general information and dispute settlement mechanisms. Member States shall ensure that the eligible customer is effectively able to switch to a new supplier.

Paragraph 4 states:

Member States shall implement appropriate measures to achieve the objectives of social and economic cohesion, environmental protection, which may include means to combat climate change, and security of supply. Such measures may include, in particular, the provision of adequate economic incentives, using, where appropriate, all existing national and Community tools, for the maintenance and construction of necessary network infrastructure, including interconnection capacity.

The new draft Directives on electricity and gas do not change these obligations.

A Directive on energy end-use efficiency and energy services was passed in 2006 that placed some further obligations on government. Paragraph 1 of Article 13 requires the installation of 'smart meters' (meters that measure and transmit consumption data on a half-hourly basis) provided cost tests are met:

Member States shall ensure that, in so far as it is technically possible, financially reasonable and proportionate in relation to the potential energy savings, final customers for electricity, natural gas, district heating and/or cooling and domestic hot water are provided with competitively priced individual meters that accurately reflect the final customer's actual energy consumption and that provide information on actual time of use. When an existing meter is replaced, such competitively priced individual meters shall always be provided, unless this is technically impossible or not cost-effective in relation to the estimated potential savings in the long term. When a new connection is made in a new building or a building undergoes major renovations, as set out in Directive 2002/91/EC, such competitively priced individual meters shall always be provided.

Paragraph 3 of Article 13 requires companies to provide cost and consumption information:

Member States shall ensure that, where appropriate, the following information is made available to final customers in clear and understandable terms by energy distributors, distribution system operators or retail energy sales companies in or with their bills, contracts, transactions, and/or receipts at distribution stations:

- (a) current actual prices and actual consumption of energy;
- (b) comparisons of the final customer's current energy consumption with consumption for the same period in the previous year, preferably in graphic form;
- (c) wherever possible and useful, comparisons with an average normalised or benchmarked user of energy in the same user category;
- (d) contact information for consumers' organisations, energy agencies or similar bodies, including website addresses, from which information may be obtained on available energy efficiency improvement measures, comparative end-user profiles and/or objective technical specifications for energy-using equipment.

It is not clear how this requirement can be met for prepayment meter consumers.

In Annex A, 'Measure on Consumer Protection', two provisions are of particular relevance. Clause (d) requires that consumers:

are offered a wide choice of payment methods. Any difference in terms and conditions shall reflect the costs to the supplier of the different payment systems. General terms and conditions shall be fair and transparent. They shall be given in clear and comprehensible language. Customers shall be protected against unfair or misleading selling methods.

While clause (e) requires that consumers: 'shall not be charged for changing supplier'.

A.2 National legislation

Member States are required to translate Directives into national law so all provisions of the EU's Directives will be part of UK law.

The main legislation relevant to the EU's Directives is the 'Utilities Act' of 2000. This provided for the Secretary of State to give guidance to the Gas and Electricity Markets Authority ('the Authority') on the measures the Authority should take towards the attainment of the Government's social and environmental policies (see below).

The Utilities Act required the setting up of a Gas and Electricity Consumer Council (energywatch) and details the duties this body has. It also changed the primary duty of the regulatory body for gas and electricity. For gas (paragraph 9):

The principal objective of the Secretary of State and the Gas and Electricity Markets Authority (in this Act referred to as 'the Authority') in carrying out their respective functions under this Part is to protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas so conveyed.

And for electricity (paragraph 13):

The principal objective of the Secretary of State and the Gas and Electricity Markets Authority (in this Act referred to as 'the Authority') in carrying out their respective functions under this Part is to protect the interests of consumers in relation to electricity conveyed by distribution systems, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity.

In short, the principal duty of the regulator became the protection of the interests of consumers.

In 2004, the Minister of State for Energy, e Commerce and Postal Services issued guidance to the 'Authority' under this legislation. This guidance reiterated the four main goals of energy policy set out the government's 2003 Energy White Paper. These goals are:

- To put ourselves on a path to cut the UK's carbon dioxide emissions – the main contributor to global warming – by some 60 per cent by about 2050, as recommended by the RCEP, with real progress by 2020;
- To maintain the reliability of energy supplies;
- To promote competitive markets in the UK and beyond, helping to raise the rate of sustainable economic growth and to improve our productivity; and
- To ensure that every home is adequately and affordably heated.

The guidance to the Authority on social issues is:

- The Utilities Act 2000 gives the Authority the principal objective of protecting the interests of consumers, wherever appropriate by promoting competition. It also places duties on the Authority in respect of a number of groups within society, namely the disabled or chronically sick, pensioners, those on low incomes and those living in rural areas.
- The Government considers that the Authority has a wide responsibility in relation to social issues, including equal access for all consumers to competitive markets and the desirability of lower levels of disconnection and arrears. It also believes consumers' interests include the quality of service provided and the size of energy bills. The Authority has a duty under the Sustainable Energy Act 2003 to produce impact assessments. These should include cost/benefit analyses of the social as well as the environmental impacts of the decisions.
- Within the context of protecting and helping vulnerable consumers, the Government is committed to achieving its fuel poverty target that, as far as practicable, no household should be living in fuel poverty by 2016-18, and no vulnerable household should be in fuel poverty by 2010.
- The Government expects the Authority, within its sphere of responsibility, to put in place measures which will help achieve these targets.

The government also passed the Warm Homes and Energy Conservation Act in 2000, which required the government to set out a 'Fuel Poverty Strategy'. This was published in November 2001. On 9 April 2008, a UK charity, Help the Aged and an environmental group, Friends of the Earth, launched a legal challenge to the Government to ensure it is held to its legal obligation under Fuel Poverty Strategy to eradicate fuel poverty by 2016.⁸⁷

Annex 2 Summit briefing agreed by the coalition

Background:

The escalating cost of domestic gas and electricity since 2003 has significantly undermined the government's Fuel Poverty Strategy and reversed the progress being made in tackling fuel poverty. High prices are outstripping income growth and outpacing the rate at which energy efficiency and heating improvements can be installed in fuel poor households.

Last year's annual progress report concedes that its 2010 target to eradicate fuel poverty in vulnerable households will not now be met. The government's own fuel poverty advisory body (FPAG) has gone as far as to say the government seems to have abandoned its fuel poverty targets.

Rather than strive to improve the situation, the government's response has been inadequate. It has:

- Relegated fuel poverty in its public service agreement, cut investment in its flagship energy efficiency programme Warm Front, and reduced the proportion of energy efficiency savings to low income households from EEC/CERT schemes, meaning these consumers now pay more but get less.
- Failed to use the Energy Bill to require energy companies to deliver real social tariffs based on agreed standards.

Ofgem's Fuel Poverty Summit must identify the steps necessary to make real progress in eradicating fuel poverty. Progress is reliant on the following policy actions:

1. Social tariffs in accordance with minimum standards

Despite the calls in the Budget for suppliers to increase their spending on social initiatives from £50 to £150 million, it was disappointing to see the government give suppliers yet another last chance to make the voluntary approach to social tariffs work. Some suppliers have made greater progress than others but, taken as a whole, the industry's response to the ultimatum laid down in the Energy White Paper has been shown to be inadequate.

A coherent and cohesive strategy is urgently needed to address the actual cost of gas and electricity paid by fuel poor consumers. Social tariffs represent the most effective way of delivering this. The government must now use the Energy Bill to ensure that all suppliers offer social tariffs in accordance with minimum standards, including the stipulation that suppliers' social tariffs should be the lowest tariff they offer.

Social tariffs offered in isolation will not eradicate fuel poverty. They must be offered as part of a holistic package which brings together affordable energy with all other available energy efficiency assistance and income maximisation initiatives.

2. Energy efficiency schemes

The government's decision to cut investment in its flagship fuel poverty programme, Warm Front (England), by 25 per cent in real terms is inexplicable at a time when fuel poverty is increasing, when there is growing concern about the number of consumers being asked to pay a 'top up' fee for work costing in excess of the grant maxima, and in light of the waiting times that some qualifying consumers experience.

As the government's own Fuel Poverty Advisory Group have stated:

The cut in Warm Front is, to put it mildly, difficult to understand - given the programme's success and given the still more pressing need, in the wake of the price increases, to improve the energy efficiency of homes and heating systems. The programme has been cut when fuel poverty is at its highest level for nearly a decade.

Government has sought to conceal Warm Front cuts behind increases in the spending on energy efficiency for low-income households that will accompany the introduction of the Carbon Emissions Reduction Target (CERT) obligation on energy suppliers. However, closer examination of CERT reveals a scheme more regressive than its predecessor.

Despite a 100 per cent increase in the levy low-income consumers pay to fund CERT, and despite the doubling in the energy saving target expected of suppliers, the share of the energy savings that suppliers derive from the provision of measures to low-income 'Priority Group' households has been cut from 50 per cent to 40 per cent, ignoring the recommendation on the FPAG. The ability of CERT to deliver the measures required to tackle fuel poverty in hard to treat homes is also limited. Despite the government now packaging the suppliers' obligation as a pillar of the fuel poverty strategy, there is no mechanism in place to assess or monitor the extent to which EEC/CERT has or will help to alleviate fuel poverty. CERT is only measured in terms of carbon savings and this is inappropriate given its stated social objectives.

Government must restore investment in Warm Front to at least 2007-2008 levels and, going forward, should seek to develop an energy efficiency programme that more effectively meets the needs of the fuel poor.

3. Income measures

While the 2008 Budget recognised the detrimental impact that high gas and electricity prices have on low-income pensioner households, it failed to recognise that high bills have devalued the Winter Fuel Payment. The payment would have covered 37 per cent of the average annual bill for a recipient in the 60-79 age group in 2003, but prices have eroded that to 24 per cent, even when this winter's one-off £50 supplement is included.

The struggle to stay warm for other groups acknowledged as vulnerable by the UK Fuel Poverty Strategy, namely disabled households, low-income families (including the 760,000 children living in fuel poverty) and those with long-term illnesses, continues to go unrecognised in the benefits system.

The government should extend the Winter Fuel Payment to those households aged below 60 who are already eligible for Cold Weather Payments. This is a readily identifiable group of vulnerable households (around 1.6 million), representing those on income support premiums because of long-term illness or disability, or because they have young or disabled children. The annual cost of this payment has been estimated by DWP at £320m. An extension of the payment would represent a significant step towards helping the government achieve its fuel poverty targets.

4. Prepayment meters

The competitive market has shown itself to be ill-equipped to recognise and serve the needs of low-income consumers. They are frequently expected to pay more for the gas and electricity they use, with prepayment meters (PPMs) presenting the most vivid example of discriminatory pricing policies.

When fuel poverty is measured on the 'basic income' definition, government data shows that around a third of the fuel poor are paying for their electricity through a PPM. People in this situation live on very tight budgets,

carefully managing their energy use, and yet are left paying the market's premium prices. A consumer using both gas and electricity PPMs pays on average £215 more per annum than a consumer using the same units of energy, but paying by online Direct Debit. In the most extreme case a consumer could be paying as much as £452 more.

The 2008 Budget recognised that these differentials have increased even since the 2007 Energy White Paper, and that the issue must now be tackled. It is very discouraging to see Ofgem chair, Sir John Mogg, defend this practice by saying that retailers are entitled to charge a premium for these meters. The government must now set out how it proposes to use statutory powers to abolish non-legitimate and inefficient PPM premiums.

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Notes

- ¹ This paper covers energy supply in England, Wales & Scotland. In Northern Ireland, the electricity system is a regulated monopoly for household consumers. The gas network is expanding but coverage is far more restricted than in England, Wales & Scotland.
- ² For example, Malcolm Wicks, the Energy Minister, told Parliament in January 2007 'the era of cheap energy has gone for ever' <http://www.publications.parliament.uk/pa/cm200607/cmhansrd/cm070123/halltext/70123h0004.htm>
- ³ <http://www.defra.gov.uk/news/2008/080616a.htm>
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- ⁵ http://www.energywatch.org.uk/media/news/show_release.asp?article_id=1109
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- ¹¹ http://www.ofgem.gov.uk/Media/PressRel/Archive/1161-r3001_21march.pdf
- ¹² http://www.of.gov.uk/shared_of/business_leaflets/enterprise_act/of516.pdf
- ¹³ More precisely, distribution companies operate the Low and Medium Voltage distribution system and some of the High Voltage network including sections of the 132 kV Transmission network.
- ¹⁴ See Ofgem (2007) 'Domestic Retail Market Report' Ofgem, London, p 3. <http://www.ofgem.gov.uk/Markets/RetMkts/Compet/Documents1/DRMR%20March%202007doc%20v9%20-%20FINAL.pdf>
- ¹⁵ However, Sainsburys does resell EDFE gas and electricity products.
- ¹⁶ <http://www.parliament.the-stationery-office.co.uk/pa/cm200708/cmselect/cmberr/293/293i.pdf> p 26.
- ¹⁷ Nuclear plants are operated 'base-load' so they represent a higher proportion of generation than they do of capacity.
- ¹⁸ SSE argued to the Business & Enterprise Committee that metering should be reinstated as a regulated monopoly as part of the distribution business. <http://www.parliament.the-stationery-office.co.uk/pa/cm200708/cmselect/cmberr/293/293i.pdf> pp 487-88.
- ¹⁹ http://www.energywatch.org.uk/uploads/Ofgem_energy_supply_markets_investigation_30_April.pdf p 16.
- ²⁰ The Herfindahl-Hirschmann Index measures market concentration and is calculated as the sum of the square of the market shares of the competitors. So, a market with only one company would have the highest possible HHI of 10,000 and a market with a large number of competitors each with a very low market share would have a HHI of close to zero. Conventionally, any market with a HHI of 1800 or more is categorised as 'highly concentrated'.
- ²¹ <http://www.ofgem.gov.uk/Markets/RetMkts/Compet/Documents1/DRMR%20March%202007doc%20v9%20-%20FINAL.pdf>
- ²² http://www.energywatch.org.uk/uploads/Ofgem_energy_supply_markets_investigation_30_April.pdf p 16.
- ²³ http://www.competition-commission.org.uk/rep_pub/rules_and_guide/pdf/CC2.pdf
- ²⁴ http://www.of.gov.uk/shared_of/business_leaflets/enterprise_act/of516.pdf
- ²⁵ UK Fuel Poverty Strategy, November 2001: <http://www.berr.gov.uk/files/file16495.pdf>
- ²⁶ For example, the New Policy Institute highlights some of the issues with the definition of fuel poverty. See <http://www.npi.org.uk/summaries/flyer%20fuel%20poverty.pdf>
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- ³⁰ http://www.energywatch.org.uk/uploads/Energy_Retail_Association_social_tariff_consultation_response_9_May_2007.pdf

³¹ <http://www.berr.gov.uk/files/file16233.pdf>

³² <http://www.statistics.gov.uk/statbase/Product.asp?vlnk=10805&More=n>

³³ Reported at http://www.nea.org.uk/Policy_&_Research/Fuel_poverty_facts/Excess_winter_mortality

³⁴ Barnardos (2006) 'Fuel poverty briefing' Barnardos. http://www.barnardos.org.uk/fuel_poverty_briefing.pdf

³⁵ <http://www.londonmet.ac.uk/research-units/hrsj/research-projects/the-impact-of-fuel-poverty-on-health.cfm>

³⁶ National Energy Action (2008) 'Fuel poverty set to return to 1997 levels' Press Release, 1 May 2008. http://www.nea.org.uk/Media_Centre/News_releases/?article_id=453

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³⁸ Department for Environment, Food and Rural Affairs (2004) 'Fuel Poverty in England: The Government's Plan for Action' DEFRA, London.

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⁴⁰ http://www.defra.gov.uk/environment/climatechange/uk/household/fuelpoverty/pdf/fuelpov_actionplan.pdf

⁴¹ <http://www.berr.gov.uk/files/file10717.pdf> , p 27.

⁴² <http://www.defra.gov.uk/news/2007/071206c.htm>

⁴³ It is payable to those on Pension Credit. It might be available to those who receive Income Support or income-based Jobseeker's Allowance and have a child under five or get one of the following: a pensioner premium, higher pensioner premium or enhanced pensioner premium; a disability premium or severe disability premium; a disabled child premium; Child Tax Credit that includes an individual element for a child or qualifying young person who is disabled or severely disabled.

⁴⁴ http://www.direct.gov.uk/en/MoneyTaxAndBenefits/BenefitsTaxCreditsAndOtherSupport/Inretirement/DG_10018668

⁴⁵ <http://www.berr.gov.uk/energy/fuel-poverty/fpag/index.html>

⁴⁶ Note that SSE increased its prices again in August 2008 so that any expected savings from switching to SSE before March 2008 would be eroded and perhaps even lost.

⁴⁷ <http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Token%20PPMs%20%20April%20May%20June%2007%20Update.pdf>

⁴⁸ <http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Token%20PPM%20and%20debt%20build%20up%20Feb%20Mar%20Update.pdf>

⁴⁹ <http://www.publications.parliament.uk/pa/cm200708/cmselect/cmberr/uc293-vi/uc29302.htm>

⁵⁰ http://downloads.bbc.co.uk/news/nol/shared/bsp/hi/pdfs/12_03_08_budget_speech_08.pdf

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⁵⁴ energywatch (2008) 'energywatch says fuel poverty announcement fails needy consumers' Press release, 11 April 2008. http://www.energywatch.org.uk/media/news/show_release.asp?article_id=1095

⁵⁵ NEA (2008) 'Additional help for the fuel poor – but not enough' Press release, 11 April 2008. http://www.nea.org.uk/Media_Centre/News_releases/?article_id=448

⁵⁶ <http://www.publications.parliament.uk/pa/cm200607/cmhansrd/cm071023/text/71023w0018.htm#07102375000007>

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⁵⁹ <http://www.publications.parliament.uk/pa/cm200405/cmselect/cmtrdind/297/297.pdf>

⁶⁰ <http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/10096-9005.pdf>

⁶¹ <http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Debt%20and%20disconnection%20best%20practice%20review.pdf>

⁶² <http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Documents1/Suppliers%20Social%20Obligations%20Monitoring%20Report%202007%2011208.pdf>

⁶³ <http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Fuel%20Poverty%20Summit%20Action%20Programme.pdf>

⁶⁴ <http://www.berr.gov.uk/files/file42720.pdf>

⁶⁵ For example, in the first six months of 2008, marketing spending by the big six energy retailers increased by 25 per cent compared to the same period in the previous year to £58.5m. <http://www.brandrepublic.com/Marketing/News/841660/Energy-brands-ramp-spend-amid-price-hikes/>

- ⁶⁶ <http://www.publications.parliament.uk/pa/cm200708/cmselect/cmberr/293/8013105.htm> Q 63.
- ⁶⁷ Ofgem (2008) 'Open letter on prepayment meter customer switching', Ofgem, 30 May 2008.
<http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Open%20letter%20PPM%20Customer%20Switching.pdf>
- ⁶⁸ energywatch (2008) 'Re Ofgem Open Letter on Prepayment Meter Switching' Letter to Ofgem, 15 July 2008.
- ⁶⁹ http://www.energywatch.org.uk/uploads/Response_to_Ofgem_Open_Letter_on_PPM_Switching_30_May_20081.pdf
- ⁷⁰ <http://www.guardian.co.uk/politics/2008/jul/22/welfare.tax>
- ⁷¹ <http://www.ofgem.gov.uk/Media/PressRel/Documents1/Ofgem%20R14-2008.pdf>
- ⁷² Sunday Times (2008) 'Inside the cheating world of Npower's rogue sales teams' Sunday Times, 6 April 2008.
- ⁷³ Sunday Times (2008) 'Exposed: energy giant Npower's dirty tricks' Sunday Times, 6 April 2008.
- ⁷⁴ Complaints centred around incorrect information given by npower sales agents as to why they were visiting the property, such as claiming they were from National Grid, the customer's current supplier or energywatch. Other complaint themes included monthly direct debits being set far too low so as to incentivise the consumer to sign up, incorrect pricing information being provided and disputed contracts due to suspicion of forged signatures. See:
http://www.energywatch.org.uk/uploads/Ofgem_energy_supply_markets_investigation_30_April.pdf
- ⁷⁵ <http://www.parliament.the-stationery-office.co.uk/pa/cm200708/cmselect/cmberr/293/293i.pdf> p.34
- ⁷⁶ <http://www.publications.parliament.uk/pa/cm200708/cmselect/cmberr/293/8013105.htm> Q. 63.
- ⁷⁷ <http://www.parliament.the-stationery-office.co.uk/pa/cm200708/cmselect/cmberr/293/293i.pdf> p.35.
- ⁷⁸ http://www.parliament.uk/parliamentary_committees/berr/berrpn19_0708.cfm
- ⁷⁹ Ofgem (2008) 'Market is sound, Ofgem assures Chancellor' Press release, 16 January 2008.
<http://www.ofgem.gov.uk/Media/PressRel/Documents1/Ofgem%202.pdf>
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- ⁸¹ <http://www.ofgem.gov.uk/Markets/Pages/Markets.aspx>
- ⁸² <http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Pages/Energysupplyprobe.aspx>
- ⁸³ The White Paper stated: 'If no further action is undertaken by companies, we will consider whether to take the opportunity for legislation to enable the Secretary of State to require companies to have an adequate programme of support for their most vulnerable customers. In this context, we may consider the role of mandated minimum standards for social tariffs in the context of the review of the policy framework.'
- ⁸⁴ <http://www.parliament.the-stationery-office.co.uk/pa/cm200708/cmselect/cmberr/293/293i.pdf> p 35.
- ⁸⁵ <http://www.parliament.the-stationery-office.co.uk/pa/cm200708/cmselect/cmberr/293/293i.pdf> p 37.
- ⁸⁶ energywatch – a government sponsored body – provides printed price comparison factsheets on request, but prices change regularly and ensuring all consumers were kept up to date with prices would be a very costly and probably not very effective measure.
- ⁸⁷ http://www.foe.co.uk/resource/press_releases/government_sued_for_fuel_p_09042008.html and
http://press.helptheaged.org.uk/_press/Releases/_items/_Fuel+poverty+initiative+will+only+scratch+the+surface,+says+Help+the+Aged.htm

Annex 3 Social tariffs for electricity and gas

Supplier	Social tariff name	Developments since Jan 2008 ⁸⁸	Positives	Issues
British Gas	Essentials		Offered on significant scale – potentially up to 750k consumer accounts	Offers nothing to fuel poor customers paying by Direct Debit. More expensive than some of BG’s open market tariffs. Least generous saving to recipients of all the social tariffs.
EDFE	Energy Assist		Lowest tariff offered by EDFE, 15% discount against existing tariff. Available regardless of payment method.	Yet to be seen how EDFE will further develop the tariff in light of the industry’s agreement with government (see footnote 1).
EON	Staywarm			EON has advised Ofgem ⁸⁹ that Staywarm is primarily a commercial product, that includes substantial support for 10,373 customers with significantly above average energy usage who are on benefits or with special needs. Restricted to over 60s and only those who are paying by Direct Debit and take both fuels from the supplier.
RWE Npower	Spreading Warmth	Commitment to invest ‘£53m in its social programmes, most of which will be spent on this new Spreading Warmth tariff’ over the next three years. Npower is aiming ‘to recruit up to 80,000 customers onto the tariff.’ ⁹⁰ Prior to announcement that figure was just 4,350. Recipients taking both fuels from Npower will now save £250, compared to £103 before.	More generous than previous social tariff offered by Npower and available regardless of payment method.	Fixed nature of offer (£125 per fuel) will mean its value is devalued by further price rises. Roughly in line with company’s best open market offer (online Direct Debit), but does not represent its lowest cost tariff.
Scottish Power	Carefree Plus		A marked improvement on their position in January 2007 when, in responding to the energywatch consultation on social tariffs, they stated that ‘ScottishPower’s position has been to date, and continues to be opposed to the introduction of social tariffs.’ ⁹¹	Only available to over 60s and even then only on severely restrictive eligibility criteria. ⁹² Not available to customers paying by Direct Debit or Fuel Direct (deducts payments towards arrears and ongoing consumption straight from benefits - used by some of the poorest consumers). More expensive than some of SP’s open market tariffs.
SSE ⁹³	EnergyPlusCare	Commitment in April to ‘quadrupling the number of customers who benefit from “energyplus care”, to 100,000 customer accounts, over the next year.’ ⁹⁴	A commitment to ensure social tariff is lowest cost tariff offered by supplier (20% discount against existing tariff – see footnote 6) and available regardless of payment method. Increase in availability from 25k to 100k accounts.	

