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Committee of Public Accounts

Ofgem: The Social Action Plan and the Energy Efficiency Commitment

Thirteenth Report of Session 2004–05

Report, together with formal minutes, oral and written evidence

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The Committee of Public Accounts

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Ms Ruth Kelly MP (*Labour, Bolton West*)

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Committee staff

The current staff of the Committee is Nick Wright (Clerk), Christine Randall (Committee Assistant), Emma Sawyer (Committee Assistant), Ronnie Jefferson (Secretary), and Luke Robinson (Media Officer).

Contacts

All correspondence should be addressed to the Clerk, Committee of Public Accounts, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5708; the Committee's email address is pubaccom@parliament.uk.

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Summary

The Office of Gas and Electricity Markets (Ofgem) is the regulator of Britain's gas and electricity markets. Its principal objective is to protect the interests of consumers by promoting effective competition wherever possible, and among its secondary duties it should have regard to the interests of vulnerable consumers, including the poor and those in rural areas.

Vulnerable consumers

Around 2.25 million households in the UK are classified as being in fuel poverty, spending more than 10% of their income on energy to heat their homes. Although numbers in fuel poverty halved between 1999 and 2002, recent price rises for gas and electricity will increase the numbers in fuel poverty over the next 12 months.

2 million gas consumers and 3.7 million electricity consumers pay for their energy through a pre-payment meter. Consumers can choose a pre-payment meter because it helps them budget for energy use. But suppliers also require consumers who have fallen into arrears on their energy bills to use a pre-payment meter. These arrears often occur because suppliers have provided inaccurate estimated bills in the past, causing a build-up of debt.

Pre-payment meters are the most expensive way to pay for energy, costing around £60 a year more than payment by direct debit. Ofgem endorses these higher prices because they enable suppliers to recover the higher costs of installing and maintaining pre-payment meters. But suppliers are not permitted to charge higher prices to consumers in rural locations, even though it is more expensive to deliver gas and electricity there.

The energy market therefore works against vulnerable consumers. They can fall into debt because suppliers do not provide accurate bills. The supplier recovers the debt through a pre-payment meter. They then have to pay the extra costs of installing and maintaining the pre-payment meter. And many consumers do not know that pre-payment meters cost more.

Energy efficiency

Increasing the energy efficiency of individual homes can help to reduce fuel poverty and also lower the UK's carbon emissions. To achieve this, the Department for Environment, Food and Rural Affairs (the Department) has designed the Energy Efficiency Commitment, which requires suppliers to meet specific energy savings targets. Its estimated cost over the three years to 2005 is £486 million. Ofgem administers the Energy Efficiency Commitment on behalf of the Department.

Suppliers meet their targets by providing energy efficiency measures, such as cavity wall insulation and low energy lightbulbs, to households. Ofgem's administration of the scheme focuses on the numbers of measures installed by suppliers, such as the number of wall cavities insulated. It does not confirm that these measures actually deliver the intended reductions in energy use.

Ofgem estimate that the Commitment added around £8 to each consumer's bill in 2004–05. The Department intends to double the size of the Commitment from 2005–06 which will increase the cost to consumers to around £18 per year. Other environmental measures, such as the Renewables Obligation, and a new Europe-wide Emissions Trading Scheme, will also add to bills. Overall, Ofgem's estimates show that environmental measures will constitute around £33, about 6%, of the average energy bill in 2005–06.

Conclusions and recommendations

1. **Ofgem should ensure that suppliers provide accurate bills to consumers**. Suppliers are required to read a consumer's meter every two years, but they do not always comply with this requirement. As a result, they provide inaccurate estimated bills to consumers, which in turn can lead to a build-up of debt.

2. **Ofgem need to enforce suppliers' obligation to inform consumers about the disadvantages of pre-payment meters**. Under their licences, suppliers must inform consumers about all payment options and their relative costs. Yet consumers on pre-payment meters are unaware of the extra costs they are incurring. Ofgem should ensure that suppliers comply with the relevant licence condition.

3. **Ofgem should not encourage suppliers to charge more to consumers who use pre-payment meters.** Ofgem encourages suppliers to recover the costs of using pre-payment meters from those who use them. Yet it protects those in rural areas from paying the higher costs of delivering energy to their homes. Ofgem's support for higher costs for pre-payment meters is not consistent with its obligations towards all vulnerable consumers.

4. **Suppliers should not discriminate against pre-payment meter consumers.** Ofgem should obtain better information on the costs of pre-payment meters to ensure those who use them are not subsidising other consumers, such as those on direct debit. If discrimination is taking place, Ofgem should direct suppliers to reduce the bills paid by consumers on pre-payment meters accordingly.

5. **The Energy Efficiency Commitment may not be delivering its intended outcomes.** Ofgem records the outputs delivered by suppliers, such as providing cavity wall insulation and energy efficient lightbulbs. These measures do not necessarily result in the intended outcome of reduced energy use and hence lower carbon emissions. Ofgem should, with the Department, confirm that these measures deliver energy savings by monitoring their impact on energy use in a sample of homes.

6. **Ofgem, with the Department and suppliers, should undertake a national campaign to encourage energy efficiency.** Doubling the size of the Commitment from 2005 will require an increase in consumer demand for energy efficiency measures. Ofgem should work with Energywatch, suppliers and the Department to launch a national campaign to stimulate consumer demand.

7. **Ofgem should identify more accurately the additional cost to consumers of the Commitment and other environmental schemes.** Ofgem estimate that environmental schemes add around 3% to the average consumer's bill. The Government's ambitious targets for doubling the Energy Efficiency Commitment and a new emissions trading scheme will add to costs. Ofgem estimate that this will amount to around £33 a year, or 6% of the average bill, but the full extent of the increase is not yet certain.

8. **Ofgem should require suppliers to identify the extra costs of environmental measures.** Energy bills should be transparent so that consumers can understand

what they are paying for. Ofgem should require suppliers to separate out on energy bills the extra cost of environmental measures.

1 Vulnerable consumers and fuel poverty

1. Ofgem is the regulator of the UK's gas and electricity markets. Under the Utilities Act, its principal statutory objective is to protect the interests of consumers wherever appropriate by promoting effective competition. The Act gives it secondary duties to ensure that:

- all reasonable demands for electricity and gas are met;
- licence holders are able to finance their obligations; and
- the interests of vulnerable consumers, including the sick and disabled, those on low incomes and those in rural areas, are met.

Ofgem and vulnerable consumers

2. In considering the interests of vulnerable consumers, Ofgem also needs to take account of households in fuel poverty – those that cannot afford to keep adequately warm at reasonable cost. The most widely accepted criteria for such households are that they need to spend more than 10% of their income on fuel to heat their home adequately. Although there is an overlap between fuel poverty and vulnerable consumers, they are distinct groups.

3. The Government's Energy White Paper set an aim of eliminating all fuel poverty in England by 2016[1] and within vulnerable groups by 2010. Fuel poverty can be reduced by higher household incomes or lower energy prices. Between 1999 and 2002, fuel poverty fell from 4.5 million to 2.25 million. Over half the 2.25 million reduction in households in fuel poverty was a result of higher incomes.[2] Since it removed direct price controls over retail energy prices in 2001, Ofgem has had only limited direct control over energy prices. Ofgem cannot therefore do much to reduce fuel poverty directly and does not have a formal target to do so. Instead, under the Social and Environmental Guidance issued to it by the Department in 2002 and updated in 2004, Ofgem seeks to promote equal access for all consumers to competitive markets, and lower levels of disconnection and arrears.

Competition

4. Ofgem considers that the best way of achieving its principal statutory duty to protect consumers' interests is through a competitive energy market. It has encouraged consumers to take advantage of competition by switching suppliers if they are unhappy with the price or quality of service.

5. There is some evidence that consumers are responding, and Ofgem believes that competition is at present working effectively. In international terms, switching is greater in the UK than in other countries. 50% of consumers have switched in the UK, compared to 13% in Finland; 10% in Sweden; 4% to 5% in Germany; and around 1.5% in the United States. And when British Gas announced substantial price rises for its gas and electricity

1 Slightly different targets apply in Scotland and Wales.

2 C&AG's Report, *Ofgem : Social Action Plan and Household Energy Efficiency* (HC 878, Session 2003–04) para 1

customers, it lost nearly 250,000 customers. Other suppliers, such as Scottish and Southern, have responded by holding their own prices down and have seen a surge of 20% in their sales.[3]

6. As competition matures, the requirement for a separate energy regulator may decline. This is because most consumers will be able to protect their interests by switching energy supplier, without any need for intervention by the regulator. Ofgem is seeking to remove detailed regulation wherever possible, in particular by withdrawing price controls and reducing the number of licence conditions energy suppliers must comply with. The pipes and wires that form the core infrastructure of the energy industry are however likely to remain natural monopolies, and as such may always need to be regulated to prevent the misuse of monopoly power.[4]

3 Q 13

4 Q12

2 Consumer debt and the use of pre-payment meters

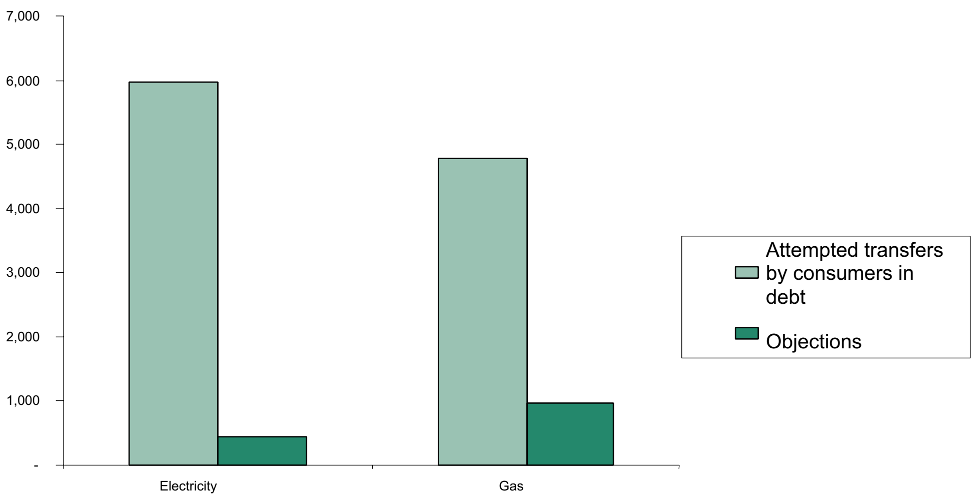
7. Ofgem has established a Social Action Plan to help protect the interests of consumers who are not well-placed to benefit from competition. Under the Plan, Ofgem works with energy suppliers to deal with problems faced by vulnerable consumers: consumer indebtedness and the use and costs of pre-payment meters.

Debt

8. As at December 2003, 1.2 million gas and electricity consumers (about 5% of all consumers) were repaying a debt to their energy supplier. Over 70% of these consumers had debts of less than £100 and only 5% over £600. It is not clear, however, whether the numbers in debt are increasing or decreasing because of inconsistencies in the way the data have been gathered over time.[5]

9. Consumers with a debt over 28 days old have experienced difficulty switching to another supplier because their existing supplier can block the transfer. This reduces the risk to suppliers that consumers will not pay their debts but it also prevents indebted consumers from accessing lower tariffs. In 2002–03 around 20% of gas consumers and 7% of electricity consumers attempting to switch supplier were blocked in this way **(Figure 1)**.

Figure 1: Attempted transfers of supply blocked because of outstanding debt, 2002–03[6]



10. Ofgem and suppliers have designed a scheme which allows pre-payment consumers with debts under £100 to switch supplier, with the new supplier 'purchasing' the debt at a factor of 90%. Suppliers trialled the scheme between December 2001 to February 2002 and implemented it in full in February 2004. Up to 70% of pre-payment consumers with a debt are now eligible to switch supplier. Ofgem plans to review progress after 12 months.[7]

5 Qq 22, 41; C&AG's Report, para 2.17

6 C&AG's Report, Figure 5

7 *ibid*, para 2.22

11. Estimated bills can lead to a build-up of debt. Suppliers' licences require them to read a meter every two years but they do not always do so. This means that, when the supplier does read the meter, the consumer can face an unexpectedly large bill for past underpayments. **Figure 2** illustrates how both estimated bills and infrequent meter reading can cause debt, and how recovering debt through a pre-payment meter can worsen a consumer's situation.

Figure 2: An example of the relationship between estimated bills, debt and pre-payment meters

A consumer's meter was not read by her energy supplier for over 3 years, even though she repeatedly requested a reading. When the supplier company finally read the meter it showed more energy used than they had billed for and she incurred a debt of around £1000. As she could not pay this the company insisted that she had a pre-payment meter. But recovery of the arrears through the pre-payment meter cost more than she could afford – over £38 to heat her house over one weekend. After the intervention of her local MP, Ofgem and Energywatch, some of the debt was cancelled and the rate of recovery through the pre-payment meter was reduced.[8]

Pre-payment meters

12. In principle, suppliers can disconnect consumers from the gas and electricity systems for unpaid debt. But Ofgem and energy suppliers try to avoid disconnection and instead suppliers recover debts by fitting a pre-payment meter in their homes.[9] The pre-payment meter is set so that part of every payment is used to recover the old debt, while the remainder pays for current energy use.

13. As a result, the numbers on pre-payment meters have grown. 2 million gas consumers (out of a total of 20 million) and 3.7 million electricity consumers (out of a total of 25 million) use pre-payment meters.[10] In 2003, the numbers on pre-payment meters rose by 7.5%.[11] At the same time, numbers of consumers disconnected has been falling, from around 27,000 to 17,300 over the last 12 months.[12] Energywatch, the representative body for energy consumers, nevertheless considers that disconnection remains a significant problem for vulnerable consumers.[13]

14. Research by electricity suppliers in the summer of 2004 revealed that 90% of consumers were satisfied with pre-payment meters, which confirmed the results of Ofgem's own research in March 2004.[14] Consumers may like pre-payment meters because they are preferable to disconnection and because they provide the consumer with certainty over how much they are spending on energy.[15]

15. Pre-payment meters do however cost more. The C&AG's Report compared the costs of using pre-payment meters with paying quarterly and by direct debit. The Report showed

8 Q 40

9 Q 36

10 C&AG's Report, para 2.3

11 Q 1

12 Q 23

13 Ev 13–14

14 Q 35

15 C&AG's Report, para 2.5

that a consumer who switches gas and electricity payments from pre-payment meter to direct debit could save over £60 a year (Figure 1).

Figure 3: Average annual extra costs for pre-payment meters[16]

		Low user (£)	Medium user (£)
Gas	Premium over standard credit	10.25	21.75
	Premium over direct debit	23.38	41.75
Electricity	Premium over standard credit	8.75	9.25
	Premium over direct debit	17.63	21.13
TOTAL	Premium over standard credit	**19.00**	**30.00**
	Premium over direct debit	**41.01**	**62.88**

16. The extra cost arises because it is more expensive for suppliers to install a pre-payment meter, and there are additional costs in operating the information systems that support pre-payment.[17] The higher price for consumers reflects Ofgem's policy that payment methods should reflect the costs involved.[18]

17. Many consumers do not realise that they are paying more for gas and electricity through pre-payment meters, and some believe that they are a cheaper form of payment. MORI research conducted for Ofgem in 1999 found that 33% of consumers did not realise they were paying more, while research undertaken in March 2002 found that around 20% of pre-payment meter users thought that the meter was cheaper.[19] Ofgem acknowledged that the lack of awareness of the higher costs reflected a failure to ensure that suppliers complied with licence condition to inform consumers about the benefits and disadvantages of pre-payment meters.[20]

Prices reflecting costs

18. Ofgem believe that prices should reflect costs, so that markets can operate efficiently. Yet it encourages suppliers to charge prices that reflect costs in some parts of their business and not others. For pre-payment meters, Ofgem encourages suppliers to charge the full cost to consumers. On the other hand, Ofgem does not allow suppliers to vary charges to consumers on the basis of geographical location. Unlike the energy supply market, in which several companies compete to supply consumers, the electricity distribution networks are monopolies, owned by one company in each region. These companies pass on their costs to the competitive supply companies but are not allowed by Ofgem to differentiate in their charges between rural and urban locations. So supply companies cannot in turn differentiate between rural and urban addresses in consumer tariffs. Nor do suppliers charge remote rural consumers more because it costs more to travel to their homes to read their meters.[21]

16 C&AG's Report, Figure 1

17 Q 57

18 C&AG's Report, para 2.2

19 *ibid*, para 2.4

20 Q 4

21 Q 56

19. It is possible that suppliers are not charging prices that truly reflect costs. For example, they may recover more than the cost of the pre-payment meter from consumers using them. Suppliers may do this because such consumers are the least likely to switch. Charging pre-payment meter consumers more means that other consumers, such as those on direct debit, can be charged less. Vulnerable consumers would provide a cross subsidy to other consumers and suppliers would be discriminating against them.[22] Ofgem do not know whether this form of price discrimination is taking place.

20. On the other hand, if Ofgem prevented suppliers from recovering the cost of pre-payment meters directly, these extra costs would be spread across all energy consumers. This could raise average prices and put some consumers into fuel poverty, and there could in fact be more losers than winners from such a decision.[23]

21. Ofgem's encouragement of prices reflecting costs in some elements of a supplier's business, such as pre-payment meters, raises complex issues of equity and efficiency. These issues go to the heart of the tension between Ofgem's principal statutory duty to protect consumers through competition and its secondary duties to protect vulnerable consumers.

22 Q 54

23 Q 6

3 The costs and benefits of the Energy Efficiency Commitment

22. The Energy Efficiency Commitment requires energy suppliers to achieve energy savings targets. Suppliers meet their targets by providing energy efficiency measures, such as cavity wall insulation and low energy lightbulbs, to households. The Energy Efficiency Commitment's estimated cost is £486 million over three years.

23. In 2003, the Committee took evidence from the Department for Environment, Food and Rural Affairs (the Department) on the Warm Front programme. Warm Front and the Energy Efficiency Commitment involve the installation of the same energy efficiency measures. But Warm Front is targeted at reducing fuel poverty, at a cost of around £150 million a year, and is funding directly by the Department. The Commitment on the other hand is directed to improving energy efficiency. Energy suppliers meet the costs, which they then recover from consumers.

24. The Department has overall policy responsibility for the Energy Efficiency Commitment, and sets mandatory energy savings targets for the suppliers. Ofgem is responsible for administering the Commitment. It monitors supplier compliance with the requirements of the Commitment, records performance against targets, commissions audits of suppliers' own systems and information, and reports achievements to the Department. Ofgem also advises the Department on the progress of the Commitment more generally, including the overall value for money of the Commitment as a way of reducing carbon emissions, and the feasibility of extending the Commitment in the future.

Performance and cost of the Energy Efficiency Commitment

25. Suppliers provide audited reports of the measures they have provided to households. Ofgem uses these reports to calculate the energy savings achieved by suppliers, based on assumptions about the energy savings that each measure ought to deliver.

26. The outcome that the Government wishes to achieve is a reduction in carbon emissions through more energy efficient homes. Ofgem, however, measures the outputs of the Commitment – numbers of lightbulbs issued, numbers of wall cavities filled – and not its outcomes. It is not clear whether energy efficiency measures achieve the intended outcome. Much of the available scientific research implies that assumed savings are overstated.[24] But neither Ofgem nor the Department has yet undertaken a comprehensive evaluation of whether the energy efficiency measures do in fact save energy. For example, they have not yet analysed in detail whether consumers exploit increased energy efficiency by increasing temperatures in the home, rather than reducing fuel use. Nor have Ofgem and the Department researched whether energy efficiency lightbulbs that have been distributed to consumers are actually in use.[25]

24 C&AG's Report, para 3.7

25 Q 67

27. The Energy Efficiency Commitment is expected to be cost around £8 per consumer in 2004–05. The Renewables Obligation, which requires energy suppliers to source a fixed proportion of their electricity from renewable sources, costs the consumer around £5 a year. In total, Ofgem estimate that around 3% of the average domestic consumer's bill (around £520) in 2004–05 relates to these measures.[26]

Doubling the size of the Energy Efficiency Commitment

28. The Department intends to double the size of the Commitment from 2005–06. This will require a significant increase in consumer demand for energy efficiency measures, as well as increase in the supply of such measures.

29. The level of demand for energy efficiency measures is at present disappointing. Research into energy efficiency awareness and behaviour amongst the UK population by the University of East Anglia in 2003 found that only one third of respondents had attempted to reduce their energy consumption in the previous year. And the C&AG's report showed that take up by consumers of energy efficiency mailshots from suppliers has been low.[27] Recent increases in fuel prices may however stimulate greater interest among consumers in saving energy.

30. On the supply side, doubling the size of the Commitment from 2005 will require the installation of cavity wall insulation in around 4.5 million homes between 2005 and 2010, about three times the current rate of 300,000 houses per annum. Ofgem described this as a challenging but achievable target and is confident that the industry can meet it.[28]

31. Ofgem accepted that cavity wall insulation and low energy light bulbs offer individual consumers value for money in terms of the potential to save energy. But it questioned whether doubling targets required under the Commitment would offer value for money.[29] Its concern reflects the extra costs borne by all consumers through their energy bills, while only a proportion of consumers benefit; doubts over how far the Commitment is achieving its intended outcome of reducing carbon emissions; and whether there is sufficient consumer demand.

32. Ofgem estimate that doubling the size of the Energy Efficiency Commitment will further increase energy bills, by about £10 to some £18 per year. Other environmental measures will also add to bills. In addition to the cost of the Renewables Obligation (£5 per consumer), the new EU Emissions Trading Scheme may add as much as £10 per consumer. Overall, Ofgem's figures indicate that environmental measures will constitute around £33, or 6%, of an average energy bill from 2005–06.[30]

26 Ev 15

27 C&AG's Report, para 3.29

28 Q 9

29 Q 66

30 Ev 15

Formal minutes

Wednesday 9 March 2005

Members present:

Mr Edward Leigh, in the Chair

Mr Ian Davidson	Mr Gerry Steinberg
Mr Brian Jenkins	Jon Trickett

The Committee deliberated.

Draft Report (Ofgem: The Social Action Plan and the Energy Efficiency Commitment), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 32 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Thirteenth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

[Adjourned until Monday 21 March at 4.30 pm

Witnesses

List of written evidence

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The reference number of the Treasury Minute to each Report will be printed in brackets after the HC printing number

Oral evidence

Taken before the Committee of Public Accounts

on Monday 13 September 2004

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Allan
Mr Brian Jenkins
Mr Alan Williams

Sir John Bourn KCB, Comptroller and Auditor General, National Audit Office, further examined.

Mr Rob Molan, Second Treasury Officer of Accounts, HM Treasury, further examined.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL:

Ofgem: The Social Action Plan and the Energy Efficiency Commitment (HC 878)

Witnesses: **Mr Alistair Buchanan,** Chief Executive and **Mr John Neilson,** Managing Director, Corporate Affairs, Ofgem, examined.

Q1 Chairman: Good afternoon and welcome to the Committee of Public Accounts. I would like to apologise to our witnesses and to members of the public for the late start of this meeting. However, this is an important issue and we are very grateful that we are here. We are having a hearing today on the Comptroller and Auditor General's Report on Ofgem: the Social Action Plan and Household Energy Efficiency. We welcome Mr Alistair Buchanan who is Chief Executive of Ofgem. Could I please start the questioning, Mr Buchanan, by referring you in the Comptroller and Auditor General's Report, paragraph 10B which you can find on page four. You will see there that it says that "Consumers who pay by pre-payment meter for both gas and electricity could save up to £63 a year if they paid by monthly direct debit." So we are talking about pre-payment meter customers here. They obviously tend to be the poorest people in society; they pay more than direct debit customers. How can it be, Mr Buchanan, that the poorest in society pay most for their energy?

Mr Buchanan: Thank you for inviting us to talk about the Report which we found extremely useful. To answer your question directly, I can split it into two parts. First of all, taking your second statement which is about the poorest in society, it is quite interesting looking at the fuel poor figures which, I am very pleased to say, have fallen from about 4.5 million to 2.25 million and in Scotland down from about 750,000 down to 280,000. That is all good news. At the same time pre-payment meters have risen very substantially. As I am sure you are aware in the last 10 years we have seen gas meters go from about 0.7 to 2.1 million users; electricity have more or less trebled to around 3.7 million. In the last year alone pre-payment meters have gone up by 7.5% while fuel poor numbers are coming down. The correlation is not a direct one but that does not mean that we do not take seriously your first statement—indeed, we take it very seriously—that you have, as you say, £63 as a comparator or £31 as a comparator depending on which one you wish to take against direct debit or standing credit. I think the key in terms of the pricing issue is that we work I suppose—when you look at the recommendations on page 8 and 9 of the Report—as an economic regulator (which is the top line on page 9) and we work within the confines of cost benefit (which is in the bottom line, although referring to something else, on page 8). Consequently there are costs associated with these meters and the administration of the meters which makes them higher. That sounds slightly negative but I do not want to be negative. The positive message that we want to take from this Report is through the very strong switching message which is that these customers can switch and potentially save £39 on gas and £62 on electricity and that we do very much want to take this message forward because pre-payment meter customers are switching at the rate of about 35% whereas on average the switch rate is about 50% and that includes vulnerable customers as well. It is a challenge, Chairman; you are right.

Q2 Chairman: That is a long answer but it does not negate the essential point that I put to you that here we have the poorest members of society—and you do not deny this—who are paying more. If you look at the Executive Summary on page one you will see there that you also have a "range of secondary duties which include the duty to have regard to energy efficiency, the environment and certain disadvantaged groups". How do you equate your need to look after disadvantaged groups with your policy of effectively charging the poor the most for their energy?

Mr Buchanan: What we try to do is, as you rightly pointed out, take our secondary duties extremely seriously. We try to bring the benefits from competition to all customers but, as you rightly identified, particularly those who are vulnerable customers. That is why the switching message is so important. In addition, we have taken a number of initiatives such as referred to in the Report—such as in the London Borough of Camden—where we are seeking in particular to promote the message. We also, through our activities both in sponsoring energy efficiency and in reviewing the priority services register—which is obviously there for the priority group—seek to encourage savings through both of those possibilities.

Q3 Chairman: That message is not getting through. If you look at page 16, paragraph 2.4 you will see that 33% of pre-payment meter customers did not know they were paying more because they were using a meter; 25% of people actually thought they were paying less. The surveys show that there is a huge group of the poorest people in society who have no idea that they are paying more because they are using one of your meters. Do you not feel that you are not fulfilling your statutory duty to these people?
Mr Buchanan: In terms of the relationship fuel poor/PPM I do not want to sound boring on this although I might do so, having already mentioned it.

Q4 Chairman: I'm not worried about whether you are boring or not. What I am worried about is having a clear answer to the questions that I am putting to you. It seems that there is a clear dichotomy here between your role as an economic regulator and your statutory duty to look after the disadvantaged. It might just be better to give an honest answer and to say that there is no way of resolving this.
Mr Buchanan: What we try to do is to ensure that all customers benefit from the switching message that we—as you can see on pages 16 and 17—seek to assist the energy efficiency message as well. In terms of knowledge and in terms of the licence conditions upon which they operate, licence condition 36 outlines that companies should outline both the advantages and disadvantages of PPMs. Quite rightly and very helpfully the NAO at 2.6 has said yes, but companies tend to promote direct debit rather than discuss the costs of PPM. It would be a fair comment for you to say—and I think this is something that we would take away with us to have a look at—that the wording of licence condition 36 was not tight enough.

Q5 Chairman: Is your basic answer that prices should reflect costs? Is that what you are telling the Committee? That is actually contained in paragraph 2.2 on page 15.
Mr Buchanan: To a large extent that is, but as I say that is a slightly defensive statement. We are trying to be more offensive in that by promoting switching, by promoting energy efficiency.

Q6 Chairman: If that is the case, can I put it to you that prices do not always reflect costs. After all, if you are living on the top of Dartmoor you are paying the same for your electricity as someone living in Exeter but it costs a lot more to provide you with electricity. You already accept that prices do not always reflect costs. If that is the case—in the example I have just referred to—why can you not do more to help people who pay for their electricity through meters because they tend to be the poorest? Not just doing inadequate campaigns which clearly are not having any effect because all the opinion research shows that very large numbers of people—maybe up to a quarter—actually come away with a totally erroneous view that they are paying less for a meter where actually they are paying on average £63 a year more.
Mr Buchanan: 50% of the fuel poor group tend to be the elderly and under 10% of them use PPMs so that correlation that I think you are trying to establish is one which—I think you have to be quite careful about the establishment of that link.
Mr Neilson: If you look at the group who are in fuel poverty, under 20% are using electricity pre-payment meters and under 15% use a gas pre-payment meter. The vast majority of those in fuel poverty—those who have to spend more than 10% of their income on energy—are not using pre-payment meters. If you did introduce a cross-subsidy in favour of pre-payment meter users in fact there would be many more losers than winners amongst the fuel poor.

Q7 Chairman: That is a fair answer. Thank you very much. Can I now go onto the Energy Efficiency Commitment? This is dealt with in the Executive Summary at paragraphs 12B and 12C on page 6. What I would like to ask you, Mr Buchanan, is why you allow the energy savings from energy efficiency measures to be over-estimated? Are they being over-estimated? Why have you not undertaken your own evaluation?
Mr Buchanan: The detailed reference within the text is 3.8, page 25 where again there is a discussion of measurements. Further into that section there are also the measurements relating to insulation. We do use a theoretical approach to measurement. We take what I can see are some of the best research and academic advisers available. For example, we are discussing with the Environment Institute at Oxford, we are discussing with Brunel University and we are discussing with various research establishments the appropriate measurements.[1] In terms of the programmes as identified in table 10 on page 24, what you will see there is that in the current EEC it would appear that we are going to meet the terawatt challenge that has been set for this current period. I think the good news is that we are on target to meet the challenge. I think the challenge that is laid down—and I know you laid it down in your comments to Defra on their Warm Front programme—is that it would be good to institute further research in ensuring that we have measurements that we feel confident with going through with.

[1] *Note by witness:* Ofgem currently uses work from the Building Research Establishment and the Energy Saving Trust to evaluate the programme. Previously we have also drawn on work from the Environmental Change Institute at Oxford and Brunel University into appliances and low energy lamps.

Q8 Chairman: Exactly, because a lot of these energy savings are in fact theoretical.
Mr Buchanan: You are absolutely right.

Q9 Chairman: Could you look now at page 7, 12H. You will see Defra's proposal for the EEC for 2005 to 2008 is for a doubling of the overall level of activity. Do you think it is reasonable to expect suppliers to deliver on this pledge when you are not undertaking a national campaign to stimulate consumer interest or demand in this subject?
Mr Buchanan: That is a great question. I have spoken to my team about this and they think that this is do-able but challenging. If we can use an example that the NAO very helpfully illustrated the Report with—which is on insulation—we are currently running at about 0.3 million houses and the Government has set out a target of 4.5 million in the period 2005 to 2010. The team believe—and it is in the Report—that this is a do-able target but it is challenging and the industry has the capacity to meet that kind of target. I think it is absolutely a correct question to ask us. As far as I can ascertain from my own team we believe that this is a do-able target and is not too aggressive.

Q10 Chairman: If you look at the Executive Summary again, paragraphs 2 and 4 at the beginning of this Report, you will see you have a difficult job because you have to balance energy savings (which you are increasingly encouraged by the Government to take action on) and you have to help vulnerable groups (which was the subject of our first conversation). They are struggling to maintain and keep themselves warm in winter. So how do you make this balance between these two requirements placed on you by the Government?
Mr Buchanan: To a degree I think there is an element of complimentarity. If we look at the energy efficiency requirements, arguably two-fold there. One is the Government's carbon targets (targets, plural, because Wales, Scotland and England have slightly different fuel poverty targets) and the other in terms of the income focus of the EEC programme. It is the income focus on the priority groups which is effectively the tie-over onto the fuel poor question that you so quite rightly point out. I think the link here is really, from our point of view, focused on our assistance to promote the energy efficiency message. As you will see on page 17 we outline what we think those challenges are for the industry to resolve and we monitor that—and have monitored it—through various mystery shopping surveys. We are basically trying to promote an energy efficiency message there. I think that is your link.

Q11 Chairman: Lastly I want to really press you on the recommendations that are made on page 9 by the NAO and it is 14A. It says, "We consider that Government should be cautious about extending the responsibilities of independent regulators such as Ofgem to administer detailed schemes". What I originally understood your role to be, Mr Buchanan, is that of economic regulator. You are there to try to try to promote competition, to get the cheapest price possible for consumers. Now the Government are giving you various other responsibilities to promote energy efficiency. Is this not taking away from what should be your primary role to reduce prices for the consumer? Do you believe that this recommendation here, that the Government should be cautious about extending the responsibilities of independent regulators, do you think that is a recommendation that you can live with?
Mr Buchanan: Very much so. I think it is a very sound statement which we have used internally a lot since this document was published. I think it is a very powerful message for us as an organisation. We have roles, as you know, set out in our primary and secondary duties. We have roles set out through sustainability and we have roles set out in our social and environmental guidance. At the same time we have responsibility—and pardon me for quoting you from 8 August 2002—you said: "Regulators have to do more to reduce the cost of regulation". We have this balance: on the one hand we have roles either in terms of our market role or in terms of the administration audit role which is largely an executive function on the environmental side. At the same time we would fully endorse what you said about regulators watching their costs. You may or may not know that from April next year we will place ourselves under an RPI minus X cost regime similar to that that we give to companies. We are currently going through that five year price review, as you know, with the companies that we regulate.

Q12 Chairman: Will there always be a need for your organisation? Surely you were supposed to be creating a sophisticated market which could operate without the need for an organisation like yourselves. Are you telling us that there will always need to be an Ofgem?
Mr Buchanan: I think in terms of the activities that we do there is a core of regulated networks—be it pipes or wires—that could be done somewhere else but arguably it is effectively done by a specialist niche unit. The aim back in the 1990s of Stephen Littlechild, for example, was to say, "Once we have introduced competition we have slayed the main dragon". We believe that competition has been introduced and one of the challenges that we outline in our corporate strategy going forward and one of the challenges that John and I have as a management team—under quite a lot of pressure from our board in this—is to have a look at our businesses and to see where it is that we can start to say that this is not a good use of customers' money going forward. For example, we have basically a bible of licence conditions, many of which have to be revisited. That, frankly, could cut down a lot of the red tape that you hear companies complain about Ofgem for.

Q13 Mr Williams: Following on from the point the chairman has just made but putting a slightly different direction on it, if we take sentence 2 of paragraph 1 of the Report, it quotes the Utilities Act 2000 objective of your organisation: "Its principal objective is to protect the interests of consumers, wherever appropriate by promoting effective competition". How are you going to fulfil that in relation to the recently announced price increases proposed by the gas industry?

Mr Buchanan: In terms of effective competition, one of the interesting things that I learned coming into this job—having followed utilities globally and looked at markets where they tried to open up to competition and markets where they had not—is that in Great Britain where you have 50% switching you have customers tasting competition; that is 50% of available customers. By contrast to other countries that is a staggering performance. In Germany it is about 4% to 5%; Finland 13%; Sweden 10%; in the USA it is, on average $1\frac{1}{2}$% even though it is available in 26 of the states. I do think that there has been a substantial success in Great Britain. You could equally say that that means that 50% have not and that is the challenge for us, which is to say to the 50% who have not, "Right now you could get £39 off your gas bills or £62 off your electricity bill" and that is a challenge which with rising pricing we have to take very seriously. In terms of a competitive market, what I think has been so interesting this year is that you will be aware that British Gas put up its prices at the beginning of the year as well as recently and at that time they lost nearly a quarter of a million customers. I think they are going to have to think very carefully—and it is up to them to think about it—about what happens because they announced their price rises—12% on gas which really took the headlines—in August. What is interesting is that Scottish and Southern last week said that they would not raise their prices and they have seen a 20% surge in sales. Scottish Power have said they have seen an increase of 25% in their call centres from customers primarily from British Gas. It would appear that in this instance the different companies are offering different approaches and that competition is working. At the same time there are very different products on offer. For example, Scottish Power and Powergen have, I think—I am not putting words in their mouth, but I think what they said is right—that they are going to try to carry some of the phenomenal increase in coal prices and gas prices with a price increase this year but then giving a price promise. That is fixed until 2006. I think we have seen quite an interesting development in terms of the competitive market with this challenge. The overall message that we, as an organisation, want to pick up, is to say that with the price increase, do look at the opportunity that switching will give you.

Q14 Mr Williams: How is it that the others are able to accommodate the 12% price increase or the pressures they claim justify the 12% price increase?

Mr Buchanan: Here I have to be very careful about assuming what one company does against another company. I think the key issue is the contract strategy that a company will follow and I have no view on the contract strategy of any particular company; that is their position within the free market.

Q15 Mr Williams: It may be their position within a free market, but you do have to have a view because you have to be able to point out—or I thought it would be part of your job to point out—if you think someone is ripping off the customers. It does seem to those of us who listen to the information you have just given that there are companies who are able to get away without a 12% increase but you have one company—the major company, the major supplier—who is hell bent on ripping off the customers of the UK, including some of the poorest people in the country.

Mr Buchanan: British Gas Centrica have to make a decision for themselves but I think the strong message that we take into that is that there is an opportunity to switch and save and that companies—I have mentioned Scottish and Southern—who have made this very clearly competitive move against British Gas are offering a different product.

Q16 Mr Williams: Are you going, in the defence of the consumer, to launch a campaign: switch to avoid the 12%?

Mr Buchanan: We have been saying that in our press releases. We have been speaking to energywatch[2] and we have for some time been planning to do a campaign.

Q17 Mr Williams: So the best thing that could happen really as a result of this hearing would be if television covered this issue and said that you can stop British Gas if enough of you will change; British Gas would then have to change. Would that be a fair assessment of what you think might happen if there were a large number of changes?

Mr Buchanan: British Gas have made their competitive decision and Scottish and Southern and the other companies are making their competitive assessment—I presume they are competitive assessments—and we have to assume that they will win a lot of customers and that British Gas may regret the decision that was taken, but it is up to British Gas to take.

Q18 Mr Williams: When it is a 12% saving that is far bigger than anything you are claiming to have achieved through your overall policies. You could actually take a lead here. You could champion the consumer which is what a regulator is expected to do and you could lead the charge in saying to the consumer: "Teach them a lesson; switch your account".

Mr Buchanan: And energywatch has a slight leadership in this role over us. energywatch run their own website; they recommend their own best price of the day, as it were. This is being done and we are talking to energywatch actively about how we might have a programme going forward.

Q19 Mr Williams: Putting the 12% in perspective, we understand from paragraph 2—we are moving slowly; I am going right through the Report from

[2] See Ev 13–14

beginning to end so it may take some time—that 50% of the reduction in fuel poverty has come from lower prices up until now and 50% has come from rising income. That must be rather disheartening news from your point of view.
Mr Buchanan: It is concerning news indeed.

Q20 Mr Williams: Where are you in that? 50% plus 50% to most of us makes 100%. So where do you come in?
Mr Buchanan: The concerning news is that for every 1% increase in fuel price in England and Wales you have another 50,000 onto the fuel poor figure. In Scotland—and I would like to develop Scotland a bit more—for every 5% you have another 30,000. Yes, you are right; it is extremely worrying. Just to come back to the energy efficiency message within the NAO's Report, the Scottish Executive in their Scottish Housing report last year identified 15% due to energy efficiency; 35% price and 50% income. They broke it down just a little bit more. Again, that shows that the energy efficiency message is important as well.

Q21 Mr Williams: You have referred to the way in which the figures were broken down differently. In the last footnote on page 1—we are making progress, we are right at the bottom of the page—they quote targets of 21 degrees in a living room, 18 degrees in any occupied rooms and so on, but why is there a different set of targets for Scotland and Wales? What is the justification for that and what is the nature of the difference?
Mr Buchanan: The nature of the difference is that in Scotland they wish to cut the 2002 figure by 30% by 2006. Everybody has basically bought into the 2016 deadline and the vulnerable customer deadline by 2010. In Wales the slight change is that they have said that if it is vulnerable customers in 2010 let us have non-vulnerable customers in social housing by 2012. That is the slight difference.

Q22 Mr Williams: We have been told that one of the problems for consumers switching is that their suppliers can block their switch. Does this apply both in gas and electricity or is it mainly apparent in one of them?
Mr Buchanan: That is a very good question. The figures that we have shown in the Report are 9% on average blocking, with 15% (rather more) in gas. What we have sought to do here is to unblock the system, if I can use that expression. 70% of pre-payment customers in debt have below £100 outstanding and consequently what we have sought to do—and we are in a pilot scheme which in February next year we will be very happy to send you a report as to what that pilot scheme shows—is to take that block away and allow customers with that kind of debt to switch as well.

Q23 Mr Williams: Switching to electricity just for a second—I am sure you played a part in this—the disconnection scandal of some years ago has rather disappeared from the public perception. We are told that last year the number of disconnections was up from 333 (which nationally is no large number, obviously) to 1,361; that is a four-fold increase. Have you had a similar problem on the gas side at all?
Mr Buchanan: The overall figure has fallen from about 27,000 to 17,300 in the last year with basically gas being 16,000 and electricity being 1,300. In terms of disconnected customers, that is 17,300. In terms of those in debt there is 1.2 million for each fuel.

Q24 Mr Williams: So gas disconnections are over 10 times greater?
Mr Buchanan: Yes.

Q25 Mr Williams: Why?
Mr Buchanan: Can I just give you the good news then I will come to that? The good news, I think, is the very rapid decline that we see from gas. Generally gas has more disconnections than electricity. Part of that is to do with the history of British Gas and health and safety.
Mr Neilson: It is much more complicated to fit a pre-payment meter in gas because you have to go round and check every gas appliance in a house if you cut the gas off. What tends to happen, in these unusual circumstances when the householder is not at home, usually the gas supply is cut off if a warrant exists and then a couple of days later an appointment is made when the customer is at home and the pre-payment meter is fitted. In electricity it is a job of a few minutes; in gas it is a complicated job which has safety aspects and which is why it tends to be done as two separate ones. If it is two separate jobs it counts as a disconnection.

Q26 Mr Williams: That makes it even more surprising because it is 10 times more frequent.
Mr Neilson: It is because in electricity disconnections have almost completely disappeared. Ten to 15 years ago they used to run at a very large rate.

Q27 Mr Williams: We are going in a circle here, are we not? The fact of the matter is that the one that has the greater difficulty in justifying its disconnections is disconnecting, in fact, 12 times more than the other; the gas industry is disconnecting 12 times more.
Mr Neilson: Yes, it is.

Q28 Mr Williams: Yet according to what you have just spelt out to us we could expect it to be the other way round. That 16,000, is that divided up fairly proportionately to market between the various gas suppliers or is it mainly concentrated in the practices of any individual supplier of gas?
Mr Buchanan: We will get you the detailed answer,[3] but my overview answer would be that given that British Gas Centrica has about 62% of the market it is proportionately going to be British Gas Centrica.[4]

[3] Ev 14
[4] *Note by witness:* Out of 15,973 gas disconnections in 2003, British Gas disconnections were 12,275 or 77%.

Q29 Mr Williams: So we have British Gas which is responsible probably for about two-thirds of that, let us say 10,000, which is still eight times more than the electricity industry altogether, just one gas supplier. That gas supplier is now going to increase its prices by 12%. What I would like you to do—and tell us if this is impracticable—if these price increases go through is to see if you can do a running check on disconnections so that we can see if, in addition to absolutely screwing the consumer, British Gas then goes along and quite mercilessly goes along and cuts the gas off from people who cannot afford it.

Mr Neilson: Everyone will be able to see that because for two or three years we have published each quarter the number of disconnections that each supplier is responsible for in both gas and electricity. That information is regularly published.

Q30 Mr Williams: In that case will you make sure that—I am sure you will be willing to do this as you publish it anyhow—a copy of your press release each quarter for the next year is passed to PAC office.

Mr Neilson: Certainly.

Q31 Mr Jenkins: Mr Buchanan, I have been sitting here listening to your answers and getting more and more confused. I have to ask the simple question: why are you there? Why do you exist? This is a private competitive market, what effect do you have on the running of this market?

Mr Buchanan: You are absolutely right, it is a competitive market. We would agree that it is a competitive market from the retail side and from the wholesale side. We would have taken action if we had felt there was any abuse of the market in recent years; we have not felt that that has been the case. Having said that, one of our roles is to monitor markets to make sure that abuse does not take place on behalf of the customer.

Q32 Mr Jenkins: So you do not trust the market?

Mr Buchanan: There is a difference between an overt interference monitoring the market and our responsibility to the customer to ensure that there is an orderly market. This slightly relates back to the previous question. You have mentioned gas prices; can I give you a little bit of colour as to what has happened in the last few years both on gas and electricity? There was a strange movement in the gas price last October and we announced at the end of May that there were two issues outstanding that we could not resolve. There have been very high wholesale gas prices this summer and there are very high prices for quarter one, winter 2005. We have a team which is looking at these three events and we would very much hope to be in a position in the next few weeks to make a statement on each of these three areas. Coming back to the previous question, because of the extent of the increase I think there is a reasonable question to be asked as to what it is that has caused that and we would seek to provide you with an answer to that in the next two to three weeks and we would be very happy to send a special report or whatever to your offices.[5]

Q33 Mr Jenkins: When you have done all your studies, do not come back with the fact of the dash for gas, Britain has squandered all its reserves and now we are having to buy dearer gas from the rest of the world. If you come back with that, I could have told you it years ago. We have abused our system. Fuel poverty is going down now and I think Mr Williams pointed out to you it is because the price of fuel has gone down and wages have gone up. If you were spending less than 10% of your income on fuel you would not be fuel poor, would you. Is there any chance that people who are just edging below 10% now—literally, because they cannot afford to spend any more—are not classified as being fuel poor?

Mr Buchanan: There might be that proposition but I am in no position to suggest that. It is a really interesting area. I have not seen any research. I have mentioned some of the really good research, for example the Scottish Executive Housing Report last year. I have not seen a sort of salami-slice of what happens at 2%, what happens at 5% up to 10%; no doubt that would be interesting.

Q34 Mr Jenkins: You could be in a position of being too poor to be classified as fuel poor under our guidelines.

Mr Neilson: The greatest problem with fuel poverty is that many houses are in a poor state and it takes a lot of energy to heat them to anything like the suggested levels.

Q35 Mr Jenkins: We will come to that later on. The pre-payment meters have gone up, right?

Mr Buchanan: There has been quite a lot of work done on this and I think it is partly because customers like them—as is referred to in the Report—to help them budget and to help them plan. Ofgem has actually changed its strategy here; Ofgem has changed its strategy from seeking a reduction in pre-payment meters to actually improving the information flow—coming back to the very first question it was absolutely right to identify that—in terms of information about price, information about products. Just last week the association of suppliers published the research which had been done by NPower and it said that 90% of pre-payment customers were satisfied. If you go back to Ofgem's research in March, 74%; back two years, Scottish and Southern did a poll and again it was 90% satisfaction.

Q36 Mr Jenkins: If I were regulator I would have to do a study as to why pre-payment meters were increasing even though they were more expensive, ie either people are too thick to understand or there is

[5] *Ofgem's probe into wholesale gas prices—Conclusions and next steps*, Ofgem, 5 October 2004, http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/881723204a.pdf

an underlying reason for this push? Did you do any research yourself as to why this push for pre-payment meters occurred?
Mr Buchanan: The trend in increase is mainly several years ago. In the last couple of years the numbers are fairly flat; a few per cent have changed. The main reason there was a change from 10 years ago is connected with disconnections. At that stage the level of disconnections was far higher and what has happened is that customers and companies have realised that they both benefit by fitting a pre-payment meter instead of disconnecting customers. I think that is the biggest factor that has led both to more pre-payment meters and to fewer disconnections.

Q37 Mr Jenkins: That is a different answer. Up to now you have been telling me that people opted for a pre-payment meter. I think there were other reasons behind that. Now you are telling me that the company has put them on a pre-payment meter. Which is it?
Mr Neilson: I think both are relevant factors.
Mr Buchanan: Coming back to customer choice and customer preference—it is boring to go back to opinion polls and what people think—but there is very strong evidence in the three polls that I have given you that 90% of people who had them liked them. I think this has seriously influenced Ofgem's approach towards them because this appears to be a product that customers like.

Q38 Mr Jenkins: If the customer likes paying more and part of your job is effectively to tell the customer where to get the best deal you are not doing a very good job, are you?
Mr Buchanan: I think our team does a pretty good job but I would accept the comment that if 35% of pre-payment meter customers are switching and 50% on average are, we have fallen short here and that needs somehow to be promoted further.

Q39 Mr Jenkins: If you look at the costs so far as the implications are concerned for a customer, if they never get the right bill, if they never get their meter read from year to year and are frightened of being faced with a bigger bill, that is why they are forced onto a pre-payment meter. Have you looked at this in the market place?
Mr Buchanan: We do have enforcement powers and were a customer to be abused particularly in a metering way, we can take action. We have taken action, as you know, against companies in the last year who have not carried out their responsibilities to customers properly and fully.

Q40 Mr Jenkins: What do you think of a company that does not read a meter for over three years although the customer constantly requested a meter reading? When the bill comes, when they actually did read it, there was over £1,000 difference and she could not afford to pay it. Then the company installed a pre-payment meter and they increased the tariff. They not only took her to court, they judged her and put the executioner in. That woman paid £38 into her meter over a weekend to try to keep warm. In the end she could not and she had to send her children to her mother. I got involved with this company and we had words. They re-changed the tariff rate and they brought it down and actually cut some of the bill because they accepted some of the responsibility themselves. But why should I have to get involved? Why is it not your job to get involved and why are you not nailing companies like this?
Mr Buchanan: I very much appreciate your getting involved. You wrote to us and we obviously acted insofar as we contacted energywatch and clearly working with energywatch you resolved this. So we do appreciate very much your help in this issue. It is very regrettable that it happened.
Mr Neilson: Under the rules that we are responsible for, the company clearly did not follow in that case because an important part of the pre-payment meter procedures involve the amount of debt recovered having to be related to the customer's ability to pay. That sounds as if it clearly was not the case in the circumstances that you referred to. It is precisely behaviour like that, if there is repeated contravention, we would be investigating.
Mr Buchanan: And we do.

Q41 Mr Jenkins: I want to move on to switching and blocking now. If someone owes an amount of money—not a large amount, a couple of hundred pounds—if I owe on my credit card £500, £600 or £1,000, if I go to another credit card company they are delighted to see me. They will give me zero on that thousand pounds for up to six months while clapping their hands. They will pay my debt for me. That is a market that seems to work very well. So what is the problem with your market then? Why can I not go from supplier A to supplier B and supplier B will pay my debt to company A and I carry on merrily with supplier B? Why is there a difference?
Mr Buchanan: As you will be aware from some of the earlier comments, we are looking to unblock this particular area and we are running a pilot scheme currently that will run through to February next year. Again, I am happy to come back with a report on that to you in terms of how successful it has been. To pick up your point—and it is a fair point—in this pilot scheme, a one year study, we have gone for a £100 ceiling; only 5% of customers in debt have over £600. What we will need to look at next February is how successful the scheme has been; it is a recommendation from the NAO—their third recommendation in this area—that we look very carefully at what the options are of extending that but within the remit—and again this is in the NAO's recommendations—of cost benefit analysis, which we started immediately.

Q42 Mr Jenkins: Why do you not come to a minister and ask him to pass a regulation that forbids this operation of blocking?
Mr Buchanan: What we have to do—as we are very much invited to do by the NAO within the Report—is analyse the cost benefit associated with this particular situation. We will analyse the results of this test programme in February next year and, as I

say, we will then be very happy to come back and tell you whether we think it is telling us that we should go higher or not.

Q43 Mr Jenkins: The last point I want to ask you about are the pre-payment meters and the cross-subsidy which you are totally opposed to so far as your policy is concerned. The cost for any meter must be met by the client or the customer. So why are you now, if cross-subsidy is abhorrent to you, cross-subsidising? Why are you charging me, as a user and a tax payer, through the Warm Front? Why are you doing this cross-subsidy now? Why have your policies changed?
Mr Buchanan: Warm Front is a government programme and ministers will take that view on Warm Front and the appropriate level of investing in it.
Mr Neilson: Ministers will also decide the level of the support that every household has to pay on the Energy Efficiency programme.

Q44 Mr Jenkins: Let us get this right. According to you and your principles and your policy you would not like to see this cross-subsidy occur.
Mr Buchanan: The cross-subsidy that you are suggesting we think would not be appropriate, that is correct.
Mr Jenkins: I was hoping we could utilise this money some other way. I worked it out that by the funding of the Energy Efficiency scheme and the Warm Front scheme it is just more than meets the additional costs of the pre-payment meters. So it actually meets all these costs of pre-payment meters so they would be on the same level playing field as every other type of payment system and the rest we could give to energywatch to improve their role because I think they have a much greater benefit to consumers at the present time than you do.
Mr Buchanan: I think that may come back to recommendation A on page 9 of the NAO Report which is that Ofgem has to be quite careful in understanding its independent role rather than a ministerial role. I think arguably you are really focussing now on government ministerial issues.
Mr Jenkins: My time is up. Thank you very much.

Q45 Mr Allan: I will be touching on some of the same themes, but starting with pre-payment can you give us an approximate percentage figure of the difference between what somebody pays if they have pre-payment and what they pay at the cheapest which, as I understand it, is direct debit dual fuel discount? What kind of order of magnitude are we talking about in terms of percentages over my total fuel bill if I am on the pre-payment as opposed to the dual fuel direct debit dirt cheap option which richer people tend to use?
Mr Buchanan: I am going to use the comparison of standard credit because I was looking at that figure to help you earlier. Because companies offer a broad range, your combined energy bill for an average medium using house would be about £590 to £650 a year and that is before the recent price increase.

Q46 Mr Allan: That is standard credit. And if I were dual fuel direct debit that would be cheaper.
Mr Buchanan: Yes. For pre-payment there is £32 on top of that.

Q47 Mr Allan: So we are talking about maybe a £50, £60 difference between the two; so 10% more expensive in percentage terms. Whatever it goes up to it will be about 10% more expensive. I think we have discussed today that there is a choice and people choose to be on pre-payment for budgetary reasons. Is that right?
Mr Buchanan: Yes, very much so.

Q48 Mr Allan: The choice used to be between disconnection and pre-payment which is not a particularly attractive choice, but that choice has now built up over time. People who would otherwise have been disconnected are now on pre-payment.
Mr Neilson: That is correct.

Q49 Mr Allan: If we see how that develops, what if somebody wants to go back the other way? What if they say, "I have looked at the hearings of the Committee of Public Accounts and I am paying 10% over the odds. I am on pre-payment; I have no debt"? Do they have an absolute right to insist on the credit meter being put back into their house and does their fuel company have to put one in to allow them to have the cheaper option?
Mr Neilson: They do have a right. Depending on their credit history they may have to pay a security deposit. Over 200,000 customers a year do change back from pre-payment to credit, so it does happen.

Q50 Mr Allan: If someone has a clean credit history, if they ring up and ask for a credit meter, the company must come and put that in, and you, as the regulator, would have a problem with a company that would not do that.
Mr Neilson: Yes, because you have a right to the different types of supply, yes.

Q51 Mr Allan: Have you ever tried to help somebody who is on pre-payment with two different suppliers to get onto the dual fuel discount cheapest credit meter system? As a piece of research I think it might be quite interesting to look at the number of phone calls, the number of stages of complexity for the average user of trying to negotiate; many people do not even know which company they are with any more when you speak to them, never mind how to get to the best option. Have you looked at that?
Mr Neilson: Yes, and obviously it depends on the customer and how much help they might need. Clearly some customers will need more assistance than others.

Q52 Mr Allan: Do you have a responsibility to assist?
Mr Buchanan: Not individual customers. The suppliers ought to help, so should energywatch in practice. Local agencies like Citizen's Advice frequently help in those circumstances when there is

a vulnerability issue with the customer that will make it difficult for them to cope with it all themselves.

Q53 Mr Allan: As the overall regulator do you have any concern that the companies in reality prefer to cherry pick and that actually the middle-class consumer who is the easy direct debit dual fuel customer is the one that they want and the person who rings up and says, "I am on a pre-payment meter, I want to get to the cheaper option" then actually the companies are not that interested?
Mr Buchanan: In terms of market they are a very important part of the market: 10% of the gas market, 15% of the electricity market. It is a brave company that says that that is not an important market and we can see through some of the developments that Scottish and Southern have worked with—EquiGas and EquiPower—to develop a refined product for that market. I think it is a very important part of the market that a company would have to think very carefully about not taking seriously. Equally, to come back to the point about cross-subsidy, if you start to introduce cross-subsidies then a company's view on whether the market is valuable or not might become somewhat undermined. I think it is quite an important issue.

Q54 Mr Allan: Are there legislative powers available for you to insist as a licence condition that you do charge an equal tariff across different meter types? Could you do that were you so minded from a policy point of view?
Mr Neilson: Only if we decided it was in accordance with our statutory duties to protect the interest of customers—which obviously means all customers—and it is a question of how you interpret your duties. Either we or ministers would have to take a positive decision to introduce such a cross-subsidy because clearly at the moment the market works and there is a considerable variation between companies. There are some companies who do not have any difference between some of their credit tariffs and some of their pre-payment tariffs; other companies do always have a difference. There is considerable variation at the moment.

Q55 Mr Allan: I think I was taking you back to the chairman's point about the Dartmoor and the Exeter customer. At the moment presumably the licence conditions say that you cannot charge different tariffs according to where you are. Could a company come along and say that people in rural areas are going to have pay more because it is more expensive to get the stuff to you?
Mr Neilson: The way that works is not through supply companies at all. The fact that there is not a rural variation is because the distribution companies who own the monopoly networks, the way their charges are structured at the moment, does not contain a differential between rural and urban areas. The costs that are passed on to the supply companies do not differentiate between rural and urban which why there is absolutely no need for the supply companies to have any differential.

Q56 Mr Allan: So the distinction here is that the metering companies who have developed as this separate creature are charging different amounts per customer according to the meter type.
Mr Neilson: Metering is the responsibility of the supply companies who sell the gas and electricity to the final customers. Clearly they do face different costs depending on whether they have to install an expensive pre-payment meter or a cheap credit meter. They also have different costs in operating the system because there are a lot more systems unfortunately in how pre-payment operates. The companies who are selling to the final customers just have different costs depending on whether the customer is on pre-payment or not.

Q57 Mr Allan: And the difference is that Transco National Grid do not do that; they charge a similar amount wherever you live.
Mr Neilson: For providing the wires. Anyone who provides meters broadly charges what it costs to provide them. Metering is now a competitive service so that the supply companies can go to any company they choose to buy meters; it is a competitive market.

Q58 Mr Allan: Moving on now to the overall costs for everybody and the long term trends in the market, I received a very nice booklet from British Gas that told me about how all our energy prices are going to be much more expensive over the next few years. Do you agree with that assessment?
Mr Buchanan: What we have currently is an increase in gas prices of 20 pence up to north of 40 pence; we have coal prices from £33 a tonne to £50 a tonne. So we have had a very major increase in price. A key element here is the linkage of gas and oil price particularly with regard to Europe but also, looking forward on the coal price, a large proportion of that increase in the coal price has been due to activities within China. In the short term looking at forward prices that are traded it is looking is as if we are going to have high prices through 2005. One of the interesting things about gas is that the UK is going through, as it were, a funnel in terms of availability of gas. In the next two winters we are going to be at a point where it is quite tight in terms of availability of gas. One of the interesting prognoses coming from the major commentators on gas prices is that with the arrival of Norwegian gas, a gas pipeline from Holland, there are three major developments that will bring gas by ship from Nigeria, Trinidad, probably Russia (rather than coming across the continent of Europe). There is a really good chance that we are going to have excess gas capacity; there are a number of analysts who are saying that by 2008 gas prices are going to be falling rapidly. It is very interesting looking forward, looking at that dynamic.

Q59 Mr Allan: Given the figures you have quoted earlier and the fact that half of the reduction in fuel poverty is down to decreased fuel prices and therefore the inverse applies, we can expect, in terms of headline figures, between 2005 and 2008 the number of people defined as being in fuel poverty to increase in the United Kingdom.

Mr Buchanan: From those figures that I have given you earlier, sadly prices are going up and 1% is 50,000 people.

Q60 Mr Allan: Some of the companies are trying to hold them down so effectively they are gambling which is what markets are all about but in gambling there are winners and losers. What happens if they become losers? What happens if Scottish Power get it wrong and they cannot hold to their price guarantee? Presumably you do not do anything. They say, "We are going to hold our prices down" and they come back in six months and say they cannot do it or they will go bankrupt then presumably that is just a market thing and everyone should rush back to British Gas, should they?

Mr Buchanan: Scottish Power will have to take a commercial decision as to where they basically maximise their margin. Are they going to maximise or maintain their margin by customer numbers and lower price, or by fewer numbers and a higher margin? That is going to be the issue. Then the question is: is it an oligopoly or is it a competitive market? It would appear from the evidence that we have that the retail market is competitive.

Q61 Mr Allan: For the customers to understand the terms and the guarantees and deals they are being offered, they are not backed up by regulation; they are market offerings. If a company fails to honour them the Government is not going to hit them with a big stick; it is up to the customers to hit them with a lot of small sticks by going elsewhere.

Mr Buchanan: That is correct. There is evidence globally where companies have taken positions. I remember there was a very major price spike in the Mid-West in 1997 and a number of the Mid-West companies in the USA had very embarrassed discussions with their shareholders at the time. That is an element of risk that they take.

Mr Neilson: It depends what the nature of the commitment is. It is possible that the company will have offered the customer a contractual commitment to keep low prices.

Q62 Mr Allan: Yes, but it is all between them and the customer and does not involve Ofgem. It is not a regulatory matter. From a customer's point of view, many people still think that energy companies are somehow public and run by ministers.

Mr Neilson: Some energy companies have made big mistakes in their wholesale purchasing in the past and have gone bust. Typically those customers have done quite well in the short term and then they have had to buy from other companies later on.

Q63 Mr Allan: The last matter I want to look at is EEC, the energy efficiency programme. Following up the comments made by Mr Jenkins about the costs of this, I think the estimate in here is that at 2004 prices it is £4 per fuel, so that would be £8 per household across the two fuels. That is if they pass on the full costs. From your evidence, do they pass on the full cost to us?

Mr Buchanan: Talking with my old hat on as an analyst, Centrica would argue that they did not pass on the complete full cost. They have to make a competitive decision again in terms of what they do.

Q64 Mr Allan: They effectively cover some of it themselves.

Mr Buchanan: Yes.

Q65 Mr Allan: Do you think we are getting value for money from it?

Mr Buchanan: In terms of: have we met our targets? then we would have to say, as the administrator, the programme is succeeding in the targets that it has set itself.

Mr Neilson: If you analyse the products that are being invested in—things like cavity wall insulation, low energy light bulbs—then yes, they do offer customers quite a good payback in terms of the money they save by comparison with the costs. The challenge will be: is the value for money equally good if you double the scale of the Commitment again?

Q66 Mr Allan: Do you look at whether the low energy light bulbs, which form a major part of this programme, are actually used or just whether they are distributed?

Mr Buchanan: That is a very difficult thing to analyse. I have read your Warm Front report with interest on that.

Mr Neilson: Yes, obviously that should be monitored. We will help Defra to do that.

Q67 Mr Allan: One of the major things that happened was the EU directive on cold appliances, they would have to be category A or B rather than C. You do not claim credit for things like that, external factors that come in and help you to meet your targets, do you?

Mr Buchanan: I have a suspicion that we would love to, but I am not entirely sure that we dare.

Mr Neilson: What we tend to do each time the scheme re-starts is that we only allow companies to claim a credit for doing more than they are compulsorily obliged to do by regulation. If an EU standard changes they only get savings to the extent that they beat the new standard.

Q68 Mr Allan: The whole point of this scheme is about energy efficiency as opposed to Warm Front which is about assisting the fuel poor, as I understand it. How do you feel about "all you can use" schemes where some of the companies in the wonderful free market offer packages saying that you pay a fixed amount every month and you can use as much energy as you like. How does that fit in with your energy efficiency obligations?

Mr Buchanan: In terms of a company offering an energy service product, what we have tried to do—

in fact we are in a two year trial phase now—is to lift some of the potential blocks that were there, particularly what is known as the 28-day rule, to allow that market to develop if it does; we will just have to wait and see if it does.

Q69 Mr Allan: But the fact that this could lead to lack of energy efficiency because they no longer worry about turning the lights off because it does not matter, is that not a problem?
Mr Neilson: I think that is for the commercial judgment of the company that chooses to offer that product. Clearly for many individuals—particularly elderly ones—it is quite reassuring to know that they have that safeguard.

Q70 Mr Allan: But not of interest to a regulator who has energy efficiency as a major target.
Mr Neilson: We have not thought it appropriate to block those kinds of offers.
Mr Buchanan: It is an interesting issue. We are looking at a two year programme and that is something we should take away and look at.
Chairman: Thank you very much. I think that concludes our questions. However there were a couple of areas I did not have time to cover in my initial questions so I think I shall ask you to provide notes. If I can start by referring to recommendation C which you can find on page 9 of the Report where it says that "Ofgem should highlight for Defra any features of the programme where suppliers appear to be incurring disproportionately high costs." I would like to have a note from you on whether you think that the Social Action Plan and Energy Efficiency Commitment may be imposing administrative burdens on energy supplies that are not justified by the benefits. I will have a note on that, please.[6] Then if I may refer you to paragraph 11 which you can find on page 6, it says there that: "The costs of achieving these savings broadly feed through to customers." I would like to have a note from you, please, on to what extent are the recently announced rises in fuel bills a reflection of the extra costs imposed by schemes such as the Energy Efficiency Commitment.[7] I would, lastly, like to have a note on the answer given to me at the start of the hearing by Mr Neilson when I was pressing you on the poor and the fact that they tend to use pre-payment meters. I accept what Mr Neilson told me that of course the fuel poor is a much bigger group than those who are on pre-payment meters, but those who are poor tend to use pre-payment meters. I wonder whether you can provide me with a note as to whether an approach that relies on switching does anything at all for those who actually prefer to use pre-payment meters because it avoids them falling into debt, and what action you can do to help these people.[8] Gentlemen, thank you very much. Clearly our report will very much focus on those who use pre-payment meters but there are other areas which interest us, particularly the fuel rises that are clearly in the pipeline. Before I end, may I thank Mr Rob Molan who is leaving us as our Second Officer of Accounts. He is going to go to the ODPM. We are very grateful for the help he has given to this Committee. He does not very often get asked a question but he has to be ready for one at any moment and reply for the entire Treasury. We are very grateful to you. Thank you very much.

[6] Ev 11
[7] Ev 15–16
[8] Ev 16

Memorandum submitted by National Energy Action

THE SOCIAL ACTION PLAN AND THE ENERGY EFFICIENCY COMMITMENT

Introduction

National Energy Action (NEA) is a charity working to ensure that low-income households have access to sufficient warmth for health and comfort at an affordable cost. NEA develops and promotes energy efficiency policy and practical initiatives to tackle the heating and insulation problems of low-income families and individuals. Working in partnership with central and local government; with fuel utilities, housing providers and health agencies; and with regulatory bodies, consumer groups and voluntary organisations, NEA aims to eradicate fuel poverty through greater investment in energy efficiency to help those who are disadvantaged and vulnerable.

NEA welcomes the Public Accounts Committee's inquiry into the Social Action Plan and the Energy Efficiency Commitment. The combination of regulatory intervention and the continued development of corporate social responsibility across energy supply companies has brought significant improvements and protection within the supplier/consumer relationship. Many companies are working hard to develop programmes and projects to provide for disadvantaged consumers. However NEA's view is that we should not depict the limited powers of Ofgem and the industry as a major element in the Government's Fuel Poverty Strategy. It should not be overlooked that fuel poverty is a consequence of low income, unaffordable energy prices and poor heating and insulation standards—these are all issues for Government.

NEA's primary interest in commenting on the effectiveness of the Energy Efficiency Commitment and the Social Action Plan is based on their potential, but largely unrealised, roles in the reduction of fuel poverty. Whilst the Social Action Plan is intended to monitor company provision for disadvantaged consumers there is no specific affordable warmth objective or target associated with Ofgem's guidance to companies; this is even more true of the Energy Efficiency Commitment which has the remit of energy savings and, consequently, carbon reduction.

The Social Action Plan

Much of the energy devoted to Social Action Plan monitoring is simply that—ensuring compliance with Licence Conditions and social obligations imposed on domestic energy suppliers. As such the Social Action Plan is primarily a policing and reporting exercise. However one important supplement to this reporting activity and one that might have a genuine and positive role in addressing fuel poverty is in Ofgem's encouragement of supplier initiatives—of which social tariffs could be an important element.

NEA is not persuaded that social tariffs have their origins in utility awareness of their role, and consequent responsibilities, as suppliers of a service essential to the health and welfare of vulnerable consumers. However, even if this were the case, this is too important an issue to be left to random, piecemeal and voluntary initiatives undertaken by commercial organisations.

As it is, it would be extremely naïve not to assume that some social tariffs are, in fact, niche marketing activities and should be seen as such rather than as serious attempts to address fuel poverty.

The Department of Trade and Industry is expected to conduct an evaluation of energy industry initiatives to assess their contribution to fuel poverty reduction. Whilst NEA welcomes this proposal as a means of identifying best practice with a view to replication and development, one possible obstacle may be company reluctance to share information on their initiatives on grounds of commercial confidentiality which, if this proves to be the case, will indicate where companies' real priorities lie.

Ultimately, however, NEA sees reliance on utility action to deliver social objectives as an abdication of Government responsibility. If there is a need for social tariffs then they should be available on a consistent and universal basis and this can only be brought about through Government action. The proper role of Ofgem, rather than coaxing or exhorting energy suppliers into "good works", should be to inform and advise Government on policies and practice to make energy affordable without any need to depend on the magnanimity of commercial enterprises.

The Energy Efficiency Commitment

One of the basic failings in current Energy Efficiency Commitment (EEC) arrangements is the lack of integration between EEC (as delivered to the priority group[1]) and Warm Front. The consequence is that both schemes are endeavouring to identify similarl client groups, but with a view to providing different levels of service. This does not in our view constitute a coherent strategy for eradicating or alleviating fuel poverty or for promoting take up of energy efficiency improvements; nor is fuel poverty reduction an objective of the Energy Efficiency Commitment although, of course, the programme does make an almost incidental contribution to the provision of affordable warmth.

There is inevitably some degree of tension between the environmental and social objectives of EEC. This has been evident since proposals for energy efficiency programmes, delivered by fuel suppliers and funded by consumers, were first introduced in 1994. The capacity to make significant energy and carbon savings by installing a range of straightforward and relatively cheap insulation measures has never been in doubt. For a programme that seeks to maximise environmental benefits the arrangements for EEC, and its EESoP predecessor, work well. However, NEA is amongst those organisations that have consistently pointed out that the poorest consumers, who have the greatest difficulty in meeting their fuel costs, contribute disproportionately to the cost of these programmes.

Whilst the principle of ensuring that these consumers also benefit from the schemes they help to fund has been accepted, the arrangements put in place seem to NEA to have the character of an afterthought. For EEC to serve a genuine social purpose it must meet the needs of the low-income consumers to whom assistance is offered rather than the needs of a fuel supply company endeavouring to meet an energy saving target at the lowest possible cost. It is for this reason that NEA has on many previous occasions suggested that EEC should incorporate affordable warmth targets for measures delivered to priority group consumers. We see it as unacceptable that the benefits of EEC to some low-income consumers is limited to receiving a few low-energy lightbulbs.

These concerns are amplified each time the EEC programme is extended. Although falling fuel prices may have cushioned the impact of increased EEC costs in the past, this is unlikely to be true in future. We note that current proposals will mean that most of the poorest consumers will pay £18 per year to fund EEC from 2005, and that the average savings will amount to only £15 for those who benefit from it. Given that fuel prices are expected to increase in the near future we are increasingly concerned that the short-term effect of EEC will be to aggravate fuel poverty rather than alleviate it.

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[1] The EEC priority group covers those households in receipt of means-tested or disability-related benefits. 50% of energy savings are required to come from work carried out on behalf of these households. The priority group is similar to those eligible for Warm Front—the main distinctions being that EEC operates across all tenures and does not require that beneficiaries should be vulnerable on age grounds ie pensioner households or households with children.

NEA is aware that the concerns outlined above are shared by others, including some of the fuel suppliers who are subject to EEC obligations. We have some sympathy with suggestions that EEC should be separated into two distinct programmes, one to serve an environmental purpose and the other to address explicitly social objectives. However the problems of marketing a programme for "poor people" are likely to be acute. NEA maintains that the optimum method of meeting both social and environmental objectives is a single, national energy efficiency programme, offering a comprehensive package of measures to all households—free of charge to those on low incomes and incorporating a sliding scale of householder contribution from those who are better off.

In the absence of such arrangements NEA believes that adopting affordable warmth targets for EEC priority group customers is essential. It would ensure that the range of energy efficiency measures available to those on the lowest incomes was appropriate to the property they live in. As an incidental benefit it might also prompt some innovation in exploiting the use of renewable sources of energy at domestic or community level; provide incentives for income maximisation by ensuring full take up of benefit entitlement; and stimulate advice on the selection of more appropriate tariffs and cheaper payment methods.

Disconnection from Gas and Electricity Supply

The Energy Retail Association (ERA) has published new proposals that are intended to prevent disconnection of vulnerable consumers. NEA's response to the ERA consultation and to the subsequent Trade and Industry Committee inquiry emphasised a number of points related to the power to disconnect:

— The overwhelming majority of customers who are actually disconnected are the "can't pays" who are supposedly protected by Licence Conditions that require sensitive and sympathetic consideration of their cases.

— Existing legislation precludes disconnection from domestic water supply primarily on grounds of health and safety—NEA would propose that removal of the means of heat, hygiene, light and cooking facilities constitutes an equivalent health and safety hazard.

— Banning disconnections would encourage energy suppliers to develop more innovative tariffs and payment methods that enabled customers to remain on supply.

— No matter how assiduous suppliers are in trying to identify and protect vulnerable consumers there will inevitably be errors and oversights that will result in frail, elderly and other disadvantaged families and individuals being exposed to the enormous potential harm of disconnection.

— The distinction between vulnerable and non-vulnerable households is too fine and complex, and too important, to be left to subjective judgements often made by company agents whose primary interest is revenue protection and debt recovery.

— The only means by which it can be guaranteed that injustice and tragedy do not result from disconnection is to end the right to disconnect.

Prepayment Meters

Despite repeated assertions from the energy industry that use of prepayment meters is more a matter of lifestyle than of poverty NEA believes that there is a strong and obvious link between this payment method and deprivation. Rationing of supply, surcharges on the unit cost, self-disconnection and the inconvenience of charging cards and keys are indicative of need rather than of free choice.

Individual companies are working towards the elimination of any surcharge (already the case in Northern Ireland). NEA would wish to see an end to the current practice of charging people who self-evidently face difficulty in paying for fuel an additional premium. At worst prepayment charges should be no higher than those paid by quarterly credit customers.

9 September 2004

Letter to the Committee from energywatch

Energy Industry Proposals Affecting Vulnerable Customers

With regard to your forthcoming session with Ofgem, I am writing to make you aware of recent developments in the energy industry regarding the disconnection of vulnerable consumers from their energy supplies and the development of an industry-wide billing standard. These are important developments that might assist the Committee to take a view on industry contribution to Ofgem's Social Action Plan.

The Energy Retail Association (ERA), the trade body of energy suppliers, has this week published final proposals to prevent the disconnection of vulnerable customers. Ofgem asked the ERA to devise the proposals in February following pressure from politicians, the media and organisations such as ourselves to address the issue.

However, ERA has also this week declined to join energywatch and others in the development of a British Standards Institute standard on energy billing. You made the point in your report earlier this year on Consumer Benefit from Competition in Telecommunications, that obscure billing and confusing tariff information make it difficult for consumers to make informed choices and benefit from competition.

This would be important at any time, but at a time of double digit price rises, growth in energy debt and the threat of disconnection, making informed choices on price can significantly improve the quality of life of those for whom energy costs are a major part of their budget.

The decision to decline its participation in this important initiative will hamper improved consumer understanding of the cost of energy and the potential savings available. This may impact on numbers of consumers in debt and will be of relevance to the success or otherwise of Social Action Plan initiatives.

energywatch has long been campaigning for an end to disconnection of vulnerable consumers as we believe society should protect its most vulnerable and not abandon them to inhospitable conditions without heat, light and cooking facilities. Of equal concern are the consumer complaints we are receiving regarding disconnection in error; where a consumer is disconnected through no fault of their own.

The ERA report proposes a definition of vulnerable consumers that would be universally adopted by industry and a series of "safety net" measures to identify and protect them from disconnection.

A great deal of progress has been made since the draft proposals were released in April and the industry's effort put into finding a solution to this issue should be praised. However, energywatch remains to be convinced that the measures proposed by the ERA will guarantee protection of vulnerable consumers.

At a time of huge price increases potentially leading thousands more consumers into fuel debt the concern remains that robust, reliable safeguards must be established, not only to define vulnerable consumers, but to identify and protect them.

The ERA states that the responsibility for identifying vulnerable consumers lies with suppliers' front line staff, many of who are not qualified to make such judgements. We believe this could result in vulnerable consumers slipping through the proposed safety net unless other safeguards are put in place to support.

energywatch is calling for these additional safeguards to come from an overhaul of the existing Court Warrant process. At present, suppliers apply to the Courts for a warrant to disconnect as a last resort to recover a debt. Following discussion with officials from courts in England, Scotland and Wales, we are concerned that the level of information provided to the courts limits their ability to assess the reasonableness of an application and that this lack contributes to the problems we have seen.

The proposed overhaul would see the introduction of a pre-action protocol that suppliers would complete ahead of any application of a warrant to disconnect.

This document would testify the supplier believes:

- it has the right individual and the correct address;
- the debt is not in dispute;
- all attempts have been made to contact the consumer;
- all alternative avenues of debt recovery have been explored; and
- plus all reasonable effort has been made to make sure there are no vulnerable consumers in the household.

These suggestions were discussed at the recent Trade and Industry Select Committee inquiry into fuel disconnections. The combination of these measures will go much further to ending disconnection of vulnerable consumers and ending of disconnection in error. I hope that your Committee will regard them as important issues which should demand the full attention of industry and regulator.

9 September 2004

Supplementary memorandum submitted by Ofgem

Question 28 (Mr Williams): A detailed breakdown of disconnections in 2003.

	Electricity	*Gas*
Atlantic	3	5
British Gas	169	12,275
London Energy	168	365
npower	2	185
Powergen	104	212
Scottish and Southern	213	558
Scottish Power	541	380
Seeboard Energy	48	532
TXU Energi	113	1,461
Total	1,361	15,973

Question 70 (Chairman): Do you think that the Social Action Plan and the Energy Efficiency Commitment may be imposing administrative burdens on energy suppliers that are not justified by the benefits?

Ofgem's approach through the Social Action Plan has been to work with key stakeholders on a variety of initiatives with positive benefits for suppliers and customers. These include research into areas such as debt and energy efficiency, where we have sought to improve understanding of these key issues. We have also given incentives to companies to improve their performance, through undertaking mystery shopping research and publishing the results so companies and customers can see how they compare. We aim to promote and develop best practice on debt prevention, and have introduced other new processes, working with the industry, to help customers in debt, eg the debt assignment protocol. We have sought to encourage innovation. Suppliers have developed a variety of schemes targeted at vulnerable customers, such as Powergen's Stay Warm and HeatStreets and British Gas's Here to Help and Warm a Life programmes.

We do not consider that these initiatives have placed unnecessary administrative burdens on suppliers. Nor have we received complaints that they do. We consider this work has supported suppliers in their overall efforts, both to be competitive and provide good service to customers.

All energy companies have corporate social responsibility programmes. Ofgem's Social Action Plan works with the grain of those—largely by promoting good practice rather than imposing heavy regulatory requirements. In some areas, such as our project with energywatch on promoting good practice by energy suppliers on debt prevention and management, this should both help the companies with their social responsibility aims and assist them commercially in their effective management of customer debt.

Suppliers have not complained to us that the EEC imposes too great an administrative burden on them. Suppliers have integrated their EEC work with their mainstream marketing activity and have achieved economies of scale in this way. The recent audits that Ofgem's carried out of suppliers' EEC schemes showed that their procedures were adequate for the purpose (albeit with one or two minor issues arising). They have dedicated teams who are now very experienced in energy efficiency.

Under the current EEC programme, the measures that suppliers employ to meet their targets generally offer consumers a good payback. It is important that this balance is maintained in the next phase of the programme, where the scale of the work is proposed to be twice as large.

Question 70 (Chairman): To what extent are the recently announced rises in fuel bills a reflection of the extra costs imposed by schemes such as the Energy Efficiency Commitment?

Price rises are driven by a number of factors, and competitive conditions are one of the most important, which means that cost changes are not necessarily fully passed through to consumers. With regard to recent price changes, most suppliers have in fact cited wholesale price changes rather than environment costs as the main explanation.

It may be helpful to set out the proportion of today's costs that relate to environmental measures, and how these are changing.

At the moment, around 3% of the average domestic customer's bill relates to these measures: the Renewable Obligation (RO) costs around £5 a year, and the Energy Efficiency Commitment (EEC) around £8.

Looking forward to next year, the RO cost will have gone up by around 15%—that is inherent in the way the scheme is designed, since it imposes an escalating obligation that rises each year. DEFRA have consulted on the future of the EEC. However, they have estimated that the cost of EEC2 is expected to be £5 above current levels per fuel, so around £18 per household. The cost of the EU emission trading scheme will start to come to bear in wholesale electricity prices from January next year. It is not clear what the cost per customer will be—it depends on how the fuel mix changes under the impact of the scheme, and also on whether generators and suppliers choose to soak up some of the margin impact for competitive reasons. The likely cost of allowances is also not clear, since although they are already traded to some extent, the market lacks liquidity. Independent projections suggest a broad estimate of the order of £10 per domestic customer per year might be appropriate, although this should become clearer after the scheme starts in January 2005.

Taken together then, we might expect to see the costs of these environmental measures in total to result in an increase in annual domestic energy bills of the order of £20 next year for households using both gas and electricity.

The table below sets out broad estimates of total annual costs (in £million) to consumers of these environmental schemes:

	Total		*Domestic Customers*	
	Now	*2005–06*	*Now*	*2005–06*
Energy Efficiency Commitment	150	400	150	400
Renewables Obligation	490	570	170	200

Ofgem is currently undertaking further work on the likely overall costs to consumers of the EU emission trading scheme. This scheme may well represent the most cost effective approach of achieving carbon reductions.

Clearly these are estimates of costs. Customers receive benefits from these schemes in a variety of ways.

Question 70 (Chairman): Whether an approach that relies on information and switching does anything for those who actually prefer to use a prepayment meter because it avoids them falling into debt, and what you can do to help these people?

Ofgem has always considered carefully the position of prepayment meter customers. Given the success of competition, Ofgem has put emphasis on promoting choice of payment method and supplier for all customers regardless of payment method. Ofgem sees this approach as consistent with its statutory duties.

There are a range of circumstances in which customers use prepayment meters. Some use them because suppliers are obliged to provide a prepayment meter to customers in debt as an alternative to disconnection (subject to this being safe and practicable). Currently 35% of gas prepayment meter customers and 15% of electricity prepayment meter customers are repaying debt. Other customers prefer prepayment meters because these help them with budgeting and are a convenient method of payment. Prepayment meters are commonly found in the rented sector, often in short let and student accommodation, where there is a high turnover of occupants. Although many prepayment meter customers will be on low incomes, they are not predominantly fuel poor, and they do not comprise a majority of the 8 to 9 million households in receipt of some form of benefit. Less than 10% of pensioners use prepayment meters, and less than 20% of the fuel poor do so.

Suppliers face additional costs in serving prepayment meter customers, because of the more expensive meter, higher maintenance costs, and the need for supporting infrastructure to enable customers to credit their meters (many payment outlets are now open seven days a week). To some extent these costs are offset by working capital benefits for suppliers.

Subject to compliance with competition law, suppliers are free to set their prices as they wish. The extent of the differential between prepayment and other payment methods varies between suppliers. It is for suppliers to take their own view on their costs and margins. Given that less than 20% of the fuel poor are on prepayment, any cross-subsidy of prepayment meters would result in more losers than winners amongst the fuel poor (as we explained in our oral evidence). For this reason we would not want to see a mandatory equalisation of tariffs, although we are encouraging companies to find innovative ways of helping alleviate the impacts of rising prices on fuel poverty. In addition Ofgem has a programme of initiatives directed at helping prepayment meter customers, including the removal of barriers to switching, improved information, and the promotion of innovation, and proposes to intensify work in this area.

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