HOUSE OF COMMONS

ORAL EVIDENCE

TAKEN BEFORE THE

ENERGY AND CLIMATE CHANGE COMMITTEE

ENERGY PRICES, PROFITS AND POVERTY

TUESDAY 12 MARCH 2013

RON CAMPBELL and MERVYN KOHLER

RICHARD LLOYD, AUDREY GALLACHER and ANNE PARDOE

Evidence heard in Public Questions 1- 84

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Oral Evidence

Taken before the Energy and Climate Change Committee

on Tuesday 12 March 2013

Members present:

Mr Tim Yeo (Chair)
Barry Gardiner
Ian Lavery
Mr Peter Lilley
Albert Owen
Christopher Pincher
John Robertson
Sir Robert Smith

Examination of Witnesses

Witnesses: **Ron Campbell**, Chief Policy Analyst, National Energy Action and **Mervyn Kohler**, Special Adviser, Age UK, gave evidence.

Q1 Chair: Good morning and welcome to the Committee. Thank you very much for coming in. You probably are aware that Derek Liquorish has been unable to get here because of some travel difficulties. So we will crack on now. We know who you are and you know who we are, so I will not go through a long formal introductory process.

We have been told that there are barriers that prevent fuel-poor households from engaging in the market and switching supplier. Given that I find that quite difficult to do myself, I can well imagine that others who are less expert in the field may, too. Do you think it is possible to overcome those barriers? Or do you think it is always going to be a difficulty for fuel-poor households to take advantage of the opportunities of switching?

Mervyn Kohler: From the point of view of the older population, one of the major barriers, of course, is access to the internet and to the use of a computer, because without the information available online, the whole process of switching becomes extremely tedious. Sometimes in this world the task of being an active consumer is a full-time job in its own right and that may be another barrier in some senses. Switching is obviously worthwhile, particularly the first time you switch, although it becomes subject to a law of diminishing returns thereafter. Arguably, if we had a strategy of fair pricing in the first place, would we need to encourage people to be switching all the time?

Ron Campbell: I think there is probably a more general point than that, that in fact we have seen a significant degree of disengagement from the competitive market across all consumers. My understanding is that switching rates across all categories of consumer are quite low; they are in a degree of decline.

In the case of low-income consumers of course, as Mervyn says, there is a number of barriers, not least of which is access to the kind of technology that, in fairness, I think facilitates that kind of process. However, there are other barriers—there is lack of confidence; there is lack of knowledge; in some cases there will be a problem because the consumer is indebted and consequently cannot switch. Also, one of the fundamental problems, possibly across the market, is that there is a degree of scepticism. There is a perception that there is very little to be gained from the switching process and consequently people do not get involved to the extent that perhaps they once did.

Q2 Chair: Are they right or wrong?

Ron Campbell: As Mervyn said, there is probably still a meaningful benefit for a first-time switcher but, again as Mervyn said, the law of diminishing returns applies. If you look at the general offerings across all six of the main energy suppliers, we seem to be seeing an increasing convergence in terms of the overall costs and I think the conclusion there is that in many instances the benefit of switching will be marginal.

Q3 Chair: Are you familiar with the Citizens Advice scheme, which I think is run with Ofgem, called Energy Best Deal? Is that something that might be helpful for vulnerable consumers?

Ron Campbell: Yes, I am familiar with the concept. I have read some reporting on it and yes, our view is that Energy Best Deal is a beneficial development but that it has the potential to be considerably better. It is modest in scope; it is modest in its ambition. Our preference certainly would be for Energy Best Deal to develop into something that could be provided on a much wider—probably national—basis, and that it should be concerned with much more than simply guiding people towards the best energy-price offer in a competitive market. For example, we would like to see an advice service that, in addition to providing the support and guidance in switching to the best payment option, provided advice on access to grants through energy efficiency schemes and/or advice on debt and money management, and a fairly comprehensive service that extended beyond simply, "This is the best deal you can get through the competitive market".

Mervyn Kohler: Ron's point there is important. Anything that has a collective flavour attached to it means that people begin to discuss issues, to understand the issues better and to develop a greater awareness of what can be and what is possible either in that market or in relation to their consumption of energy more generally. So there is room for encouragement for schemes like that.

Q4 Chair: Mr Campbell, could you just explain collective switching and how that works and how people benefit from it?

Ron Campbell: Thankfully, I have Mervyn here, who I think may make a better fist of explaining how it will work. As the Committee knows, the Government invested significant amounts of money in supporting collective switching arrangements, primarily through local authorities but also through voluntary-sector agencies. That money was made available in the autumn of last year and, as we understand it, progress will have been limited up to now. I would say however that the kind of collective switching that seems to be encouraged by the Government initiatives seems to us to be more the kind of initiative that we would want to see, that is to say, it appears to be based on a community, on a geographical area, and as such would not have the exclusive nature that might apply across some other collective switching arrangements, for example, where there is a compulsion to pay by direct debit in order to join whatever that community of switchers was.

Mervyn Kohler: Nothing very much to add, Chairman. We, Age UK, are participating in this really with the intention of finding out how useful it is and how helpful it can be, remembering that a lot of the older population in particular—but probably the population as a whole—will sometimes want to buy their energy for reasons other than simply price. This adds extra tiers of complication to a collective arrangement. If people like the idea of paying on a traditional quarterly bill basis or of some add-on services like a safety check and things of that nature in the package they are getting from their supplier, that makes the whole collective principle more difficult to organise and goes back to the fact that you can really do it adequately only if you are using a computer-based system.

Q5 Sir Robert Smith: There is a lot of concern that the ECO will not make a significant impact on fuel poverty. Is that a concern you share?

Mervyn Kohler: Very much so. Looking at the potential funding that ECO is going to provide for dealing with fuel poverty, it seems to be a disappointingly small total in relation to what we have seen in public expenditure in the past through Warm Front. Indeed, the Government's own impact assessment, looking at how many people will have been taken out of fuel poverty over the next decade is very, very disappointing—125,000 to 250,000 households. In relation to the target, which is now probably over 6 million households, that is just a drop in the bucket.

Q6 Sir Robert Smith: So expanding the ECO would be a solution?

Mervyn Kohler: Or finding some other form of finance with which to do the essential energy efficiency work that we want done in houses. In England now, we have no publicly funded scheme. We are front-loading it all on to the energy companies and that means that all consumers, including those in fuel poverty, are contributing towards the cost of these housing improvements that we all recognise as the ultimate solution of where we want to go.

Ron Campbell: As Mervyn says, the most recent impact assessment suggested that between 125,000 and 250,000 households might be removed from fuel poverty over that 10-year period to 2013. That is not necessarily a reduction in the scale of fuel poverty because we do not know fully what the impacts of other developments in energy markets will be as a result of Government programmes. However, given that there are currently 4 million fuel-poor households in England alone, and that of course the ECO funding is distributed across Great Britain, we think that is a very modest outcome.

As Mervyn says, despite constant assurances from Government during the passage of the most recent Energy Act that additional resources would be available to address fuel poverty, that the level of resources that would be available would dwarf previous levels of expenditure and that therefore we should not be overly concerned about the loss of Warm Front, that just has not proved to be the case. Resources are considerably reduced and, in fairness, I think they will not be deployed in the optimal manner because there are two things: the level of resources and the means by which these resources are deployed. The existing ECO schemes—at one point the Government's estimate was £1.3 billion; we would emphasise that the energy suppliers suggested the cost of ECO might be as much as double that amount—these resources would be much better deployed through the kind of programme, the National Retrofit Programme, that will be introduced in Scotland, which, rather than considering fuel poverty in individual households will look at addressing fuel poverty on a community basis. You will have heard this before. You will have heard this from us. You will have heard this from any number of agencies, not least the Energy Minister, who in evidence to your Committee, I think in October or November, was extremely enthusiastic about the idea of a community-based, street-by-street, energy efficiency programme.

Sir Robert Smith: So more resources and community-based would be your approach?

Ron Campbell: Much more resources and community-based would be the approach. As Mervyn says, this is a problem too with the Energy Company Obligation. The imposition of levies on domestic consumers, while it obviously has a beneficial impact, also has a negative impact. To some extent, we have seen this in Government programmes before, that the well-intentioned schemes that impose fairly significant levies on domestic consumers result in the redistribution of fuel poverty. The households who cannot benefit from the programmes that are introduced and implemented lose out in real terms.

Mervyn Kohler: Just to underscore Ron's arguments, I believe the approach to use a local initiative to get this sort of work done to be truly important because that brings the community together. People live in areas where the housing will often share similar characteristics and they can chat to each other about, "What's happening in my house; what's happening in yours" and gain strength, reassurance and confidence about what is happening to them and to their home as a result of being able to work together. To make a local initiative really work, we have to somehow draw in the local authorities, who have both information about households in their patch and who will understand the nature of the housing stock in the area. Making it more possible for more local authorities to become engaged is a very important aspect of what we hope we will find in the forthcoming fuel poverty strategy.

Ron Campbell: Could I just reinforce that point, very quickly? I am not sure about what the protocol is about quoting other witnesses. I did laboriously copy out what the Minister said to the Committee in the autumn, but regardless of that, the point is that the Minister was strongly supportive of the area-based approach.

I think there is another point here that, given the eligibility criteria for schemes, and the view of energy suppliers that accessing eligible households is prohibitively expensive and adds significantly to the cost of these schemes, we need to reduce the expenditure that goes on reaching the eligible households. It is a very expensive process.

Q7 Sir Robert Smith: On a specific community that I suppose is even more difficult, the concern is that the ECO will not tackle fuel poverty in rural areas—although it does solid walls—and that the fuel poor will not be able to benefit in the same way as elsewhere because you would want to combine it with the Renewable Heat Incentive, where there is an upfront capital cost or a Green Deal cost.

Mervyn Kohler: That is absolutely right. There is a technical problem as well, that as you define an area as having characteristics of multiple deprivation and so on, sometimes in rural areas the geography just does not allow you to identify those sorts of clusters in the way you can do in an urban world.

The problems of rural fuel poverty sometimes invite different solutions, not available in urban areas, which is to do with renewable generation and so on, which could be very helpful. Going forward, a special focus on rural fuel poverty issues might be helpful as part of a fuel-poverty strategy.

Ron Campbell: Within the Carbon Saving Community Obligation there is a fairly modest 15% rural safeguard. I am not sure how reasonable it is, but if you were to translate that into monetary terms, I think it would be equivalent to about £29 million as the rural safeguard element. It is probably advisable that there be such a specific requirement, that a certain level of work be carried out on behalf of rural households because otherwise energy suppliers are going to find the measures expensive and they are going to find accessing eligible households expensive and they are going to find the whole logistics issue expensive. That is one of the difficulties with a programme like this that is to a large extent driven by suppliers. It is not like Warm Front, where you would have a rural household that knew because it had seen a leaflet about the eligibility criteria and the measures that were available, that they could get a grant for £6,000 towards the cost of a new oil-fired central heating system and/or additional insulation measures. As Mervyn says, there are significant problems with rural households. There is the built type. That is an issue that is more commonly found in rural communities than in urban communities. Of course, there is the off-the-mains-gas network issue, which is a significant problem. However, the main concern in relation to ECO support for rural households is that energy suppliers, or whoever is tasked with delivering the measures, will not be prepared to fund the level of required works.

Sir Robert Smith: Except they are being focused on solid walls so that will help rural building.

Ron Campbell: Yes, the Energy Company Obligation is. That is the primary rationale for that part of the Energy Company Obligation, the Carbon Reduction Obligation. ECO is quite a complex issue, given that it is now seemingly divided, with three different components. In relation to the Carbon Reduction Obligation, rural households should not be any more disadvantaged really than urban households with that built type. However, we have not seen any indication that there is an enthusiastic appetite for these measures and again the energy suppliers are now asserting that in order to incentivise take-up of solid wall insulation, the subsidy will have to be even greater than was originally envisaged and certainly it was originally envisaged that the level of subsidy would be that which would be sufficient to comply with the golden rule of the Green Deal. This is another problem that the suppliers have raised.

If I could just make another point about solid wall insulation, if it transpires—and it looks as though this is the case—that private sector householders occupying a property with solid walls are not encouraged to take up a Green Deal arrangement, despite the fact that 50% of that cost might be defrayed by ECO subsidy, if that is the case and the private sector does not take this up, we said from the outset that the £1.3 billion ECO expenditure should be devoted in its entirety to fuel-poverty programmes. We think this is a particularly rational solution. If the idea was to kick-start development of the solid-wall insulation industry in this country and, by doing so, bring about a situation whereby this measure became economically feasible, became cost effective, then you can do that by using the social-rented sector as, to some extent, a testing ground.

Sir Robert Smith: Thank you.

Q8 John Robertson: Can I ask why it is not taken up by the private sector?

Ron Campbell: I think it is simply the scale of expenditure required. I think we would be talking about £10,000 or so for external solid-wall insulation and despite the fact that the subsidy would be significant—the subsidy might be 50% or so—it would be organised in such a way—in righteous economics it should be organised in such a way—as to just tip that measure over into compliance with the golden rule in the Green Deal. So, say it would be £5,000, but it would not be £8,000 or it would not be £9,000. It would just be enough to make this measure cost effective. I cannot honestly see the marginal economic benefits that would accrue to a household prepared to invest £5,000 in that measure being something that appeals to a huge section of the population living in solid-walled properties.

Mervyn Kohler: To build on that point—and you may not want to go here yet because I'm talking about more generally the difficulties; the barriers to getting this sort of energy retrofit work performed—a lot of people will be looking at the construction, the inconvenience of the work. In the private sector, about one third of the housing stock is occupied by older households, and I am afraid I hear from a lot of older people, "Oh, I don't think I'll be around for another five or 10 years at the most and I can't be bothered to have the work done". We have to get over that barrier as well, as we craft and develop the ECO or whatever we have for the future.

Q9 Barry Gardiner: Mr Campbell, National Energy Action suggests that 45% of fuel-poor households will be unable to benefit from cavity-wall insulation under the ECO. Can you just explain why that might be the case?

Ron Campbell: To be honest, I do not recognise that figure.

Barry Gardiner: Maybe if you want to check whether you did come up with it and if so if you want to write to us and advise us why, that would be helpful.

Are you aware of the sensitivity analysis that DECC has done for uptake by 2022?

Ron Campbell: No, I am not familiar with that.

Q10 Barry Gardiner: What about the Committee on Climate Change’s recommendation of uptake for 2015?

Ron Campbell: Of solid-wall insulation?

Barry Gardiner: They have done an uptake on solid-wall, loft and cavity-wall insulation.

Ron Campbell: I think these things are not terribly scientific. I think there is a general recognition certainly that the kind of measures that were the basis of previous grant schemes—

Barry Gardiner: What is it that is not particularly scientific? Any estimates that DECC come up with or any recommendations that the Climate Change Committee come up with?

Ron Campbell: Both, I think. There is a degree of conjecture in these things. You have to look into the heart of households and energy consumers to see just what it is; how they will react to various grants, schemes and incentives. The Climate Change Committee did say something rather supportive about the negative impact of the cost of ECO on fuel-poor households and in relation to solid-wall insulation. It did suggest that this was a good and rational deployment of resources to fund solid-wall insulation on behalf of fuel-poor households.

Mervyn Kohler: I think a lot of these projections are anticipating how the public is going to respond and here we are so recently into the Green Deal-related programmes, it is very difficult to make a judgment and that is probably where a certain amount of the speculativeness that Ron is referring to comes in. We certainly do need to make sure that the public get behind the concepts that we are trying to extol here—the idea of making homes much more energy efficient. Sometimes it is not helped particularly by the fact that the Green Deal has been crafted very much as a market-led initiative and the energy companies are seen to be among those who will be in the van leading the charge.

Q11 Barry Gardiner: My point, Mr Kohler, was that it has been marketed and also stated that the policy is there to reduce carbon emissions and therefore the recommendations that are put forward by the Climate Change Committee are related to what is necessary to achieve those levels of emission reductions. For solid wall, for example, they said that there should be 2.3 million installations of solid wall by 2015. So given what you have said about the marketing of the scheme and the reluctance of people to have work done in their properties, do you see any possibility of those recommendations being fulfilled?

Mervyn Kohler: Not, I fear, without considerably more effort to generate interest in this sort of subject from communities and so on.

Q12 Barry Gardiner: You said that in an ideal world you would tip the scales to make any subsidy conform with the golden rule of the Green Deal. Nevertheless, that would be ideal only if the Green Deal itself and the golden rule itself were incentivising people to take up the Green Deal programme, would it not?

Mervyn Kohler: Absolutely correct.

Barry Gardiner: It is not, is it?

Mervyn Kohler: No.

Q13 Barry Gardiner: So when Energy UK found that the cost of ECO could not be perhaps the £1.3 billion that DECC have estimated but £2.35 billion or more, adding on average £94 to consumers' bills, do you think that is a more realistic estimate?

Ron Campbell: This is the kind of report that we have had from the industry relating to the last few years of what they see as very challenging targets, so the super-priority group element of the carbon emissions reduction target reaching these households and offering them some kind of incentive to adopt energy efficiency measures—I am not entirely sure what the figure was, I think it was something like £200 per household—and that I think is for fairly basic measures. If I could go back—

Barry Gardiner: I would rather you answered the question.

Ron Campbell: If the cost of the scheme is as expensive as the energy suppliers claim, it will work out at £94 per household.

Q14 Barry Gardiner: DECC have rejected having benefit entitlement checks carried out as part of ECO. Would that have been a useful way of ensuring that more people in fuel poverty engaged in this deal?

Mervyn Kohler: It is an absolutely essential way of making progress on several fronts all at once. Linking benefit entitlement checks to energy efficiency work is a convenient link to make. The important thing at the end of the day is that the benefit entitlement check is carried out because—certainly again I would speak with knowledge only in this respect of the older population—the numbers of people who are under-claiming on benefits, and under-claiming by very significant amounts is quite frightening.

Q15 Barry Gardiner: So why do think DECC decided not to include it?

Mervyn Kohler: Presumably again on the grounds simply of managing the costs of the programme.

Q16 Albert Owen: Can I just move on to more general environmental and social levies? We have heard that these social and environmental programmes are paid for through levies on the energy bills and these costs can hit the fuel poor the hardest. Why is that?

Mervyn Kohler: It is a question of proportionality. A person in fuel poverty is going to be spending, by definition, a larger chunk of their available income on energy and if a chunk of that energy cost is going up, it bites on their broad budget in more general terms. Also, the fact of the matter is that we charge for these environmental and social obligations on a per household bill basis. There would be surely a greater case in terms of equity if it was charged on a per consumption-unit basis.

Q17 Albert Owen: I understand your general theme there, but some housebound people who are fuel poor need heating all the time so they would pay more under a per-unit charge.

Mervyn Kohler: Absolutely right. Again, with the older population, living in their homes 24 hours a day, 7 days a week, probably needing a higher ambient temperature because of their health conditions, people who might be incontinent and need gallons of hot water to wash their bedding and things of that nature, they will need to be looked at in a slightly different way if we were to move to a payment-by-consumption basis. They would need to be properly safeguarded.

Q18 Albert Owen: I am not really sure what you are saying as an organisation. You said in your opening remarks that you supported the units. Yes? Unit cost. However, that would be detrimental to some people whom you represent.

Mervyn Kohler: As an organisation we look at the figures, which give us the flavour in the big picture of things, that people who are in fuel poverty are usually smaller consumers so let's start with that and then deal with the exceptions, who we want to protect.

Q19 Albert Owen: However, are they the exceptions? The people I come across or visit in their houses in my constituency who have concerns, they are growing in number. So I am not so sure that the balance would be, in the way that you said, better for them by going to unit price.

Mervyn Kohler: This may be a subject worth more research and more discussion, but I come back to the fundamental point that the most profligate users of energy are wealthy households, and the converse is true as well.

Q20 Albert Owen: The Fuel Poverty Advisory Group has advocated that there be a protected block of consumption. Do you think that would work? Is that the practical solution to the dilemma that you outlined there: that you can identify who are the fuel poor and then in their bills there is a block of consumption exempted?

Mervyn Kohler: The fly in that particular ointment is whether you can identify the fuel poor. We have spent a lot of time debating the definition of who is in fuel poverty or not and wherever you make a definition of a description of a household, you are going to have silly cliff-edges where people are either in or out of the box and sometimes inside it and sometimes outside it.

Q21 Albert Owen: Nevertheless, a lot of people on benefits are fuel poor as well so those would be an easy target group for the DWP.

Mervyn Kohler: They would, and undoubtedly to find some way of protecting those people by a strategy such as having a protected block of expenditure would be a help—and a help to people who are living on such seriously narrow margins that even a small amount of help is going to be very welcome respite.

Q22 Albert Owen: So you think it is a good idea and it is something worth looking at?

Mervyn Kohler: It is definitely an idea worth looking at.

Ron Campbell: My assumption here is that all households would benefit from a number of units that were not subject to any kind of levy, so it would not simply be a question of identifying fuel-poor households. The hypothetical benefit to fuel-poor households would result from the fact that they generally do consume less energy. Consequently, what would be a higher charge on the second tranche of units would not impact so badly on these households because they consume so many fewer units of the second tranche.

The main issue about raising funding for Government social welfare and environmental objectives is not so much to do with how the levy is structured and whether the levy is right in principle. The levy is regressive in its function, not simply because energy costs represent a higher proportion of low-income households' expenditure and income; it is because it does not take any account of their ability to pay.

Q23 Albert Owen: Neither do the other breakdowns of the bill. Transmission costs—if you are rural poor in the west of Scotland, you are still paying more for your transmission costs. So it is not just the environmental and social costs that that applies to in the bill.

Ron Campbell: The fundamental issue here from our point of view is less to do with modifying the way levies are imposed on domestic energy bills and more with developing some kind of system that better reflects ability to pay and that, we consider, unavoidably involves Exchequer-funded programmes rather than levies on consumer energy bills.

Q24 Albert Owen: Just one final question, I think you have covered most of what I was going to ask. How confident are you that these are passed on to the consumers in a fair way because we do not really know from the bill. I am sure you are familiar with the figures, Ofgem suggests 11% or £59 per annum on electricity and 6% or £49 on gas. Do you think that fairly reflects what people are paying?

Mervyn Kohler: I think that to have the information about these extra charges much more clearly spelled out on the bill is a good thing in principle. It makes people, if they are going to pay any attention to their bill at all say, "Oh, what are these social and environmental levies? Oh, is that what it's about?", and it would perhaps improve their overall awareness of the energy that they are using, how they are using it, why they are using it. It would help with that background noise of making energy something that people are prepared to talk to each other about in the convenience store or in the pub or whatever.

Albert Owen: They are talking about it now and they don't like it, many people.

Ron Campbell: Levies are simultaneously problems and solutions.

Albert Owen: My question was do you think there is sufficient information now?

Mervyn Kohler: There is not sufficient information on consumer bills, no.

Albert Owen: That can be done quite easily by the regulator suggesting that the energy companies do it?

Mervyn Kohler: A very simple change, yes.

Q25 Albert Owen: What about DECC? How can they control how companies decide on the levy?

Mervyn Kohler: I think I was answering you, Mr Owen, on the basis of how we explain to consumers what the levies are about, not how we fix the levies.

Q26 Albert Owen: That was my first part, yes, which you answered. You are saying it is very simple; it can be done. The second part I wanted to talk about relates to when you were talking about unit costs and household costs earlier. Can DECC have a direct input into this?

Ron Campbell: I think DECC can frame the structure of levies in any way they see fit. I could not imagine what the—

Q27 Albert Owen: Do you think they should be more proactive or just leave it to the companies? We will be asking them and we will be asking the companies, but we are asking you now.

Ron Campbell: Presumably they will tell you that they are being as proactive as they can.

Albert Owen: They will give us their account. We are asking for yours.

Ron Campbell: Levies are very complex. As we have been discussing here, certainly you can structure levies so that they benefit, for example, the majority of fuel-poor households. The unintended consequence in certain cases—depending on the individual household's circumstances, say, an all-electric household—is that you might end up inadvertently penalising a fuel-poor household, but these are issues where there has to be a kind of utilitarian approach. The vast majority of fuel-poor households would presumably benefit from option A, but a smaller proportion of fuel-poor households would further be penalised.

Mervyn Kohler: I think the question of whether DECC leaves the setting of the levies to the companies is an unusual one and an odder one, but I would feel instinctively that it is for DECC to decide and to apply uniformly across the companies, or else we are inviting the companies to do even more obscure things with their bills in order to try to provide the argument that they are offering the best price to consumers, and we are all surely about simplifying bills rather than making them more complicated.

Q28 Mr Lilley: Presumably we can all agree that cost efficient programmes to reduce the amount of energy you consume—particularly for poor families—is a good thing, and the Green Deal therefore in principle, if the golden rule is met, meets that criteria and that the cost will be less than the benefit. You mention ECO costing £1.3 billion. My simple arithmetic, if there are 20 million households, is that that makes £65 per household, presumably over the lifetime of the programme. Do you think that is a good deal?

Ron Campbell: I think if the overall expenditure can be limited to the £1.3 billion, I think that is one of the main concerns at the moment. The industry is suggesting that, because of the way the programme is structured, expenditure might be in the region of 100% more than the £1.3 billion. It is all to do with the outcomes and the value for money of course, and to go back to—

Mr Lilley: Surely the ECO is designed to cope with the things that cannot be financed by the Green Deal, i.e. whether costs exceed the benefits to the household? Almost by definition the costs exceed the benefits, so it is not a good deal.

Mervyn Kohler: Yes, the cost of ECO is going to fall on all households and only a handful will see the benefits of that programme of expenditure, in terms of having work done in their homes. That is the balance that we have to try to address. That would be the balance if you were the householder in question looking at the extra cost of the levy on your bill, and looking at the energy efficiency that you are getting out of your property at the moment.

Q29 Mr Lilley: Are your organisations concerned about other costs of the Government's climate change programme, in general? The costs of moving from relatively low cost coal, gas and old nuclear, to renewable energy, which costs twice or more as much: wind, offshore wind, new nuclear?

Mervyn Kohler: We are very conscious of the fact that the energy industry is facing huge costs going forward, in terms of generating and the manner in which electricity and gas are provided to us, and distribution. All these matters will add remorselessly to our energy bills. If we are concerned about fuel poverty, of course we will be concerned about how these extra costs are going to be factored into bills and consumer costs going forward into the future, because it looks as if it could plunge a lot more people into fuel poverty. So, yes, we are aware of the bigger picture.

Q30 Mr Lilley: Are you aware that, according to Lord Stern's report that the Government uses as justification for imposing all these higher costs, the costs of these measures will not be exceeded by the benefits in terms of reduced damage from climate change until the next century, in 100 years' time?

Mervyn Kohler: From my point of view, I do not think I have the intellectual apparatus to challenge Lord Stern.

Q31 Mr Lilley: No, I am not seeking to challenge him. I am asking whether you accept his analysis, which is in his report?

Mervyn Kohler: I can see the argument that we have to make a difference to climate globally. The contribution that we will make in the United Kingdom, by sheer dint of our size, will be a relatively small part of that, but that is not an argument for not doing it.

Q32 Mr Lilley: Don't you think it is a bit rich that your client group—the elderly, the least well off—are being asked to subsidise future generations, which again, according to Lord Stern's forecast, in 100 years' time will be three times as well off, even on his worst scenario for climate change, and in 200 years' time will be seven times as well off, even on the worst scenario he shows for global climate change. Should the poor today subsidise the rich tomorrow?

Mervyn Kohler: You make your challenge to me, Mr Lilley, about the older population. I would submit in return that the older population feels a sense of the importance of leaving an inheritance to their children and to future generations. A safer planet might seem to me to be an important part of that inheritance.

Q33 Mr Lilley: However, if their planet is going to be seven times as well off, it is pretty well saved, isn't it?

Mervyn Kohler: "If", you said.

Mr Lilley: According to him, his worst scenario.

Q34 John Robertson: I want to ask some questions about the Energy Bill and the Retail Market Review. Unfortunately, your colleague who is not here—the first question was to him, really, but perhaps if I can structure it in a way that you will be able to let me know what your thoughts are. The Government have said—I think I can even quote part of it here—that the costs of the Contracts for Difference will be passed to consumers in their energy bills and that there is no intention to charge the industries for it. How do you feel about that?

Ron Campbell: Obviously, in relation to our client group, anything that impacts negatively on energy costs is to be deplored or at least regretted. We recognise—and I suppose this is very much in line with what Mervyn was saying earlier in response to Mr Lilley's question—that there are compelling arguments related to the generation mix and how we develop the generation mix in the future, and that—unavoidably, it seems to us—additional costs will be incurred as a result. We get a kind of tentative reassurance from Government. I personally do not find it remotely reassuring, but I think it is intended to be reassuring in that, as much as energy costs may be higher, they will be less high than they would be if we continued with business as usual in terms of generation. That simply, in relation to the fuel-poor population, isn't good enough.

We say this in relation to as and when you identify a detrimental impact on fuel-poor households, your primary objective should be to develop a proportionate response to ease or eliminate that detriment. As I say, there are two issues here. One is the macro energy generation issue. The other one is back at the individual household level—what actions do you propose to take to mitigate the negative impact on these households?

Mervyn Kohler: We have to look at this in the round as well. To add to Ron's point, the Government is trying to steer the market by a number of different levers, of which Contracts for Difference is one and carbon taxes and so on are others. We have to look across the piece here and see what benefits there will be for consumers. I would submit that we would be talking about the potential costs to consumers of things like Contracts for Difference, and the benefits that might be accrued if we looked at the revenues from carbon taxes going forward as being a pot of money we could use to help people in fuel poverty.

Q35 John Robertson: Yes. I have many elderly people in my constituency, and I sometimes think that perhaps we should be looking after not just them but people with disabilities, people who do not have the money. Should we try to introduce some kind of levy that helps them, as opposed to other people?

Mervyn Kohler: It is perfectly right and proper and laudable, and no doubt Age UK would argue that it should be done too, that we make special provision for people who are disabled or who have special needs and so on. However, what we know in the long run is that the solution that we want to reach is housing that is much more energy efficient, where we do not have to have this discussion about, "Do you have enough money to keep yourself adequately warm?" The slowness of our collective effort, our willpower as a country over the last 30 years to improve our housing stock is why we have an urgent problem now, with so many people in fuel poverty and so many different potential ways—I do not criticise your potential ways of helping people who are poor, but they are essentially "finger in a dyke" operations, whereas we actually want a bigger dyke.

Q36 John Robertson: Yes. Mr Campbell, NEA said that the Government had failed to undertake a rigorous and convincing analysis and fully consider the advice consequences of the Energy Bill. What was missing from the Government's analysis?

Ron Campbell: I think the fundamental thing that was missing was a credible indication of the impact that electricity market reform would have on households in general, and fuel-poor households in particular. As I say, much of the emphasis in the impact assessments related to the Energy Bill have concerned, not the actual degree of detriment to households but have concentrated on how much worse potential detriment would be if the proposed measures of the Energy Bill were not undertaken. We have no way of deducing from that kind of analysis just what the implications are for fuel-poor households. We have 4 million fuel-poor households in England at the moment, 5.0 million-something fuel-poor households in the UK. We have no idea how many fuel-poor households there will be in 2020 or 2025, and we would like to see some kind of analysis that demonstrated the extent of that problem over the next 10/15 years or so, but more importantly, I think, increased recognition of the need to undertake remedial action to address what appears to be a significantly growing problem.

Q37 John Robertson: NEA have suggested an alternative approach to that set out by the RMR would be to offer a universal social tariff to households meeting the pre-defined eligibility criteria. Can you explain this proposal in a bit more detail, and what you think would be preferable to simply putting all consumers on the lowest tariff rate?

Ron Campbell: This would be an attempt to bring clarity, consistency and uniformity across the energy industry, working on the assumption that you have identified a category of the population that is particularly vulnerable, that is financially disadvantaged and that is in need of specific assistance. We see this now across a whole range of fuel poverty labelled programmes, because eligibility criteria are converging. Whether it is based on the Warm Home discount, whether it is the Affordable Warmth element of the Energy Company Obligation, whether it is cold weather payments, the most vulnerable and financially disadvantaged households are being prioritised for assistance. I think in relation to a universal social tariff, that simply reflects the way other benefits work or other sources of support work, that there is a consistency across all entitlement to the extent that a household knows whether they qualify for some kind of support and/or an adviser knows how they can refer people into that level of support and what that degree of support will be. So you do not have individual suppliers having a non-standard offer.

Q38 Ian Lavery: I want to focus very quickly on the *Hills Fuel Poverty Review*, the independent review for Government, which was published in March 2012. Some concerns have been expressed about the new fuel poverty indicators recommended by Professor Hills. Can you explain the potential pitfalls of the new low income, high costs indicator?

Mervyn Kohler: I think the key point is that John Hills observed in our current definition of fuel poverty that it was too sensitive to price changes, and the key point about his proposed alternative is that it is not sensitive enough to price changes, and that because he is taking a median of a median, and things like that, to help define who is going to be in fuel poverty under his new definition, we will be looking at a target that scarcely ever changes. The value of a fuel poverty definition is that it gives us a picture of the scale of the problem. It also enables us to measure whether we are going forwards or backwards dealing with it, and if we have a measure that doesn't change very much it doesn't seem to be awfully helpful from that point of view.

Neither measure helps us do anything very tangible with targeting measures to alleviate fuel poverty. So, in that sense, there is a certain amount of technical happiness about getting the right definition of fuel poverty, but it doesn't necessarily help us with practical implementation of fuel poverty strategies.

Q39 Ian Lavery: Do you think that the *Hills Review* in some cases was a distraction from designing effective fuel poverty policies?

Mervyn Kohler: It has certainly taken people's eye off what is happening on the fuel poverty front. As we have seen, the price of energy continued to spiral upwards in such a widespread way. It has also brought into disrespect the will of Parliament, for example, in 2000 with the Warm Homes Energy Conservation Act, getting agreement from the Government that fuel poverty would be eliminated as far as practicable by 2016. We are not going to get there. What is Parliament going to do about it?

Q40 Ian Lavery: Finally, if the Government decides to adopt the new definition, do you think a new target should also be set?

Mervyn Kohler: There certainly needs to be a new strategy. How far we can attach targets to that I do not know, but I certainly want to see the targets bringing down the numbers of fuel-poor much faster than we have currently forecast for the intervention of Green Deal and ECO and, above all, to make sure that the trajectory is downwards instead of remorselessly upwards, as it has been for the last seven or eight years.

Chair: Thank you very much indeed for coming in. It is much appreciated.

Examination of Witnesses

Witnesses: **Richard Lloyd**, Executive Director, Which?, **Audrey Gallacher**, Director of Energy, Consumer Focus, and **Anne Pardoe**, Energy Policy and Liaison Officer, Citizens Advice, gave evidence.

Q41 Chair: Thank you very much for coming in. I am sorry we are running slightly behind time but we will proceed now. I will not go through a formal introduction, as we know who you are, and you should know who we are.

Some of the Committee visited Glasgow last month, and we did hear concerns from members of the public who said they were simply unable to afford their bill. One homeowner claimed their bill was more than £400 a month. We were not able to stand that up while we were there, but another one was saying they had to switch off their heating for six months of the year. Do you think that is a genuine and widespread experience for people?

Richard Lloyd: I think it is, Chairman, and we have been polling every month now for a year what are consumers' top financial concerns. Domestic energy prices are consistently either the top concern or the second. The second is often the price of petrol or diesel. We found that a significant proportion of consumers are dipping into savings, using credit to pay for domestic energy costs; up to 40% of consumers in our most recent tracker. So all the evidence we have seen is that this is a very widespread and longstanding problem for consumers. They are worried about the trajectory of prices into the future, they are worried about what they are hearing from the Government about where prices are likely to go before potentially the effects of decarbonisation start to mitigate that, and they are looking to the Government for solutions, and all of this with a backdrop of deep mistrust of the energy suppliers.

Audrey Gallacher: I think probably Citizens Advice will have more specific anecdotal evidence around the clients that go to them, but we have a small complaints handling team up in Glasgow in fact that deal with debt and disconnection cases. It is a statutory responsibility that we have. They have never been busier. They are reporting that they are seeing increasing cases of consumers who have self-disconnected from pre-payment meters, to an extent that they are encouraging us to do more work to understand the drivers behind that. So I think, as Richard said, it is a significant problem—not one that is going away, but one that is only getting worse, but I am sure Anne probably has lots more examples around that.

Anne Pardoe: Yes, I think it is one of the biggest issues that our bureaux are dealing with at the moment. Last year we had 97,000 inquiries just to our bureau alone about fuel debt. In the first three-quarters of this year we have received 68,000, which is roughly the same proportion of our overall inquiries. Interestingly, every year we survey our bureau, as a policy team, to see what the biggest issues they think we should be working on for the year are, and this year, perhaps unsurprisingly, welfare reform came top, and then energy prices were something that they thought we should be doing something about second.

Energy prices are rising hugely out of step with household income, and the cost of living is rising hugely as well. It is becoming more and more of an issue, and we think that it is going to get worse, with the prices continuing to rise. We are particularly concerned about the impact of welfare reform on benefit claimants as well.

I brought a couple of examples along with me of some bureau clients who we have seen quite recently, since January this year. We had one client who was a widow and she lived alone on a very low benefit income. She was in poor physical health. She was working part-time, but was currently signed off sick. She could not afford to turn her heating on during the winter as she was terrified that she wouldn't be able to pay the bill when it came. She had resorted to wearing extra layers of clothing, hats and scarves, indoors. We also had a 35-year-old woman, with two young children, who is in receipt of benefits. She had arrears with her gas company that were being collected through her pre-payment meter at the rate of £8 per week. She could only afford to put £20 per fortnight on her meter, which only gave her £4 worth of gas. She and her children were very cold and the children were getting ill and hadn't been going to school as a result.

Q42 Chair: Could a benchmark retail energy price help?

Richard Lloyd: In our view, yes. One of the problems with the market, both retail and wholesale in our view, is that there isn't a clear reference point for pricing. In particular, if you look at other markets where there is a benchmark price set by the regulator, for example, in some states in the United States, in Northern Ireland, and around that, suppliers can compete. It gives consumers—the vast majority, as you know, are very disengaged in this market—some assurance about whether they are paying a fair price. I think what we have seen over the years, where we have relied on a liberalised competitive retail market, is growing distrust on the part of consumers about whether the price they are paying is fair, a great difficulty in navigating their way around the market and identifying the best deals, and nowhere to look to, to compare authoritatively whether the price they are paying for gas and electricity is a decent one. So, in our view, yes, it would help.

Q43 Chair: Consumer Focus, you have expressed concern about the Carbon Floor Price. Could you tell us how you think carbon tax receipts could be used to alleviate fuel poverty?

Audrey Gallacher: There is a campaign running at the moment called the Energy Bill Revolution, which is looking at making the homes in the country more energy efficient, so making them as energy efficient and up to the standard of homes built today. Obviously, to do that would cost a significant amount of money. We know there is pressure on public spending, so it is quite difficult to see where that would come from. To us, there is an obvious vehicle around the Carbon Floor Price, which is obviously a tax on carbon. As an organisation, we would rather see that scrapped. We do not think it is a very good policy vehicle. We do not think it really delivers the intent to reduce carbon; it just displaces it across Europe. We would do much better to try and work with other member states to sort out the EU ETS. However, on the basis that we have this, that it is raising significant tax receipts every year, the Energy Bill Revolution suggests anything up to £4 billion a year.

There has been some economic modelling done and it shows that if you use that money you can make homes more energy efficient. You can take nine out of 10 homes out of fuel poverty and, as a by-product, clearly you are reducing carbon, which is an ongoing aim, but you are improving the health of those households. Potentially you are offsetting the need to build increasing amounts of generation plant, because we won’t be using as much. It would also create quite a lot of jobs, which is clearly something that we are looking for in these current economic times.

Q44 Mr Lilley: Mr Lloyd has referred several times to lack of trust in the energy companies by consumers. Do you think this is justified? I presume you mean by that that they think that the profit margins taken by the energy companies account for a significant percentage of the increase in price that they have experienced. Do you agree with that?

Richard Lloyd: I think there is a justified lack of trust. The energy suppliers acknowledge that and they are saying to us they are trying to rebuild that trust. I think there are a number of causes. One is a lack of transparency about how the price and, in particular, the price increases that people have been paying have been arrived at, with very regular, very substantial profit announcements by particularly the vertically integrated suppliers, who are making significant margins on their generation business, perhaps not so significant on their retail end of the business. That fuels the perception among consumers that there is something going on in the industry.

Q45 Mr Lilley: I am not talking about perception; I am fully aware of the perceptions of consumers. I am saying, do you objectively think that increased profits account for a significant proportion of their increased bills?

Richard Lloyd: I think they do.

Mr Lilley: How much?

Richard Lloyd: This is part of the problem that we have with the industry—

Mr Lilley: The simple answer is you do not know.

Richard Lloyd: —is that there isn’t enough transparency about what is going on in the market—both at the retail and the generation end—to be able to objectively assess whether there is some advantage being taken of consumers through people being very reluctant to move in this market. So my view is, yes, people are right to distrust the market. Whether they are right to distrust individual suppliers, I would say depends on how transparent those suppliers are being about what they are doing about the costs that they are imposing on people, and in general—I will have to come back to this—what we are asking consumers about is consistently finding there is a low level of trust for those reasons.

Q46 Mr Lilley: Roughly, what proportion of the cost to consumers is profit to shareholders? Is it all stages of the process do you think?

Audrey Gallacher: We did some research last year: “Who Pays?”, which is about consumer attitudes to—

Q47 Mr Lilley: No, I am not asking about consumer attitudes. I am asking about the reality, the facts, the money going to shareholders, not what people think it is but what you know it is or do not know it is.

Audrey Gallacher: We have done some work looking across the whole value chain, so distribution activities and generation. We thought about 20% of the bill was made up of profits and some investment. We really do not know—and this is another issue for consumers—companies continually tell us that they need to make profits because they need to invest, but we do not ever see what that investment is. However, we thought approximately 20% of the bill—all told, not just suppliers, right through the value chain. That was peer reviewed by some DECC economists, who did not find any fault with it but were not going to sign up to it. Again, it is quite a lot of conjecture because we just do not know.

Q48 Mr Lilley: By how much do you think that percentage has increased?

Audrey Gallacher: One of the concerns that we have had on—

Mr Lilley: Could you just answer the question: by how much do you think that has increased? It could be, “Yes, 5%, 10%” or “don’t know” or “100%, don’t know”.

Audrey Gallacher: We have some figures where we have seen that—

Mr Lilley: Tell me what the figures are.

Audrey Gallacher: I will need to look for them in my brief, but profitability across from 2008 to 2012 has shown that the—can I come back to you on that because I don’t want to waste a lot of time looking for it?

Q49 Mr Lilley: Sure. Presumably, at one stage they might have been earning zero profit. It could have gone up to 20%, so the maximum amount of the price increase it could account for is 20%, if previously they were earning zero profit, which would have been an unsustainable position.

Richard Lloyd: What we can say is that on the retail end for the Big Six, for the largest suppliers, margins have been on average about 1.3% to 3.2% over the last three to four years.

Q50 Mr Lilley: That is trivial compared with the cost increases my consumers have suffered.

Richard Lloyd: For the same companies, the wholesale electricity businesses that they own have been showing margins of between 30% and 10%. So, again, this is part of the difficulty consumers have in trying to figure out—when they are presented with for a group, say, like Centrica—what the truth is here. You are hearing about very substantial margins on their generation business, still reasonable pretty healthy margins on the retail business—

Q51 Sir Robert Smith: What percentage of the bills is the generation business?

Richard Lloyd: About 60% of the average bill.

Sir Robert Smith: So that is 8% on the final bill?

Mr Lilley: No, you are giving the figure as a percentage of the final bill, aren't you?

Richard Lloyd: Yes.

Sir Robert Smith: When you were saying 17%, was that on their wholesale operation or was that—

Richard Lloyd: 17% on their wholesale operation is margin.

Sir Robert Smith: So that only makes up half the bill then?

Richard Lloyd: Your maths is better than mine, Robert. We can write to you with what we think in more detail the numbers look like.

Q52 Mr Lilley: It is becoming clear to me that you are feeding public concerns that the main reason for the rise in their bills is an increase in the profit margin. You have little evidence for this, and the maximum, from the figures you have given us now, if they previously had or could in future have zero profit—which is obviously unsustainable—is it could add 15% to their bill. Bills have gone up by much more than that, so it must be other factors. You should be expressing that. The main factor I would have thought is increased fuel costs. A secondary factor is increased Government costs imposed by all these green levies.

Richard Lloyd: We have always stressed that a significant proportion of what people are paying as an increase in their bills is due to decarbonisation, to social policies.

Mr Lilley: You have not told us that.

Richard Lloyd: You did not ask me about that, with respect, Peter.

Mr Lilley: No, we asked you—you volunteered.

Richard Lloyd: You asked me about the contribution of profit to the increase in people's bills.

Mr Lilley: I am talking about what you talked about. You talked about consumers' concerns that it was about the companies' dishonesty and lack of transparency. You never mentioned the Government's position in your opening remarks.

Richard Lloyd: I have said consistently publicly that there are a lot of components—

Mr Lilley: Except today.

Richard Lloyd: With respect, you did ask me a very specific question about profit but I am very happy to talk about the range of policies that are also driving the increase in bills, and I was saying that I thought very clearly that the consumer perception is one of distrust in the energy market. A part of that is the lack of transparency about what is driving retail prices, but then if you look at the results that companies are reporting, they are reporting much healthier margins on the generation businesses than the retail businesses. That is part of why there is a perception, on the part of consumers, that there is something perhaps untoward going on between the different arms of vertically integrated companies. On top of that—as I also said in my opening remarks—people are worried about what they are hearing from the Government about the costs they are going to have to pay to decarbonise the system. I thought I was quite clear on that.

Mr Lilley: You did actually say that, and I apologise. I suggested you had not said that. You did say that.

Audrey Gallacher: I have some figures. Do you want me to come back?

Q53 Albert Owen: Can I just—Mr Lloyd is absolutely right to say that there is this lack of trust because of transparency, and it is the companies themselves that actually admit to this now. Do you ever think that we will get to a position where there is full transparency and that people will accept that energy costs are going to keep going up? Do you think we are ever going to get to that stage or is it always going to be this sort of cloak and dagger we are worried about, whether the price has been reflected, whether the costs are passed on to the consumer? Do you think we are ever going to get there because some of the energy companies are asking for that, to be fair to them?

Richard Lloyd: The reforms on the table at the moment aren't going to get us there. I think the opportunity is there, were the reforms on the table to go further. The most forward-thinking suppliers actively want that degree of transparency because they want to regain the trust of their customers, as I said before. Why do those reforms not go far enough, in my view? Well, I think if we have a much simpler market, we are taking some steps towards getting that simplicity, whereby people feel they are more likely to be able to engage in it, to be able to spot the cheapest deal, to switch more easily, to get—if they are not engaged with the market—a price that they can feel confident is fair.

Q54 Albert Owen: I understand all that, but my point is—and the current Secretary of State for Energy and Climate Change has said it as well—that in the short term there is going to be an increase but, when market reform comes in, there is going to be mid to long term cheaper bills in the future, but we are going to have to pay this bill. Do you accept that premise?

Richard Lloyd: I do accept the premise and support the idea that if we get the system to work better, more efficiently, that if we can all better manage our energy consumption, we should be better off than where we otherwise would be. However, that is a very difficult message to get across to people.

Q55 Albert Owen: Final point, do you think collectively we have a responsibility to have that open argument with the public?

Richard Lloyd: I think we do, and part of that needs to be a responsibility on the part of suppliers and the regulator to get out into the open what is going on between the different arms of their business, to get some numbers out, some facts out, a reference price as we were mentioning earlier. In the end, having that honest conversation—as one of the suppliers has been saying they have been wanting to have with the public—about what is genuinely driving the increase in their bills, what they can do to manage that, and where the investment that we are all paying for through our bills is taking us. However, I fear we are a way off that and, in particular, while there is still this question mark about what is going on with the profitability of companies, there will still be that suspicion that there is something not quite right in the system, and that is the hump we have to get over.

Q56 Sir Robert Smith: That leads into one of the aspects of how the companies communicate with their consumers, and I think Consumer Focus have expressed concerns that it can be misleading with the way they make their comparisons. You say particularly with European countries' prices. What other aspects of the communication are misleading?

Audrey Gallacher: What I have found quite frustrating over the last few years—and it leads to this point around trust and profitability—is that around 2008, companies told us that they didn't make any money at all, and so that is why they had to increase. This is in relation to price increases, so "We don't make any money so have to increase our prices". In that period, from 2008 to 2011, there has actually been a 36% increase in profits across the Big Six, but that is another story.

Sir Robert Smith: Is that 36% across the whole vertically—

Audrey Gallacher: Yes, so, on the production and the trading arms as well. We have taken that from financial accounts. We then heard that prices have to go up because wholesale prices are increasing, and clearly we have seen that. We have evidence of that. We know that there was a spike, but since that big price spike in 2008, wholesale gas, wholesale prices have come down and we haven't seen a corresponding reduction in consumer bills. That is something we campaigned about for ages—whether prices were passed on. Ofgem has found some potential evidence that falling prices were not passed on as quickly to consumers as rising wholesale prices were.

Now that we have a less volatile or certainly a lower wholesale price, companies are now using the excuse of social and environmental obligations and other non-commodity costs to justify price increases. So, I think, as consumers we are just about sick of these continually changing messages, which adds to that degree of mistrust that Richard has been speaking about. I really don't think it helps because we don't understand the magnitude of those issues on bills, particularly in relation to certain costs that you discussed in the previous evidence session. We have no idea what those costs are. We are going on what the companies tell us. So I think there is quite a lot of conflicting information out there.

My worry would be that we now have an industry that points towards Government and blames Government for rising costs. There is absolutely no doubt that Government energy policy will contribute to consumer bills, but to continually be involved in this kind of bun fight over whose fault it is isn't really going to take the debate forward or help consumers to reduce their energy costs.

Q57 Sir Robert Smith: Can you see any way of providing a clear way of communicating those Government costs to consumers?

Audrey Gallacher: One of the things that is quite difficult is that there is not really an open discussion, so we have seen situations whereby, for example, at the moment the Energy Bill is looking at introducing measures to put consumers on the cheapest tariff because it was mentioned by the Prime Minister in the House of Commons. However, there isn't really as much prominence of how Government energy policy is potentially going to contribute to consumer bills. We have accepted that we need to break the link with fossil fuels, that we need to decarbonise and that all these measures will mean that, longer term, prices will be cheaper than they would have been had we done nothing, but we still have a good 10 years to get people there. That is going to be massively painful, and I don't think there has been a proper debate about whether consumers can afford that, the pace and the scale of it. Also, potentially, Government policy is much more targeted at the supply side rather than reducing demand. So if you have done things to make houses more energy efficient, people use less. We shave peaks. That would deliver the same benefits in terms of carbon reduction, but it would probably be a bit more comfortable for consumers, so there is an issue.

We have a budget. Every year the Chancellor gets up and says what he is doing with taxes. A lot of these levies on energy bills are, in effect, imputed tax, but there doesn't really seem to be the same level of public exposure around them, and that makes it difficult for consumers to make a judgment. The last thing we need is industry and Government at each other's throats because what we need is consumers changing their behaviour, becoming more energy efficient, engaging with the smart metering programme, taking up the Green Deal, all of those things. While there is that continued argument in the background, there is a real danger that consumers will not take action because they are leaving it up to everybody else to sort it out.

Q58 Sir Robert Smith: So you think the Government needs to be clearer about costs as well as the industry?

Audrey Gallacher: Yes. We have done research and consumers were not aware that they paid social and environmental obligations on their bills.

Sir Robert Smith: Even though you have said that the companies are exaggerating that, that had not got through to the consumers?

Audrey Gallacher: I do think they are. I am quite worried now about what the background commentary is on profits. Potentially, we need the Government to come out and make a statement on whether prices are fair or not and let us know where things are potentially going.

Richard Lloyd: If I can add to that, Robert? I think there is a limit, especially where consumers are at the moment, to what you could expect people to do in engaging with these numbers. If organisations, like Consumer Focus and *Which?*, are not able to translate the limited data we are being given—because it is very limited—about what is driving costs into a way that consumers would engage with, then I think the suppliers will struggle as well.

There are examples of companies producing graphics with a radiator with different chunks of it in different colours, attributing costs to different drivers, to different sources, but in the end if you know that most people don't look at their bills or read their annual statements or want to engage in that level of detail, I think there is a job for the Government to do to help—and for us to help in doing that—to translate what is going on into more accessible information to consumers. There is a lack of transparency in the market that allows us to do that.

Q59 Sir Robert Smith: Do you think Ofgem could have more of a role in encouraging an open understanding of what is going on?

Richard Lloyd: I think it should, and they need to think about how they can much more clearly present what is going on to consumers; much more proactively do that. I think they have been far too quiet about this for too many years. Surely it is part of their job, as the regulator with a duty to protect the interests of consumers, to be explaining to consumers in much more understandable language what is going on in this market and what they are doing to protect people from unnecessary costs.

Anne Pardoe: We would agree with that as well. We would like to see Ofgem take far more of a role in mediating the public debate around this. When there is a round of price rises from suppliers, they have the information there, they have the ability to say, looking at the market, "This is fair" or "This is not fair." Is the level of profits fair? Surely it is part of Ofgem's job to look at that and mediate that debate. We would also like to see more of a unified, sensible public debate about the costs. What are the costs imposed by the Government? What are energy profits? What are the wholesale? We think Ofgem has a role to play in mediating that public debate as well. We would like to see them do a lot more.

Q60 Sir Robert Smith: I suppose a lot of the debate has been about the retail market, and trying to make that as competitive as possible to maximise efficiencies, but you have highlighted that, in a sense, underlying that you can have a really efficient retail market but if the wholesale market is producing a product that isn't so competitive then retailers cannot make much difference. It is only on their retail margin that they are going to be competitive. So you are thinking that there are deficiencies in the wholesale energy market. What sort of data on wholesale gas and electricity prices are currently publicly available and what do you think needs to be done to tackle your perception of the deficiencies?

Richard Lloyd: There is a very small proportion of the trades in gas and electricity for which there is publicly available data. For example, while 70% of day ahead trading is on N2EX, an exchange for electricity, only 6% of total consumption is estimated to be traded. The vast majority of trades are done behind the scenes for a far longer curve into the distance; three years and that kind of timeframe. It is impossible for people outside the industry to know what kind of deals that far out are being done, and there is no transparency about the prices that are being paid. In particular, in the vertically-integrated companies, there is a lot of self-supplying going on, for which there is no publicly available data. So our view is, at the very least, there needs to be much more transparency about the prices that are being paid to wholesalers, including by their own retail businesses.

We have welcomed the moves that Ofgem have been encouraging to make more energy traded openly through exchanges. Some suppliers agree that one of the things they could do to rebuild trust in the market would be to do much more through exchanges, rather than the kinds of very large volume trades that are going on behind the scenes. However, in the end, there is very little data that suggests to third party observers what is going on, what are the prices that are being paid to the wholesalers.

Audrey Gallacher: Yes, I would agree. Early estimates are that about 85% of trades are made bilaterally, so there isn't really any proper disclosure around about that price. Of course, we have seen the recent scandal where the reporting organisations, who rely on traders to tell them the price, are suggesting that that price may have been slightly manipulated to improve position.

Sir Robert Smith: Did that not actually ironically improve the position to the benefit of the consumer?

Audrey Gallacher: I am sorry, I don't know enough about it. I suppose the issue is that we are looking at this market reference price to set Contracts for Difference, for example, in the future, so it is really important that we have a robust price to start with. Whether or not there is any kind of merit—

Q61 Sir Robert Smith: So greater liquidity in that market?

Audrey Gallacher: I think that is the main thing. First, we don't understand the price that is being paid, and Ofgem has options open to it, we think, through the European Directive to get more information on the costs companies are actually paying. However, the long-term goal is that we need to sort out liquidity, because we are not going to have a true reference price if we do not have a properly competitive market. This is an issue that Ofgem identified in the probe in 2008 and we need to get it sorted out, particularly as we are bringing in electricity market reform and we are going to be reliant on that reference price. The biggest thing—which I think Richard alluded to—is that it is a potential barrier to new entry into the market. Acquisition products are generally 12 month fixed rate contracts. Right now the market is completely or more or less illiquid after six months, so it is quite difficult for any new supplier to come in and purchase the cheaper energy that they need for that contract without taking a significant risk. They will either price that risk into what they are offering customers or they just will not enter the market.

Richard Lloyd: I think it would be helpful if we had the same focus on what it would take to create a genuinely competitive wholesale market, as we have had on the retail market in recent months. So what would it take in terms of transparency in the publication of data, in ensuring more wholesale trading is done through exchanges? If there is—and as I say we don't know because we do not see the data—an unfair competitive advantage being given to the retail arms of the wholesale companies in the vertically integrated suppliers' case, should there be a restriction on self-supplying? Should the generators be required to put all their energy on to the market rather than selling it to themselves in this very non-transparent way? So I think we need Ofgem and DECC to take as hard a look at that as they have on generating competition in retail.

Q62 Sir Robert Smith: Is there an argument, though, that the vertical integration might mean a benefit for the consumer in terms of hedging and, therefore, in what is a very big market, the companies' ability to see its way through the troughs and peaks?

Richard Lloyd: That is what the suppliers would say and that may well be true. Again, we cannot look into enough of the trades to say if that is right. What we do know, though, is that if you are a vertically integrated company and you increase your wholesale price, even if that loses you some retail customers by the way you pass that price through to the consumer, you are still a net winner as a group. So what is there in the system that incentivises efficiency in generation, maximum competition in generation, and therefore what is being passed through to the consumer being kept in check? At the moment it is a very murky world and, as we have seen with the allegations of gas price rigging, one that is reliant on a very small number of players, a small number of traders who have access to very sensitive market information. The vast majority of trades are not done transparently.

Q63 Chair: I think you have advocated a review of competition. Do you think that needs to go beyond what Ofgem have already been doing in this area?

Richard Lloyd: I think it does. As I say, we have welcomed the moves that Ofgem have been proposing on greater liquidity and ensuring that the smaller suppliers can challenge the bigger in this market. Although I think there is much more that could be done, both to address the consumer confidence point that I was discussing with Peter earlier, but also to ensure that they can reassure the consumer that this is a market that is operating efficiently and competitively, and the previous efforts to look at this, segmented accounts and the investigation into vertically-integrated suppliers and what is going on, did not deal with that adequately. I think you will find some suppliers would advocate, too, that there is now a moment where part of the process of regaining trust in the energy industry needs to take a very hard look at how the generators are operating, how the wholesale market is operating and potentially some changes to ensure that people have confidence in that.

Q64 Christopher Pincher: Can I clarify something that Ms Pardoe said earlier, with respect to the role of Ofgem and price and profit? I can understand that Ofgem may have an interest in a role with respect to prices that are charged, but do you think that Ofgem should have a role with respect to profit? After all, a company can be very efficient and that might improve its profit margin. Does Ofgem have a role to play there or shouldn't that be more properly the role of the tax system?

Anne Pardoe: I certainly think they have a role to play in terms of saying whether a price is fair, looking at the retail price and the wholesale price. Whether they have a role to play in profit, I think that is more something for them and the Government to look at, to be honest.

Q65 Mr Lilley: How would you define a fair price?

Anne Pardoe: A fair price? I think it is more of what is a reasonable price, given what people can afford to pay, given that it is an essential service and based on the wholesale cost of the energy.

Q66 Mr Lilley: Those are two rather different things, aren't they? So you are saying the price should not reflect primarily the costs?

Anne Pardoe: I think, given Ofgem's role as regulating the market in the interests of consumers, as well as other businesses, I think they should have a role to play in deciding what a reasonable price is.

Audrey Gallacher: I think there is a different issue about the cost reflective price and the degree of cross-subsidy that currently goes on. I think a fair price is arguably going to be one that is cost reflective, we haven't seen that—well, we have seen issues of a fairly significant cross-subsidy so we are talking about allegations that are being made around predatory pricing where acquisition deals are significantly—

Mr Lilley: So prices may be too low?

Audrey Gallacher: There is a concern that inactive customers are providing a cross-subsidy for suppliers to offer attractive deals. While that might be great for those individual customers, and while it might be difficult for me as a consumer advocate to say I do not want people to get cheap bills, there is an issue in that. As Anne says, it is an essential services market. It is a non-discretionary spend, and at the beginning of this session we heard some really quite emotive stuff around the impact that an inability to afford energy has on households. We know it has a massive impact on health and wellbeing and all of that stuff, so there is an issue about having a fair pricing regime that doesn't allow those degrees of cross-subsidy. Although I suppose there is then another question about whether as a society we rely on a competitive market to deliver what essentially might be some social intervention that is required by Government. We could find ourselves—particularly as we see the levels of investment required over the next 10 years—with lots of affordability issues. One of our concerns is that the energy policy debate has not given enough prominence to the affordability issue. We would like to see it up there with security of supply and decarbonisation, so there is a real issue about how we cope with that, and whether we should be relying on the competitive market to deliver that for consumers or whether we just need to recognise it will only go so far and we need some other intervention, like a really decent energy efficiency programme or some additional financial assistance.

Richard Lloyd: There is a market I am fond of quoting—and apologies if I have told you this before—there is an example of regulators in the United States that, on behalf of consumers in their area, go to the market and see what the best price is that they can get with their expert knowledge on behalf of people who are on a default standard tariff. The market operates around that. It effectively becomes a price for others to beat. That gives the unengaged consumer confidence that an expert on behalf of them has secured the best possible price, with all the variables in that market, the pressures that are exactly the same as in our market, in terms of wholesale costs and Government policy. However, it effectively sets a benchmark around which the rest of the retail market could operate.

Which? is always the last consumer advocate to advocate price controls, and we are not advocating it in this case. I think that, particularly if we have a much simpler market, people are more likely to move around, they are likely to be mobile. Competition should be the best way to keep prices fair and keen. Nevertheless, given the complexities and the lack of transparency in this market, I think people would take comfort from an expert intervening in that market and saying, "This is a price that is fair". That is why collective switching has occasionally given people that assurance because, as individuals in this market, they are feeling completely overwhelmed or disempowered relative to the size and expertise of the supplier that you have to engage with.

Q67 Mr Lilley: I was excited by the suggestion that there are under-priced, cut price deals available. I haven't been able to find them. If there are, why don't we all pile in and it will have the effect of reducing any excess profits that the company are making and put pressure on them to be more efficient. I would have thought the answer to my question—which I will offer you—was that a fair price is one which does not have a monopoly price element, so it is generally competitive, where there is pressure through competition on the suppliers to keep down their costs and where the Government does not impose too many extra costs, which I fear it is doing and that is my principal concern. That is the principal avoidable element, if we did not have all these feed-in tariffs and high cost energy we are being forced to use. The last point is contentious but the first two ought not to be.

Richard Lloyd: If I can come in on your third point? I think there is an issue, putting aside the rights and wrong of decarbonisation, about whether the costs to the consumer of decarbonisation are being kept in check too. With ECO, there is the hope that competition between suppliers will keep the price of ECO under control. I think that is rather naive. The Smart Meter programme: again, the Government is hoping that competitive pressures between suppliers will keep the cost of that programme in check. Contracts for Difference: how do we know that the price that is being negotiated between the Government and suppliers is the best possible for the consumer? So again, there is a cloud of non-transparency hanging over a significant and growing chunk of what people are being expected to pay, and a hope on the part of Government that competitive pressures, competitive forces will keep those costs in check and, therefore, keep the price that is passed through to the consumer in check. If we cannot see the numbers, if we cannot see the data, certainly we cannot reassure consumers that they are paying a fair price, and I think that feeds the suspicion we were discussing earlier.

Anne Pardoe: There is also the point to make on whether that should be on consumers' bills at all in the first place and whether it could be funded through general taxation, which is generally less aggressive and has less of a distributional impact which colleagues in the earlier session were talking about around if people who are paying for these energy efficiency programmes are not benefiting from them personally, that can have an impact of pushing people into fuel poverty, so there is a wider debate around how you fund that as well.

Q68 Sir Robert Smith: Can I just ask if *Which?* were confident that the market was working and that the horrendous bills people were paying reflected the world we live in, but your readers wanted to believe there was a magic solution and that it was all down to large companies exploiting them, would you be up front with them and say, "I am afraid there is a real problem and it is the fundamentals that are causing your bills to be this high"?

Richard Lloyd: We are already being that up front with them because we know that there are pressures in the wholesale market. Everyone knows that. What we do not know is whether those pressures are being kept sufficiently in check through competition, through competitive forces. What we also know is that the retail market is not operating effectively for consumers, so absolutely. In all our public messages, just to reinforce the point I made to Peter, we are constantly saying, "No one should be fooled by anyone that your energy bills are going to come down in the near future". The wholesale market is bound to be driven upwards in the medium term over time through pressures on commodity prices. We all know that.

Sir Robert Smith: What we need to know is that it is not being driven higher than it needs to be.

Richard Lloyd: What we want is to be able to assure people that they are not being taken for a ride through the structure of the market, through a lack of competitive forces, through unnecessary Government-imposed social and environmental costs, and that this is a market within which you can be confident: provided you move around in it and use your consumer muscle, you can get a fair deal. At the moment it is only a very small minority of people that are engaged enough to be able to do that. Yes, we are already telling the million and a half people who subscribe to us that they should be in no doubt that you should expect that your bills will rise. What you should be in doubt about is whether the current system is keeping that rise in check enough.

Q69 Ian Lavery: *Which?*, Mr Lloyd, has suggested there is a lack of information relating to the uncleared, over the counter (OTC) trades and you say there is a particular cause for concern with regard to these. Can you say what is known about these types of trades and how they influence wholesale energy prices and ultimately value for money for the consumer?

Richard Lloyd: It is the dominant form of trading, over the counter in the wholesale market. It is about 80% of electricity and 70% of gas that is traded in that way. They are largely primarily commercially confidential contracts so there is no data about the prices, the volumes, the products that are being traded in that way. If such a large proportion of wholesale energy is being traded in that way, it is very difficult to understand how a price signal is sent to, for example, small suppliers, how you can be confident that those trades are being done in a genuinely competitive fashion and how the interests of the end user is being taken into account. It is significant. It is often trades between the retail and wholesale arms of the same business and, as I think I mentioned earlier, only about 6% of total electricity consumption is traded externally, for example, through to N2EX. There are ways of finding out. There is data available if you want to pay for it about some of the trades that are done, pricing data in particular, but by and large it is very hard to get to the bottom of the prices that are being paid and what are the dynamics in those trades.

That is why we think there needs to be much more trading through exchanges and much more price transparency, much more data transparency.

Q70 Ian Lavery: In the interests of competition, do you think there should be some form of alternative model such as a pooling system? Would that be fairer in terms of competition?

Richard Lloyd: We think it is worth exploring other mechanisms including the pool that has been tried in the past but I think for us probably the primary focus should be on whether there should be a restriction on self-supply and whether in vertically-integrated companies there should be a legal separation of their retail from their wholesale generation arms. That would help bring the transparency and, we think, the competitive forces to bear given that the six largest companies are dominating the wholesale and the retail markets. We think that is the first place to look.

There are other issues here about the ability of smaller players to access the market, in particular their ability to get credit that will allow them to trade and hedge in a way that allows them to compete with the large suppliers. I think a mix of liquidity and transparency, probably some form of self-supply restriction, would go a way towards reassuring us that the market at the generation end is operating more competitively.

Audrey Gallacher: I think we have looked at issues around the pool and what we could do because obviously there are advantages in that buyers and sellers have access to each other, there is a lot more transparency around the price. It would also probably help market entry, as Richard has already alluded to. There were potential concerns around gaming, so there would need to be some safeguards in place. I think for us one of the issues is that we are going through such a massive round of policy change and electricity market reform that to make that kind of wholesale change to the wholesale market might just create too much change, making it riskier, which would ultimately increase investment costs being passed on to consumers. I suppose our issue is how much we can reasonably do all at the one time, given the scale of the job that is in front of us and whether it would be a prudent idea to start dismantling the whole of the wholesale and trading arrangements. I do not have an answer but we would need to weigh those things up. It may well be that looking at options to try to fix what we have rather than scrapping it and starting again may be a better option at this particular time.

Q71 Ian Lavery: Ms Gallacher, I know it has been stated from Consumer Focus that there is evidence of a decline of competitive intensity in the UK energy market, do you have any evidence of this?

Audrey Gallacher: It depends on what your measure of competition is. Historically it has always been around the levels of switching, so we have seen that levels of switching have significantly tailed off since 2007, from 20% down to about 11%, I think, are the figures but I am going to have to come back to you and clarify those figures. If that is a measure that you are using: consumer engagement in the market and switching, we know it has reduced. What we think is that there needs to be just a whole additional raft of information and more effective monitoring within the market to really understand what is going on, because companies will come back and say, “Quite a lot of switching goes on within the company”, with consumers going on new products that are more attractive and that, in itself, is evidence of consumer engagement, but we really do not understand that. We don't know the spread of products across companies, how many customers are on them. We know about payment methods—that about 55% of people are on direct debit—but there is still a whole chunk of consumers who are paying cash and cheque, about 15% on pre-payment meters. Frankly, there is no competitive offering out there for them.

In the last 3 years, about 280-odd new tariffs have come out on to the market. Only 3% of those have been available to pre-payment meter customers, so we have a really segmented market, where you have a core of engaged consumers, you have people who are online, prepared to pay by direct debit and who can get access to good deals, but you still have approximately 45% of the market who nobody really appears to be competing for. I am sure the companies will call me on that one, but there is a real issue about the products that have been made available and this links back to the work that Ofgem is doing on its retail market review. Quite a lot of the solutions that it is putting in place and the remedies are really targeted at a group of consumers who are arguably already fairly engaged. I have real concerns that there is a big chunk of the market out there, generally the people who are in fuel poverty and the people who have real affordability issues, for whom the market is just not working.

Q72 Ian Lavery: How could Ofgem use EU legislation to encourage suppliers to disclose the actual cost of trading energy?

Audrey Gallacher: Since 2011, there has been a European Directive in place. It came in on the energy third package, which is about Ofgem being able to require companies to say how much they actually spent. Continually, when we talk about the relationship between wholesale and retail prices, it is quite difficult because Ofgem will make an assessment. It will come out with a report, and then the companies will commission an alternative report that will completely refute what Ofgem says. This really confuses customers all the more and that is because nobody really knows the actual cost that has been paid. Companies will say, “You have used the wrong hedging strategy. That is not the price we paid. That is not the average consumption for our consumers”, so lots and lots of holes are picked in the various bits of analysis. Moreover, there is an ability for Ofgem to go and require companies to tell them how much they paid. It would be done retrospectively but it might be quite a good check on the industry if they knew that there would be an audit coming down the line that would require them to disclose what they had paid and therefore we could retrospectively see whether prices are falling as quickly as they should or increasing too quickly and give some retrospective reassurance. The fact that that would be a threat to companies might keep them honest in the intervening period.

We have put it to Ofgem that it should do this. It has not so far. It has not explained why not. I do not know whether it is too complex, if it does not have the skills, if it cannot do it, but we think that there are potentially tools available there that it would appear that Ofgem has not yet utilised.

Richard Lloyd: We would support that, and just to reiterate that what that would not do, of course, would be give market participants pricing signals, so it would be a retrospective reassurance, not a means for ensuring that there is greater competition in the day ahead, the month ahead, further ahead in the market. Why have Ofgem not done it yet? I do not know. In what form they would do it that would allow third parties to scrutinise this has yet to be explained, but I think it would help.

Q73 Sir Robert Smith: Back to trying to understand the market and improve transparency and information. Ofgem have come up with a supply market indicator, which you and *Which?* have some concerns over. It is, I suppose, a sort of averaging. Could you maybe outline your concerns with where it could be improved?

Audrey Gallacher: Is it the segmental accounts or the ongoing Ofgem weekly stuff?

Sir Robert Smith: The supply market indicator.

Audrey Gallacher: We think it is okay. It has given a picture of potential profitability. The information could probably be disaggregated. It would not be a simple message, but you could make that information available. I suppose the issue we have is that the industry continually picks holes in it and we also have done some kind of backward analysis where we have looked at what the segmental accounts are seeing around company profitability compared to what the market indicator was saying around what company profits should be, and we have put that in a written submission. There are some issues around how accurate it is and this is why we have often put a challenge out to both Ofgem and industry that what might be quite helpful is if we had a set of metrics that everybody could agree on so that instead of continually having these arguments about whether we were looking at the right things and how helpful or otherwise they might be, is that if we are all agreed what it is we are looking at, we could hopefully get a more robust picture on what is going on in the market—competition, profit value, whatever—but also it just shuts down these circular arguments that are not really doing anything in taking it forward or tackling issues around consumer trust.

I have already said this, but the longer we continue to talk about consumers or if consumers feel as if they are getting ripped off and they are not getting a good deal and somebody is going to fix it for them, it takes the onus off ourselves doing something about the fact that energy is becoming increasingly unaffordable and we need to take measures personally to sort it out. That is my view.

Richard Lloyd: We think the indicators are not enough. They do not say a great deal more than we already know. They are based on estimates of expected wholesale and operational costs. We think, as Audrey has just said, there is a much more robust set of indicators that would be much more helpful.

Sir Robert Smith: Do you have an idea of what indicators those would be?

Richard Lloyd: Yes, I think there is information about wholesale energy trading that they could put out. There are volumes of trading, numbers of market participants and so on, to allow us to build a much more robust picture of what is happening in the market. There are probably indices they could develop that would allow us to track that better too. I would be happy to write to you with more detail, but it would be a build on what they currently have.

Q74 Christopher Pincher: *Which?* and others take the view that the SMI indicators are okay. Ofgem takes the view that more substantial data needs to be reported upon hence the Consolidated Segmental Statements, but when you commissioned BDO to analyse the CSS, they found some significant issues about the data that was supplied. What do you think are the main deficiencies in the CSS in terms of the timeliness of data, the data that is included and the understandability, if there is such a word, of the data?

Richard Lloyd: BDO themselves concluded—and it was quite a thin report as you will remember—that it was impossible to see whether the transfer pricing had been done in the best interests of consumers. It was impossible to determine the prices offered to the supply businesses within the vertically integrated companies. I think much more transparency about transfer pricing and the methodologies that are being used is a start, but in the end, without more structural changes the segmented accounts, to be honest, at times just raise more questions than they answer. Without that greater scrutiny about what is going on in the wholesale market it is impossible to tell whether—just by looking at the segmented accounts—what is going on is indeed fair. It is quite a mixed picture that BDO reported, yet Ofgem seem to have parked that and moved on.

Strong supporters of segmented accounts but they do not show enough to us of what is going on in the market for us to be able to say that, in particular, with the vertically integrated companies what is happening is competitive and fair.

Audrey Gallacher: I would echo that. A fundamental omission is that the trading activity is not included in them and, as they are pretty out of date by the time you get them, some of the values are questionable, but, yes, I have no doubt that it costs Ofgem and companies a whole lot of money that will ultimately will be borne by consumers who produce them. So there is an issue about either sorting them out and make them more robust or not doing them—we really question the value of them.

Q75 Christopher Pincher: They are costly to produce. Have you seen any benefit as a result of them? Has there been any change in behaviour or any change in engagement as a result of the data that is produced?

Audrey Gallacher: I have not observed anything like that. I do not understand either why Ofgem did not choose to implement all the recommendations from BDO. It would be quite helpful to understand whether it was cost drivers or technical or physical ability to do that but you would really have to question why you would pursue this if it is not really helping the situation. I might be wrong but personally I have not seen any evidence that it has changed things because of that fundamental omission on trading activities.

Richard Lloyd: What it has not done, if I may, is allow us—again sorry to keep going back to my earlier point—to translate what we think is an accurate picture of what is going on in the market to consumers. Again, to go back to the earlier point, if part of what is intended through the publication of segmented accounts is to give customers some assurance that the businesses are operating competitively and the retail end in their interest, as well as to show shareholders what is going on, then they are failing in that objective. There is not sufficient data there for us to be able to say with confidence that consumers are in a competitive market that is giving them keen prices.

Q76 Christopher Pincher: Just in the term you used there, the translation of data.

Richard Lloyd: Yes.

Christopher Pincher: There seems to be general agreement among you that the data provided is not really comprehendible by many people who may wish to benefit from it. Does that then mean that rather than improve the situation, the CSS and the data in it, and the SMI and the data in it, simply muddy the waters?

Audrey Gallacher: I think it is a difficult one because obviously it does generate quite a lot of debate now. Maybe if we had not had them, the level of consumer interest in energy prices might not be as great as it is, so I think they have definitely prompted a degree of debate. I think the fact that prices have doubled over the last seven years is probably the bigger issue for consumer interest in energy but, nevertheless, we have this thing that goes out there and generates a bit of a story. If that is something that brings focus on this market and encourages Ofgem, Government, consumer bodies, and industry to try to sort it out, rebuild consumer trust and try to give greater confidence on price fairness and transparency, then that is a good thing.

I suppose it is just the fact that we have these things rather than what they are themselves that potentially brings the benefit because it brings more focus to this debate. I know that sounds kind of strange because we are thinking they are not very good, but they do act, probably, as a bit of a catalyst and a prompt to have these kind of discussions and if it leads us to a place where we have something that is a bit more meaningful that will allow us to offer consumers those assurances or challenge the industry when things go wrong, I think at this point in time we have reports that do not do either of those jobs. They do not allow us to reassure consumers. They do not allow us to find out where there are problems in the market and get somebody in place to try to fix them, so in that respect they do not work.

Christopher Pincher: What you seem to be saying is that although they act as a catalyst for debate and they focus concerns, they do not really encourage greater understanding of the way in which the market works and the costs and the way pricing operates.

Audrey Gallacher: Yes.

Q77 Christopher Pincher: What are the disparities between the data as reported through SMI and the data as reported through the CSS? Are there any glaring differences?

Audrey Gallacher: Yes, we looked back retrospectively through to 2010, when the segmental accounts were speaking about industry profitability at about 0.3%, but Ofgem were showing that the difference was on margins of about 6% across the board on the weekly monitoring, whereas on the segmental accounts it was 0.3%. There was quite a significant gulf between those two different reports. Obviously, when we were looking back at them, it was two years before we obtained the segmental accounts. There is an issue that Ofgem on an on-going basis is telling us the potential level of profitability in the industry, albeit that industry refutes that, but we then look at the financial statements that tell us quite a different picture. That in itself can be quite confusing when you understand where that disparity lies, whether it is around pricing strategies or whether it is the veracity of the reports themselves.

Q78 Mr Lilley: Am I right that the SMI is simply the retail cost and profit breakdown?

Audrey Gallacher: Yes.

Mr Lilley: So the problem is that it does not tell you anything about the wholesale cost and profit breakdown?

Audrey Gallacher: I think it is looking at the relationship between prices as well.

Richard Lloyd: They use estimates of expected wholesale costs in arriving at that figure.

Mr Lilley: Yes, so it is just the retail?

Richard Lloyd: Yes.

Q79 Mr Lilley: Over time that will even out, whereas the Consolidated Segmental Statement does that give us the breakdown for the generating level, for example, in electricity?

Audrey Gallacher: It gives generation and retail but it does not give trading activities.

Mr Lilley: All right, but it does give generating which is what we need to know as well as the retail figure?

Richard Lloyd: Yes.

Audrey Gallacher: Yes.

Mr Lilley: It is surprising they make such a meal of this and do not seem to define things very clearly. It says in our briefing, or rather in Consumer Focus stuff, that to get from a 6% margin across the majority of consumers to a 0.3% margin across all consumers might imply predatory pricing. That is still at the retail end, not wholesale?

Audrey Gallacher: Yes, that has just picked up the retail aspect of the segmental accounts that were saying supply businesses looked as though they were breaking even with 0.3% profit in that 2010 year, but if you looked at the SMI through that period, Ofgem is suggesting that there was a £30 margin which is a 6% margin. There is an issue that we have two sets of information that are quite significantly different and the issue is can we understand why that is? Is it about how robust the reporting arrangements are? Clearly one of them was after the event, actual what was reported by companies. One of them is Ofgem's estimates, so it will again call into question whether those estimates are so far out from what has been reported. It just continues with this level of uncertainty over what consumers are paying, and whether they are paying a fair price. I think probably more work needs to be done to ensure that the—

Mr Lilley: It ought not to be beyond the wit of man to establish what the profits and what the costs and what the prices are?

Audrey Gallacher: It apparently is.

Mr Lilley: I am baffled.

Richard Lloyd: I think if you are baffled, the average consumer is baffled many times over.

Q80 Mr Lilley: That brings me to another point. I am slightly diverging, Chairman, but in my younger days *Which?* used to tell us which was the best buy for things.

Richard Lloyd: We still do that.

Mr Lilley: Do you tell people which is the best buy, given their particular household circumstances or consumption pattern, for buying electricity and gas?

Richard Lloyd: We do. We also do customer service ratings so we can tell people not only—if they provide the right data—who the best supplier is likely to be, but also whether they are likely to be treated well or badly by them.

Mr Lilley: Most of us would put the priority on having a low bill. Have you seen the work by Stephen Littlechild who says *The Sunday Times*' best buy was the SSE tariff and that is now prohibited under the Government's widely supported proposals for limiting the number of tariffs? Do you think that is a good thing, that by trying to simplify the market we outlaw the best deals?

Richard Lloyd: It depends, I am afraid, is the answer. Our view is that simplifying the market is absolutely essential in enabling more people to engage in it and thereby we would hope for a more competitive market to exist and for prices to be keener.

Q81 Mr Lilley: Why do you think people are particularly incapable of shopping around in this market? I went to buy some hair shampoo the other day and there were 40 different varieties at all different prices. I managed to stagger through and buy some. No one says I need to be protected from myself in this market. If I go and buy a car, there are scores of different models at different prices and I can negotiate a better deal here than I can there. Nobody says I have to be protected from it. The competitive forces seem to work.

Richard Lloyd: You have a much simpler pricing arrangement. You do not need to figure out for your shampoo whether you are a low, medium or high user of your shampoo.

Mr Lilley: Yes, I do. There are all different varieties. You have not studied the shampoo market.

Richard Lloyd: I think perhaps the shampoo market may be a poor analogy but it is the simplicity. In our view what we have done is ask consumers, “Look at the tariffs and the pricing structures that exist now. Can you spot the cheapest deal for you?” We wanted to test whether people could themselves navigate around the market without an intermediary and people—with the way pricing information is presented under the existing mechanisms—in most cases could not spot the best deal on the market for them.

Mr Lilley: However, there are many markets which would not exist.

Richard Lloyd: We would like to see simple markets that consumers can operate in and operate in a far more mobile way. That is what we were set up to create. It is not in our interest to promote complexity.

Mr Lilley: You give consumers the information on the assumption that they could use it, but in this market you say, “No, we are not going to give them the information. Let us reduce their choice to four tariffs and that is it”.

Richard Lloyd: No.

Mr Lilley: This almost inevitably means that the companies will cut out their cheapest tariffs, does it not?

Richard Lloyd: Again, the cheapest tariff needs to be one that is competitive and that is exactly why we have been saying if the price is presented in a complicated way that people cannot compare easily then competition will not be sufficient to keep that price in check. That is why we have said that Ofgem’s proposal for a comparative rate is just too complicated. You need to have a single unit price that, like your shampoo, you can compare one product against another at a glance and spot the cheapest deal. I would be delighted if there was no need for comparison sites, for pages of reports about how you can find the best deal in the gas and electricity market. It is different from shampoo. You need it to live. You cannot get by without energy and that is why a move to more simplicity, in our view, is to the greater good of consumers and then we can get on with advising people about which supplier to look to for other dimensions of service delivery and customer satisfaction.

I think under the current reform arrangements we will not move to a market where the prices are presented in a simple way that will allow people to choose between suppliers quickly, and that means we will not get those competitive forces operating that we were talking about.

Q82 Mr Lilley: Would it not be fairly easy to devise an app for our mobile phones that if it had our gas and electricity bills fed in to it automatically, it would tell us which is the best deal?

Richard Lloyd: We have developed a prototype for that with Scottish Power and we have been asking the energy suppliers, all of them, to buy in to that system where you could download your consumption data, plug it in to a comparison site like *Which?* Switch and find the best deal on the market for you. They have been dragging their feet on that, so I am with you on that. That would certainly take some of the friction out of switching but, again, you have to recognise that it is a minority sport still. There are not that many people who are that interested, despite the cost, in going to the market and switching.

Mr Lilley: For most people the most important single worry is their heating bill.

Richard Lloyd: It is the paradox about this market that despite people being worried about the price, a lot of people are so disengaged in the market that they are not shopping around and getting the best deal for them even with a simpler structure of tariffs there will be gains for them to do that. That is why we need a mix of things to enable consumers to engage—simpler pricing, easier and quicker switching with less hassle, easier means to identify the best deal on the market for you—and not this halfway house of some tariff simplicity but still complex presentation of pricing, slow switching and so on.

Q83 Sir Robert Smith: Is there a fear of getting yourself trapped in an even worse deal or is it just that some people's minds go blank and they think it is all too confusing?

Anne Pardoe: I think with the complex market, obviously if you simplify it then you reduce the areas where suppliers can compete and offer innovation. The issue being that for some of the sharper elbowed consumers, more able consumers, then that is fine. They may be able to, with some difficulty, navigate their way round the market. The issue comes for time poor and also less able consumers who just do not have the time or the ability to sift through all those and work out which is the best deal for them. In order to allow them to engage in the market more effectively you need to simplify. In terms of your example, where I think you said SSE had this with the tariff—

Mr Lilley: *The Sunday Times* said it was the best buy on the market.

Anne Pardoe: Yes, the issue around that is if everyone did decamp and switch on to that tariff it would no longer be viable for SSE to run that tariff because of the way that pricing is worked out, quite often some tariffs are subsidising other tariffs. It sort of works out in a way that if we all were savvy consumers and switched on to that, that would probably not be available anymore and a lot of the suppliers say, although they would not say on their advertising, "It is open for 200,000 consumers" or whatever, and then as soon as that number of people are on that, that tariff would then be closed and they will have to open a new one.

Mr Lilley: It seems a very funny position for a consumer advocate to say a tariff may be too good; too many people may be attracted to it; let us be satisfied that it has now been outlawed by the Government. This whole business baffles me.

Anne Pardoe: No, it is not. It is just giving everyone an equal chance to be able to access a tariff which is the best one available for them. Obviously, we would love suppliers to offer the best tariffs to everyone, but it is simply not the case that that happens at the moment. With pre-payment meters, in particular, I think there is one supplier now that is moving to open all their tariffs to pre-payment customers, but in the vast majority of cases the pre-payment customers do not have access to those deals.

Audrey Gallacher: I think some of the Big Six, and certainly smaller suppliers, have alleged predatory pricing and we have had some positive statements from some of the larger suppliers.

Q84 Mr Lilley: I would love some predatory pricing. I would go and sign up for some predatory pricing. You are against predatory pricing and you are against high pricing. What sort of pricing are you for?

Audrey Gallacher: I think predatory pricing of shampoo is okay, but when it is an essential service and the people subsidising that predatory pricing are the people who can least afford it and who are really suffering quite significant hardship as a result of it then there is a question about whether that should be allowed. So we would move towards fair pricing, whatever fair pricing may be, but we would move towards fair pricing rather than cheap pricing.

Chair: I think on this note of bafflement we will have to draw to a conclusion. Thank you very much for coming in.