House of Commons

Energy and Climate Change Committee

Energy Prices, Profits and Poverty: Government and Ofgem Responses to the Committee's Fifth Report of Session 2013–14

Fifth Special Report of Session 2013–14

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The Energy and Climate Change Committee

The Energy and Climate Change Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department of Energy and Climate Change and associated public bodies.

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Publication

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at www.parliament.uk/ecc.

The Reports of the Committee, the formal minutes relating to that report, oral evidence taken and written evidence from witnesses are available in a printed volume.

Committee staff

The current staff of the Committee are Sarah Hartwell-Naguib (Clerk), Vinay Talwar (Second Clerk), Dr Alfred Gathorne-Hardy (Committee Specialist), Tom Leveridge (Committee Specialist), Shane Pathmanathan (Senior Committee Assistant), Jonathan Olivier Wright (Committee Assistant), Joe Strawson (Committee Support Assistant), and Nick Davies (Media Officer).

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Fifth Special Report

On 29 July 2013 the Energy and Climate Change Committee published its Fifth Report of Session 2013–14, *Energy Prices, Profits and Poverty* [HC 108]. The Committee received the Government's response to the Report on 2 October 2013 and Ofgem's response on 27 September 2013. These are appended below.

Appendix 1: Government Response

We welcome the ECC Committee's inquiry and report into Prices, Profits and Poverty and the opportunity to respond to the conclusions and recommendations you have made.

We agree with the Committee's overall finding that transparency in the energy market is critical and that communications between energy companies and consumers need to be clear, transparent and easy to understand. Government, the regulator and industry all have a role in improving this. The Coalition is committed to driving a more competitive market with more choice for consumers, innovation, transparency and better value. This includes radical proposals through the Retail Market Review to simplify energy bills and make them clearer and fairer for consumers. This will help consumers to secure a better deal – and in so doing increase the competitive pressure on energy suppliers to deliver good customer service at efficient cost. It will also secure consistency across the market in the way energy companies communicate with their customers for example through the Tariff Comparison Rate, Personal Projections and the suppliers' cheapest tariff message on bills. The Government is taking powers in the Energy Bill to give statutory backing to Ofgem's key RMR proposals.

Government has committed to publishing information on the impact of Government environmental levies and programmes on consumer bills through the "Estimated impacts of energy and climate change policies on energy prices and bills"[1] report. This also provides a breakdown of the other costs that make up a bill including wholesale, transmission, distribution and metering costs, and other supplier costs.

Government and Ofgem are taking steps to increase competition in the energy market, in addition to the reform of the retail market. The Government has also increased the customer number threshold at which suppliers are required to participate in certain social and environmental programmes. Poor liquidity (the ability to quickly buy and sell) in the wholesale electricity market can also act a barrier to market entry to the supply and generation markets. Ofgem is tackling this through its proposed reforms and the Government is taking powers through the Energy Bill to enable it to intervene if that proves necessary. The Government is also working to strengthen the route to market for independent renewable generators in order to ensure they are able to play a fuller role in delivering investment under EMR and widening consumer choice.

We agree that there needs to be increased transparency over the profits of large, vertically integrated energy companies to engender trust in the industry. We support the steps that

1 https://www.gov.uk/policy-impacts-on-prices-and-bills.

Ofgem has taken to improve transparency, including introducing a requirement for them to publish Segmental Statements outlining the revenues, costs and profits from their generation and supply businesses and providing its own analysis of the statements for consumers. We also support the work the Committee has done to investigate in what ways the statements could be improved. Given the centrality of this issue to trust in the whole industry, we very much support the further work Ofgem is planning to do to see if it can improve transparency in this area.

The Committee's report comes at a crucial juncture for the development of fuel poverty policy. In July this year, we announced that we are adopting a new definition of fuel poverty that more accurately reflects the heart of the problem and will help us tackle it better. We also tabled amendments through the Energy Bill to the Warm Homes and Energy Conservation Act. Once passed, these will see us put in place a more sustainable framework for targeting and measuring progress in tackling fuel poverty. The Committee's endorsement of our overall approach on the fuel poverty target, which was also echoed in debate in the House of Lords, is very welcome.

As the Committee notes, engaging with fuel poverty practitioners is a vital element of helping us to build the most effective strategy possible, with a real focus on delivery. We continuously strive towards very close and effective joint work with the range of interested stakeholders, recognising that we may not always be able to be in full agreement. There are many areas of genuine consensus and we will look to develop these further when we set out a new fuel poverty strategy in 2014. This strategy, the first for over 10 years, will reflect the insights from the new, improved definition and help us ensure we are using our resources as effectively as possible.

Meanwhile, we continue to deliver policies that we know are making a genuine difference on the ground, with the Warm Home Discount delivering to over 1.1 million of the poorest pensioners automatically and nearly 200,000 measures delivered by the Energy Company Obligation since its launch earlier this year.

Energy prices

Section 1: Communicating reasons for price rises

1. Energy bills are rising and are likely to continue to rise in the future. The wholesale price of fuel has been the largest contributing factor, driven by rising global gas prices. Several other factors are also contributing to price rises including the need to invest and finance UK's electricity and gas network and energy and climate change policies. The extent to which energy supply companies are actively working to reduce their operating costs remains unclear. (Paragraph 20)

The wholesale cost of fuel makes up around 50% of the average dual fuel bill and has been the largest contributing factor to increases in bills in recent years, accounting for at least 60% of the increase in household energy bills between 2010 and 2012. The remainder of the average dual fuel bill is made up of: transmission, distribution and metering costs which account for 20%, other supplier costs and margins which account for 19% and VAT which accounts for 5%. In 2013, Government policies to achieve energy savings, provide support to vulnerable consumers through the Warm Home Discount Scheme and incentivise the

shift from fossil fuels to alternatives are estimated to account for around 9% of household energy bills. Accounting for efficiency savings, household energy bills in 2013 are expected to be 5% lower on average than they would have been if these policies were never introduced.

Some information on the operating costs of the 6 largest energy suppliers is provided in the segmental statements that they are required to provide to Ofgem. These show the revenues, costs and profits for generation and supply businesses annually.

Competition between energy suppliers will put downward pressure on their costs and Government and Ofgem are taking steps to increase competition in the market. The reform of the retail market will help consumers engage in the market more easily. The Government has also increased the customer number threshold at which suppliers are required to participate in certain social and environmental programmes.

2. We welcome Ofgem's and the Government's proposals to ensure energy companies improve the way they communicate with their customers. ***In addition to their proposals we recommend that the regulator compel energy companies to*****:**

a) Standardise the presentation of their bills to make it easier to understand bills and compare prices (for example on a price comparison website);

b) Identify the various components which make up the costs of the bill (i.e. wholesale price of fuel, costs of supply (i.e. transmission, distribution and metering), the costs of UK/EU policy (including support for low-carbon/renewables and energy efficiency schemes) and company margins (i.e. operating costs and profit);

c) Express price changes in pounds and pence as well as percentages. **(Paragraph 25)**

The Retail Market Review proposals will require suppliers to standardise the format and content of bills to a significant degree. This will include grouping together related information with standardised headings to assist consumers in navigating the document and making the information more engaging and accessible. Tariff summary boxes will provide easily understandable information on a customer's current tariff and energy usage and the new tariff information label will provide an easy way to compare the terms and conditions of tariffs in the market on a "like for like" basis.

Ofgem has taken a targeted approach in setting the level of prescription to which suppliers must adhere and focused on areas where consistency and standardisation is of most benefit to consumers. The Tariff information label has a high level of prescription with the format as well as the content specified so that it can be easily used for cross market comparisons. More generally on bills, the content and headings will now be set in order to ensure consistency across the industry and familiarity with consumers but there is less prescription on the messaging to allow for supplier differentiation and non-price competition to reflect their branding, and the framing and tone that they consider appropriate to their customer base.

The Government believes the level of standardisation required by Ofgem will enable consumers to compare tariffs across the market much more easily. Ofgem have committed to reviewing the RMR package as a whole by 2017.

The Government agrees that we must be transparent about the impact of Government environmental levies and programmes on consumer bills and that is why the Government has committed to publishing this information in the "Estimated impacts of energy and climate change policies on energy prices and bills"[2] report. This also provides a breakdown of the other costs that make up a bill including wholesale, Transmission, distribution and metering costs, and other supplier costs. Ofgem already produces fact sheets that provide a breakdown of the costs which make up a typical energy bill.

Given that information on the components of an energy bill is already available elsewhere we do not see a case for requiring suppliers to provide it on bills. Our priority is to ensure that consumers have clear information to help them engage in the market.

In terms of how energy companies express price increases in communications to customers, the Government notes that one of the proposals under the RMR is to require suppliers to provide in price increase notification letters information on the previous unit rate and standing charge alongside the new rates. Suppliers must also provide a Personal Projection for the consumer's current tariff at the old and new rates. All of the information in the price notification letter, including the personal projection is to be presented in pounds and pence.

3. We are disappointed at the regulator's slow progress on requiring energy companies to improve their transparency and communication with their customers. We hope that Ofgem will use its existing powers to ensure that its RMR reforms are implemented. If the requirements proposed under Ofgem's RMR are not in place by the August 2013 as promised, we recommend that the Government stand ready to use any statutory powers to compel greater transparency from energy companies, early in 2014. We believe that this intervention should deliver the desirable long-term aim of incentivising companies to provide more competitive products for consumers. It should not be considered a one-off intervention to reduce energy company profits. (Paragraph 26)

The overall objective of the RMR is to make the market simpler, clearer and fairer for consumers. The RMR is intended to deliver the long-term aim the Committee sets out of incentivising companies to compete hard for customers. The proposed new rules strip away the unnecessary complexity of tariff choices, arm consumers with better, more relevant information to make it radically easier for them to make better choices. This will help consumers to secure a better deal – and in so doing increase the competitive pressure on energy suppliers to deliver good customer service at efficient cost.

The Government is taking powers in the Energy Bill to give statutory backing to Ofgem's key RMR proposals, which will focus minds on the delivery of these important reforms. We are pleased to note that since the Committee published its report Ofgem have published their final decision on the licence modifications and that the necessary amendments to supplier licence conditions will take affect from 23 October 2013. In addition, the new Standards of Conduct licence conditions, which set out requirements for suppliers to carry out their interactions with customers in an honest, transparent, appropriate and professional manner, have already come into force.

2 https://www.gov.uk/policy-impacts-on-prices-and-bills.

5. Despite serious shortfalls in the way energy companies communicate with their customers, we are pleased to see that they have started to make some progress on improving how they communicate with their customers. It is clear that some are doing better than others. We commend those companies, including British Gas and EDF Energy, who are developing innovative new ways of communicating complex information to their customers. We are concerned, however, that their efforts are still falling far short of what is required to increase transparency and improve consumer trust. It is clear that meaningful improvements are unlikely to be achieved without regulatory intervention. (Paragraph 29)

6. We are disappointed that energy supply companies have not gone to greater lengths to explain to their customers the reasons behind energy price rises. It should come as no surprise to energy companies that poor communication on their part has resulted in deep mistrust from their customers. We welcome the industry's acknowledgement that it has failed to act and needs to simplify and improve bills including explaining the individual components of a bill and the reasons for the upward pressure on prices. (Paragraph 35)

We have grouped these responses.

It is important for each energy company to explain to their customers changes in prices, the profits they make and where they go.

The Government welcomes the steps that a number of suppliers have already taken to simplify their tariffs and improve their bills in order to increase transparency and improve consumer trust. We look forward to seeing further improvements from the industry following their acknowledgement that of the need to simplify, improve and explain bills.

There is a clear role for regulatory intervention to secure consistency across the market in the way energy companies communicate with their customers. The RMR is providing this with a step change in the levels of transparency and standardisation and by introducing new cross industry tools for communicating information such as the Tariff Comparison Rate, Personal Projections, the suppliers' cheapest tariff message on bills and other communications. The new Standards of Conduct licence conditions set out requirements for suppliers to carry out their actions in an honest, transparent, appropriate and professional manner; and that suppliers provide accurate information and ensure customer service arrangements and processes are fit for purpose.

4. We also repeat the recommendation made in our Consumer Engagement report that DECC should lead a full and frank conversation about the contribution that consumers are being expected to make towards ensuring we have safe, secure and affordable energy supplies in future. DECC should set out a detailed strategy and programme for action over the next two years. This should include how it will engage with the public on these issues in a meaningful way. (Paragraph 27)

The Government is committed to being open and transparent about the impacts of energy and climate change policies.

DECC publishes estimates of the impact of energy and climate change policies on energy prices and bills, covering the period to 2030. The last such assessment was published on 27

March 2013[3]. This report details the impacts of policies on electricity, gas, and energy (electricity plus gas) prices and bills, split by household, business, and large energy intensive users. The assessment includes a breakdown of current household gas and electricity bills by their constituent parts (wholesale costs, transmission, distribution and metering costs, supplier costs and margins, energy and climate change policy costs and VAT) and distributional analysis of the impacts of polices on household energy bills (e.g. by household type, expenditure level, type of heating used etc.).

Accompanying this, DECC also published easy to understand info-graphics showing the contribution that policies make to bills which aimed to address some of the public misconceptions about how much energy and climate change policies are currently contributing to bills.

DECC has been upfront in stating that energy prices will go up: putting a price on emissions and providing support to low-carbon technologies is necessary to decarbonise our economy and help tackle dangerous climate change. But we also have a range of policies to improve energy efficiency, helping households and businesses reduce energy consumption, and offsetting the costs of policies. As a result, overall we estimate that by 2020 household energy bills will be, on average, 11% lower than they would have been in the absence of government policies.

DECC is open to feedback on improving the communication of the impacts of government policies. DECC has met with stakeholders – including consumer groups, think tanks, and energy suppliers – to gather reactions from different perspectives. In response to the feedback received, several changes were reflected in the most recent report. These included analysis of the impact of minimum efficiency standards for new and replacement boilers, a new assessment of network costs for business and industrial users, an analysis of the impacts on household bills by type of heating fuel and presenting impacts separately for CRC and non-CRC-participating medium-sized business users.

DECC is actively engaging with the public, giving them the information and advice they need to shop around and get on the best tariff or energy efficiency measures for their needs. The Government has provided £900,000 in 2013/14 to fund the creation of the 'Big Energy Saving Network'. The Network, a representative body comprising Third Sector Organisations, will focus on helping consumers understand tariffs and the switching options as well as how they could benefit from energy efficiency programmes available to them. In addition, a nationwide communications and advertising campaign was launched for the Green Deal programme.

DECC has undertaken a series of actions during 2013 to highlight the scale of the energy challenge facing the UK. This has included face-to-face events in seven cities across the UK and at the Hay Festival. These have targeted local key influencers and have used DECC's 2050 calculator. This tool has enabled DECC to frame a conversation about the transition required in the way we make and use energy; highlighting the options, challenge and opportunity. We have also delivered energy exhibitions in Newcastle and Manchester with a final event happening in Bristol on 10 October. These have been targeted at the public and have been designed to bring the energy challenge to life through interactive exhibits.

3 https://www.gov.uk/policy-impacts-on-prices-and-bills

Finally, a series of three animations have been produced to explain 1) the overall energy challenge, 2) the impact in terms of new infrastructure and 3) help for the consumer.

We are developing a longer term proposition to take the approach outlined above to scale. This will be done through a partnership approach, working with a broad range of organisations, including those from the energy sector, other business, local government, community groups, NGOs and academia.

Section 2: Ensuring a competitive retail market

7. We recommend that Ofgem also include 'profit margin' and 'rate of return on capital' (because excessive profit margins are a symptom of poorly functioning markets) in the above list of metrics which would help determine whether the supply market was competitive. (Paragraph 40)

8. We conclude that the small level of switching by customers between energy suppliers suggests the retail market is not as competitive as it could be. There is, however, insufficient data to determine accurately the actual level of competition in the retail market. ***We repeat our recommendation that when Ofgem implements its final Retail Market Review measures, it should publish its targets for improvements in the market as a result of these measures and the criteria it will use to judge the success of the measures. Going forward, Ofgem should also publish an annual assessment of the effect those measures are having on competition and consumer engagement.*** **(Paragraph 42)**

DECC and Ofgem have been working to improve competition in the domestic retail energy market. We have reduced barriers to entry by increasing the customer number threshold at which small suppliers are required to participate in certain environmental and social schemes. We are supporting Ofgem's work to address poor liquidity in the wholesale electricity market and to increase consumer engagement in the retail market. Ofgem's Retail Market Review proposals will introduce a clearer simpler tariff framework and give consumers clear personalised information on their bills helping them to compare and switch. As the Secretary of State pointed out in his evidence the domestic retail energy market has seen an increasing number of new entrants over the last few years, with three new companies entering the market last year and a further two companies entering the market this year. Some of the smaller suppliers are experiencing strong growth with companies such as Ovo and Co-op participating in collective switches.

The Government agrees that it is important that Ofgem use metrics to help determine whether the supply market is competitive. Ofgem already collects information on the profit margins of the six largest energy suppliers through the segmental statements, which they are required to provide to Ofgem. These show the revenues, costs and profits for generation and supply businesses annually. Though there are limits to comparability between suppliers and over time due to changes in the requirements of the statements over time, they can provide useful information. We understand Ofgem will explore the extent to which 'rate of return on capital' can usefully contribute to this task, in particular in assessing generation activities. We also agree with the Committee that an annual competition assessment would be useful and we are working closely with Ofgem to determine the content of this.

Ofgem have committed to monitoring the direct impact on consumer engagement of the RMR package once it is introduced and track the impact this engagement has on competition in the market. In the October 2012 RMR consultation, Ofgem proposed a wide range of market indicators they would use in this monitoring and covering a wide range of indicators of effectiveness of competition, and the level of quality of consumer engagement. Ofgem have also said that they will review the package in full no later than 2017 and earlier if they consider that the reforms are not having the expected effect.

Section 3: Profits

9. We understand that there may be difficulties in getting large vertically integrated energy companies to report their trading activities especially if they are foreign owned or based overseas. However, we believe that the increase in transparency and associated consumer trust clearly justifies including trading activities in the statements. ***We recommend that Ofgem require the big six to include trading activities in the statements. There is an opportunity for energy companies to make reputational gains by setting an example of best practice. In the context of low consumer confidence, we hope that energy companies will see the benefits of increased transparency.*** **(Paragraph 62)**

10. We believe that obtaining an independent opinion as opposed to requiring an audit of the statements is unsatisfactory because it does not provide a sufficient level of assurance to bolster trust in energy companies. The potential cost and inconvenience to the large vertically integrated businesses would be eclipsed by the gains in confidence an audit would bring. ***We recommend that Ofgem require the statements to be audited.*** **(Paragraph 65)**

11. We note that Scottish Power recently changed its financial reporting period to align with the majority of companies. We believe that the costs and inconvenience to SSE to change its year end would be outweighed by the gains in comparability across the different statements. We recommend that Ofgem require SSE to change its financial reporting period to align with the other large vertically integrated energy companies. (Paragraph 67)

12. We reject Ofgem's assertion that most of BDOs recommendations would put unnecessary burdens on the big six. The impact of BDO's recommendations should be considered as a package. We believe that taken as a whole, the benefits of BDOs recommendations - in terms of improvements to transparency and comparability of the statements and associated improvements in consumer trust - significantly outweigh any burdens on the six largest vertically integrated energy companies. We acknowledge that there will be additional costs involved with implementation of BDO's recommendations, but we believe that the benefits in terms of increased transparency and competition, and the potential downward pressure on prices that may result, justifies the expense. (Paragraph 70)

13. ***We recommend that Ofgem should require the six largest vertically integrated companies to implement BDO' recommendations 1 (publishing statements to the same year-end), 2 (independent auditor opinion on statements), and 4(reporting of trading function results). We also encourage Ofgem to consider requiring implementation of BDO's recommendations in full and to publish, in its response to this report, its analysis of the cost to energy companies of full implementation. We also recommend that Ofgem undertake further work to assess current transfer pricing policies.*** **(Paragraph 71)**

We have grouped the responses to these questions.

The Government supports the steps Ofgem has taken to increase transparency over profits of large, vertically integrated energy companies. The requirement for them to publish Segmental Statements outlining the revenues, costs and profits from their generation and supply businesses provides helpful information on their businesses in Great Britain. It provides a profit figure for each company's retail business which helps inform our understanding of the market and provide further information on the link between companies' generation and supply businesses.

We agree that there are some limitations to their use and that the statements themselves are not easily understood by consumers in assessing the profits made, given the complexity. To that end, we welcome Ofgem's accompanying factsheet to the 2011 statements that provides analysis of the statements for consumers and Ofgem's commitment to repeat these annually.

We support the work the Committee has done to investigate in what ways the statements could be improved. We note that Ofgem has already made a number of improvements to the statements' transparency and comparability between companies, including taking up some of the recommendations of the BDO review that you have cited. These are decisions that Ofgem, as the independent regulator, has taken following their assessment of the costs and benefits of all the recommendations that BDO made. We also note the steps some energy companies have voluntarily made to improve their statements, for example one has including trading information in its latest statements. We acknowledge that the cost of complying with such a requirement would vary amongst the companies.

We agree with the approach Ofgem has taken. We believe that improvements should be made that are proportionate, increase trust in the sector, and where the cost of achieving them would not be too high a cost to one or all companies, given that costs may ultimately be borne by consumers. Government does not have access Ofgem's cost-benefit assessment and the commercially confidential information contained in BDO's recommendation, so is not in a position to comment on the cost-benefit analysis of including these specific items. However, given the importance of this issue for trust and transparency, we support the decision that Ofgem has taken to re-consult on whether further information should be required of the energy suppliers.

Supply Market Indicators

14. We believe that the Supply Market Indicator is a useful tool, for assessing the supply margin of the big six's retail business. The disagreements between Ofgem and the energy companies over the figures, played out in the media, are deeply unhelpful and

only work to erode public trust in the companies and confidence in the regulator. Companies should engage constructively in improving the SMI. ***We recognise the methodological concerns and recommend that Ofgem actively review the methodology and improve it so that the SMI more accurately reflects the actual activities of energy companies.*** **(Paragraph 77)**

We agree with the Committee that the Supply Market Indicators are a useful tool. As Ofgem have said during the evidence they gave, it is not designed to be a measure of profits earned by suppliers, rather an indicator that tracks the movement over time of the factors that make up energy bills. In order to do this, Ofgem has to make appropriate assumptions, for example they assume a hedging strategy for purchasing energy for a representative supplier. Despite the limitations to the indicators, which have been highlighted by the Committee and the energy companies, we support their production. As stated in the original evidence to the Committee, we think these do improve transparency in the energy supply market and we also find them useful as an indicator to use before official statistics are available such as DECC's retail price statistics or the companies' Segmental Statements, which are published annually and with a lag.

We agree with the Committee that the methodology and assumptions should be kept under review, as with all indicators. We welcome Ofgem's decision to update the figure for typical domestic energy consumption, one of the areas which was highlighted in the report[4].

REMIT

15. We recommend that the Government ensure Ofgem takes full advantage of these new REMIT powers. (Paragraph 79)

The Government supported the EU Regulation on wholesale energy market integrity and transparency (REMIT) as it would help:

- Improve market integrity in wholesale gas and electricity markets, by preventing market abuse and insider trading;
- Improve confidence in traded energy markets, leading to more trading and an increase in allocative efficiency, and thereby reduce costs to the consumer; and
- Encourage cross-border market integration which will in turn support our wider energy objectives of increased competition in EU energy markets, improved energy efficiency and a move to low carbon.

The Government's REMIT enforcement regulations came into force on 29 June. The enforcement regulations facilitate the requirements prescribed under REMIT by providing Ofgem with the tools to enforce against breaches of the REMIT prohibitions. Ofgem's powers include the ability to request any relevant information; carry out onsite inspections; and impose unlimited fines for breaches of the REMIT prohibitions. It is hoped that the regulations will facilitate better regulatory practices and foster cooperation between Ofgem and market participants.

4 https://www.ofgem.gov.uk/ofgem-publications/74735/tdcv-review-consultation.pdf

Ensuring wholesale market competitiveness

16. Improving wholesale market competitiveness will be vital in ensuring customers are paying a fair price for their energy. We are astonished at how long it has taken Ofgem to act since it first identified this as an issue in 2008. The relatively light touch approach favoured by Ofgem has failed to deliver the changes required to improve competition. ***We recommend that urgent intervention is required to resolve this problem. Ofgem needs to implement its proposals to improve liquidity as soon as possible taking a more assertive approach than it has in the past.*** **(Paragraph 87)**

We agree that wholesale market liquidity is an important feature of a competitive market, and an important enabler of the Electricity Market Reform programme. We need a market that supports diversity – large companies have an important role to play, but cannot do it all. Independents drive competition and innovation.

The GB wholesale power market has low levels of liquidity relative to other major European markets and international commodity markets – this is acute in the forward markets. We therefore welcome the ambitious package of reforms recently announced by Ofgem to address this.

Ofgem intend to implement these reforms by early 2014 and we would like to see industry engage fully with Ofgem to ensure this target is met. We would also like to see the reforms implemented fully, with maximum impact.

The Government considers it necessary to retain the flexibility to be able to act if Ofgem's reforms are delayed or frustrated. We are therefore taking powers in the Energy Bill to promote market liquidity.

Government is also looking at other barriers including how independent market participants secure long-term contracts that allow them to finance generation projects. Government has tabled an amendment to the Energy Bill to enable it to implement an Offtaker of Last-Resort mechanism to provide additional confidence to the market, should it prove necessary.

Fuel Poverty

17. We conclude that the focus on low-income under the proposed LIHC indicator, by reference to the official poverty line, ensures a more accurate identification of fuel-poor households. The use of a 'fuel poverty gap' is welcome in giving a measure of the severity of the problem faced by households as energy prices continue to increase. However, we are concerned by the use of median national spend on fuel to determine "high costs" within the indicator. It is clear that fuel costs can be below the median and yet still remain unaffordable. If the median national spend is high it may not provide a true indication of affordability. We recognise that consumers who are paying the median could also be finding their energy bills unaffordable, even if they are not classed as fuel-poor. ***We recommend Government modifies the proposed definition to better reflect affordability in the context of low-income households by introducing a link between the income threshold and the energy costs threshold within the new indicator.*** **(Paragraph 100)**

We agree with the Committee that the fuel poverty gap is a welcome and helpful measure in understanding and responding to fuel poverty. As the Committee has noted, the fuel poverty gap will help us keep track of the effect of changes to energy prices on those households in fuel poverty.

On affordability, we recognise that all households on a low income face pressures in meeting household bills, including energy costs. It is however important to recognise the different causes of such difficulties and to keep a particular focus on the unique character of fuel poverty. In this context, our priority concern is for those whose energy requirements are relatively high, including because they tend to have limited scope to further reduce their energy bills.

This is a concern that is reflected in our decision to adopt the new Low Income High Costs definition of fuel poverty. We understand why many see the choice of threshold for "high costs" to be significant. However, given our focus on fuel poverty, rather than general poverty, we will want to support those households that are furthest from the energy costs threshold wherever it is set. Having clarity on priorities is especially necessary given the reality of limited (if significant) resources. We note this is a view expressed clearly by Professor Sir John Hills when he gave evidence to the Committee.

Although we believe there is an important distinction between fuel poverty and general income poverty, we naturally recognise that rising energy prices affect everyone on a low income and our policy package reflects this. For example, the Warm Home Discount is characterised by a focus on low income households rather than fuel poor homes. The Government is committed to doing all we can to help keep bills down, as set out in the Framework for Action on fuel poverty published in July 2013.

18. *We welcome Government's commitment to monitor the number of fuel-poor households living in E, F and G-rated properties, and recommend that Government use this information to help focus policy on improving some of the UK's most inefficient housing stock.* (Paragraph 101)

While in future our main method of understanding the scale of fuel poverty will be to use the LIHC indicator, including the fuel poverty gap, the Committee is right to highlight the value of a broader indicator set. We are committed to monitoring a range of indicators of fuel poverty in future and to publish these each year. This could certainly include the number of fuel poor households living in E, F and G rated properties.

19. We are alarmed by the reported lack of Government engagement with input from consultees during the Review process, in particular with regard to recommendations from the Government's own statutory advisory body (Fuel Poverty Advisory Group). Government has not modified the LIHC indicator, despite the fact that two thirds of respondents were opposed to the use of the national median to determine "high costs". We seek assurances that DECC will take full account of stakeholder concerns when formulating the new fuel poverty strategy. (Paragraph 102)

We believe the characterisation of a lack of engagement to be unfair. DECC Ministers and officials have engaged in detail and at every stage of the Hills review and subsequent work with a wide range of stakeholders. This is evident from the warm public welcome for our recent Energy Bill amendments on fuel poverty from FPAG, NEA and others. It must also

be recognised that in our consultation on changing the definition of fuel poverty, the majority of stakeholders welcomed our overall proposals.

We recognise and accept that some concerns were expressed by stakeholders in relation to the energy costs threshold under the new definition. However, in our view, none of the suggestions put forward provided an alternative methodology which improved on our own proposals. These built on the conclusions of the Hills Review which provided an independent and painstaking analysis of the issues.

Our engagement with stakeholders will continue throughout the process of developing a new fuel poverty strategy to be published in 2014. As just one example of this, we are actively supporting a strategy workshop being provided by the Fuel Poverty Advisory Group in October 2013.

20. ***We welcome Government's recent commitment to consider extending the use of data-sharing to ensure the most efficient and cost-effective delivery of fuel poverty policies. We further recommend that Ofgem considers introducing a licence condition to ensure that energy companies share data on household energy consumption and spend with Government, in order to facilitate identification of fuel-poor households.*** **(Paragraph 106)**

Data-matching has been shown to be a major success through the Warm Home Discount scheme which is expected to deliver more than 1.2m Core Group rebates in 2013/14. Building on this success, though currently on a smaller scale, DWP data matching is also used by several suppliers to verify Warm Home Discount Broader Group customers and as part of ECO Affordable Warmth. These data-matching activities differ from Core Group data-matching because customers specifically provide consent for data to be shared. We have learned from all of these approaches and continue to work with suppliers, Ofgem and DWP to look for ways data sharing can improve delivery.

In order to introduce data-sharing in situations where individual consent is not given, new primary legislation would be required. We would need to have clear evidence that the benefits to individuals outweigh the risks and costs of data sharing. Ofgem would have a similar approach when considering a new license condition.

Government recognises the potential benefits of data sharing when used securely in the right situations and is considering appropriate legislation as part of the legislative programme.

Regarding consumption data, Government already gathers such data for households as part of NEED (the National Energy Efficiency Database).

21. We conclude that while an accurate definition of fuel poverty is important, the Government has been unacceptably slow to respond to the Hills Review and take action to stem rising fuel poverty. We are concerned that fuel poverty policy has effectively been frozen at a time when significant energy price rises have made energy costs increasingly unaffordable for vulnerable and low-income households. We welcome the recent publication of the Government's framework for action on fuel poverty which will underpin the Government's fuel poverty strategy when it is introduced. It is imperative that the introduction and implementation of the strategy, expected at the end of this

year, is not delayed any further. For Government to have done all that is reasonably practicable to tackle fuel poverty, the new fuel poverty strategy should be published and implemented as an urgent priority. (Paragraph 109)

Commissioning the Hills Review was a significant step. It is right that we take the time necessary to respond to its findings and to put in place a better, more sustainable framework for future fuel poverty action. The amendments we have introduced to the Energy Bill for a new target framework also set out the timetable for the new target and strategy. These provide for regulations setting out the fuel poverty target to be put forward within six months of the Bill becoming law. A final strategy to ensure the target is met must then be published within six months of the regulations being agreed. These are maximum time limits: our intention is to bring forward all our proposals as soon as possible.

Our work on the new fuel poverty framework has been additional to our efforts to deliver successful fuel poverty policies. Since 2011, DECC fuel poverty policies have included Warm Front, the Energy Company Obligation, the Warm Home Discount and a highly successful local authority competition.

22. We conclude that energy efficiency programmes should be the focus of Government's fuel poverty policy in order to tackle the long-term root causes of the problem cost-effectively. It is disappointing that so much of current Government fuel poverty policy centres on short-term help with bills when improving the thermal efficiency of UK housing stock should be the priority. ***We welcome the recent announcement in the Spending Review that the Winter Fuel Payment will no longer be paid to those living in warmer European climates. We recommend that Government considers better targeting of the Winter Fuel Payment through means-testing, considering how savings made could be used to boost investment in energy efficiency programmes. We also recommend that Government reviews the allocation of funds for fuel poverty policies, prioritising energy efficiency initiatives over provision of financial assistance.*** **(Paragraph 114)**

We share the Committee's view of the importance of raising energy efficiency standards to tackle fuel poverty. Policy instruments with other aims – such as providing financial assistance for energy bills – can also be cost effective and help address the distributional impact of our policy package.

Our overall approach is set out in detail in the fuel poverty strategic framework – which we published alongside the amendments to the Energy Bill to change the fuel poverty target. This sets out a set of guiding principles that we will use to shape future policies. One of these principles relates to supporting fuel poor households with cost effective measures, thus ensuring we are using our available budgets effectively.

One innovation in helping us understand the type, nature and scale of the interventions we need is our new assessment of the 'merit order' of fuel poverty interventions (set out in the Fuel Poverty Marginal Alleviation Cost Curves – FP MACC). Published as part of our new framework, this helps us identify which policy interventions are the most cost effective and to see the trade-offs associated with delivering more costly measures. Underscoring the Committee's view on the importance of energy efficiency, the current version of the FP-MACC show that many of the most cost effective ways of supporting fuel poor households

involve relatively low cost insulation and heating measures. This is precisely the sort of measure currently being supported through the Energy Company Obligation (Affordable Warmth). The FP-MACC also shows an increasingly likely role for renewable heat technologies. It is also worth noting that the FP-MACC also shows that energy bill rebates (like Warm Home Discount) are in fact more cost-effective at present than some of the more expensive energy efficiency and heating measures. There is therefore a clear role for such policies.

In relation to the Committee's comments on Winter Fuel Payment, the Government has no plans to introduce a means test for this benefit.

23. England will be the only country in the UK without a tax-funded energy efficiency programme to address fuel poverty following the closure of Warm Front. We are concerned that there have been such significant reductions in the fuel poverty budget for England at a time when rising energy prices are having an increasingly adverse impact on vulnerable households. (Paragraph 116)

Neither the Government's commitment to fuel poverty nor the spending directed towards it has diminished. Spending will, in fact, be higher in 2014/15 than it was in 2009/10. In any event, the Hills Review was clear: when tackling fuel poverty, the source of funding is not as important as how it is spent. Spending figures are not, therefore, the best metric for gauging the scale of fuel poverty action. This is underlined by evidence from ECO which shows that we are delivering more cost effectively than before – this means we are helping more households per £ spent.

Under Warm Front in 2010/11, around 80,000 households received major heating and/or insulation measures from a budget of £366million. By contrast, the ECO Affordable Warmth obligation is expected to deliver heating and insulation measures to around 130,000 households each year of the scheme for an annual cost of around £350m. Coupled with the ECO Carbon Saving Communities obligation, worth around £190m per annum, we expect some 230,000 low income households to be assisted each scheme year. We also expect the main ECO carbon obligation to assist further low income households. Early delivery data under ECO is bearing all of this out.

Of course, the scale of potential investment in measures to tackle fuel poverty is high. We do therefore intend to continue to consider how we can bring additional investment to this important area to enhance the significant support already provided.

24. We conclude that resources under ECO are insufficient considering the scale of fuel poverty. ***We recommend that ECO expenditure is devoted primarily to fuel-poor households, and further recommend that Government reconsider how best to incentivise take-up and funding of the most expensive energy efficiency measures such as solid wall insulation.*** **(Paragraph 120)**

We note the Committee's view that more ECO expenditure should be devoted to fuel poor households. However, it is important to recognise that the ECO has two broad objectives – reducing fuel poverty and reducing carbon emissions. The Government's aim in shaping ECO has been to balance delivery of these important objectives in a cost effective way. An additional factor in this context is the requirement, under Article 7 of the EU Energy Efficiency Directive, for Member States to put in place an energy supplier obligation (or

equivalent policy measures) in order to meet a binding target of 1.5% cumulative energy savings between January 2014 and December 2020.

As mentioned above, ECO is expected to lead to investment in home thermal efficiency improvements equivalent to around £540m per year, supporting around 230,000 low income households. By any measure, this is significant support for fuel poverty.

Whilst solid wall and hard to treat cavity wall insulation are eligible measures under the Affordable Warmth obligation, it is our expectation that suppliers will try to meet their Affordable Warmth targets in the most cost-effective way to minimise the overall cost of the scheme. This is only right given that these costs will ultimately be passed through to consumers. It is also worth underlining that some low income households will benefit from the Carbon Saving Obligation under ECO, particularly social tenure properties which present economies of scale.

25. In a letter in July 2012 to Minister of State Gregory Rt Hon. Barker MP, we outlined our concerns about off-gas grid consumers and questioned the effectiveness of self-regulation in the domestic heating oil market, suggesting that Ofgem could have a role to play. *These concerns still stand, and we urge Government to review regulation of the domestic heating oil and LPG market, as well as extending support for fuel-poor households reliant on these fuels*. (Paragraph 121)

At the Ministerial Round Table meeting on heating oil and LPG held on 11th September, the Energy Minister, Michael Fallon, welcomed the new Code of Practice and Customer Charter, which was published by the FPS (Federation of Petroleum Suppliers) on 1st September. It is a welcome commitment from the industry to engage with consumers on a fair and consistent basis and implement best practice to raise standards. The Energy Minister also welcomed the FPS commitment to review the effect of its Code of Practice and Customer Charter next year. The Round Table members, including members of Parliament, consumer organisations, oil buying groups, competition and regulatory authorities, were asked to promote the FPS Code of Practice and Customer Charter widely though their various organisations. The Energy Minister plans to hold another Ministerial Round Table meeting in April 2014.

The supply of heating oil and Liquefied Petroleum Gas (LPG) is not covered by the natural gas and electricity regulatory regime established through the Gas Act 1986, the Electricity Act 1989 and updated through more recent legislation, notably the Utilities Act 2000 which established Ofgem as a combined regulator for Gas and Electricity. This is because the Gas and Electricity Acts principally addressed the issues of setting up a regulatory regime to ensure that the natural monopolies of the gas pipe network and the electricity transmission and distribution systems are not exploited. Ofgem also ensure appropriate regulation of gas and electricity supply, which are licensed activities for reasons that include the need to balance the electricity and gas systems and the relationship with the natural monopoly networks. As there is no natural or structural monopoly for supply and distribution in the heating oil or LPG markets, regulation by Ofgem is not deemed to be appropriate.

DECC recently published the fuel poverty strategic framework which highlighted the key factors that increase the likelihood of a household being fuel poor. This analysis showed that heating the home with a fuel other than gas was one of the factors most strongly

associated with being fuel poor and in severe fuel poverty. In developing the detail of the new strategy we will consider how well Government policies are supporting the most severely fuel poor households.

26. We conclude that further and more specialised resources are needed to tackle fuel poverty in rural areas, in particular to address the difficulties experienced by off-gas grid customers. *Ofgem and DECC should consider further measures as part of RMR and the Fuel Poverty Strategy to ensure that pre-payment customers and those without internet access are able to obtain best market deals.* (Paragraph 123)

The Government recognises that some consumers need extra help and advice to engage with the energy market and to give them the confidence to take decisions that will reduce their bills. That is why we have launched the Big Energy Saving Network of voluntary organisations and community groups which will work proactively with trained energy advisers to support vulnerable consumers to engage in the energy market, including those on Pre-payment meters. .

Whilst the use of pre-payment meters is more common among poorer households, it is not the case that all customers are in fuel poverty – less than 20% of fuel poor households are pre-payment customers.

Prepayment meters enable customers to monitor and control their energy expenditure. Since 2010, pre-payment customers have been offered the same prices by large suppliers as customers paying on standard credit. In addition, Ofgem have raised the debt threshold where prepayment consumers can switch suppliers to £500 under a voluntary agreement with suppliers. This will help those paying off debts through prepayment meters switch supplier to find the best deal for them.

Smart meters are expected to bring savings to suppliers in the prepayment market, such as those savings from avoided site visits to replace credit with pre-payment meters and vice versa. Consumers on pre-payment could benefit if these operational costs savings are passed on as lower prices.[5] Smart metering should also greatly improve the customer experience for prepayment customers. For example, suppliers will be able to offer a range of ways to top-up – so topping a meter could become as easy as topping up a mobile phone.

The analytical work carried out in support of the fuel poverty strategic framework highlighted the key factors that increase the likelihood of a household being fuel poor. This analysis showed that heating the home with a fuel other than gas was one of the factors most strongly associated with being fuel poor and in severe fuel poverty. In developing our new strategy we will consider how well Government policies are supporting the most severely fuel poor households.

5 DECC 2013 Smart Meters Impact Assessment: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/78666/IA-Feb.pdfpg 50-51

Use of levies on bills

27. We conclude that the increasing use of levies on bills to fund energy and climate change policies is problematic since it is likely to hit hardest those least able to pay. We note that public funding is less regressive than levies in this respect. (Paragraph 136)

28. We are particularly concerned by the significant projected increase in the wholesale electricity price and how this will impact on households reliant on electric heating. It is clear that vulnerable and fuel-poor consumers require protection from the impact of rising bills and extra support to ensure affordable warmth in their homes. ***We therefore recommend that Government consider introducing a "protected block of consumption" on bills exempt from levies, as proposed by FPAG and Consumer Focus.*** **(Paragraph 137)**

29. We note that under the current tariff structure, energy users are effectively penalised for low consumption, with reduced rates for high energy consumption. This is at odds with both energy conservation and fuel poverty aims. ***We therefore recommend that the Government and Ofgem consider how tariffs could be restructured to ensure that energy conservation is incentivised, while ensuring that high consuming vulnerable consumers are protected.*** **(Paragraph 138)**

We have grouped the responses to these questions.

We share the concern that energy prices are likely to continue on an upward trend, with or without policies, as a result of rising fossil fuel prices and network costs. However, on average, energy efficiency policies mean bills will rise by less than they would do in the absence of policies.

The distributional impact of policies is driven by a number of factors – in particular, who pays the costs and who benefits. The Affordable Warmth obligation and the Warm Home Discount are examples of levy-funded policies whose benefits are focused on low-income households. This helps to mitigate the regressive impact of rising energy costs.

The Department is conscious of the potential for the climate and energy package to have a regressive distributional impact. That is one reason why we publish a report on the impact on prices and bills of our policy approach. Distributional analysis undertaken for the Government's March 2013 report 'Estimated impact of energy and climate change policies on energy prices and bills[6]' found that the average impact of policies is a reduction on energy bills across all expenditure deciles and for each different household composition, compared to if these policies had never been introduced.

The poorest 30% of households are expected, on average, to see the largest reduction in bills as a percentage of their household expenditure, seeing reductions of between 1.0% and 2.4% of total expenditure in 2020 compared to what would happen in the absence of energy and climate change policies.

We recognise that electrically heated households are projected to experience higher bills, on average, as a result of policies. There are policies specifically to help off gas grid customers, such as Ofgem's current work to encourage the extension of the gas distribution networks to fuel poor households and homes that were in the Carbon Emissions Reduction

6 https://www.gov.uk/policy-impacts-on-prices-and-bills

Target (CERT)[7] priority group. We also have the Renewable Heat Premium Payment, a one-off grant scheme which helps householders with up-front costs of installing renewable heating equipment[8].

An important advantage of levy funded market-led policies – like Affordable Warmth – over Exchequer-funded schemes is that the market tends to find the most cost-effective way of delivering a particular outcome. This means that more households can be helped within a given budget.

We note the Committee's recommendation on removing levies from the initial block of consumption. In practice this would lead to suppliers recouping costs from subsequent units – that is, the units of energy consumed above the initial block. This type of change would share some of the characteristics of a rising block tariff – which is a tariff where initial units of energy are priced at a lower rate. While this would be a broadly progressive change – reducing costs on lower income households – it would penalise a large number of 'low-income high usage' households, who would see an increase in their energy costs. It would also benefit low usage and high income households and so would not be a targeted way of providing support to those who struggle to afford their energy bills.

Furthermore, as was demonstrated in the analysis undertaken by the Committee on Climate Change for their first progress report, this type of policy would also result in a worsening of fuel poverty. The fuel poor tend to have the highest energy requirements. This means that any tariff that increases the unit price of energy above a given threshold will penalise the fuel poor, making it more difficult for them to heat their home to an adequate standard. It is for this reason that Professor Hills did not make the case for rising block tariffs in his final recommendations to Government.

Under the Retail Market Review reforms, suppliers will no longer be allowed to offer tariffs which vary the standing charge or unit rate for different levels of consumption. This means that suppliers will no longer be allowed to offer multi-tier tariffs where suppliers charge customers a different price for different blocks of units. This will simplify the market to help the vast majority of consumers, who currently do not engage in the market, onto cheaper tariffs.

30. We agree with Government that an elimination target is not the best approach for tackling fuel poverty. The importance of a target lies in its ability to create political momentum and measure the effectiveness of policy. The current target has failed to achieve these objectives. ***We therefore support Government proposals to introduce a new target which focuses on improving the energy efficiency of fuel-poor households. We look forward to hearing further details on the form, date and level of the proposed target. Government should also consider whether further short-term, fuel poverty targets which can adapt to changing policy contexts could also be introduced as part of its forthcoming fuel poverty strategy.*** **(Paragraph 142)**

7 The 'Priority Group' was made up of vulnerable and low-income households, including those in receipt of eligible benefits and pensioners over the age of 70.

8 The scheme provides support for solar thermal, biomass, air-to-water source heat pumps and ground source heat pumps. Whilst all households can receive support for solar thermal installations, the grants for the other three technologies are available to off gas-grid householders only.

We very much welcome the Committee's conclusion that an elimination target is not the best approach to tackling fuel poverty. We are also grateful for the support for an energy efficiency target, as we have proposed. As noted above, our approach has also been welcomed by a range of stakeholders with whom we have engaged. It is important to recognise that targets of this kind can only drive effective action when they are properly formulated. The Government's proposals on the detail of the new target, including any interim milestones, will follow when the amendments to the Warm Homes and Energy Conservation Act have received Royal Assent.

31. We conclude that energy companies are not the best delivery agent for fuel poverty policies due to low levels of consumer trust and lack of local knowledge. In the longer term, policy instruments such as the Energy Company Obligation may not therefore be the most effective means of addressing fuel poverty. Local councils and voluntary organisations may have greater knowledge of property and occupant characteristics, leading to a more effective targeting of resources. ***We therefore recommend that Government considers how to maximise the involvement of councils, voluntary sector organisations and other trusted intermediaries as part of its new fuel poverty strategy. We also recommend that Government considers extending access to the ECO brokerage scheme to local councils, in order to ensure finance for locally-led energy efficiency projects.*** **(Paragraph 147)**

We note the ECC's recommendation that Government considers further the role of local partners in delivering support to the fuel poor.

The Fuel Poverty Local Authority Competition 2012-13 sought to improve the thermal efficiency of fuel poor households, providing £31 million funding to 60 projects, involving 169 local authorities working individually or as part of consortia. From the outset we sought to capture learning from these widely varying projects to gain insight into local authority-led delivery models for alleviating fuel poverty. Evaluation of the outcomes is ongoing. Many of the projects have sought to demonstrate how partnership working at the local level can be useful in identifying the fuel poor, and enabling them to access support. We are testing this approach further through the Big Energy saving Network. The outcomes of these activities will inform future policy development and we will discuss in the forthcoming Strategy.

In terms of ECO brokerage, it is that the case that access to the brokerage platform is currently open only to Green Deal Providers (GDPs). A number of housing associations (HAs) and the Local Government Association (LGA) have argued that access should be opened up, which may help in identifying qualifying properties, increase competition and potentially drive down ECO costs (which are passed onto consumer bills).

However, there are also trade-offs. By extending access to the platform and giving all ECO delivery agents a direct route to brokerage we risk the decoupling of ECO from the Green Deal and subsequently encourage a market that relies on 100% ECO subsidy. We also understand that HAs do not intend to offer Green Deals to social housing tenants which could undermine the benefits of increased competition that we might expect from an expanded platform. In the long term, blending ECO and Green Deal finances will be key to keeping the costs of ECO low and expanding access now could have negative effects on GDPs, consumer bills, and the Green Deal more generally.

There are also issues surrounding the regulatory framework governing LAs and HAs which only apply to their own housing stock which brings into question the standards and consumer protections in place. Energy companies are also aware that while some LAs and HAs have an excellent track record of delivery, others do not and lack the skills and capacity to estimate and deliver ECO. Furthermore, it is expected that the contracts LAs or HAs enter would be significant, which would open up both the HA/LA and energy companies to large financial risks if undelivered. In reality, and partly owing to this, we do not think that there would be many non-GDPs joining brokerage if access was opened up due to many being either unable or unwilling to sign the Bilateral Off-take Contract which sets out the terms for delivery, payment, and damages for non-delivery. While we have heard from the LGA, we have not received anything directly from specific LAs.

The brokerage mechanism is proving to be a very successful avenue to date with over £203 million traded through the platform over 16 auctions. We have decided that, while the market continues to establish and settle, and while brokerage participants familiarise themselves with the whole ECO process from start to finish, access will not be extended. We will re-examine the issues at stake in future.

Appendix 2: Ofgem Response

Introduction

Ofgem welcomes the Committee's comprehensive report on Energy Prices, Profits and Poverty. The report is an important contribution to the debate on prices and profits. We agree with the Committee that at a time of rising costs there is an urgent need to rebuild consumers' trust and to reassure them they can have confidence in the energy market. We also agree that greater transparency is an important part of the honest conversation the Committee wants the energy industry to have with all consumers.

The Committee makes a number of recommendations about steps Ofgem should take to help improve competition and to give customers greater confidence in the market. We have actions in hand in many of these areas, but we have listened to the Committee's recommendations and we are looking again at what more we can do.

The Committee acknowledged the important role of our Retail Market Review in stripping away complexity to give consumers clearer information and make it simpler to compare tariffs. We are pleased to confirm that in August we directed the necessary licence changes and suppliers are now required to implement our reforms. The Standards of Conduct which we introduced on a faster track are already in force. Backed by fines if necessary, these require suppliers to treat their customers fairly.

We recognise the need highlighted by the committee for us to be transparent and rigorous in our monitoring of the impacts of RMR. We are currently developing the detail of our monitoring approach and will take the Committee's recommendations on board as we do that. In particular we are planning to produce an annual report which will provide a clear picture of the state of the market.

The Committee also highlights the important role that liquidity reforms and our new REMIT powers can play in making the wholesale market more effective and driving competition for consumers. We agree with the committee about the importance of these areas and the need for timely action. Our proposed measures to improve liquidity are on track to come into effect early next year and we have consulted on how we will use our REMIT powers, which came into effect, as anticipated, at the end of June this year. We have also been looking at the role of price benchmarks in the Over The Counter (OTC) market which is another area where there is scope to improve transparency and market confidence. We set out in more detail later in this response the work we have in hand in these areas.

The committee further recommended that we improve our supply market indicator (SMI) methodology to better reflect the activities of energy companies. In that context, we have already adjusted the methodology to take account of the significant reductions in gas and electricity consumption over recent years. It is important to recognise that the SMI, which is a forward looking indicator based on public domain information, can never provide a fully accurate picture of industry profitability.

On the issue of profit transparency we share the Committee's view that this is critical to building consumer trust and confidence in the market. As we noted in our evidence to the

Committee it is solely because of Ofgem's actions in recent years that companies are now required to publish Segmental Statements. We have consistently sought to improve the way they are prepared and presented year-on-year in order to shine a light on companies' profits.

The Committee's report recommended that we adopt all of the BDO recommendations as a package. Our decision not to take forward some of these recommendations was based on the detailed advice provided by BDO and the feedback from extensive consultation. There are costs to increasing transparency which will be born ultimately by consumers in higher bills and it is important that any steps we take are proportionate and do not damage competition. We are currently not persuaded there is a case to adopt BDO's recommendations in full. However, given the Committee's recommendations and continuing consumer concerns about profit levels we intend to revisit this issue. We plan to consult later this month on how best to build confidence in the market through greater transparency around revenues, costs and profits, including looking again at all the BDO recommendations – both individually and as a package.

Everything Ofgem does is aimed at making a positive difference for consumers. We pay particular regard to consumers in vulnerable situations and have recently published an updated Consumer Vulnerability Strategy. This sets out our work to support these consumers in engaging in the market and explores how to identify those who need extra help in particular circumstances.

Rebuilding trust and confidence in the market is vital. This was a key theme of Ofgem's Retail Market Review. Listening to the Committee has encouraged us to take a wider look at what more can be done to reassure consumers and give them confidence in the energy market.

Ofgem is identified in recommendations 2, 7, 8, 9-13 and 14 - 16, 20, 26, and 29 of the Committee's report. Below, the Committee's recommendations are shown in bold and the paragraph references at the end of each recommendation correspond with those in the Committee's report. Ofgem's response is given beneath each recommendation.

Energy Prices

Recommendation 2: We recommend that the regulator compel energy companies to: (Paragraph 25)

a) ***Standardise the presentation of their bills to make it easier to understand bills, and compare prices;***

We share the Committee's view that a key factor in rebuilding consumer confidence is simpler and clearer bills.

A key outcome of our Retail Market Review (RMR) is the requirement we have now placed on suppliers to standardise and simplify elements of the presentation of a range of customer communications, including the bill. We have recently made the changes to suppliers' licences and suppliers have until the 31 March 2014 to make the necessary changes to bills and other communications. We are also requiring the use of a Personal

Projection and Tariff Comparison Rate which will allow consumers to compare their current tariff with others more easily, to support more informed switching decisions.

b) Identify the various components which make up the costs of the bill, the costs of UK/EU policy and company margins;

We share the Committee's view that consumers need to be able to find out what makes up the costs of the bill. However we are not persuaded that providing information on the bill is necessarily the best way to achieve this. Our consumer research shows that consumers already find bills confusing and the priority is to ensure they are clear what they need to pay and what tariff they are on. Some suppliers do provide a breakdown of the costs on the bill but we do not propose to require it.

We do however publish regular information for consumers on the components of the costs of energy supply including providing topic specific factsheets[9]. We also publish our Supply Market Indicators (SMI) which are updated every week with information about the elements of the costs of energy supply. Both of these tools are publicly available on our website[10].

c) Express price changes in pounds and pence as well as percentages.

We agree with the Committee that it is important information is communicated to consumers in a way which is simple and easy to understand, to facilitate informed engagement with the market. Within RMR we have made the decision to implement a range of information based proposals, which provide consumers with new tools to help them engage, and make existing communications more informative. As a part of this we have required information to be presented in pounds and pence.

More specifically, our existing rules require suppliers to inform consumers in advance when prices increase, or any other changes that may significantly disadvantage them. We have tightened these rules to ensure consumer receive personalised information, in pounds and pence when prices increase.

We are now requiring suppliers to use a Personal Projections on price change notices, and other communications. Personal Projections create a common way of projecting the estimated annual cost for a specific customer tariff and consumption. Suppliers will be required to present this personalised cost information in pounds per year.

When prices, or any other term increases, supplier will be required to provide the consumer with a comparison of the difference in cost, in pounds per year, personalised for their consumption and tariff. This must be provided in a clear table format, set by Ofgem and on page one of the communication. This will ensure this information is prominent and the personal impact of the price increase is clear for all consumers.

9 https://www.ofgem.gov.uk/information-consumers

10 https://www.ofgem.gov.uk/gas/retail-market/monitoring-data-and-statistics/electricity-and-gas-supply-market-indicators

Recommendation 3: If the requirements proposed under Ofgem's RMR are not in place by August 2013 as promised we recommend that the Government stand ready to use any statutory powers to compel greater transparency from energy companies, early in 2014. (Paragraph 26)

We can confirm that Ofgem made the licence changes to implement RMR in August, in line with its commitment to the Committee. The appeal period has now passed and the licence conditions come into effect in phases with suppliers required to have simplified their tariffs by the end of the year and to provide the additional information on bills and elsewhere by the end of March 2014.

The Standards of Conduct and the non-domestic rules were on a faster track and came into force in August. Suppliers are now required to treat their customers fairly and are exposed to financial penalties if they do not.

We note the Committee's disappointment with the time taken to reach this position. This is a complex area with different stakeholders having strong views on the best approach and a need for Ofgem to consult fully on what are quite detailed proposals. We will however reflect on whether there are lessons that we can learn for policy development going forward.

Recommendation 7: We recommend that Ofgem also include 'profit margin' and 'rate of return on capital' (because excessive profit margins are a symptom of poorly functioning markets) in the list of metrics to help determine whether the supply market was competitive. (Paragraph 40)

We share the Committee's view on the importance of looking at a range of metrics to help determine the level of competitiveness in the supply market. We are currently developing our approach to monitoring and evaluation but would expect to include most if not all of the metrics suggested by the Committee.

In particular we agree with the Committee that the level of profit margin is a relevant indicator of supply market competition. That is why we introduced the requirement on the six largest energy suppliers to prepare and publish Consolidated Segmental Statements which made public, for the first time, information on the profit margins of the supply and generation businesses of vertically integrated companies.

It is unclear how useful ROCE is as an indicator of profitability for the supply market given these are not infrastructure businesses. More generally, there are a number of complexities surrounding the robust calculation of ROCE. However as part of our consultation on further steps to improve transparency we will look again at the practicality of calculating ROCE for the generation aspect of vertically integrated businesses.

Ofgem is committed to ensuring stakeholders understand the level of energy company profitability. Going forward we will continue to look at ways in which we can ensure that clear and accurate information about energy company profitability is available to all consumers and stakeholders. We will use this alongside other metrics to inform our view of the state of competition.

Recommendation 8: We repeat our recommendation that when Ofgem implements its final RMR measures, it should publish its targets for improvements in the market as a result of these measures and the criteria it will use to judge the success of the measures. (Going forward, Ofgem should also publish an annual assessment of the effect those measures are having on competition and consumer engagement). (Paragraph 42)

We agree with the Committee on the need for robust monitoring of the effects of RMR. We have set out in our consultations the broad approach that we intend to adopt and the outcomes that we expect to see from the RMR.

The RMR measures are designed to ensure consumers receive fairer treatment to facilitate trust; to provide greater tariff comparability through simpler choices; and improve the quality of information provided to consumers, to allow more informed decisions. This should make it easier for consumers to engage with market, and encourage them to so do.

Ofgem routinely tracks a number of retail market indicators and carries out regular consumer research to understand consumers' experience of and attitudes towards the energy market. For instance, in June this year we published the results of our Consumer Engagement with Energy Market Tracker Survey 2013[11]. This analysis has helped us identify areas where further action may be necessary.

We already publish all our consumer research and anticipate publishing regular reports on aspects of our evaluation of RMR. Responding to the Committee's desire for an annual assessment of the effects of RMR on competition and consumer engagement, we confirm that going forward we plan to produce annual reports looking at the state of the market.

While we are clear about the broad outcomes that we expect from RMR we do not consider it would be appropriate to set specific quantitative targets for success. RMR is intended to deliver a complex series of outcomes that cannot easily be captured or published as simple targets. The package needs to be viewed in its totality in order to judge the impact of the reforms.

We are now in the process of developing our approach to reviewing the effectiveness of the RMR. As a part of this we are looking to articulate what a successful outcome will look like both in terms of the changes we would expect to see in consumers' trust and understanding of the market, as well as how that then translates through into more effective competition. We expect that our approach to monitoring will include a wide range of market indicators as well as qualitative information on consumer behaviour and attitudes to the energy markets. We have already committed to work with stakeholders on the detail of our approach to monitoring and evaluation over the coming months.

11 Customer Engagement with the Energy Market - Tracking Survey 2013,Report prepared for Ofgem 12 June 2013, found here: https://www.ofgem.gov.uk/ofgem-publications/74756/customer-engagement-energy-market-tracking-survey-2013.pdf

Profits

Recommendation 9 – 13:

We recommend that Ofgem require the big six to include trading activities in the statements. (Paragraph 62)

We recommend that Ofgem require the statements to be audited. (Paragraph 65)

We recommend that Ofgem require SSE to change its financial reporting period to align with the other large vertically integrated energy companies. (Paragraph 67)

We also encourage Ofgem to consider requiring implementation of BDO's recommendations in full and to publish, in its response to this report, its analysis of the cost to energy companies of full implementation. We also recommend that Ofgem undertake further work to assess current transfer pricing policies. (Paragraph 71)

We share the Committee's view that increased transparency around prices and profits is key to re-building consumer trust and confidence in the market but we are currently not persuaded of the case for implementing these particular changes. We will however revisit the issue in the light of the Committee's views and continuing consumer concerns about the levels of prices.

When we consider action in the area of transparency, we have to be mindful of the policy framework that governs our energy markets. This establishes that end-user gas and electricity prices should be set – and kept in check – through competitive markets, recognising the additional benefits that competition can bring such as providing customer choice and driving innovation. Ofgem has an important role to promote competition to protect the interests of consumers. Transparency can be an effective tool in supporting these objectives, especially where it promotes confidence among consumers.

As we made clear in our evidence to the Committee it is only because of Ofgem's actions that companies are now required to publish annual Segmental Statements which provide separate information on the profitability of their generation and supply activities. This is now the fourth year that these Statements have been produced and they are generally welcomed by stakeholders. We have consistently sought to improve the robustness and usefulness of the Statements year-on-year in order to shine a light on companies' profits.

As a part of this commitment to continuous improvement, in 2011 we commissioned BDO to carry out for us a detailed review of the Statements. BDO concluded that the methodologies used by suppliers to compile their Statements were broadly fair and appropriate and the contents were consistent with their audited numbers. They also found no evidence of distortions of company profitability. As requested they made a number of recommendations to improve the transparency and comparability of the Statements.

We consulted on a range of proposals based on these recommendations and made a number of changes last year. We consider that these modifications strike the right balance between the potential benefits from promoting transparency of energy company profitability with the potential costs which will ultimately pass through to consumers. For example, requirements on energy companies to organise and operate their businesses in a specific way to facilitate reporting may reduce their ability to manage costs efficiently,

leading to higher prices to customers. Similarly disclosure requirements can in some cases harm competition by, for example, revealing details of commercial strategies. We are required by law to ensure that our interventions are both necessary and proportionate.

In terms of the specific recommendations, the evidence that was presented to Ofgem as part of our consultation suggested that the benefits to be gained from requiring SSE to alter its financial reporting period, or from reporting trading function results, were small and outweighed by the costs, which would be passed through to customer on their bills. There are also questions about our ability to require information on trading activities, for example where they are managed on a pan-European basis.

With regard to having an independent auditor's opinion on the Statements, we concluded that the cost was not justified, given that we already require each company to reconcile its Statement to a set of audited financial accounts. However we did implement a variant of BDO's recommendation and obtained an independent review of the 2011 Statements by the accountancy firm PKF. PKF concluded that the companies had completed the Statements appropriately and the reconciliations to audited accounts had been carried out in line with the licence condition.

The Committee express surprise that we did not adopt BDO recommendations in full. We would reiterate that it was our initiative to seek BDO's advice initially. Their written advice made clear that the methodologies used were broadly fair and appropriate and acknowledged some of the risks and issues with their recommendations. We are required to consult on changes we make to suppliers' licences and the responses we received to this consultation led us to conclude that it would not be appropriate to take forward certain of the recommendations in the form proposed.

However we recognise consumers remain concerned as to whether current profit levels are justified and we acknowledge the Committee's views on the need for further action. We therefore propose to consult how best to build confidence in the market through greater transparency around profits. This will include but not be limited to potential improvements to the information made publicly available about energy company profitability by Ofgem and the companies themselves. We will set out in full the reasoning behind our existing measures and will explore whether new evidence has emerged since their implementation that would now justify a different approach. We will look, in particular, at the Committee's views and BDO recommendations.

The Committee recommended that we should look at the recommendations as a package and not consider the costs of individual elements. While we recognise the interplay between the different elements, in assessing proportionality we will need to look at the costs and benefits of the individual recommendations as well as the overall package.

Recommendation 14: We recognise the methodological concerns and recommend that Ofgem actively review the methodology and improve it so that the SMI more accurately reflects the actual activities of energy companies. (Paragraph 77)

We welcome the Committee's comments on the Supply Market Indicator (SMI) and their support for it as a tool for assessing trends in average energy supply bills, costs and margins of the six large energy companies' retail businesses. Our aim in producing it is to help

stakeholders to better understand the relationship between wholesale costs and retail prices.

We aim to keep the SMI accurate and representative of the position for the average consumer. We are committed to making periodic and proportionate adjustments to the data when the available evidence warrants it. In particular, as we noted in our evidence to the Committee, we have been reviewing the domestic consumption assumptions used given concerns that these were out of date.

We implemented new, lower consumption figures in mid September, which brings SMI consumption data more in line with the observed declining trend in domestic consumption. As a result, the SMI more accurately reflects the current average bill, costs and margins. The resulting September 12-month snapshot margin for the average consumer is now £65 (down from £90).

While we aim to have robust, updated and publicly available data, the SMI has some limitations as an indicator. Some of the data is necessarily lagged, and we have to estimate other components. In addition, the indicator does not seek to provide estimates of companies' profits, either collectively or individually. Detailed information on individual companies' revenues, costs and profits in both their generation and supply arms is available on a backward-looking basis in their Consolidated Segmental Statements.

As always, we remain open to ideas for improvements and will consider for inclusion in the SMI any robust evidence that stakeholders provide us.

Recommendation 15: We recommend that the Government ensure Ofgem takes full advantage of these new REMIT powers. (Paragraph 79)

We share the Committee's view of the important role of our new REMIT powers in providing confidence that wholesale gas and electricity prices are set in an efficient manner and that profits cannot be made from market abuse.

Member States are required to establish an effective, dissuasive and proportionate regulatory framework for investigating and penalising breaches of the REMIT Regulation. UK Parliament passed regulations that included civil powers for Ofgem to impose unlimited financial penalties. These regulations came into effect on 29 June 2013 and are a significant first step in creating an effective regulatory regime. We look forward to discussing the case for strengthened enforcement powers (including criminal sanctions) with the Government. We hope that, moving forward, this will take proper account of developments in the regulation of market abuse across the European Union.

In the meantime, we have consulted on our approach to the use of our new powers under REMIT (including our policy on imposing penalties) and expect to finalise guidance in October. As the competent National Regulatory Authority for wholesale energy markets in Britain, Ofgem routinely monitors the market for suspicious activity. Where appropriate, we will initiate investigations and use new civil enforcement powers. Decisions on carrying out enforcement action will be taken in line with our enforcement guidelines for REMIT, which are part of our consultation package.

Recommendation 16: Ofgem needs to implement its proposals to improve liquidity as soon as possible taking a more assertive approach than it has in the past. (Paragraph 87)

We agree with the Committee that we need swift action to improve liquidity and transparency in the electricity wholesale markets, the aim of which is to ensure that consumers get the full benefit of a competitive energy market. Ofgem has an important role to promote competition to protect the interests of consumers.

Our proposals should allow independent suppliers and generators to access the full range of wholesale market products they need to compete effectively.

Our proposed Secure and Promote licence condition aims to provide small suppliers with a level playing field when accessing the wholesale market. This means that they can compete effectively with the established players. It should also improve liquidity and transparency in the forward market, by requiring the six large vertically integrated energy companies to 'market make'– i.e. to post the prices at which they are willing to buy or sell power - in a range of forward market products.

The Authority will take a decision on whether to proceed with the licence condition in the coming months taking account of responses to our consultation. If we do decide to proceed, we would expect to see the licence condition fully implemented early in 2014.

As well as our work on liquidity we are looking at how to improve the robustness of price benchmarks, which are an essential component of the way in which gas and electricity is traded on the over-the-counter (OTC) market.

Following allegations about the potential manipulation of benchmark prices last Autumn, Ofgem launched a review to consider some specific activity in the market that took place on 28th September. In parallel we considered that the formation of benchmark prices and the processes of Price Reporting Agencies (PRAs) more generally might be an issue requiring further investigation. We issued a call for evidence in June. This sought views from market participants about how they both contributed to and used price assessments and indices, and sought stakeholders' views more broadly on whether current arrangements are fit for purpose.

This is another area where we believe there is scope to improve transparency and market confidence.

Fuel Poverty

***Recommendation 20: We further recommend that Ofgem considers introducing a licence condition to ensure that energy companies share data on household energy consumption and spend with Government, in order to facilitate identification of fuel-poor households.* (Paragraph 106)**

We agree with the Committee that improved data sharing has a role to play in helping identify those in fuel poverty but note that there are difficult privacy issues involved.

FPAG proposed in its 2011-12 annual report that Government share more data with suppliers, and the committee rightly notes that there is widespread support for this. As the report notes, we think there is a case for greater data sharing and/or matching on this basis,

and we will be discussing this further with DECC and through our ongoing involvement in the Fuel Poverty Advisory Group (FPAG).

The Committee's recommendation is different and is that companies should share consumer data with Government. The Committee will be aware that this is potentially a sensitive area, not least in the context of the roll-out of smart meters. There are obvious potential privacy concerns and so the Committee's recommendation would need significant public engagement first and may be a matter more appropriately decided by government/parliament.

Government does already have powers to collect data for statistical purposes under the Statistics of Trade Act 1947. It uses this power to collect consumption data for modelling purposes.

As we noted in our evidence we are currently undertaking a review of the Priority Services Register regime, as part of our wider Consumer Vulnerability Strategy. This will amongst other things consider issues relating to the identification of relevant consumers. We have already undertaken some consumer research for this project and will be continuing our work through the rest of this year. We would be pleased to keep the Committee updated on our work in this area.

Recommendation 26: Ofgem and DECC should consider further measures as part of RMR and the Fuel Poverty Strategy to ensure that pre-payment customers and those without internet access are able to obtain best market deals. **(Paragraph 123)**

We share the Committee's concern about the need for additional support for pre-payment customers and those without internet customers. We already have a number of strands of work underway aimed at providing additional support to those customers.

We have established a consumer and industry working group to consider the development of our Market Cheapest Deal proposal, which is particularly focused on how best to help the vulnerable and most disengaged, to access the cheapest deals on the market. We expect the initial outputs from the group to be made public later this year.

Early this year Ofgem launched a programme focussing on consumers' interaction with brokers and Third Party Intermediaries (TPI). As part of this programme we are also considering issues relating to consumers in vulnerable circumstances, including for example those who do not have internet access. We will be working with the Citizens Advice consumer service to consider how best to take forward our Energy Best Deal collaboration and how this might fit best with DECC's new Big Energy Saving Network.

Through our RMR proposals, all customers, including those on prepayment meters will be given regular, personalised Cheapest Tariff Messaging on their bills and other communications. This will ensure that these customers are given regular prompts on the best offers from their supplier.

Recommendation 29: We therefore recommend that the Government and Ofgem consider how tariffs could be restructured to ensure that energy conservation is incentivised, while ensuring that high consuming vulnerable consumers are protected. **(Paragraph 138)**

We recognise the need to incentivise energy conservation while ensuring vulnerable consumers are protected. These were factors we look into account in developing our RMR which outlaws existing two-tier tariffs that are hard for consumers to understand and reward higher consumption.

Although the RMR proposals limit the number of tariffs suppliers offer, we have specifically considered how best to ensure that more innovative tariffs used to incentivise behaviour, such as time of use tariffs, can develop and thrive. Our proposals allow significant flexibility on tariffs for customers who use smart meters. We will also have the ability to make derogations from some of our policies in order to allow suppliers to pilot more innovative tariffs.

Research conducted to inform the RMR proposals also explored the viability of numerous tariff structures, including rising block tariffs. Rising block tariffs, where the price consumers pay for their energy increases in a staged way as consumption increases, will not be permitted under the current proposals. We are aware, from research we commissioned from the Centre for Sustainable Energy, that a considerable proportion (around one-quarter) of low income consumers have above average consumption levels. Rising block tariffs would therefore have the potential to increase energy bills for a considerable number of low income households.