Assisting with Affordability Concerns for Vulnerable Energy Consumers

Phoenix Supply Limited Response to the Utility Regulator Consultation Paper

April 2010

Q1 (Chapter 2): Are there any additional key context issues that should be noted?

Other key context issues which Phoenix Supply Limited (PSL) has identified are:

- How a social tariff would impact upon the development of competition within the natural gas industry and perhaps more importantly, between fuels (in particular between natural gas and oil); and

- Does introduction of a social tariff sit comfortably with the licence obligations of energy suppliers?

In addition we note references to high level energy prices and in particular the energy tariff increases in 2008 but we are disappointed the consultation document does not give the same level of coverage to the significant natural gas price reductions in 2009. PSL reduced its natural gas tariffs by 22.1% in January 2009 and by 19.0% in October 2009, taking tariffs in the Greater Belfast Licensed Area to 2006 levels. We therefore do not consider it appropriate to automatically assume that fuel poverty levels in Northern Ireland (NI) are currently significantly higher than 2006 levels.

We note that a review is currently being undertaken to update the NI fuel poverty statistics, however, this is based on energy prices in 2009, which have now significantly changed. It is important that NI has a dynamic fuel poverty model which can provide more timely data and take into account significant changes to energy tariffs.

Furthermore, it is appropriate to highlight that tariffs which arose from the price increases applied in 2009 were not in effect for the full year. Natural gas tariffs reached their peak in October 2009, however, were quickly reduced in January 2010.

These are important issues which we have highlighted to provide further balance to the second chapter of the consultation paper.

Q2 (Chapter 3) Comments are welcome on the potential and appropriateness for an expanded statutory remit for the Utility Regulator to allow regulatory mechanisms to potentially tackle affordability issues.

As the feasibility study into the application of social tariffs to the natural gas industry in Northern Ireland[1] prepared by PSL highlighted, we agree that for the Utility Regulator (UReg) to devise and implement a social tariff regime would, in all likelihood, be in breach of UReg's statutory powers.

At the end of 2009 nearly 275,000 homes and businesses in the Greater Belfast Area had access to the natural gas network with around 50% of those already enjoying the benefits of natural gas. Continual growth to the Phoenix network has resulted in the conversion of 50% of industrial and commercial businesses, over 50% of Housing Executive homes, 90% of all new build properties and one in four private homes in the last twelve years. The continued growth in the number of natural gas customers is a factor in helping to keep conveyance charges at their current level, or drive them lower, which is to the benefit of all natural gas consumers.

Looking at NI as a whole however, only around 12% of homes and businesses are using natural gas. The majority of fuel poor households in NI use oil, as over 70% of households here use oil as their principal heating source. Clearly any measures to help address fuel poverty need to include the oil industry, if fuel poor households are to be successfully targeted.

The Energy (Northern Ireland) Order 2003 sets out the various statutory duties that the Department and UReg have in furthering their principle objective to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in NI.

In furthering its duties UReg must ensure a high level of protection of the interests of the consumers of gas. The Energy Order states that:

> *"In performing that duty, the Department or the Authority shall have regard to the interests of –*
>
> > *(a) individuals who are disabled or chronically sick;*
> >
> > *(b) individuals of pensionable age; and*
> >
> > *(c) individuals with low incomes;*
>
> *but that is not to be taken as implying that regard may not be had to the interests of other descriptions of consumer."*

UReg would therefore need to be satisfied that in imposing a social tariff they had due and proper regard to the interests of other descriptions of consumers. We concur with UReg's view that action cannot be taken which might protect a particular subset of consumers but which would be detrimental to other consumers and thereby does not protect the interests of consumers as a whole.

[1] A Feasibility Study into the Application of Social Tariffs to the Natural Gas Industry in Northern Ireland, Phoenix Supply Ltd, May 2009

Q3 (Chapter 3) Comments are welcome on the suggested staged approach to affordability policy/scheme development.

Q4 (Chapter 4) Have we identified the appropriate key Stage 1 questions / issues?

Fuel poverty is a complex issue involving a wide range of organisations in the NI energy industry. A staged approach is therefore essential to ensure that views and representations can be made at each and every opportunity so that any resulting policy is as informed as possible.

The main questions / issues stem from the areas identified in the paper (i.e. the problem we are trying to alleviate; size of policy intervention and implications for funding; who should benefit and to what extent.)

However, we would question how effective engagement can be achieved with the NI oil industry to ensure oil consumers are not overlooked when considering a social tariff scheme. This issue needs to be given careful consideration and appropriate mechanisms established in order to ensure meaningful and effective engagement with the oil industry.

Q5 (Chapter 4) Comments are welcome on 'scope and purpose' questions/issues. Should any policy intervention be aimed at affordable warmth in the round or at a more limited problem such as electricity affordability and anxiety about bills?

The issue of Social Tariffs has been raised by various organisations as a potential means of helping those households in fuel poverty by providing a form of discount to their energy bills. As a regulated energy supplier PSL is committed to delivering the lowest possible price to all consumers. Currently this is the fundamental principle used in setting tariffs.

In the past year the Northern Ireland Executive has paid £22.5m to around 150,000 households on pension credit and income support, each receiving £150. This measure followed the increase in wholesale energy costs in 2008 and was designed to help those most vulnerable to fuel poverty. For those households using natural gas this £150 payment reduced the average annual gas bill at that time by around 30%. For a natural gas customer in receipt of the winter fuel allowance of £250, the aggregate payment of £400 reduced the average annual gas bill at that time by around 75%.

Clearly the Executive can continue to target funding in order to help those households considered to be in fuel poverty, within available government spending limits.

Government spending is however finite and whilst such payments help households meet current financial liabilities, this does not tackle the root of the problem. Unless the energy efficiency of a household is maximized and household incomes increased, the problem is unlikely to recede in future years. Policy intervention therefore needs to address the issue of fuel poverty in the round rather than address one area alone.

It also appears to us an important consideration that only a proportion of NI households use natural gas to heat their homes. However, almost every home in NI uses electricity therefore it would seem that this is a more effective method of targeting any policy intervention.

Q6 (Chapter 4) Comments are welcome on the issues raised above in relation to the intended target size and scope of any intervention, size of fund required to deliver this, and impact on 'paying' customers.

Q7 (Chapter 4) Comments are welcome on policy funding questions/issues. In the absence of additional new government funding, should any intervention on energy bills be paid for by all customers or a subset of customers?

As a consequence of the link between household income and fuel poverty energy suppliers are not in a position to identify customers who are in fuel poverty as they have no information in respect of household incomes. This information, together with data in respect of benefit entitlement of households, is held by government departments who are best placed to identify households requiring assistance. It therefore seems more appropriate for Government to identify qualifying households and provide them with direct assistance rather than have natural gas suppliers or indeed customers identifying themselves as being in fuel poverty and meeting arbitrary social tariff criteria set by individual suppliers.

As PSL is subject to a Price Control which ensures the company operates a low cost business model and caps margin at 1.5%, any Social Tariff would mean that customers benefiting from such a tariff would be paying less than the actual cost to supply. In the consultation paper it is suggested that one option would be that this shortfall would be met by other customers who would be paying a premium. The cross subsidy which would result from operating a Social Tariff regime could delay, or remove the prospect of, competition for Social Tariff customers as a new entrant to the market could, presumably, not supply these customers at less than the true cost of supply. Therefore, one possible effect of a Social Tariff would be to limit the development of competition for this important section of consumers.

Furthermore customers currently on the margins of fuel poverty could, as a result of higher charges associated with any of the options, be forced into fuel poverty that would otherwise never have experienced fuel poverty. This would be a perverse and counterproductive outcome and any assessment of available options must detail how many additional households are likely to be pushed into fuel poverty as a result of implementing a social tariff. It is our view that this would require some form of detailed modelling.

We agree that consideration needs to be given to the impact the introduction a Social Tariff would have on the competitiveness of local businesses and the NI economy as a whole given the current economic crisis and the fact that many businesses are currently struggling financially. It is likely that business customers would bear a significant proportion of the burden associated with raising the funds necessary to implement a Social Tariff. DETI would therefore be best placed to consider these issues of competitiveness and ensure the views of business stakeholders were considered.

These issues should be considered in detail prior to implementing any form of Social Tariff regime in order to ensure customers are appropriately protected and the NI economy is not competitively disadvantaged relative to other economies. In this regard, we view this as a necessary precondition prior to any suggestion of moving to "Stage 2" as outlined in the consultation paper.

PSL is concerned at the level of contribution required to be made by non fuel poor households as identified in Table 2 of the consultation paper. To provide £300 to 100,000 households being funded by approximately 300,000 households equates to an annual contribution of £100 each. To put a contribution of this magnitude in context, this would equate to an increase of around 25% in the average annual domestic gas bill. This is clearly unacceptable and should be ruled out as an option.

Also given that PSL's margin is capped at a maximum of 1.5% it is not possible to fund any social tariff regime through energy companies. We also note that in 2009 energy suppliers cited rising social obligation costs as one of the reasons for not decreasing retail prices despite a significant fall in wholesale energy costs. It is clearly the case that even in markets where energy suppliers enjoy margins in excess of 5% that social costs are borne by consumers.

Q8 (Chapter 4) Comments are welcome on the issue of which customers should be targeted for help (and why) and to what extent per annum.

The precise definition of a Social Tariff is somewhat uncertain with various definitions being used by a wide variety of voluntary sector organisations. However, a fundamental principle which emerges from each definition is that a Social Tariff is where vulnerable customers pay less relative to other customers.

National Energy Action has offered the following eligibility criteria in respect of qualifying as a vulnerable customer:

• *"A household in receipt of Pension Credit;*

• *A household in receipt of Income Support or Income-based Jobseeker's Allowance and where the benefit includes one of the following:*

- *Disability Premium*
- *Severe Disability Premium*
- *Disabled Child Premium*
- *Higher Pensioner Premium*

• *A household in receipt of Income Support or Income-based Jobseeker's Allowance and with responsibility for a child under five years old*

• *A household in receipt of Child Tax Credit which includes a disability or severe disability element"*[2]

Means-tested benefits are arguably the most appropriate means of identifying consumers who are both vulnerable <u>and</u> fuel poor. Targeting groups such as the over 60s means that vulnerable consumers will receive support <u>but</u> not all of these will be fuel poor. The question that policy makers

[2] National Energy Action website (15th March 2010) www.nea.org.uk/social-tariffs/

need to consider is how vulnerable, fuel poor customers are identified. As highlighted, suppliers do not have access to information on income levels or benefits and therefore any social tariff with this criterion would require customer self-identification. There is also no means for suppliers to verify that the information provided by a consumer is true without addressing the various data protection issues.

The provision of PSL's Pay-As-You-Go ("PAYG") tariff, structurally designed to deliver PAYG tariffs at the same rate as standard credit tariffs, has been a significant contributor to reducing the number of households in fuel poverty in the Greater Belfast area. PAYG customers are in direct and constant control of their expenditure on heating costs and as a result consume less energy than their standard credit or direct debit counterparts.

Fundamental to the consideration of the application of a Social Tariff is the attitude of customers to such a scheme. PSL commissioned Millward Brown Ulster to conduct research in order to understand attitudes from its customer base. The fieldwork, which comprised 400 telephone interviews with PSL customers, was completed in January 2009.

There was little support for the introduction of a Social Tariff among customers with around 60% of customers not agreeing that they should pay more to help vulnerable households.

Secondly almost a quarter of natural gas customers said they were likely or very likely to switch to oil, LPG or solid fuel if PSL introduced a Social Tariff. This should be considered in the context that over two thirds of customers surveyed had natural gas installed in the past five years, therefore, these customers in particular would be aware of the cost and potential inconvenience associated with converting their heating system from one fuel to another. If customers were to convert to alternative heating forms this would significantly damage the likelihood of achieving the Northern Ireland Executive's targeted reduction in greenhouse gas emissions of 25% reduction from 1990 levels by 2025.

Furthermore, the conversion of natural gas customers to other heating forms following the introduction of a Social Tariff would have the perverse effect of increasing natural gas prices for those continuing to use natural gas (as the same investment is required to be recovered from a fewer number of customers). This impact would not be limited to those bearing the cost of the subsidy. A cross subsidy scheme could have the unintended effect of increasing costs to the subsidised, thus reducing the perceived benefit of the scheme.

Research also indicated that the introduction of a Social Tariff would discourage new customers to connect to natural gas which is important to ensure network charges are kept as low as possible for natural gas customers. This is concerning from both social and environmental viewpoints and demonstrates that there are firmly held views among customers with respect to the introduction of a Social Tariff.

Q9 (Chapter 5) Can respondents identify a data set that would enable us to assess the risks to different customer groups of equating 'high user' with 'not vulnerable'?

Q10 (Chapter 5) What other household characteristics are associated with higher or lower electricity consumption?

A rising block tariff is examined as an option in the consultation paper.

In addition to the drawbacks outlined in the consultation paper it should be remembered that:

- A rising block tariff is clearly not cost reflective (i.e. the marginal cost to supply an additional kWh of natural gas reduces as consumption increases rather than vice versa).
- A rising block tariff is contrary to the accepted convention that unit price reduces when larger quantities of a product are purchased. The suggestion of a rising block tariff therefore creates perception issues with customers.
- Reduced consumption by high energy users would result in network charges increasing for all consumers, as lower volumes transported through the network results in higher conveyance tariffs.

Q11 (Chapter 5) Respondents' views are welcome on the issues raised in relation to an appropriate mechanism for the collection of funds.

PSL is a regulated natural gas supplier, operating under a licence granted by UReg in accordance with the powers granted by the Gas (Northern Ireland) Order 1996. Suppliers require a licence in order to supply natural gas and are required to operate in accordance with the conditions of their licence. Failure to comply with licence conditions can lead to the imposition of financial penalties and ultimately the revocation of the licence.

Condition 2.5 of the Supply Licence, entitled 'Undue Discrimination and Undue Preference', contains obligations in respect of a Supplier who is in a dominant position and which are relevant in the context of a Social Tariff.

> *"2.5.1 Dominant position*
>
> *If the Licensee, together with any of its affiliated or related undertakings operating in the same market, is in a dominant position in a market for the supply of gas to consumers whose demand for gas at any premises is not reasonably expected to exceed 2,197,500 kilowatt hours in any period of twelve months, then the Licensee, in the terms on which it supplies or offers to supply gas to consumers in that market:*
>
> *(a) shall not show undue preference to any consumer or class of consumer; and*
>
> *(b) shall not exercise any undue discrimination against any consumer or class of consumers;*
>
> *and shall not set prices for the supply of gas to consumers at premises:*
>
> *(c) in any market or markets in which it has a dominant position which are unduly onerous; or*

(d) in any market or markets which are predatory."

For the Condition to be relevant it must firstly be determined if PSL meets the test of being in a dominant position. The decision as to whether PSL occupy a dominant position rests with UReg as determined by Condition 2.5.5:

"2.5.5 Determination by Authority

Any question arising under this Condition as to whether the Licensee or any other gas supplier (whether alone or together with any of its affiliated or related undertakings operating in the same markets) is in a dominant position in a market shall be determined by the Authority, having regard to any representations made to it."

UReg operates a Price Control for PSL, and in that context UReg has previously indicated that it is likely that PSL is in a dominant position.

"In response to the interim determination paper, some parties queried the rationale for the selection of only customers who consume less than 25,000 therms per year for inclusion in the price control. UReg has decided that competition from alternative fuels is not sufficient to protect the interests of this segment of the gas market. In addition, although customers in the Phoenix licensed area became eligible to choose an alternative supplier since January 2007, there has been an absence of new entrants to the domestic gas supply market."[3]

On the basis that PSL occupy a dominant position, PSL are required not to "show undue preference to any consumer or class of consumer" and "shall not exercise any undue discrimination against any consumer or class of consumers".

The cross subsidy model of Social Tariff, by its very definition, means that some customers pay more in order that others pay less, for an equivalent service. A Social Tariff could give rise to a breach of Licence Condition 2.5 as a customer who is paying more to cross subsidise customers who benefit from the Social Tariff could argue they are subject to undue discrimination.

Furthermore, it may be the case that increasing prices for some customers or groups of customers is a breach of Condition 2.5.1(c) as PSL is required to "not set prices for the supply of gas to consumers at premises...in any market or markets in which it has a dominant position which are unduly onerous." "Unduly onerous" is defined in Condition 2.5.3 where "terms in respect of particular customers shall be taken to be unduly onerous if the revenue from supply on those terms significantly exceeds costs in respect of those consumers".

PSL is satisfied that in order to give effect to a Social Tariff it would be necessary to significantly increase prices for customers providing the funding for the Social Tariff. For example, a customer making, say, even a nominal £100 annual contribution towards a Social Tariff, would experience a c.25% increase in their average annual PSL bill. This would potentially place PSL in breach of its licence conditions and the magnitude of increase in the average annual bill is, in our view, unacceptable.

[3] Utility Regulator, PSL Price Control (2007 - 2008) Final Determination, April 2008

Q12 (Chapter 5) Views are welcome on need for enhanced energy efficiency advice for vulnerable households including size, resourcing and best-delivery options.

NI consumers consume around 33% less energy than their counterparts in GB and this is largely due to the provision of energy efficiency advice from the moment a consumer considers connecting to natural gas. PSL would therefore argue that energy efficiency advice should be provided to all consumers regardless of fuel-type or whether these consumers are considered vulnerable. In the Greater Belfast area Phoenix Natural Gas promotes energy efficiency to natural gas customers at the time of connection to the natural gas network and provides a free energy audit of the customers' home. PSL regularly promotes energy efficiency to all its natural gas customers through the provision of timely energy efficiency advice and the promotion of other independent external bodies which can assist customers.

Natural gas is also the cleanest of the fossil fuels and NI consumers making the switch to natural gas have reduced their emissions of carbon dioxide into the atmosphere by over 2.4 million tonnes to date. In our experience therefore giving energy efficiency advice to consumers from the moment they consider converting to natural gas does make a significant contribution to reducing carbon emissions going forward.

While we note that the oil industry has committed to a voluntary agreement to promote energy efficiency to their customers we see no evidence of this in practice. The oil industry must be required to promote energy efficiency to oil users which must be rigorously monitored and enforcement action taken where necessary. If implemented this could be a significant contributor to the alleviation of fuel poverty in NI.

Q13 (Chapter 5) Views are sought on the relative merits and disadvantages of helping the poorest energy consumers through a fund, or a tariff.

Q14 (Chapter 5) Respondents' views are welcome on the issues raised in relation to identifying eligible customers.

As highlighted above, suppliers do not have access to the appropriate Government databases to access customer information and identify whether they qualify under a vulnerability tariff if this is income or benefits based. PSL would also consider it inappropriate for suppliers to have such access. Social tariffs would therefore require identification by Government.

It is not appropriate to use low energy consumption as a proxy for those in fuel poverty. To provide only one example, this could mean an individual who owns an apartment which is only occupied for a small proportion of the year would be in receipt of assistance with their energy bills despite not being in fuel poverty. There are a significant number of factors which make low energy consumption a poor proxy for fuel poverty.

Q15 (Chapter 5) We invite comments on an appropriate mechanism and potential costs for the disbursement of funds to eligible households.

A Social Tariff would also require the visit of an engineer to the meter, the issue of replacement payment cards etc alongside the more obvious cost of developing a system to manage the operation of the scheme and the administrative costs of providing additional staff to operate the scheme and provide customer support. These measures are not cost free. PSL estimates that the total additional costs of servicing, say, 50% of PAYG customers in this way could be in the region of £2 million.

Suppliers would obviously be required to implement changes which are implemented via a tariff and we have commented on the identification and cost disbursement issues above. However if the payments are income or benefits based one-off payments such as the Winter Fuel Payment, Government would have to distribute these as suppliers do not have such information.

Identifying and quantifying the administration costs associated with a social tariff regime is a vital component of any cost/benefit analysis. PSL considers this type of analysis as fundamental prior to progressing to “Stage 2”.

Q16 (Chapter 5) We welcome respondents’ views on the potential impact of affordability schemes on the retail market in Northern Ireland (NI) and potential for competition.

There are other legislative issues require further consideration. Firstly the Competition Act 1998 places obligations on companies who occupy a dominant position which UReg has indicated is likely to be the case in respect of PSL.

The penalties arising as a result of a breach of the Competition Act are considerable. Under the Competition Act, if a company is found to have acted anti-competitively it can face a financial penalty of up to 10 per cent of UK group turnover. The Competition Act also provides for directions to be made to order companies to stop acting anti-competitively and, ultimately, directors of the offending entity could be disqualified from acting as directors in the future. It could be argued that a company operating a cross subsidy Social Tariff model would be in breach of the Competition Act by showing an undue preference to Social Tariff customers and therefore unduly discriminating against other customers. Under Competition Law, discrimination is the act of applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at an objective disadvantage. Discrimination is prohibited unless objectively justified which in this case is difficult to envisage as there are not, prima facie, differential costs of supply.

Q 17 (Chapter 5) Comments are sought on the appropriateness of creating exit provisions in a scheme, and on how these might best be designed.

The appropriateness of an exit provision will depend on the chosen method of implementation. If this is income-based an exit provision can be simply implemented using an income threshold.

If the exit provision relates to improved energy efficiency of a household then this would require a visit to the property and would add additional cost and indeed management time to effectively manage and co-ordinate the scheme. Again we have to consider the question of who does this and who pays.

Q18 (Chapter 5) Comments are sought on the proposed assessment criteria for any scheme.

No comments on this question at this stage.