

# Chapter 1

## **Introduction**

Fairness in Retail  
Energy Markets?

## Key Points

We explore evidence relevant to discussions of fairness and how concerns about fairness have influenced the retail energy market, rather than determining what is fair or unfair

Movements in households' energy expenditure shares provide a possible explanation for the current political salience of the UK retail energy market

Regulatory independence and its interpretation has evolved over time, potentially reflecting this political salience

We suggest a change in research and policy emphasis, rather than identifying concrete policy solutions

Our evidence raises various questions about the real-world phenomena that official fuel poverty statistics identify

Greater weight should be placed on measuring and addressing households' observable problems rather than the official fuel poverty statistics

Our findings are from a large multi-disciplinary research programme, 'Equity and Justice in Energy Markets', undertaken at the University of East Anglia as part of the UK Energy Research Centre's research programme

Qualitative and quantitative evidence is presented from economics, law, human geography and policy studies

Ideally, qualitative interviews and quantitative surveys should be used as complements in a continuous iterative cycle to maximise both detail and representativeness

The evidence is presented under five broad themes: (i) long-term outcomes, (ii) institutions, (iii) engagement, (iv) fuel poverty, and (v) data

Detail on the methodologies used to generate our original evidence is provided in a methodological appendix (Appendix 1)

Concern about fairness in the retail energy market is clear from recent headlines about variations in the prices paid by different consumers and companies ‘ripping off’ those who do not search for better prices.<sup>1</sup> This concern about companies in a market profiting at the expense of consumers, and some consumers achieving better deals than others, has replaced the original emphasis at privatisation, which focused on raising the energy sector’s efficiency to increase the total benefits it could deliver and the regulation of areas that remained true monopolies. Distributional concerns about the division of benefits have contributed to the government imposing a ‘wide’ price cap,<sup>2</sup> which represents a significant moment in a policy path often characterised as the retreat of state intervention via privatisation and liberalisation. Such new directions make this a natural time to assess the retail energy market’s position. Evidence from our ‘Equity and Justice in Energy Markets’ project on fairness in the retail energy market complements the Competition and Markets Authority’s focus on competition issues in its 2014-2016 Energy Market Investigation.<sup>3</sup> The traditional focus of economics on efficiency has never claimed that markets are effective tools for delivering equitable outcomes, and the traditional framework of ‘pure’ economic regulation is challenged by the present focus on fairness.

Evidence has been gathered from several perspectives and disciplines which together raise fundamental questions for the future governance of the market. First, the substantial increase in the share of household expenditure devoted to energy since 2003-04 helps to explain the political salience of the energy market. Can the market ever escape political intervention at a time of rising energy prices? Second, this political salience affects the independence of the market regulator, Ofgem; independence appears less absolute and clear-cut than was originally envisioned. Regulatory independence has evolved, with governments altering Ofgem’s statutory framework and exerting pressure through less formal channels. Third, we present evidence indicating that there are problems with implementing the main framing of fairness regarding energy in the UK, leading to the concept of ‘fuel poverty’. We suggest that the current approach to analysing fuel poverty, and associated policymaking, would benefit from a reboot. Focusing on directly observable real-world phenomena which underpin the complex problem of fuel poverty, for example, low and precarious incomes, cold homes and health issues, such an approach would encourage consideration of interventions beyond energy efficiency.

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**1** For example, see: ‘Energy companies ‘ripping off’ millions, ministers say’, Toby Helm and James Tapper, *The Observer*, Sunday 12 March 2017, available at: <https://www.theguardian.com/money/2017/mar/12/millions-overpaying-energy-bills-admits-ministry-big-six> (last accessed 08.08.18), or ‘GRIDDDY GUTS: Fatcat energy bosses taking home up to £5.9 million causing bills of hard-up families to rise by £60’, Daniel Jones, *The Sun*, 27 November 2017, available at: <https://www.thesun.co.uk/money/5005893/energy-companies-bills-rising-profits-chief-pay/> (last accessed 08.08.2018) or ‘Energy firm E.ON ‘paid £6m to Age UK in return for the charity promoting expensive tariffs to pensioners’’, Tim Lamden, *The Daily Mail*, 4 February 2016, available at: <http://www.dailymail.co.uk/news/article-3431006/Energy-firm-E-paid-6m-Age-UK-return-charity-promoting-expensive-tariffs-pensioners.html> (last accessed 08.08.18)

**2** Domestic Gas and Electricity (Tariff Cap) Act, 2018 available at: <http://www.legislation.gov.uk/ukpga/2018/21/contents/enacted/data.htm> (last accessed 07.08.18)

**3** Competition and Markets Authority, ‘Energy market investigation: Final report’, 24 June 2016, available at: <https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf> (last accessed 08.08.18)

## A large multi-disciplinary research programme

Research was conducted at the Centre for Competition Policy at the University of East Anglia as part of the UK Energy Research Centre's programme, in particular its 'Energy, Economy and Societal Preferences' theme (see page 11). The research is strongly multi-disciplinary, drawing together researchers from a range of disciplines: economists (David Deller, Amelia Fletcher, Glen Turner and Catherine Waddams Price), legal scholars (Michael Harker and David Reader), human geographers (Tom Hargreaves and Noel Longhurst) and a policy analyst (Elizabeth Errington). Each chapter has been drafted by the researchers who generated the evidence, while the editors (Deller and Waddams Price) are responsible for the overall presentation here.

Our range of specialisms provides a rare opportunity to consider fairness and retail energy markets in the round. The report's five main chapters present findings from different disciplines and methodologies to juxtapose evidence which is rarely encountered together. This includes two sets of elite interviews; a 45-year time series of electricity bills; a 35-year time series of energy expenditure shares; detailed analysis of statutes, parliamentary debates and consultation documents; cross-sectional data from an energy-specific consumer survey; interviews with social housing tenants; and survey data from individual UK households followed over multiple years. In assembling this evidence, we are grateful to our partners Broadland Housing Association, Cornwall Energy and Ofgem for the access and data they have provided, as well as to the Parliamentary Archives and all our interviewees. The methodology behind each piece of original evidence is provided in a methodological appendix at the end of the report, and the underlying academic papers are referenced in each chapter.

The research team provides not only an unusual breadth of disciplinary perspectives, but also academic independence. We do not define what constitutes fair or unfair. Rather, we present evidence which is directly relevant to assessments of fairness or which has implications for interventions motivated, at least in part, by distributional concerns. We conclude that analysis of distributional concerns in the retail energy market's political economy is crucial, since the retail energy market and energy affordability seem likely to remain an area of political salience unless the cost of energy falls substantially. Our focus is on the retail energy market, though we recognise that factors extending far beyond this area affect issues such as fuel poverty.

The new evidence presented in this report provides context, detail and nuance to broad points that have sometimes appeared in earlier policy discussion. For example, there appears to be little understanding of the porous boundary between households and microbusinesses or how microbusinesses choose between domestic and non-domestic energy supply contracts. Similarly the real-world phenomena that official fuel poverty statistics attempt to capture need to be clarified. New data collection efforts may be required to resolve these uncertainties.

While many of our findings question existing statistics or knowledge, their implications are central to evidence-based policy making: technical/statistical issues can alter the evidence on which policy is founded. Changing statistics or their interpretation may require a policymaking response.

A distinctive part of this report is its presentation of both qualitative and quantitative evidence alongside each other. Neither provides better evidence than the other, and they provide complementary insights. For example, large scale quantitative surveys provide the opportunity to assess the prevalence of a particular issue within a population of interest, whereas small scale qualitative interviews reveal a depth of detail about households' experiences as they perceive it. Rather than making a choice between qualitative and quantitative approaches, we suggest an ideal approach may be to follow a continuous iterative process alternating between the two (where resources allow). Qualitative interviews can highlight

areas of concern whose prevalence might be assessed by a subsequent survey wave, while restricted survey questions may raise puzzles that may only be illuminated by in-depth interviews.

## An overview of the chapters

Our findings are presented under five broad themes: (i) how long-term outcomes contextualise the retail energy market's political salience; (ii) how distributional objectives feed into institutions; (iii) the multi-faceted nature of engagement with energy; (iv) the detailed experiences of those at risk of fuel poverty; and (v) how data/statistics can be improved.

**Chapter 2** presents context to the current prominence of fairness in the retail energy market, showing that while energy expenditure share and incumbent electricity bills are currently at a level similar to the 1980s, they have increased substantially since the early-2000s. Energy expenditure doubled in nominal terms between 2003-04 and 2013. Moreover, since energy is a necessity, the energy expenditure share is much higher for lower income groups. At a time of low income growth and increasing concern about distributional issues, the salience of energy affordability should therefore come as no surprise. However, some common perceptions need questioning; for example, it is arguably wrong to suggest consumers are intolerant of all energy price differentials, since regional electricity price differences have existed since at least 1970. Our doubts about the feasibility of ending political intervention in the energy market are partly based on the timing of two key energy affordability policies, the Fuel Poverty Strategy and Winter Fuel Payment, which were introduced in the early-2000s when energy was at its most affordable since the mid-1970s.

Accepting an enduring political interest in energy affordability, **Chapter 3** reports on how distributional concerns have been balanced against competition concerns in policymaking institutions. Perhaps the strongest way to communicate objectives to Ofgem is through its statutory duties. The weight afforded to individual statutory duties has become less clear over time as the number of duties has grown substantially. Elite interviews with members of the regulatory community indicate that, over the same period, instances of government exerting influence over Ofgem through less formal channels has occurred more than was perhaps expected. There was consensus among those interviewed from the regulatory community that decisions about significant distributional objectives should rest with elected politicians rather than unelected regulators. Chapter 3 then highlights how the delivery of fuel poverty objectives is potentially made more challenging by the complex web of institutions that influence the design and implementation of fuel poverty policy. Some of this complexity results from fuel poverty being a cross-cutting concept that does not fit neatly within existing institutional silos.

**Chapter 4** presents evidence on how consumers engage with energy. It highlights the importance of understanding the detail of how consumers actually engage, rather than relying solely on economic models of behaviour or policymakers framing consumers' ideal behaviour as that which maximises competition. Engagement needs to be considered in terms which stretch beyond searching and switching. Interviews with households at risk of fuel poverty show considerable emotional engagement with controlling their energy consumption, even if they do not switch supplier. To gain an enhanced consumer perspective, policymakers often rely on third sector bodies, some representing disadvantaged groups. However, interviews suggest that, while these organisations have formal opportunities to engage with policymaking, a lack of resources may hamper their involvement thereby limiting the communication of their insights to policymakers.

This chapter also presents evidence on the complexities of assessing engagement when this is framed in terms of switching. While the case for the recent energy price cap rests partly on the prevalence of

persistent non-switching, we identify challenges in identifying persistent non-switching from survey questions alone. Moreover, the way we understand engagement by micro and small businesses needs to reflect differences from the domestic setting. Many micro and small businesses have multi-year energy contracts which automatically limit the frequency of market engagement. Also, while intermediaries are heavily involved with micro and small businesses switching, many micro and small businesses report a dislike of intermediaries' marketing communications, suggesting that further direct regulation of energy intermediaries may be beneficial.

Since fuel poverty is a major frame for fairness regarding energy consumption in the UK, **Chapter 5** (and much of Chapter 6) raise questions around the official fuel poverty statistics and the emphasis on using energy efficiency to address fuel poverty. We start by outlining the meaning of fuel poverty and the main fuel poverty statistics. While recognising the distinction between fuel poverty and income poverty, Chapter 5's evidence emphasises the important role of persistently low incomes and sudden reductions in income in energy affordability difficulties. While some government initiatives to improve energy affordability are income based (for example, the Winter Fuel Payment and the Cold Weather Payment), much of the effort to reduce fuel poverty has focused on energy efficiency. However, we find that, despite social housing having the highest average energy efficiency of any tenure, social housing tenants' median energy expenditure share is persistently higher than that of tenants in private rented accommodation between 1992 and 2014. Qualitative interviews show that, even in energy efficient dwellings, individual social housing tenants can still struggle to afford energy. Initial findings from large scale panel data show that, for many fuel poor households, the issue appears to be a relatively dynamic phenomenon. If the primary policy objective is addressing the affordability of energy, other policy options beyond energy efficiency should be explored.

Finally, the quality of the data available to address distributional questions related to energy is discussed in **Chapter 6**. A significant 'missing data' issue is identified affecting energy expenditures for households with prepayment meters in the Living Costs and Food Survey (and its precursors) prior to 2013. Correcting for this issue substantially increases the estimated average energy expenditure of prepayment meter households and impacts on average energy expenditure for low income households more generally. Fuel poverty rates calculated using this corrected 'reported'<sup>4</sup> energy expenditure data were higher than official fuel poverty rates based on 'required' (modelled) energy expenditure in some years, contradicting previous claims that fuel poverty statistics based on reported energy expenditure under-record fuel poverty relative to those based on required energy expenditure.

Using a different dataset, a more fundamental issue with energy expenditure-based fuel poverty statistics is identified: a very limited overlap is found between households identified as fuel poor using reported energy expenditure and households reporting an inability to afford adequate warmth. Further research combining survey data with in-home temperature data seems necessary to form conclusions about this lack of overlap and its implications.

Chapters 4-6 highlight the contribution to evidence-based policymaking that academics can make through in-depth analysis of policy relevant statistics. This leads to Chapter 6's final suggestion that there should be a presumption in favour of sharing anonymised raw data from surveys commissioned by economic regulators wherever possible.

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<sup>4</sup> We use 'reported' energy expenditure to refer to survey data where households self-report their energy expenditure. In contrast, 'required' energy expenditure is calculated from behavioural assumptions and an engineering model of energy consumption.