Sustainability first Viewpoint

The independent charity and think tank shaping sustainability policy and regulatory agendas for UK utilities, for the benefit of consumers, citizens and the environment.

The Energy White Paper – Reflections on Fairness

Introduction

The Energy White Paper highlights the need to ensure that the energy transition is fair and affordable. But what does a just transition mean in practice? Decisions in this area can be complex but need wider debate if we are to build public support for change.

One of the central themes of the Energy White Paper is Affordability and Fairness and BEIS will be publishing a Call for Evidence on this issue in the coming months (by April 2021). Sustainability First welcomes the focus in an area which has been at the centre of our own work over many years. Indeed, we have specifically advocated a wider public debate on fairness and the principles for cost recovery for the transition, including bringing the voices of consumers and citizens into that debate.

This Viewpoint pulls together the various strands of our work in this area to help provide a framing for the issues that we would hope BEIS will want to explore in its Call for Evidence. In particular we would highlight questions around the different dimensions of fairness, policy costs and charging, the assessment of impacts, some radical options for change and barriers to the uptake of new technologies.

Sustainability First's long-running interest in these issues is reflected in the major programme of work that we have been carrying out through our Fair for the Future' project, helping the energy, water and communications sectors better address the politics of fairness and the environment. This has viewed fairness in terms of processes, outcomes and opportunities.

Citizen Engagement

As set out in the White Paper, the citizens assembly - Climate Assembly UK - highlighted fairness, including for the most vulnerable, as one of the top two principles that should guide decisions around net zero. More specifically they argued that it needed to be '*Fair to people with jobs in different sectors. Fair to people with different incomes, travel preferences and housing arrangements. Fair to people who live in different parts of the UK*'. They explored the arguments for funding through taxation or bills, highlighting the complexities of the issues involved in what determines fairness.

We believe that this sort of deliberative exercise can provide invaluable insights into questions around perceived fairness provided the questions are framed appropriately, focussing on the citizen perspective, and sufficient time is given to the issues. Our blog[1] on deliberative engagement set out some of the criteria for success in such engagement. We hope that BEIS's future work on Fairness and Affordability will include an element of citizen (as well as consumer) engagement.

Dimensions of fairness

In order to better understand the state of thinking on different dimensions of fairness we commissioned a meta-analysis of existing research, funded by Nuffield. From this we developed a framework showing how affordability, inclusion and access, spatial distribution and intergenerational impacts all need to be factored into a 'just transition'. This work also highlighted gaps in the current literature, including around inter-generational fairness. In the Forward to the White Paper the Secretary of State describes climate change as an inter-generational challenge but neither the White Paper itself nor the HMT Net Zero

[1] Also see our commentary comparing the French and UK climate assemblies – Part 1 and Part 2

Review Interim Report explicitly address this aspect. Recognising this gap, we have commissioned some pro bono work from Frontier Economics to help us explore approaches to inter-generational equity. We would hope to be able to feed the results of that work into the Call for Evidence.

Our earlier work also highlighted the spatial dimension to fairness. While the Energy White Paper addresses levelling up issues around job creation for example, there are outstanding questions around fairness in charges and how far these should vary by location when the underlying costs vary – or whether this creates what would be seen as a 'postcode lottery' for energy. Ofgem has signalled in RIIO ED2 that it is reluctant to allow funding for particular cities to have accelerated climate programmes where network boundaries do not align with democratic boundaries. We have argued that there are wider societal benefits in such pathfinder programmes that would justify a more flexible approach. These spatial issues could usefully be explored further through the Call for Evidence.

Policy Costs and Network Charging

Understanding these different dimensions of fairness and how they are seen by citizens provides an important backdrop for the complex policy questions around charging for use of the energy system which are at the heart of the issues that the White Paper raises.

The White Paper rightly identifies that with the energy transition we are increasingly moving to a system in which the costs are related to the provision of capacity in the form of upfront capital costs while fuel costs – previously a key determinant of energy prices – disappear with increased use of solar and wind. This then raises the question of how these essentially fixed costs, including policy costs and fixed elements of network costs, should be recovered in a way that is fair. It highlights too the issues around consumers who largely self-supply but continue to benefit from their grid connection when they need it.

These were the questions that we explored in our key paper 'What is Fair? How should we pay for the energy system of tomorrow?'. This highlighted that these questions around the structure of policy costs and network charges need to be seen in the context of the overall value chain and whether or not suppliers will actually reflect the envisaged structure of underlying charges in their end tariffs to consumers. While economic theory suggests that, ultimately, they will have to do so, there may be practical or customer acceptability reasons why they choose not to which need to be better understood.

We also argued that in allocating fixed costs Ofgem should be mindful of the wider policy goals of government and that there was a role for government in providing direction around the various trade-offs that are inherent in charging. We argued that clarity of roles and responsibilities around distributional issues was needed – a point picked up by the National Infrastructure Commission. We are therefore pleased that BEIS is now engaging in this wider debate on charging which should not just be seen as a technocratic regulatory exercise with important distributional issues relegated to the technical annexes of industry consultations.

Assessment of impacts

Through our work we have consistently stressed the importance of a sound analytical framework for assessing the distributional impacts of different charging structures and have hosted roundtables to consider the evidence around the distributional impacts of Ofgem's various charging reforms. We have also stressed the importance of looking at the cumulative impacts of the various changes, not just each on its own.

Following our recommendation, we welcome the steps that Ofgem have taken to enhance their impact assessment framework looking at the impacts of decisions on different income deciles and on different household customer archetypes. However, we have raised some significant methodological concerns with Ofgem's approach which suggests that there is no material difference in

energy consumption between income deciles (when using equivalised income). This however runs counter to the on-the-ground experience of consumer bodies. The latest Ofgem archetypes also fail to adequately reflect the position of the 2 million homes currently reliant on electric heating who have higher than average electricity consumption (and are also typically lower income). We have encouraged Ofgem to engage in a wider debate around their methodology to ensure that consumer groups can be confident in the results that they yield and so that it more closely relates to the dynamic situation in the real world and is not simply a "black box" model.

We have also highlighted through our PIAG work the need for Ofgem and BEIS to have access to anonymised / aggregated half-hourly smart meter data linked to socio-demographic information to help them in assessing the fairness implications of a shift to time-varying tariffs, for example. Ofgem has acknowledged the potential value in smart meter data and we have encouraged them to work with BEIS to explore how access to it might eventually best be achieved.

Considering radical options

As a part of our What is Fair report, referenced above, we set out at a very high level some more radical proposals on approaches to charges, tariffs and future energy retail models. We believe there is merit in proper consideration of such responses to the challenges around fairness and the Call for Evidence should provide an opportunity to explore these options further. In particular we have advocated some form of household capacity charge as a way to recover the essentially fixed costs of the system, which are increasingly capacity-driven, both in terms of generation capacity as reflected in the capacity market costs and network capacity. Our report considered the merits of different approaches to capacity charging.

We recognise that this would be a major change for domestic customers but it is already commonplace in other countries. Capacity charges retain an element of fairness and 'rough justice' (as those who impose greater burdens on the system pay more). It would also provide some incentive for flexibility aimed at reducing peak load which a standard fixed charge does not – and which any future charging structure needs to deliver.

We have also suggested that one answer to the self-supply challenge would be to tackle the issue directly by introducing a fixed (or capacity based) charge for the right to export, which would recognise the additional system management costs that such two-way flow entails.

Finally, irrespective of how the underlying charges are structured, we recognise that the energy transition is likely to increase costs for some customers who are already struggling to pay their bills. We welcome the extension of the Warm Homes Discount in the White Paper and see a mechanism of this kind as central to helping mitigate any residual impacts on this key group of customers. Other more radical options in this space would include some basic level of energy consumption at a cheaper rate (perhaps most easily achieved through differential VAT rates) or new dedicated universal service energy retailers whose customers are exempt from certain energy costs. Or - a major move and looking beyond energy – there could be a case for re-visiting the idea of some form of personal carbon allowance.

We note the framework in the HMT Interim Report for considering distributional impacts which includes targeting distributional impacts alongside other objectives, the use of exemptions or the use of tax and welfare to compensate for the impacts. We consider this a helpful framework which covers the range of options that we set out in our report.

Within all this, however, there remain questions around whether it is fair that those who are supporting the move to net zero through the use of EVs or heat pumps should have to pay a higher charge, reflecting the increased load on the energy system. Recognising that, at least over the next decade, EV owners will be predominantly higher income, that would not seem inherently unfair but does risk creating an additional barrier to EV take-up which needs to be worked through. On heat there are links to the wider debate, noted in the White

Paper, about the need to address distortions in the price signals between gas and electricity, which again needs further work. There are also questions around how far electric heat will be able to offer flexible operation at peak times while keeping homes sufficiently warm and hence the role of time-varying tariffs in this context. This reinforces again the need to consider charging in a wider, evolving policy context and to consider these issues in the round.

Barriers to uptake of new technologies

That bring us to the final area that we have considered through our work which is the barriers that exist to the uptake of these new technologies by customers in vulnerable circumstances. As well as the specific affordability questions highlighted by the charging debate, a just transition requires that no-one is left behind. Our Project Inspire 'Energy for all – Innovate for all' report looked at some of these barriers as well as at examples of good practice. It included a recommendation for vulnerability to be explicitly considered as part of innovation funding decisions which Ofgem have picked up on in their network innovation funding arrangements but which could be considered more broadly by BEIS. The report also highlighted the need for inclusivity to be considered in setting standards for smart appliances.

In thinking about how to facilitate wider uptake of smart tariffs, our What is Fair? paper recommends ensuring that the 'treating customers fairly' principle clearly applies to the design and marketing of these more innovative tariffs as one way of mitigating the impacts on customers in vulnerable circumstances, without unduly restricting innovation.

The BEIS Call for Evidence needs to address these issues and seek practical ways of increasing participation in smart markets such as through support for smart electric storage heating which we have advocated as a technology that supports the wider goals of decarbonisation and flexibility and targets those consumers who may otherwise have little opportunity to participate.

Even at a basic level there are questions around how to encourage take-up of energy efficiency measures which the White Paper rightly identifies as crucial both for achieving net zero but also for maintaining affordability. We welcome the additional funding being provided for energy efficiency measures for those on low incomes but would encourage BEIS to ensure it fully understands the wider barriers to participation that might inhibit take-up even in this less high-tech area. Energy efficiency offers the opportunity to tackle both de-carbonisation and fuel poverty, mitigating the bill impacts of other essential policies – as well as being a source of local employment. It must remain high on BEIS's priorities as central to a just transition.

As this overview shows, Fairness and Affordability is a broad topic but one that is crucial to unpack and to get right if the energy transition is to secure public support. We hope that the work that we have been doing and continue to do in this area can help shape BEIS thinking on these issues and we look forward to contributing to the Call for Evidence in the spring.

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