



COMPETITION AND MARKETS AUTHORITY

ENERGY MARKET INVESTIGATION

RESPONSE TO NOTICE OF POSSIBLE REMEDIES FROM COMHAIRLE NAN EILEAN SIAR

Introduction

1. Comhairle nan Eilean Siar (Western Isles Council) is the Local Authority for the Western Isles of Scotland.
2. The Comhairle is fundamentally of the view the energy market is comprehensively failing consumers in the islands and that a new approach is required for the most peripheral parts of the country.
3. The market as it operates in the islands is monopolistic and is characterised by a lack of transparency and choice. The economic and social development of the area is hampered by discriminatory levels of transmission charging, with local consumers further disadvantaged by unacceptable distribution surcharges. The failing market and these discriminatory approaches have resulted in an energy rich community suffering the highest levels of fuel poverty in the UK.
4. There is a case to be made that the wider UK market is working efficiently, but there is little doubt that there are multiple failures in the periphery. The Competition and Markets Authority (CMA) should undertake a detailed investigation into the market as it operates in most peripheral parts of the UK, such as the Scottish Islands, to fully appraise itself of the level of failure and to bring forward appropriate remedies to tackle these failures.

Detail

5. OFGEM's interest in the electricity market is driven by overarching policy goals of reducing emissions, ensuring security of supply and improving the affordability of prices. The operation of the markets has particular geographic impacts and, for the Outer Hebrides, the most significant impact is excessive, and rising, levels of Fuel Poverty. The Comhairle is not convinced that OFGEM has sufficiently recognised this impact or proposed adequate regulatory action to address it.
6. The market share of The Big Six is referred to in the CMA report. Again, the effects of this are exacerbated in the North of Scotland where SSE (Scottish Hydro Electric) has a

exacerbated in the North of Scotland where SSE (Scottish Hydro Electric) has a market share of 70%, with anecdotal evidence suggesting even greater market share in areas such as the Outer Hebrides". Incumbent brand loyalty towards 'The Hydro' is particularly strong in the Outer Hebrides and lack of customer engagement in the market is allowing SSE to price their product well above cost.

7. Two tariffs are unique to SSE: a) Total Heating Total Control (THTC); and, b) Economy 10. THTC is one of the most expensive tariffs in the country at 9.84p per kWh for heating and 18.5p per kWh for other domestic use (July 2015). By contrast, an SSE Dual Fuel customer pays 4.2p per kWh for gas and 14.86 per kWh for electricity. Economy 10 peak rate is 17.78p per kWh and off-peak is 11.8 per kWh (July 2015), significantly higher than comparative Dual Fuel tariffs.
8. Neither THTC nor Domestic 10 tariffs appear on price comparison websites. SSE's monopoly position, unique tariffs, incumbent brand loyalty and weak customer response all contribute to excessive electricity prices in the Outer Hebrides. This situation is compounded by the highest wind speed, the lowest average temperatures and the highest rainfall in the UK, producing unacceptable Fuel Poverty levels of 72% (as opposed to a Scottish average of 27%).
9. In a recent example of using incumbent brand loyalty and weak customer response to disadvantage customers while giving the appearance of being competitive, SSE introduced a 5p per kWh discounted tariff for THTC, which could have saved customers £300 to £400 per year. This discounted, one year tariff, was poorly advertised and then withdrawn after only 10 days. Just one week before this tariff was introduced, SSE wrote to fixed price tariff customers whose contracts were about to end saying that the cheapest renewal deal available was a three year fixed rate tariff appearing at number 51 in the price comparison 'charts'.
10. There is no access to mains gas in the Outer Hebrides so consumer choice is further compromised and electricity is the principal means of heat for a large number of households. The factors outlined above result in island consumers paying 26% more per kWh (on average) to heat their homes than the UK average. This is an unacceptable market impact in an area of low income, high climatic exposure and high cost of living.
11. The CMA report fails to address the Locational Surcharge which is levied on customers by SSE in the North of Scotland. On average, SSE customers in this area pay 2p per kWh more than counterparts in the south of Scotland to reflect the cost of distributing electricity to the margins. Since there is a monopoly on distribution of electricity and electricity is a 'necessity good', indispensable for maintaining a standard of living and with a low income and price elasticity of demand, consumers in the Outer Hebrides are left with no choice but to pay this punitive tariff. The Comhairle views this as a conspicuous market failure and questions why there has been no effective regulatory intervention to protect consumers' interests.
12. Proposals to meaningfully address Fuel Poverty in the Outer Hebrides centre around aligning local Renewable Energy generation with local consumption. The Comhairle is currently facilitating the establishment of the Outer Hebrides Energy Supply Company (ESCO) which, in line with Scottish Government policy, will take a share in commercial wind generation on behalf of the local community. Immediately after energisation of the proposed Western Isles Radial Connector in 2021, the wholly community owned Outer Hebrides ESCO will control 25MW of renewable electricity generation (a 20% share in the proposed Stornoway Wind Farm). This will be retailed through the licenced ESCO

to island consumers at a preferential tariff, within OFGEM parameters, and, for the first time, a real impact will be made on the cost of electricity for those in Fuel Poverty.

13. The Outer Hebrides ESCO will be a unique type of electricity supplier. It will be wholly community owned and operated on a not-for-profit basis. There will be no shareholders to remunerate and, since generation and consumption takes place within the islands, there will be no significant Transmission cost element to customers' bills. The CMA should recommend that a bespoke tariff class be developed for areas facing structural energy challenges who have taken the initiative and set up their own generation and supply arrangements, using the wires of the existing Distribution system. Given the savings produced by foregoing profit and avoiding Transmission costs, the ESCO will be in a position to offer a local tariff (restricted by postcode if necessary) which will be significantly below the standard tariffs of existing commercial electricity suppliers. On the face of it, this may appear to have an Adverse Effect on Competition but the CMA and OFGEM should recognise that a Remote Islands Tariff will not distort the wider UK electricity market and will meaningfully address major systemic and structural problems which the current electricity market seems to be exacerbating. A geographically constrained derogation from tariff regulations should therefore be available for this initiative.
14. In any measures to increase competition in the electricity markets, the CMA should be careful not to prejudice Remote Island Wind as a discrete category of electricity generation. In the Outer Hebrides, 525MW of such generation is already consented and contracted to Grid, awaiting the installation of Grid reinforcement by the Transmission arm of SSE as North of Scotland Transmission Owner. Connection of this Remote Island Wind will meet OFGEM objectives of reduced emissions and enhanced security of supply while addressing affordability of prices for those most in need through the Outer Hebrides ESCO.
15. Remote Island Wind is innovative in the way its product is transmitted to Grid through cutting edge subsea HVDC technology. Remote Island Wind should therefore be well represented in the 'Emerging Technology' auction pot overseen by DECC. Given that the viability of high cost island generation schemes seems to be the principal driver behind the Transmission Owner's decision to reinforce the Transmission network out to the islands and that the Transmission Owner's intransigence to date can be regarded as a non-competitive market failure, there may be a case for allocating CfD directly to Remote Island Wind out-with the auction process as hinted at in the CMA report provisions.
16. Whether or not energy suppliers are restricted to four tariffs as a result of the CMA investigation, provision should be made for a 'Community Tariff' which reflects local circumstances and may be lower than standard tariffs to combat Fuel Poverty and other local inequalities. In its efforts to Joint Venture with an existing energy supplier in order to offer cheaper electricity to local consumers (prior to ownership by the ESCO of local generation), the Comhairle is constrained by the limited range of tariffs available to these suppliers. Often there is no 'slot' available for a bespoke Community Tariff and this should be considered as a unique tariff category over and above any restricted quota of regular tariffs.
17. The Small Supplier Exemption from environmental obligations should be retained. The Comhairle has discovered, at first hand, the significant market entry and customer base challenges facing a new entrant to the market without having to contend with burdensome obligations which are par for the course for a larger supplier.

18. Smart Meters should be rolled out to all households across the UK network with all possible haste. Smart Meters will enable half hour, real time meter reads and will empower consumers to choose when and how they use electricity. This will result in significant savings and will pave the way for a future situation in the islands where a high proportion of local generation will come from intermittent wind sources. Smart Metering will be essential to better align generation and demand for the benefit of both suppliers and consumers. Smart Meters should be considered as a controllable alternative to pre-payment meters with their punitive tariffs and supplier switching constraints.
19. OFGEM should provide an independent Price Comparison Website with easy switching capability built in to enhance customer engagement. This Website should publicise all tariffs, including SSE's THTC and Economy 10 tariffs.
20. OFGEM should introduce a more active regime for prompting consumers to switch and for outlining, in plain language, the benefits of switching. Short term discount tariffs should be discontinued and their realisable savings rolled into a review (and reduction) of longer term standard tariffs.
21. A transparent, easily understood 'Cost Plus' tariff should be introduced across all suppliers, enforced by OFGEM. This should be targeted at disengaged customers and those in real difficulty with meeting fuel costs.
22. OFGEM should be instructed and directed to return to its pre Electricity Act 2010 duties in respect of competition promotion. With adequate resourcing, this should not impact adversely on OFGEM's duties in other areas.