



Department
of Energy &
Climate Change

Hydro Benefit Replacement Scheme and Common Tariff Obligation

**DECC response to the call for comments on the three
year statutory review of these schemes**

August 2013

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Introduction

Purpose of these statutory schemes

The Hydro Benefit Replacement Scheme is designed to protect consumers from the high costs of distributing electricity in the North of Scotland. It is funded by charges on all licensed suppliers across Great Britain. It was commenced under a power in section 184 of the Energy Act 2004.

The Common Tariff Obligation ensures electricity suppliers in the North of Scotland are not able to charge comparable domestic customers different prices solely on the basis of their location within the area. This is designed to protect customers in remote rural areas from the relatively high costs of supplying electricity in these areas. It became law under the Electricity Act 1989 (Uniform Prices in the North of Scotland) Order 2005.

Review of these schemes

There is a statutory requirement to review the Hydro Benefit Replacement Scheme every three years, and Ministers committed to review the Common Tariff Obligation at the same time.

For the latest review, DECC assessed the operation and policy objectives of the two schemes, and was not minded to make any changes. However, before making a final decision, DECC invited any views from stakeholders through a call for comments document which was published on 1 March 2013.

This response document summarises the stakeholder responses received and DECC's replies to them.

Decision summary

DECC has decided to retain both schemes at this time. DECC will keep market conditions under review and the schemes will be subject to statutory review no later than 3 years from now.

Summary of responses and DECC consideration

DECC welcomes the comments made by all respondents to the call for comments. Responses were received from five organisations: Consumer Focus, E.ON, Good Energy, Scottish Power and SSE. In general, respondents considered that the Hydro Benefit Replacement Scheme and the Common Tariff Obligation continued to meet their original policy objectives and were operationally effective. Two respondents provided data to support this view, whilst several additional points of detail were also raised.

Responses are summarised below, together with DECC's replies to the points raised.

Hydro Benefit Replacement Scheme

Respondents considered that the scheme continued to meet its policy objectives, both because the North of Scotland would otherwise have the highest distribution costs by a significant margin, and because there is a relatively higher incidence of fuel poverty in the remote rural communities of that area. A range of data in support of the scheme's retention was cited:

- The North of Scotland has the highest system length per 1,000 customers of any distribution network. At 63.2km this is more than double the GB average of 27.2km per 1,000 customers.
- Distribution costs for consumers in the North of Scotland remain higher than elsewhere, even after the reduction from the scheme has been applied. The assistance provided an average bill reduction of £36 a year to each domestic consumer in the North of Scotland.

There was general agreement with DECC's assessment that there is no economically rational basis for setting a threshold to exclude some smaller suppliers from contributing to the costs of the Hydro Benefit Replacement Scheme. One respondent argued that the only fair reason for excluding some small suppliers would be if the burden involved in processing the relevant payments was disproportionate. However, this was not considered to be the case as all suppliers needed to have the administrative capacity to process invoices. It was also suggested that any exemption for small suppliers could distort competition in the energy retail market and actively disadvantage larger new entrants.

One respondent considered that the costs should be recovered through general taxation, rather than from electricity suppliers (and hence electricity bills), as this would represent less of a burden on lower income households.

DECC response

Responses to this call for comments confirm DECC's view that the scheme remains justified and is appropriately designed. It is clear that the scheme's removal would adversely impact domestic and non-domestic electricity customers across the North of Scotland.

DECC does not believe that the scheme should be funded through general taxation. Lower administrative costs can be expected by retaining the existing arrangements for recovery of the assistance amount. In addition, a typical domestic electricity consumer in Britain contributes less than £1 per year to the scheme, and it is unlikely that this small amount would have a material effect on fuel poverty.

Common Tariff Obligation

Three respondents gave their full support to continuation of the Common Tariff Obligation as it stands. It was noted that this kind of cross-subsidy could have some effect on the geographic incidence of fuel poverty between urban/rural areas in the North of Scotland, but it was understood that the increase in bills for individual urban consumers would be smaller than the decrease in individual rural bills.

One respondent considered that retention of the Common Tariff Obligation was arguably less necessary because energy companies normally charged common prices within electricity distribution areas for reasons of simplicity and administration. However, the respondent had no objection to retaining the Common Tariff Obligation if it was felt to provide additional assurance.

A concern was expressed that the wording of the Common Tariff Obligation was insufficiently clear, meaning that it could be misinterpreted as applying to factors beyond geographic location.

DECC response

In line with responses to this call for comments, DECC continues to believe that the policy intention of the Common Tariff Obligation to protect domestic customers remains valid. Whilst it is not possible to be absolutely certain that removal of the measure would cause customers in remote rural areas to be disadvantaged, it is prudent to retain the measure in order to provide the necessary assurance. The relatively higher incidence of fuel poverty in remote rural communities in the North of Scotland has already been noted in this response document.

As regards the concern expressed about the wording of the Common Tariff Obligation, DECC believes that the policy intention is clear. When introduced in 2005, the purpose of the measure was very clearly expressed as protecting comparable domestic consumers in remote rural areas from being charged higher prices solely on the basis of their geographic location within the area. There was no suggestion that the Common Tariff Obligation was directed at other factors. However, DECC will consider whether any further clarification is required.

Wider points

It was suggested that there might be a case for extending both the Common Tariff Obligation and the Hydro Benefit Replacement Scheme to other DNO areas. Specifically in relation to the Hydro Benefit Replacement Scheme, it was considered that DNOs whose networks were more extensive in rural areas might need to make proportionately larger investments in future to support measures such as distributed generation and the expected growth in renewable heating installations.

DECC response

There are very particular challenges in the supply of electricity in the North of Scotland – primarily related to the relatively large, difficult and sparsely populated terrain – which do not exist to the same extent in other areas of GB. This is shown by the fact that consumers in the North of Scotland are currently paying higher electricity prices than elsewhere, even with the benefit of the Hydro Benefit Replacement Scheme. Hence DECC does not believe the geographic scope of either scheme should be changed at present. However, the schemes will be kept under review and as a minimum will be subject to statutory review no later than 3 years from now.

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