The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 29 June 2011

Session 4

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ECONOMY, ENERGY AND TOURISM COMMITTEE
3rd Meeting 2011, Session 4

CONVENER

*Gavin Brown (Lothian) (Con)

DEPUTY CONVENER

*John Wilson (Central Scotland) (SNP)

COMMITTEE MEMBERS

*Chic Brodie (South Scotland) (SNP)
*Rhoda Grant (Highlands and Islands) (Lab)
*Patrick Harvie (Glasgow) (Green)
*Angus MacDonald (Falkirk East) (SNP)
*Mike MacKenzie (Highlands and Islands) (SNP)
*Stuart McMillan (West Scotland) (SNP)
*Anne McTaggart (Glasgow) (Lab)

*attended

THE FOLLOWING GAVE EVIDENCE:

Alistair Buchanan (Office of the Gas and Electricity Markets)
Paul Delamare (EDF Energy)
Charles Gallacher (Office of the Gas and Electricity Markets)
Norman Kerr (Energy Action Scotland)
Trisha McAuley (Consumer Focus Scotland)
Ian Peters (British Gas)
Alistair Phillips-Davies (Scottish and Southern Energy)
Rupert Steele (Scottish Power)
Sara Vaughan (E.ON)
Paul Williamson (RWE npower)

CLERK TO THE COMMITTEE

Stephen Imrie

LOCATION

Committee Room 4

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 29 June 2011

[The Convener *opened the meeting at 10:02*]

Energy Prices

The Convener (Gavin Brown): Good morning, everybody, and welcome to the third meeting in this session of the Economy, Energy and Tourism Committee. Today, the focus will be almost exclusively on energy.

I remind everybody present to check that their mobile phones and BlackBerrys are switched off; otherwise, they will interfere with the recording equipment.

Agenda item 1 is energy prices. There will be three panels this morning. The first panel consists of Norman Kerr from Energy Action Scotland and Trisha McAuley from Consumer Focus Scotland. I have been told that you do not want to give long opening statements. Do you want to say anything at all by way of introduction before we ask questions?

Trisha McAuley (Consumer Focus Scotland): I am happy to start.

Consumer Focus Scotland very much welcomes the committee's decision to undertake an energy prices inquiry and its recognition of the impact of rising energy prices on consumers and the country's economic wellbeing. We have had concerns about the energy market for some time, and we have done research that shows that, out of 45 markets in the United Kingdom, with no different position in Scotland, the energy market was ranked lowest in respect of consumer trust and confidence. Therefore, there is a lot of work to be done and we very much welcome the committee's input.

Norman Kerr (Energy Action Scotland): Energy Action Scotland is primarily concerned about the fuel poverty and energy efficiency side. We have seen the recent price increases contributing significantly to fuel poverty in Scotland, and we believe that close on 900,000 households in Scotland—or approximately 40 per cent of households in Scotland—are at risk of or are in fuel poverty. The percentage is greater in rural communities that are off the gas grid and rely on electricity or other expensive fuels to heat their homes. Therefore, like Consumer Focus Scotland, we welcome the inquiry.

The Convener: I know that Patrick Harvie wants to ask about the legislative targets that have been set.

Patrick Harvie (Glasgow) (Green): Good morning.

The three factors that are most often cited as factors that push fuel poverty figures in one direction or another are prices, incomes and the efficiency of the housing stock. Prices are going up—that is why we are taking evidence today. Incomes are under immense pressure. Many people face multiple years of a pay freeze, which means a real-terms drop in their income, and there are other pressures on household budgets. The Scottish Government has cut by around a third the investment that it puts into energy efficiency. All members were committed to establishing legislative targets on fuel poverty, so I take no pleasure in asking this question. At what point do we have to say that the targets need looked at again? From where we are now, is it possible to reach the targets by the time for which they were set?

Norman Kerr: Yes, it is possible. We need to look seriously at investment and we need to consider not only how we invest in Scotland but how we can tap into the new programmes that will come along for England and Wales as well as Scotland, such as the green deal and the energy company obligation.

However, meeting the targets is becoming increasingly difficult. Three or four years ago, Energy Action Scotland said that we would require to invest £1.7 billion if we were to eradicate fuel poverty by 2016. Over a 10-year period, that would mean investment of £170 million a year. That was a conservative estimate. We have not spent £170 million a year and it looks as though we will not spend £170 million a year. As every year goes past, the amount of money that we need to spend increases significantly.

We are close to the point at which we must make a conscious decision about investment and whether we will strive to meet the targets or simply let them slide—or look at the definition of fuel poverty, as is happening in England, where the Hills fuel poverty review is considering whether the definition is the right one. Energy Action Scotland is sceptical on that; the easiest way to solve a problem is to define it out of existence. I hope that that is not the route that Professor Hills chooses to take, but I cannot speak for the review.

Patrick Harvie: I absolutely agree. I spent time arguing, with your support, for a £100 million-a-year programme, which the Government said was unaffordable, although it sounds pretty modest now compared with the figure that you suggest is now required, which will only go up the later we leave it. I talked until I was blue in the face about how important such investment is compared with £100 million-a-mile road projects, for example.

We are where we are. The Scottish Government claims that a difficulty that has prevented it from doing more is the requirement to work around the carbon emissions reduction target obligations. The Government has to work around energy company responsibilities that are defined at UK level and, if we do not get the design of a Scottish scheme right, we could lose CERT money. Given that that is the case, do you support calls for a change in the Scotland Act 1998 to give the Scottish ministers the power to define the energy companies' responsibilities in the area, so that they fit with policy, rather than policy having to fit around UK-defined energy company obligations?

Norman Kerr: That would be a useful step forward, but we need to bear in mind that CERT and the community energy saving programme will disappear and that the Energy Bill that defines the energy company obligation and the green deal is well under way. We must also bear in mind that the green deal will be financed not by the energy companies or the public but through private finance, and it is hard to see how ministers could legislate for that, although they could legislate for the energy company obligation. I am not convinced that we need legislation, but better dialogue between ministers and the energy companies would be more helpful.

Trisha McAuley: I support Norrie Kerr's point about dialogue. In principle, we would support anything that would devote the right amount of resources to the Scottish population. However, much more work is needed on the impact on consumers across the board of dismantling any UK subsidy or funding. The work should be done, but I would not say that in principle the approach that has been suggested should be taken, because I do not know what the impact on consumers would be of dismantling the UK-wide aggregated approach to the market.

On Patrick Harvie's first point, I agree with what Norrie Kerr said about investment and fuel poverty. I do not want to say that it is not possible to reach the targets but I am more pessimistic than Norrie—I cannot see how we can do it.

I support everything that has been said about investment. We are hoping that the new Government will make a step change in its approach to fuel poverty. At the start of the previous Administration, there was a positive approach. The energy assistance package was introduced and the fuel poverty forum was reconvened. By the end of that Administration, we were disappointed that there was nothing new on the horizon, given the huge increase in fuel poverty, which will now increase even further. There was no strategic look at what to do next. The fuel poverty forum was extremely unhappy that it could not get enough information from the Government on whether the energy assistance package was working. Cutting investment in that significant area is not what we would want, but we live in hard times and we wonder whether good money is being thrown after bad in the energy assistance package. If we are taking a serious look at cutting back on public sector funding, there is a big issue here about preventive spending, and having a fuel poverty strategy that looks at the impact on people's health and takes a cross-Government approach, rather than just being in one silo.

The Convener: Norman Kerr stated that an investment of £170 million a year would be required to meet the legislative target of 2016. For clarity, is that your position today or was it your position a few years ago when the work was carried out? Has your position changed since then?

Norman Kerr: That was our position a few years ago. As Patrick Harvie has alluded to, we are probably talking about significantly more than that now. We based our calculations on between £6,000 and £8,000 spend per household in Scotland to bring them up to a certain level of energy efficiency. We believe that the best way to—if you like—insulate people against price rises is to have more energy-efficient homes. The standard that we were looking to at that time was a national home energy rating of 7. We believe that that should now be closer to 8, which means, again, a significant spend.

Trisha McAuley: We are starting to get evidence of consumers who have invested in energy efficiency in their homes and still cannot afford to pay their bills because of the price rises.

Mike MacKenzie (Highlands and Islands) (SNP): Up until fairly recently, there was some success in eradicating or at least reducing fuel poverty. To some extent, we are in danger of losing that progress. To what extent has progress to date been about picking the low-hanging fruit and making the easy household interventions, such as the 300mm loft space insulation that can be put in relatively inexpensively?

On another point, we are facing a much more intractable problem of dealing more comprehensively with insulation. Given the state of the housing stock, that presents a formidable challenge. I am not aware of anyone having any answers for that, so I would be interested to hear whether you have answers.

Trisha McAuley: You are absolutely right. Significant improvements have been made in new-build housing standards. It is the existing homes that are the issue, particularly private rented accommodation, hard-to-treat houses and, as Norrie Kerr said, housing in rural areas. We have reached the easier consumers. Research that we have carried out shows that consumers on higher incomes invest in energy efficiency measures. They are also the people who switch more and get a better deal on their energy supply. They will be cushioned against price rises. In terms of reaching the housing stock in Scotland, we have done the easy bit. The hard-to-treat homes are really what is left.

People on lower incomes are not inclined and do not have the wherewithal to invest in energy efficiency measures. It is very hard to find the solutions, but we believe that the area-based approach is definitely the best. That involves going to communities, knocking on people’s doors and giving them advice individually, using economies of scale. We should not underestimate what it will take to tackle the problem. It should be top of the agenda for the Government in the session that has just commenced.

10:15

Norman Kerr: I echo Trisha McAuley’s points. When we designed the energy assistance package that the Government adopted, we said that it was part 1—a reactive approach, whereby some people identified themselves or professionals would identify people as being in need of support. That was the low-hanging fruit.

We recognise that that was not necessarily the most economic approach, as it involved moving about, doing a job in one place, another job 50 miles away and another job 100 miles away, for instance. We were therefore very supportive when Patrick Harvie and the Green party adopted a proposal for a universal insulation scheme. The Government adopted that scheme. However, the two sides are not working closely together in a strategic manner. We do not have a route map indicating the worst parts of Scotland, the places to start and how things will end up. Instead, there is a bidding war by local authorities, and we are spreading the money as thinly as we can across as many local authorities as possible so as to give each of them something, rather then making a concerted move to tackle the worst-affected areas.

We need a fuel poverty map and an energy efficiency map, and we need to resource the programmes for those areas. Trisha McAuley is right to say that the area-based approach works. The universal home insulation scheme that Patrick Harvie and colleagues designed and presented to the Government has not yet been evaluated. We know, however, that it had a higher success rate than the home insulation scheme.

As we have said before, there are probably too many schemes with too many names. The public, and sometimes the professionals, get confused between EAP, CERT, CESP, HIS and UHIS—I apologise to the reporter trying to copy that down.

My point is that people need to understand. They need clarity, and we do not yet have it. The same can be said when it comes to tariffs from energy suppliers, as it is hard to distinguish between the myriad tariffs that are offered, and it is difficult for consumers to be educated in that regard.

Rhoda Grant (Highlands and Islands) (Lab): What did Trisha McAuley mean when she said that the Government was throwing good money after bad?

Trisha McAuley: I was talking about central Government. As Norrie Kerr has said, there is no strategic approach to fuel poverty. Investment in the budget has been cut back, which is regrettable, although something has to give. My point is that the energy assistance package has not been properly evaluated, and we cannot tell whether it is working. A lot of money is going into something whose effects we do not know.

When the package was set up, we said that it was a good thing. It is generally reckoned to be the right approach. However, as a member of the fuel poverty forum, I have not been able to get any evidence to show that the package is making inroads into fuel poverty. My point was about central Government: if money in the budget is to be cut back, the money that is available must be spent in the best possible way. That goes back to what Norrie Kerr and I have both been trying to say about the route map, taking into account the importance of having a strategy and a radical approach to tackling and targeting fuel poverty. We should also be focusing on preventive spending in the health budget and lifting people out of fuel poverty because it costs us more money.

Rhoda Grant: I have a question about people on prepayment meters. That seems to be an obvious sign of people struggling to pay fuel bills and having difficulty with their budgeting. In our research briefing we were told that those people are the most unlikely to change suppliers. On average, however, they could be saving £256 a year if they did. The companies know who is on a prepayment meter and who pays by direct debit, for example. Is there a duty on the companies to target particular people with home insulation packages and more competitive tariffs? Is anybody offering that kind of assistance?

Trisha McAuley: There are many different schemes, but they are not really joined up. We think that the energy companies could take a lead and do a lot more. Prepayment meters are a huge problem. Their use is rising—I presume because of the recession and the levels of debt. Last year, 2,000 new meters were installed in Britain every day. We have evidence that thousands of people who are on prepayment meters are disconnecting themselves and are rationing their energy. We would like such people to be targeted by the energy companies, and to receive more help from the Office of the Gas and Electricity Markets. Point-of-contact advice from the energy companies should ask whether a prepayment meter is suitable for someone. Often, vulnerable people are affected: we have heard about people with Alzheimer's disease and about people with asthma who need to use nebulisers constantly. Those people need a continuous supply, but they are given no choice but to be on a prepayment meter; they may then be cut off because they cannot afford to pay.

We would like the energy companies to intervene more. Once people's vulnerability has been established, the best thing is to put in place payment plans that they can afford if they are on a prepayment meter. The suppliers should actively consider whether those people are on the lowest tariff possible. The people should be given access to advice on energy efficiency and on benefits.

The energy companies could do more to help customers on prepayment meters. It is a significant and growing problem, and self-disconnection is growing. This affects about 20 per cent of the population in Scotland.

Rhoda Grant: You say that 20 per cent of the population are on prepayment meters. What percentage of the population is deemed to be in fuel poverty?

Trisha McAuley: About a third.

Norman Kerr: The official Scottish Government figure is 34 per cent. Energy Action Scotland's calculation, using Government figures, puts the figure closer to 40 per cent. If you also consider off-gas grid, the figure rises significantly.

Trisha McAuley: We have commissioned the Centre for Sustainable Energy to estimate what the impact on customers' bills would be if every energy company followed the example of Scottish Power—I think that that is mentioned in the committee's briefing from the Scottish Parliament information centre, and I think that Ofgem has considered the issue as well. It would put £175 a year on to the average bill. It would increase our estimates, or Scottish Government estimates, of the number of people in fuel poverty from 33 or 34 per cent to 36 or 37 per cent. That would take us back to the baseline position of 1999; we would be back to square 1 after all the good work that has been done. That is why we are quite pessimistic.

Norman Kerr: We have been told that the price rise will be approximately £178. If you insulated your loft, having never done it before, it would save you approximately £145; or if you installed cavity wall insulation, it would save you £100 a year. You can do work to increase the energy efficiency of your home, but the rise in prices will still be above any savings you could make.

The warm home discount will be applied from next year. It is £120—again, that is lower than the price rises. People will be paying more whatever they do.

The Convener: You gave a figure of 40 per cent. Is that based on today's figures? Sometimes there can be a bit of a lag.

Norman Kerr: Those figures are Energy Action Scotland's calculations; they are not Scottish Government calculations. The Scottish Government figure remains at 770,000 households. That was in 2009; later this year, we will see a revised estimate for the 2010 figures. You might argue that it is unscientific, but we are simply using the calculation that the Scottish Government house condition survey team would use, and applying our own price information to it. It is not an official figure.

The Convener: But it is today's figure.

Norman Kerr: It is.

Chic Brodie (South Scotland) (SNP): Good morning. At the weekend, I had the opportunity to look at a proposed domestic housing development involving a combination of solar panels and wind turbines. Do you think that the planning regulations and those who are responsible for planning across Scotland are up to speed with the energy efficiency targets and how those objectives can be achieved?

Norman Kerr: Over the past 10 years, the energy efficiency of homes has changed significantly. A house that is built to today's standards will use between 25 and 30 per cent less energy than a house that was built in the 1970s or 1980s, so we are moving forward, but it is an incremental change.

You mentioned homes with additions on them, but we can build homes whose fabric or outer skin is so energy efficient that they do not need to have a heating system inside them. However, we have not yet got our building regulations to that stage. We would like the building regulations to be reviewed at least every five years, if not every three years, so that we reach the stage at which the homes that we build are zero-heat-load homes—the energy that they use will be for lighting, entertainment, hot water and so on. We can do that; it is just a case of making the necessary progress.

Research by Professor Boardman at the University of Oxford suggested that 80 per cent of the homes that we have now will be with us in 2050, so the problem that we face is not just with new homes, although we must address their energy efficiency. It goes back to the point that Trisha McAuley made earlier. People who live in poverty do not move into new homes—they stay in existing homes. They have less choice about where they stay and the quality of home that they are offered. We need to look seriously at that issue, particularly in the private rented sector, in which there is a complete lack of regulation, in that someone can put a house on the market regardless of its energy rating. We would like to see planning address that by ensuring that, if someone is to rent out a house, it must meet a minimum standard. We do that for fire safety and we should be doing it for energy efficiency.

Trisha McAuley: I agree with what Norrie Kerr said about the building regs. I do not know enough about planning to comment on that aspect of your question, but I have a point about existing homes and microgeneration that builds on Norrie's last point. We have done work on consumers, and microgeneration is not something that people know much about. They would not know where to start, so a lot of work needs to be done on that. There are many good community-driven programmes, but people who do not live in one of those communities or who live in a backwater somewhere do not have access to them.

I noticed that, this week, the Scottish Council for Development and Industry produced a report called "The AEA Scottish Microgeneration Index". It makes the stark point that, although Scotland is well ahead of the rest of the UK when it comes to large-scale developments such as wind farms, we are a long way behind England and Wales when it comes to microgeneration for individual homes. There is a big economic debate about renewable energy, the development of which we are highly supportive of, but we are not convinced that that debate is looking at how renewable energy can help to alleviate fuel poverty and how microgeneration can help communities to have access to cheaper energy. We think that the debate in Scotland is not joined up enough in that regard.

The Convener: Mike, do you have a supplementary on that specific point?

Mike MacKenzie: Yes. The question that I was going to ask has been answered only partially.

You would probably agree that, prior to the credit crunch, we were building approximately 1 per cent of our housing stock per annum, whereas now we are building only about 0.5 per cent of it per annum. Therefore, by definition, it will take us 200 years to replace the housing stock. Although I welcome greater energy efficiency in new housing, that makes up only 0.5 per cent of the housing stock per annum. The real problem lies with existing hard-to-heat properties. Has any work been done on the cost of comprehensively upgrading the insulation properties of the existing housing stock to give us an accurate picture of what it will cost and what interventions are needed to tackle the problems with the existing housing stock?

10:30

Trisha McAuley: I cannot say that that has been done at all, but that is precisely what we need from the route map that Norrie Kerr has talked about. We need to know the scale of the problem and we must have a strategy, timelines and deadlines for tackling it. I am not aware that that work has been done—it has been very patchy.

Norman Kerr: The Scottish house condition survey team has undertaken some of that work and has provided some estimates of the cost of bringing houses up to a certain level, but we have not concentrated on the hard-to-heat properties. We need to look to emerging technologies. The energy assistance package that Trisha McAuley mentioned earlier has embraced two new measures: external cladding for certain homes and air-source heat pumps, which will benefit hard-to-heat homes. Unfortunately, the cost of those measures is significant and with every installation of an air-source heat pump at a cost of £7,000 or £8,000 a lot less loft insulation at a cost of £500 can be installed. It is about how we spend our resources on the basis of a calculation of how much it would cost us. We have done that calculation—although, I stress, not scientifically—and the figures that we are coming up with are around £7,000 to £8,000 per house.

The Convener: Stuart McMillan has several new issues to raise.

Stuart McMillan (West Scotland) (SNP): Norrie Kerr touched on tariffs. There has been a great deal of concern about mis-selling, the complexity of energy bills and the problem of tariff switching. We have a growing elderly population and not everyone is information technology savvy—not everyone has a personal computer, a laptop or an iPad. There are almost 400 tariffs but the switching rate is down and many of the 40 per cent of people who switch do so on the doorstep. Four companies are under investigation by Ofgem. How important is the complexity of tariffs? How big an issue is that in getting a better deal for the customer?

Norman Kerr: We have suggested and continue to suggest that every energy consumer should have a check every year, which should be carried out by their energy supplier. Many people who have bank accounts will have their bank carry out a check for them to see whether they are on the right savings plan, and we think that energy companies should have a duty to undertake a similar programme with all their customers, particularly the vulnerable ones, to ensure that they are on the right tariff and using the right payment method. We have mentioned prepayment meters. For many people who do not have a bank account and cannot set up a direct debit, a prepayment meter is an option. It is about looking at what payment method is right for the customer.

You are right to say that, with more than 400 tariffs, it is difficult to understand what offering is best for the individual. It would be good if it were easy to make a comparison. When someone drives along the high street, they know what every garage will charge them for a litre of unleaded petrol or diesel, but we are unable to compare the price of every kilowatt hour of electricity or therm of gas in that way—there are too many variables to make it easily understandable. Ofgem tried to tackle that last year by asking energy companies to reconsider the complexity of tariffs; unfortunately, that resulted in more tariffs becoming available, not fewer. That did not support Ofgem's proposal for more straightforward energy tariffs.

Mr McMillan mentioned companies under investigation. Scottish Power raised its prices and it is difficult to understand how those increases are spread across all the tariffs. However, from what we can see, the price rises apply mainly to the daily standing charge and not necessarily to the cost of energy. If someone invested in energy efficiency, the savings would not necessarily be significant, because there would be no saving on the daily standing charge.

Similarly, a number of low-use consumers have a two-tier tariff in which the units in the first tier are charged at a higher rate and those in the second tier are charged at a lower rate. As far as we can see, the increases pan out at 30 per cent for tier 1 units and 2 per cent for tier 2 units. People who cut back therefore do not save the full percentage; they save a lower amount than someone on a very low usage who pays the full price.

It would have made much more sense to load the tier 2 tariff because that would have encouraged people to save energy. There is no encouragement for people to save energy when they pay the highest increase on the first number of units that they use, which is set fairly low at around 250kWh a quarter. Everybody will use that amount. They cannot cut back more than that unless they live in a very energy-efficient home. As I said earlier, people who live in poverty do not live in energy-efficient homes.

Trisha McAuley: We welcome and support Ofgem's moves, but we have found in recent research that people, particularly low-income consumers, are totally disengaged from their energy bills. They are not engaged with the market, they distrust suppliers and, if left to their own devices, they will not switch, look for a better deal or move to energy efficiency.

From our perspective, that inertia means that the market remains stagnant because there is not enough movement by consumers, particularly in Scotland. Any costs that the energy companies incur therefore get passed straight through. In a competitive market we would expect companies to say, "How can we steal a march on our competitors, give people a better deal and get more customers?" That is not happening enough.

Some matters are reserved, but we believe that in Scotland much more can be done proactively to help people get advice and help them switch. We ran the energy best deal campaign, in which we trained 300 money and citizens advice bureau advisers across Scotland. They will help people switch. We would also like to see that sort of information included in Scottish Government fuel poverty programmes so that we get the market moving in Scotland a bit more than it has been.

Stuart McMillan: I am a firm believer in using the KISS—keep it simple, stupid—method in anything that I do. I find it incredible that the number of tariffs has gone up from 180 to over 400—I can understand why there is such confusion out there. Is there an optimum number of tariffs per company? Should there be a limit on the number of tariffs? What would be the best option?

Norman Kerr: We need a simplified tariff structure. I appreciate that a number of tariffs reflect time of use. For example, someone with an electric heating system can move to something called dynamic teleswitching, which means that the company will give the consumer energy at a time during the day when it has excess generation. That is not like the old meter system, whereby you got your charge from 11 at night until 7 in the morning. Something like 400,000 Scottish consumers are on the dynamic teleswitch tariff. When a company generates more energy at a time of low demand, it can put it into your storage radiators.

We acknowledge that we need some flexibility and innovation, but moving from 180 tariffs to 400 seems like a move in the wrong direction. We need simplified tariffs that can be measured against one another. I am looking for a reduction in the number of tariffs—I do not know that there is an optimum number, but I guess that it is below 400.

Trisha McAuley: I pretty much agree. As a consumer organisation, we have traditionally supported consumer choice, but there is no effective choice in the proposal because the information is so confusing. I have no idea what an optimum number of tariffs would be. Ofgem has been doing a lot of good work in the area and has proposals to reduce the number of tariffs, but we are not sure whether it will reduce them so far that there is less choice.

As Ofgem implements its retail market review, we hope that it will work with consumer organisations, energy companies and other stakeholders to try to reach the position that Stuart McMillan is talking about. There is further discussion to be had about an optimum number of tariffs, but it is certainly not 400. The number of tariffs should give people effective choice, rather than confuse them.

Stuart McMillan: Given the price increases that were announced a couple of weeks ago and any announcements that might come from other companies in the near future, would you like the additional VAT moneys to be ring fenced for fuel poverty measures in Scotland?

Norman Kerr: I apologise for smiling—it is not because that was a funny question. We wrote to the Exchequer in the previous Westminster Government and asked that, given that the additional income from energy price rises was an unexpected windfall for the Government, it put that additional income aside. We worked out that in the region of £600 million came from the additional VAT generated by price rises in 2009. The reply from the Exchequer was that, as people bought more fuel at a reduced VAT rate of 5 per cent, they would spend less on things that incurred the higher VAT rate—for example, going to the ballet, eating out or some other form of entertainment. Therefore, the Exchequer said, it was losing money because of the increase in VAT. I am not sure who crafted the letter—I do not believe that it was the chancellor—but it was a work of art. I do not believe that many fuel-poor families in Scotland have time to spend a lot of excess money on other forms of entertainment. They are just happy if they can keep their homes warm.

Trisha McAuley: It would be really good news if we could get additional VAT moneys to be ring fenced for fuel poverty measures. I smiled when I heard Norrie Kerr talk about that letter—which I did not know about—because a consumer copied me into a reply that he received recently from the Treasury after he wrote a similar letter. I think that he wrote to *The Herald* too. The Treasury gave him exactly the same reply—it received no net gain in VAT from the energy price increase because people spent less money on other things. We thought that that was quite sad.

John Wilson (Central Scotland) (SNP): The discussion has been interesting. We have concentrated on fuel poverty, which is a major concern of mine and we have covered the global figure that relates to fuel poverty. There is another calculation, however, which is for those in extreme fuel poverty. Mr Kerr, you gave what you considered to be the current figure for those in fuel poverty. Will you give a current figure for those in extreme fuel poverty? For those who do not understand, those who are said to be in extreme fuel poverty spend 20 per cent of their income on energy costs.

10:45

Norman Kerr: We have not done that particular calculation. Extreme fuel poverty is something that we have loosely acknowledged. We believe that there is a danger that, if we draw lines through fuel poverty and start to section people off, it might lead to a situation in which we address only those in extreme fuel poverty and serve less well those who pay only 15 per cent of their income on fuel rather than 20 per cent and are therefore in marginal fuel poverty.

Our argument has always been that someone who is in fuel poverty requires help. Even with today's price increases, the top 30 per cent of households in the UK will still pay less than 5 per cent of their disposable income on fuel while the bottom 30 per cent will pay more than 11 per cent. We are penalising poor people more. We therefore do not necessarily agree that there is an argument about extreme fuel poverty. For us, fuel poverty is fuel poverty. The argument about the need to address the issue on an area basis is what is important. If you target only those in severe fuel poverty, there is a danger that your approach will be fragmented and you will end up going back into an area two or three times. We know that the area-based approach that Trisha McAuley and Patrick Harvie alluded to works. Area-based schemes in England, such as the warm zones scheme, have brought about a vast improvement.

Trisha McAuley: The Scottish Government's "Rural Scotland Key Facts 2010" document gives relevant figures. It is not in front of me—it is in my briefcase—but I think that it says that the rate of extreme fuel poverty is about 10 per cent in accessible rural areas and is significantly higher in remote rural areas. That document is available from the Scottish Government.

John Wilson: I acknowledge Norman Kerr's point that the preferred programme is an area-based programme that deals with one area at a time. However, people who are in fuel poverty and people on low incomes do not necessarily all live in the same area—there is a spread of fuel poverty and deprivation throughout Scotland, as he recognises, particularly with regard to rural fuel poverty. How do we help those who are in the greatest need of assistance with their energy costs and with the insulation measures that should be put in place? To use a hypothetical example, only 10 per cent of people living in an area that is being addressed under an area-based strategy might be in fuel poverty.

You referred to the use of the Scottish house condition survey. In a previous committee that I served on, we had a debate about ways in which we could determine which houses needed more insulation. Two houses might look the same on the outside, but their insulation needs might be completely different because of the work that has been done on them. A person in one house might be living in fuel poverty while a person in the same kind of house next door might be benefiting from loft insulation, cavity wall insulation and other such measures. How do you determine where you should spend your resources?

Norman Kerr: Mr Wilson makes some excellent points. Energy Action Scotland's manifesto before the recent Scottish Parliament elections called for reactive and proactive approaches. We said that we continued to need the energy assistance package because, as you say, people cannot wait for an area-based approach to reach them. We need people to be identified, either by themselves or by health professionals, care workers and so on, as needing support so that we can react.

We also said that we need a route map. Some years ago, with the support of the Scottish Government and the Energy Saving Trust, Energy Action Scotland put together a fuel poverty map; it is now significantly out of date, because we used 2001 census data. We were able to identify down to ward level and, in some areas, down to sub-ward level the areas where people were at greater risk of fuel poverty. We used the index of multiple deprivation, housing stock records, build patterns, years of construction, building standards at those times and levels of previous investment by the local authority, housing association or, indeed, homeowners to create a map of Scotland that, although requiring some updating, could still be used as a starting point.

The map showed that even in rural parts there were affluent areas that did not require to be addressed as quickly as other areas that had greater levels of deprivation. If we had a route map, we could address the areas where we need to start this work. Nevertheless, the difficult decision of where we need to start and where we need to go must be taken and there will be 32 local authorities saying, "You've got to start in my area." A five-year plan up to 2016 would allow you to have not only a reactive programme to support those who would not be covered in year five, but a five-year rolling programme to address every fuel poor area in Scotland over that period.

Trisha McAuley: I was going to say the same thing about the energy assistance package. In principle, it is the ideal way of targeting people most in need and ensuring that their homes are treated holistically and that they receive advice and the necessary income. However, its delivery has not been so successful; it has not reached enough people and we have no information on whether it has reached anyone effectively. As a result, we need the route map that Norrie Kerr mentioned and a shot in the arm for the delivery of the energy assistance package to individuals. The Fuel Poverty Forum should also have a bit more input into how that happens because, as a forum member, I have felt frustrated that stakeholder input has not really been taken into account.

John Wilson: I commend the organisations for the work that they have carried out over the years to insulate homes, in particular the homes of households that might otherwise have been in fuel poverty. However, as Mr Kerr pointed out, no matter how much money is being put into roof or cavity wall insulation or what the Government and other agencies are doing to insulate homes, fuel costs are rising. Fuel poverty is calculated on the basis of income and expenditure and if we take into account the figures suggesting that gas prices have risen by 80 per cent and electricity prices by approximately 55 per cent over the past five years, the costs to individual households and the infrastructure costs that, according to Ofgem's reports, will be borne by consumers over the next 10 years, fuel costs will certainly continue to rise and fuel poverty will continue to increase. After all, incomes are not rising to match rises in fuel costs. Do you think that the energy companies—not the Governments—are doing enough to protect those on low incomes and those in fuel poverty?

Trisha McAuley: They could certainly do more. I referred earlier to moves to establish vulnerability but the fact is that the companies are too inflexible, especially when it comes to helping people get the cheapest deal. People with prepayment meters cannot access the same deals as those on standard credit or, indeed, those with access to a personal computer. We should remember that a third of Scotland's population, particularly those on low incomes, do not have a PC. We think that the energy companies could do more. Getting back to what I said about competition, there is a straightforward passing through of costs rather than looking at how to stimulate the market and make it work better, which would bring in more money for the energy companies. The energy companies could do much more.

The UK Government could also do much more by looking at whether the costs should all be borne by consumers or by taxpayers, and at what time they should be paid for by consumers. I am not arguing with Ofgem's analysis, which is spot on, but the assumption is always that the costs will be borne by consumers, despite the fact that energy companies will benefit from the increased investment in our infrastructure, as they will be able to make more money out of it. The consumer interest is not taken into account sufficiently in the debate. The automatic assumption is that the costs will be passed on to consumers, yet other people will also benefit from the improved infrastructure.

As I said, renewables have so much potential and we totally support the development of renewable energy as an alternative, but we are not convinced that the impact on consumers' bills has been thought through. I am sure that it has somewhere, but one day you read a report that says that renewables will decrease people's bills and the next day you read a report that says that it will cost more. People are confused about whether the Scottish Government's energy policy agenda will really benefit them.

Norman Kerr: Although I agree that the energy companies could do more, we need to acknowledge the work that they are already doing. Whether it is through setting up trust funds or through their social tariffs, they have done a significant amount of work. Can they do more? Yes. Should they do more? Yes. Both Consumer Focus Scotland and Energy Action Scotland continue to press companies to do that.

I said in response to Stuart McMillan that there could be an annual review of energy bills. That is one step that could be taken; another would be having fewer tariffs and making them more transparent so that people can understand them. Can they do more? Yes, but we need to acknowledge the work that they already do.

I declare an interest at this point, as I am the chair of the ScottishPower Energy People Trust. Scottish Power has invested some £8 million in programmes that have supported vulnerable communities and people working in such communities. I am also Scottish and Southern Energy's independent fuel poverty adviser and it had the best social tariff on the market. SSE took a straight 30 per cent off the bills of consumers who were identified as being fuel poor. It invested a lot of its own money in identifying fuel-poor customers, through the use of its own databases and other work. Unfortunately, that social tariff will be no more because of regulation by Westminster, whereby the warm home discount is being introduced. I believe that that has stifled innovation. I can understand why it was done, but the type of social tariff that I have described actively supported people, particularly in rural areas and in vulnerable households, yet it has been taken away.

The Convener: We need to wrap up this evidence session and move on to the next one. I thank Norman Kerr and Trisha McAuley for their evidence and suspend the meeting for a minute or two while the witnesses change over.

10:59

Meeting suspended.

11:03

On resuming—

The Convener: I welcome everyone back for our second panel of witnesses. We have representatives from each of the big six energy companies. I give a quick reminder to anybody who was not here for the first panel: please switch off your mobiles and BlackBerrys so that they do not interfere with the recording equipment.

I invite members to keep their questions as brief as possible so that we can get through as much as possible. All six of the panel members do not have to answer every question unless it is directed to them, but they should feel free to come in as and when they have more to say. In that way, we will get through as much as possible.

As we have six panel members, we will not have opening speeches from them all, but I invite each panel member to introduce themselves and say who they represent. We will then go straight into questions.

Ian Peters (British Gas): Good morning. I am the managing director of energy at British Gas retail.

Paul Williamson (RWE npower): Hello. I am up from RWE npower. I am currently head of customer markets controlling.

Alistair Phillips-Davies (Scottish and Southern Energy): I am the generation and supply director at Scottish and Southern Energy.

Paul Delamare (EDF Energy): Good morning. I am head of regulation for EDF Energy.

Rupert Steele (Scottish Power): I am director of regulation at Scottish Power.

Sara Vaughan (E.ON): Good morning. I am director of regulation and energy policy at E.ON.

The Convener: I thank everybody for coming to the meeting.

I want at least some of the six witnesses to answer my first question, but I invite Rupert Steele to answer it first. When energy prices have risen in the past and the proposed prices have been mentioned, wholesale prices have been put forward as the main underlying reason for the increases. Research that is based on Ofgem figures has been given to the committee. According to the graphs in the document in front of me, the wholesale cost of gas has not changed over the five-year period since March 2006 and it is now slightly lower than it was then, and the wholesale cost of electricity is the same as it was in March 2006. If those graphs are correct and gas and electricity prices have been the same over a five-year period, why have the retail costs risen by so much?

Rupert Steele: Taking a particular point in time is misleading. We can choose different points in time and get different relationships, as wholesale and retail movements take place at different times. There can be a variety of relationships, depending on precisely what points are picked.

The segmental accounts that Scottish Power is filing with the regulator show that, over the past two years, we have made an average of £10 from selling gas and electricity on a typical annual bill of £1,000 for a dual fuel customer.

The Convener: Do you accept that the figures over a five-year period that Ofgem has pushed do not show increases in the wholesale costs of either gas or electricity? Do you dispute those figures?

Rupert Steele: I have not looked at those particular numbers. As I have said, we can get a variety of relationships; it depends on the start and end points that are used. If we add up the costs of the energy that we bought over 2009 and 2010 and compare them with what we sold it for, we will find that we are looking at an overall profit of an average of £10 a year on a £1,000 bill. That is in our segmental statement.

The Convener: Okay. I open up my initial question to the other panel members.

Alistair Phillips-Davies: I hope that members have seen the evidence that we submitted. For those who have the luxury of a colour printer, there is a nice little graph at the back of that evidence, which I printed off at home—fortunately, the kids have a colour printer. That graph goes back to January 2004. You will see in it the prices over the five-year period. I am trying to read it, as I have not seen Ofgem's analysis. The figures do not look wildly dissimilar. It will be noticed that picking the particular period that was picked was slightly selective, as it can be seen from our graph that retail prices at that point in time had nowhere near caught up with the massive increase in wholesale prices. Actually, all the companies probably protected consumers from those significant increases. Members will also see from the graph that there has been a significant increase in wholesale prices, and that increase has been more significant than the increase in retail prices. That is clearly laid out in the evidence that we submitted.

Wholesale price increases are only one of three elements that result in price changes. I think that members will see representatives of Ofgem later. In a report that was published last week, Ofgem said that there had been a 30 per cent increase. There have been significant increases year on year in energy prices because of world events at, for example, Fukushima and in Germany, where significant numbers of nuclear plants are to be closed.

The network costs must be added to those increases. Ofgem regulates the networks, and we just take the costs from the networks. Those costs have increased significantly over the past two or three years and even over the past year, and have fed through into pricing models that people use in looking at what they can do over the balance of this year and going into next year.

The final element is Government schemes. The costs of those schemes have increased significantly, although I think that they have significantly benefited consumers, as there has been much more spend on energy efficiency. I listened to the discussion about fuel poverty with the previous panel.

The companies have spent a great deal of money on energy efficiency. SSE, in particular, has focused its spend in Scotland—50 per cent of our schemes under the CESP arrangement, which Norrie Kerr helps us to look after, are focused on Scotland. During the past two to three years we have seen a 10 to 20 per cent drop in consumption of electricity and gas, which translates into significant savings for consumers, and SSE has probably seen a 20-plus per cent reduction in the cost of energy to consumers.

Paul Delamare: An important point to build on in that regard is the value of the segmental accounts that are provided and the degree of trust that there is in them. The convener's question implied that supply businesses are profiteering or making excess profits. I think that members have seen in their committee papers that EDF Energy's margins in the domestic space are very tight and sometimes negative. Margins are tight in the business market, too.

The transfer pricing that we use in our segmental accounts is based on market prices. We have said to Ofgem, as part of its most recent review, that we are happy to demonstrate each year that that is the case. We are happy to open up our books so that Ofgem or an auditor can see that our transfer prices between our generation business and our supply business are based on market prices, because it is critical that customers, elected members and other stakeholders have faith in the segmental accounts and can see that—certainly in EDF Energy's case—profiteering is simply not happening.

Sara Vaughan: In the material that it put together for the committee prior to the meeting, SPICe included graphs from Ofgem's "Electricity and Gas Supply Market Report" at figure 5. If we look at the line for net margins from August 2004 to August 2011, we can see that margins in dual fuel and gas over the period have predominantly been negative—below the zero line. Those are Ofgem's figures. The net margins in electricity look healthier but they do not get up to a significant amount and they were negative in 2005 and 2006 and they dipped into negativity in 2008 and a bit in 2009. Ofgem's report, which was produced in June, a couple of weeks ago, shows that it is not a question of electricity and energy companies profiteering and then saying that wholesale prices are the reason; Ofgem's figures show that that is absolutely not the case, on an average basis.

My colleagues referred to the segmental accounts, so I should also do so. E.ON operates cross borders—our trading business is in Germany—so we transfer price on an arm's-length basis in accordance with Organisation for Economic Co-operation and Development guidelines on transfer pricing. That means that our figures must satisfy not only the UK tax authorities but the German tax authorities that we are transferring price on an arm's-length basis. Therefore it is not a question of hiding profits in one part of the business that should be reflected somewhere else. We are happy for Ofgem to look at and assess the numbers.

Paul Williamson: If we look at Ofgem's projections in the same graphs, we can see that the net margin for dual fuel is heading towards negative. At current prices there is not profit in energy supply. On the segmental analysis, from the RWE domestic perspective, we have not made any profits during the past couple of years. The segmental reporting will show that.

Ian Peters: Most of my colleagues round the table have made the key points so I will try to take this to a different level. Sam Laidlaw, our chief executive officer, made a speech last week about what he called the honest conversation. In the UK, we are trying to reconcile three major trends. We were self-sufficient in cheap North Sea gas as recently as 2003. We now import 50 per cent of our gas from overseas, which is intrinsically a higher price and more volatile. It could be 75 per cent within a matter of years. That is the first trend.

11:15

Secondly, we are committed to significantly reducing carbon emissions. We have the most aggressive target in the UK—32 per cent by 2030, which implies an investment across the industry of around £200 billion over the next 11 years. That needs to be funded. Ofgem's calculation put the range of increase on a bill from that investment at between 23 and 52 per cent. The third trend is the outcome of that, which is how we keep bills as low as we can during a period of intense pressure on household incomes.

Reconciling those three trends is a really important honest conversation in which we should all participate, whether that is the Government, the regulator, the suppliers or the consumer groups, because those are the fundamental forces at play in our market right now.

Rhoda Grant: I want to ask about companies that generate energy. You said in your previous answers that you pass on the market price of fuel to retailers. However, companies that self-generate are producing that energy more cheaply. As we all know, world prices are based on dollars rather than pounds. We also see that profits for the big six are all going up. If you are generating your own energy and you are doing that more cheaply than at the market value, would it not be possible, in an open market, to pass that on to customers?

Alistair Phillips-Davies: The generation supply profits of our business went down last year on the previous year, so I would dispute the fact that we are making more money in generation supply.

On the issue of liquidity, we tend to sell between three and four times the volume that we produce into the market, therefore we see significant churn in our portfolio. I am not aware that we generate cheaper than the market.

Sara Vaughan: We operate our generation and supply businesses separately. The generation business sells energy to our trading business, which is based in Düsseldorf, and our supply business buys from the trading business. That is done at market price. That was the point I was making about our business being on an arm's-length basis. What the supply business is getting is what the rest of the market is getting. We do not operate according to a self-supply approach.

Ian Peters: We are exactly the same. Our generating business sells at market rates to our retail business. We also trade 75 per cent of our overall capacity into the open market. There is a belief that that generation capacity is held on to internally—that is not true, because 75 per cent of it is open-market traded.

Paul Williamson: The same is true in RWE. For gas, we do not have any assets so we buy all our gas on the market.

Rupert Steele: In our case, the results for the retail and wholesale segment of Scottish Power in the first quarter of 2011 were down 54 per cent in euro terms compared with the same period the previous year. There is clearly a reducing profit trend rather than an increasing one across the business. As far as the trading of our business is concerned, we trade three to four times the amount of electricity that we generate.

Paul Delamare: From EDF Energy's perspective, I echo those comments. As you know, we have a large nuclear fleet, which is particularly suited to producing baseload products—those units are best run on a continuous and consistent level of output. Those products are traded many times in the market. Any supplier, big or small, is welcome to talk to us about procuring energy from that fleet and our other stations.

Rhoda Grant: Would it not be possible to pass on cheaper prices if the retail market was truly competitive? You have access to energy that you generate and, although you operate as different companies, you are the one company—the generating company and the retail company are the same. It seems strange to me that you would sell to competitors at exactly the same price as you would sell to your own company. How do you manage to provide the most competitive prices to your customers and encourage more to sign up? Is that not the aim of a working market?

Sara Vaughan: Our trading business seeks to optimise the position of our retail business by buying as cheaply as it can for the retail business. That leads to what we call a make-buy decision. If the business can buy more cheaply from generation that SSE, for example, has in the market, then that is what will happen—there is no point in buying our own generation if it is more expensive than the generation in the market. If that happens, our generation will not be scheduled to run. Therefore, the market truly operates as a competitive one, with our generating systems having to compete to get on to the market.

Rupert Steele: The generation side of the business is pretty capital intensive. That capital has to be remunerated, so it would be self-defeating to sell from the generation business at prices that do not remunerate the investment. Since the takeover of Scottish Power by Iberdrola in 2007, we have spent £1.5 billion investing in generation in Scotland. That is a huge investment, which clearly brings with it a need to have commensurate returns.

Anne McTaggart (Glasgow) (Lab): I have listened all morning to the different figures and I am now all figured out, so this will be a bland statement. We have now heard from all of you, but we spoke to earlier witnesses about the fact that 40 per cent of our households are still in fuel poverty. I know that when I go back to my constituency tonight people will ask, "What happened at the meeting, Anne?" The citizens advice bureau is rattling my telephone to say that there is such a problem. Forty per cent of households in fuel poverty is huge. How much importance do you place on the issue?

Ian Peters: We place enormous importance on it. We spend more on addressing fuel poverty relative to our market share than any other supplier. You say that you are bored with figures, but I will give you a few more. A voluntary agreement is in existence. Collectively, British Gas has spent £227 million on fuel poverty in the past three years—£100 million more than we were obliged to spend. A third of our entire CESP spend is going to Scotland, and about 10 per cent of our CERT spend on improving housing stock is going to Scotland—and I say up front that we would be delighted to spend more of that in Scotland. We are happy to work with anybody up here to drive all of that.

A point was made earlier about the effectiveness of that assistance. We can show that, where we help to improve the housing stock, we can mitigate the effect of bills. Our unit price is going up, and we have seen overall consumption fall by about 25 per cent over the past four years where we have helped with cavity insulation, roof insulation, upgrading boilers and so on. We take all of that work seriously. We are spending more than £1 billion over three years on fuel poverty. We have the biggest social tariff in the country—we have about 340,000 customers on it. It is a direct tariff relief that was about £140 last year, plus £50 excess credit that we gave in the winter. We are heavily committed to the work, and we can do more.

I listened to the end of the previous evidence session, and I think that there is an opportunity for Government and industry to work in a much more targeted way if we can open up the Department for Work and Pensions data-sharing agreement. We started that last year in fairly narrow terms in order to put credits on pension credit beneficiaries. The way in which the legislation is enabled currently prevents us from targeting energy efficiency measures on those beneficiaries' households. We argue strongly that, considering pound-for-pound spend, we could be much more effective at addressing the root causes of fuel poverty if we could properly target people, using DWP data.

Sara Vaughan: I absolutely agree with that. Fuel poverty is a huge problem for all of us and we take it very seriously. It is important that tackling it is fair not only to those who need that but to those who fund doing it, because it is funded across the rest of the energy consumers. The best way of ensuring that it is fair across all consumers is to ensure that it is properly targeted at the consumers who need it most. Energy companies cannot do that on their own. We do our best and we will work with people to try to identify the customers who are in fuel poverty. For example, in relation to the CERT super-priority group, we offered a £100 discount on their energy bill for people who were prepared to fill in a questionnaire about their homes and give that information to us so that we could identify whether their homes were suitable for energy efficiency measures.

Apart from targeting, the other point that I want to stress is that energy efficiency is, without doubt, the most sustainable way of taking people out of fuel poverty. When we were in the committee ante-room, we listened to the previous evidence session. I think that it was Norman Kerr who talked about the amount of money that could be saved each year by insulating a house, saying that around £260 could be saved through cavity wall and loft insulation. Whether it is £260 or £360, it is a lot more each year than comes just from putting money into off-the-bill savings. For example, the warm home discount gives about £120 or £130 off bills. That does not give the same bang for your buck as putting energy efficiency measures into homes. We stress that the focus should be on that rather than purely on discounts on bills.

Alistair Phillips-Davies: I have a few figures for the committee. We spent £27 million last year on fuel poverty and will spend £45 million this year. The CERT and CESP schemes that we put in place are worth between £100 million and £150 million per annum. Overall, 50 per cent of our schemes on CESP are in Scotland, even though probably fewer than 20 per cent of our customers are in Scotland. We are therefore very focused on Scotland. We would like to do more CERT schemes in Scotland, but that is more difficult because of the issues around solid walls. We spend more money to provide insulation in the Highlands and Islands than in England and Wales, because we acknowledge our responsibility to Scotland.

On transition arrangements, Norman Kerr mentioned that we had the best or deepest social tariff of any of the major suppliers. However, that is now disappearing and some of the people who will fall off that do not qualify for the new arrangements. However, we will put special arrangements in place in order still to provide them with funding, which will be out of our own pocket.

Comments were made earlier about putting together a route map or some detailed information for Scotland and having an agency that can bring together data in three key areas. The people who would understand how much income individuals had and what the housing stock is like are the local authorities and the energy companies. We could therefore focus our money on those in fuel poverty.

We need an agency that co-ordinates and takes the best bits of innovation from the various activities that are going on, brings together in one place comments from the people around this table, the citizens advice bureaux that are ringing up Ms McTaggart and so on and focuses the funds that we have to offer to ensure that we deliver something for Scotland.

11:30

Paul Williamson: Npower is spending about £100 million a year on vulnerable customer initiatives covering CERT, CESP and various other schemes. I should perhaps highlight a few other figures. As far as insulation and energy efficiency are concerned, we are insulating about 1,000 homes a day, which is a mammoth task; and we have also introduced a number of schemes, including our health through warmth scheme, which is targeted at people whose health is affected by cold conditions. Through that scheme, we are working in partnerships in 15 areas to try to help customers who are feeling a real impact.

Anne McTaggart: Having heard more figures, I am even more confused. People are spouting that so many millions of pounds have been set aside for fuel poverty initiatives, but the fact is that 40 per cent of our people are still in fuel poverty. Is that because the however many millions that you are spending are simply not enough or because the evaluations and so on are not being carried out properly?

Alistair Phillips-Davies: We have said that such initiatives could be better targeted. Those of us at the table might not agree on many things, but I think that we would agree that it would be sensible to have that kind of targeting; to establish a central agency to help to deliver such initiatives; and to update the map that Norrie Kerr referred to, formulate a central plan and go to all the companies and say, "This is the sort of money that we need and this is the money the Government is offering. How can we put those two things together and deal with the issue most effectively?"

Sara Vaughan: Unfortunately, all that takes time. We are carrying out a CESP scheme in Falkirk and discussing other such schemes for north Glasgow and west Dunbartonshire. However, as I have said, it takes time to have those discussions with local authorities, work through the details and get it all through Ofgem, and I am afraid that we are going to have to go through a process to get to where we want to be.

Ian Peters: There are other radical options; indeed, the one that I am about to suggest is probably the most politically sensitive. The last research that I saw on winter fuel payments suggested that only 18 per cent of them went to the fuel poor, which means that, at a major level, the option exists to redistribute those payments and target them much more at eradicating fuel poverty. Of course that is a political decision, but the proposal should be put on the table as part of the bigger debate.

Paul Delamare: I will not bore the committee with the list of firsts that EDF Energy has had in this area but I note that in London, where many of our customers live, we work actively with the local authorities to help vulnerable consumers find out whether they are getting full access to the benefits to which they are entitled. I have to say that when we were able to listen to the previous evidence session—the sound was not available at the start of the meeting—I did not hear a lot about that. We have heard a lot about insulation and the various CERT and CESP schemes, but I stress that our work in London has been very valuable in helping vulnerable customers to get access to the money that they are entitled to. I will be happy to talk to members about that offline.

Ian Peters: Likewise, we have a scheme that last year helped 300,000 people ensure that they got the benefits to which they were entitled. Paul Delamare is right; there are other ways into this that address the income as well as the expenditure side of things.

Sara Vaughan: As we have started on this issue, I beg the committee's indulgence for a little bit longer. The work that we have carried out suggests that somewhere between 65 per cent and 80 per cent of people have not been claiming the benefits to which they are entitled. Indeed, we found that, in 2009, unclaimed benefit amounted to £2,000 for each home. In a particular project in which we have been working with people on insulation, we found that we could get those spending less than 13.5 per cent of their income on fuel—that is the only figure that I will use—out of fuel poverty through energy efficiency measures and so on. Above that, however, the gap was just too great, and income measures were required. That is where the benefits system and the Government can play a real role.

Rupert Steele: We have been doing work in that area, through the ScottishPower Energy People Trust. The typical experience has been that, for every pound that is spent on the programmes, we recover something like £20 in unclaimed benefits on behalf of consumers. Billions of pounds of people's entitlements are not being claimed, because people do not understand the rules. We are doing what we can to help people get what they are entitled to, which is another way of addressing what is a very serious problem.

Angus MacDonald (Falkirk East) (SNP): As the constituency member for Falkirk East, I am pleased to hear that CESP is up and running in Falkirk. I am also encouraged by the acknowledgement that there is a serious issue with fuel poverty.

The energy efficiency aspect, which has been pushed today, does not address the problem that we currently face. It addresses the problem in the long term but, as we have learned, 20 per cent of people have still been on prepayment meters; 60 per cent had a household income of less than £17,500; more than half received some kind of means-tested benefit or disability benefit; and, in more than half of cases, the chief income provider did not have a job. In addition, more than one third of the homes concerned were home to someone with a long-term physical or mental health condition or a disability. The energy efficiency measures are all well and good, but they do not address the serious problems that those people have right now.

To pick up on Anne McTaggart's points, we were informed today that dual fuel customers with prepayment meters pay an additional £83 per year relative to those who pay by direct debit. We have also heard that the margins are tight; we even hear that they are negative at times. We fully take that on board. However, I am still concerned that not enough is being done to ensure that prepayment customers in particular have access to lower tariffs, especially those who are classed as being in fuel poverty or severe fuel poverty. I do not think that social tariffs are enough. Given the recent announcement by Scottish Power, can Rupert Steele justify such a disparity?

In addition, I have a letter from a constituent dated 22 June, in which he highlights what he calls the "outrageous increase" in the standing charges, from 18.72p to 27.01p. I am curious about how that can be justified given that service charges are presumably not based on wholesale fuel prices—although I might be wrong about that. I would like to hear about that, in particular from Rupert Steele.

We acknowledge that efforts have been made. We heard from Energy Action Scotland that Scottish Power has invested £8 million in a trust to help deal with fuel poverty. We have heard that

SSE has the lowest social tariff in Scotland. However, there is still much to be done.

I am sure that everybody has taken on board the fact that power companies should liaise a lot more with Government ministers. If we can all get our heads together and work on the situation together, I am sure that we can come to some sort of solution. Specifically, I am keen to hear what Rupert Steele has to say on the points that I have raised, particularly on the increase in standing charges.

Rupert Steele: We recognise that these are tough times for our customers and that is why we held off for as long as we could before making our pricing announcement.

Prepayment meters cost us significantly more to operate than payment through direct debit because the meters are more expensive; because there is greater customer contact—customers ring up our call centre and we have to have someone sitting there waiting to receive those calls; and because of the fees that are paid to newsagents and others who operate the machines for charging the tokens and the cards. All those costs that are present for prepayment customers are costs that we do not have to bear for customers who pay by direct debit, who, in general, never ring us up. As a result, on a like-for-like basis, the profitability of prepayment customers is lower than the profitability of direct debit customers. We go as far as we can to mitigate the higher costs of the prepayment method.

As far as the increase in our standing charge is concerned, historically, Scottish Power has had one of the lowest standing charges in the industry—we had not increased it since 2006. When we looked at the price increase that we are having to make, we looked again at the standing charge and discovered that it was too low in comparison with our costs. The result of that was that people with higher fuel bills were, in effect, subsidising people with lower bills. Although that may sound okay, it must be recognised that some of the people who have high fuel bills are people such as pensioners, who are in more of the day and who need more warmth, or people who have electric heating. We were concerned that if we did not bring our tariffs more closely into line with our costs, those people would lose out. I make it clear that the average percentages that we quoted when we announced our price increase included the effect of the changes that we made to the standing charge.

Angus MacDonald: I am not quite sure about the logic of that, but I guess that my points have been taken on board.

Chic Brodie: Good morning.

I return to the issue of competition. We heard earlier that there is stagnation in the marketplace as a result of people's lack of willingness to switch supplier. The Scottish market has three main participants, which, in aggregate, supply 86 per cent of the Scottish market. Just as there is stagnation and a lack of market pull, equally, there is—as far as I can see—no market push.

Leaving that aside, I want to address the fact that, in my experience, when one power company issues new prices, that is followed fairly closely by the remainder of the companies issuing their new prices. I am sure that it is a coincidence that all your companies buy ahead at the same time. From a competitive point of view, I would have thought that there would be better competition in the marketplace if you bought ahead at different times but, as I said, I am sure that it is a coincidence that you issue price increases almost at the same time.

Returning to the pricing issue, of course raw material costs are a significant element. I am sure that considerations such as the forward price of the dollar against sterling are all taken into consideration, but when it comes to Sara Vaughan's point about dual fuel charges, I see that, over the past seven years, wholesale prices have risen by £230 million, customer bills have gone up by £600 million and other costs have risen by £500 million. In the context of other costs, I make no apology for looking specifically at the very significant salaries of the highest-paid directors of the three major providers to the Scottish marketplace. In one case, the total remuneration went up from £429,000 in 2008 to £802,000 in 2009. In another case, there was a 70 per cent increase in the share allocation—and so it goes on. I just wonder how much attention is being paid to the other costs and what you intend to do or can do about introducing a real element of competition into the marketplace, because it seems to me that, at the end of the day, the consumer is paying the bill.

11:45

Paul Delamare: I am not going to comment on the competition issue, because it is not true that the six suppliers who are represented here all put up their prices roughly at the same time last winter. EDF Energy was the only supplier to have a winter price freeze guarantee, and we held off passing on a higher cost to our customers until March this year, so our customers had that protection through what was one of the coldest winters that we can remember.

You might not be aware of that, because there need to be more EDF Energy customers in Scotland—we would love there to be more. If there were, more people in Scotland would have benefited from our independence of strategy.

Chic Brodie: I accept that point. I should have made it clear that I was focusing on the three main providers in the Scottish marketplace, whose earnings before interest and tax in the last recorded year were £1 billion. My view, rightly or wrongly, is that there is insufficient competition. I do not believe that there is competitive procurement, because there is no real market pull and, as a consequence, there is no market push. Given the salaries that are being paid and the share increases at the higher levels of those companies, I question whether there is the motivation to achieve the social responsibility goals that Rupert Steele clearly enunciated earlier.

Alistair Phillips-Davies: On competition in general, we believe that there are different actions on the part of the companies. We are all very different. We offer different levels of service. We offer different prices over a long period of time. SSE is proud of the fact that we have offered the best prices and service levels over the past six or seven years, and we try to significantly differentiate ourselves from the other companies.

With regard to competition in the market, Ofgem quoted numbers of 15 per cent and 17 per cent switching last year. Over the past five years, across Britain—there are fewer statistics purely on Scotland—the market has seen greater switching levels than any other market in Europe. The only other markets that are potentially comparable are in a couple of states in Australia. With regard to other sectors, such as mortgages, home insurance, car insurance and phones, only one sector—car insurance, I believe—shows switching levels at the same sort of level as we have seen in this market over the past five years.

On competitiveness, one issue is that a number of competitors in this market have gone bust, as margins are generally low. Ofgem said in its report—and it is generally accepted—that over the past six or seven years, margins have been low or, potentially, negative. We recently welcomed the Co-op into the market. It is interesting to note that its prices are not terribly different from those of many of us. Part of that is because the portion of the total cost that we can use to differentiate our prices is relatively small. What we are doing is passing on the costs from international coal producers, international gas producers and producers in other fields. Some 50 per cent to 60 per cent of the costs over the past three years have come from fuel and between 20 and 25 per cent of the costs have come from networks, which is a regulated cost that comes from Ofgem. That means that there is only a small proportion of the overall bill in relation to which we can try to differentiate ourselves by being cost efficient and so on.

On salaries, I will quickly just say that at SSE we have an independent committee of people who set salaries. The non-executive directors sit on the committee and there is complete transparency. I think that the chairman of our remuneration committee won an award last year for the quality of the remuneration report. As far as we are concerned, we have independence on setting salaries, complete transparency and clear accountability. The information is out there so that everyone can see exactly what we are doing.

Chic Brodie: I accept that and I thank you for your answer. On costs, though, I do not know what productivity targets you have, but at the end of the day it seems inordinate that the raw material costs have gone up by £230 million during the past seven years but the other costs, which I assume include—

Alistair Phillips-Davies: A significant proportion of the other costs will be network costs. In our submission we included a little breakdown of costs in 2008 and 2011. As well as network costs, there are the costs of all the Government schemes, some of which are renewables schemes, which promote renewable energy, such as the offshore and onshore wind farms that we are building in Scotland, and some of which are the energy efficiency schemes. When I became a director of the company we were spending £3 million to £5 million a year on energy efficiency schemes; we now spend closer to £150 million a year on energy efficiency schemes—and that is the figure for a single company. Over the period that you are looking at, I would be surprised if the other costs, in terms of what SSE puts into the market, have gone up considerably, because we pride ourselves on our cost to serve.

Given the level of churn in the market, sales and marketing in relation to switching and getting customers onto new tariffs create a lot of costs for us. We are probably talking about £80 million to £100 million a year on sales and marketing efforts, in order to do not much better than stand still during the past year or two, given the small gains in customers. All that switching, which Ofgem wants and people want, costs an awful lot of money, although I do not think that it will have added to the cost base anywhere near as much as the networks, the renewables and the energy efficiency measures have done. As I said, energy efficiency measures have brought significant benefits to consumers. We have seen significant drops in consumers' usage, particularly in Scotland, where insulation really does help.

John Wilson: Someone mentioned the issue to do with whether the company buys its energy in dollars or euros. I think that Mr Steele said that the exchange is in euros. Ms Vaughan said that prices for producers are fixed in Germany. Are they fixed in euros? I seek clarification on how the international money market affects energy prices in the UK, particularly for companies that are owned and controlled by companies on the continent.

Sara Vaughan: To the extent that we are buying on UK markets it will be in sterling. It depends on the market on which one is buying.

Rupert Steele: There is interaction between UK gas markets and European gas markets and between UK gas markets and global gas markets through liquefied natural gas. There is a balance of supply and demand for gas in Britain. That will be dealt with partly through gas from the North Sea fields, which accounts for perhaps half the volume. There will be imports of liquefied natural gas, which might be dollar denominated. There will be trade with the continent, which will be euro denominated. The market will have to find a balance that takes account of the currency and underlying price factors. Businesses take such issues into account as they buy the gas to sell to customers directly or to direct to power stations to generate electricity.

John Wilson: Thank you for the explanation. My question might have sounded slightly odd, but it is important to understand European and world markets in the context of energy costs and how they are reflected in what consumers pay.

Mr Steele, you said that your company makes only £10 for every £1,000 of consumer spending on energy. On my calculation, that is a 1 per cent profit on that £1,000.

The committee is looking at energy costs. We hear Scottish Power's announcement that it is going to put up energy costs by X amount. The consumer—the ordinary consumer, who is sitting in their house and who has to pay that bill—looks at the profits of some of the companies that are increasing their prices. You may want to correct this, but the figure we have in front of us for 2010 is a £1,240 million profit at Scottish and Southern Energy, and Centrica had profits last year of £3,074 million. The figures over a five-year period show that we have actually seen increases in profits.

A rough calculation based on the figures in front of us is that Centrica's profits increased by around 50 per cent and Scottish and Southern Energy's profits increased by between 60 and 70 per cent. As politicians, we have to explain to consumers—particularly those who live in fuel poverty—who see such profit margins why companies are allowed to get away with putting prices up. There is also an onus on the companies to explain why prices are going up and what the match is between rising prices and their profits. My difficulty—and, I think, that of many consumers—is that if you are not profiteering at the expense of the consumer, who are you making profits from? That issue was referred to by a number of panel members earlier.

Ian Peters: That is a good question. There are four aspects to the answer. First, the profit figures that you quoted are for the group as a whole, within which we have a portfolio of businesses in North America and some in Trinidad; we also have storage businesses. We run all those components to optimise their profitability. The British Gas residential figure, which is the one that grabs all the headlines, was much smaller than your figure: it was £742 million. Portfolio is one aspect of it. I will come back to communications in a minute.

The second aspect goes back to the point about our commitment to invest to deliver the reduction in carbon emissions. Centrica has been investing £1.60 for every pound of profit that it has made, year on year, for the past five years. We have a commitment to invest a further £15 billion over the next 10 years. That is all to do with building new nuclear fleets and wind farms, investing in new gas production and so on. The investment side of the profit equation is really important.

The third aspect is margins, which we have talked about already. Over the period, margins in the retail business were extremely thin. They go up and down. Last year was an exceptional year because of the weather, but we announced yesterday that, year on year, our margins have fallen by 50 per cent. There are a number of factors at play.

You have a key point in relation to communication. As an industry—I do not exempt my company from this—we have not done as good a job as we could and should have done on explaining to our consumers and the country as a whole the fundamental shifts that are going on in energy supply. I come back to my statement about the big conversation. Given the way in which the process is accelerating, over the next 12 months the Government, consumer bodies and suppliers will all need to get together to try to work on better communication of what is going on.

Paul Williamson: On communication, I think I am right in saying that the price of energy in the UK is one of the lowest in the European Union; we are certainly the lowest on gas, and we are pretty low down on electricity. That is a key point that we should not forget about. We are a lot cheaper than other parts of the EU.

Sara Vaughan: I agree with Ofgem, if that is not unacceptable. Ofgem recently said that energy suppliers need to transform the way in which they deal with consumers.

I have read the paper from *Which?* that committee members received before the meeting. In that paper, *Which?* made four points along similar lines—about our needing to change the way in which we communicate, to explain more, and to be more prepared to be open and transparent.

12:00

My point is a bit like the one Ian Peters made about British Gas: E.ON realised about a year or 18 months ago that we were not doing as well as we should have been doing, and that we were communicating through press releases in a very corporate way, which was not the right way to try to explain things to consumers. Although I accept that we were perhaps not the best-qualified people to decide how consumers should be dealt with, we sat down and considered the best way of dealing with them. Over the past year, we piloted town hall meetings and talked to people in school gymnasiums and village halls in our core area about their worries, about rising prices, about energy and about insulation. We covered a range of topics, and we were stunned by the amount of interest.

We have also been blogging. We have a talking energy site, which invites people to talk to us, ask questions and share their issues. We also have E.ON people who take part in the conversations that go on at moneysavingexpert.com and moneysupermarket.com. They identify themselves as being from E.ON, and they are not there to sell, but when consumers have a question, they answer the question and say, “I am from E.ON, and this is how our company can help you.”

We are not there yet. I am not at all complacent about this. However, we are trying to change the way in which we deal with consumers. I hope that we are moving towards having more openness and transparency.

Ian Peters: Mr Brodie is keen on competition, so this will sound like one-upmanship. We have gone further than that: we now have a permanent customer board, on which I sit. We have invited that group of 12—it was a group of 40 previously—into every aspect of our business. They have gone to the trading desks and the power stations, and they have sat in on my operations. We test everything with them—every aspect of pricing and communication. The top two things on their agenda will come as no surprise to anybody—simplification of tariffs, and simplification of bills. We will probably discuss tariffs in a minute in the context of Ofgem—we might agree with the spirit of proposals, but we might disagree on their degree.

On the layout of bills, it is a fact that 66 per cent of the content of a bill is dictated to us by the regulator, and we can debate whether we need all that. However, we are testing two different forms of bill design. One is, in effect, a signpost to our cheapest tariff; the other is a signpost to either a website or a phone number, so that people can discuss the best tariff for them. Interestingly, the feedback from tests is that people are in favour of the latter: customers want choice—they do not want to be told. They prefer the dialogue signpost to the cheapest tariff signpost. That is a tangible example of what is coming out of the customer board.

Alistair Phillips-Davies: In the period that has been discussed, the supply business made less than 20 per cent of the overall profit figure that was mentioned. Like others, we have significant other businesses—for example, network businesses, gas pipe businesses and a contracting business that has to find work for 3,000 electricians up and down the country every day of the week. We also have some businesses in Ireland, and recently we bought some offshore exploration and production businesses.

The critical thing about many of those businesses, however, is that they are very capital intensive; indeed, I suspect that the replacement costs of our hydro assets in Scotland alone are probably between £2.5 billion and £3 billion. Over the period to 2015, we will be spending something like £3.5 billion in Scotland’s renewables sector, and we are very proud that in recent years we have become the second largest company in Scotland. We bring a lot of investment and jobs to Scotland. For example, we were delighted to buy the Cumbernauld call centre and save hundreds of jobs that would otherwise have gone.

One of the foundations of our success is that we can offer investors and the people who provide us with capital a reasonable return on their money. All the profits that you have seen come from investments in assets, and you might find that if we were unable to make those profits we would get bought by a Spanish, German or French company and would no longer be a very successful Scottish company that is very committed to Scotland.

Rupert Steele: Scottish Power is also a very successful Scottish company that is fully committed to Scotland. Among the things that have happened here is the opening of Iberdrola’s global centre for offshore wind, which is based in Glasgow.

As far as the numbers are concerned, in 2010, Scottish Power’s profit at the EBIT—or earnings before interest and taxes—level was £679 million, which was down 15 per cent on the previous year. Eighty per cent of that came from the regulated network business, where the returns are essentially set by Ofgem according to very elaborate formulae. That reflects the huge amount of investment that we are putting into the network business.

As for the rest of those profits, the margins on generation and retail were really quite thin. On the retail side, the segmental statement suggests a £81 million profit, most of which was made from non-domestic consumers. The domestic side was very thin indeed, with £10 profit from retailing electricity and gas on a £1,000 bill.

John Wilson: I should perhaps say that, before I asked my questions, I—like other members—should have declared that I get my power from one of the companies represented at the table. However, I will not say which one.

I hope that the panel understands the frustration that is felt, particularly in Scotland. A couple of witnesses have already referred to last December's cold weather, which affected Scotland more than other areas. As you will have heard, we have targets for tackling fuel poverty, and we recognise and welcome the kind of investment that energy companies are putting into ensuring that homes are energy efficient. However, despite all that investment and despite all the good work on benefit take-up campaigns and so on, the figures show that the number of people in fuel poverty in Scotland is increasing year on year. How do we all—the Parliament, the Scottish and UK Governments and the energy companies—tackle that problem, particularly in the current economic climate, when many families face extreme hardship with their salaries being frozen or cut and energy costs are going up? One energy company has put its neck on the line and increased its energy prices but, in light of Centrica's announcement to the stock exchange yesterday, we expect the others to follow suit. How do we eradicate fuel poverty in Scotland when, despite the good work that is being done on making homes more energy efficient, energy costs continue to go up?

The Convener: Just before we come to the answers, let me reiterate that we do not need six answers to each question. I am keen to move on to questions from Patrick Harvie and one or two other topics. If one or two people deal with John's question, we can then move on.

Rupert Steele: It is helpful to start with what we can do to limit the costs. A lot of the cost comes simply from international energy markets and the factors that drive them, and there is a limited amount that we can do about them. However, there are other factors that are within the control of Government, either here or in Westminster. For example, the carbon price floor will force up the cost of wholesale electricity. The Government did not necessarily have to do that or do it to that extent. There are energy policy reasons why it wanted to, but the policy has a cost.

Other programmes and targets are more expensive than their alternatives. One thing that we emphasise strongly is the importance of onshore wind as a delivery tool towards meeting the renewables target. It is half the cost of offshore for consumers, so where we can we should maximise onshore. We now have 1,000MW of onshore wind in Scottish Power's portfolio. That is another area in which we can try to get costs out of the system at source and do everything that we can to be as efficient as possible.

Ian Peters: I will make two quick points. The carbon price floor is an excellent example of the debate that I was trying to frame earlier. It is one of the costs of taking carbon emissions out of the UK. There is a longer debate about whether it is the best mechanism. We think that it is, and it is consistent with the policy, but clearly there is a debate to be had overall.

I listened to the end of the earlier panel's evidence. The fuel poverty question requires concerted action as no one party can fix the problem on its own. In England and Wales, a review has been kicked off under Professor John Hills; I do not think that there is an equivalent in Scotland. Whether or not that is the right mechanism, the issue will require everyone to sit around the table, pool all their ideas and work together.

The Convener: Let us move on to a slightly different topic with Patrick Harvie.

Patrick Harvie: It is hard to know where to start. We have heard continual explanations that the wholesale prices both are and are not the source of the problem. We have heard a defence of high remuneration at the top end that I would expect to hear from the Royal Bank of Scotland but which I had not expected to hear at this meeting. We have heard one implication that the people who should be happiest about a whopping increase in the standing charge are pensioners. I suspect that, if any one of us replied to a constituent on that basis, we would not be doing ourselves any favours at all.

We can all acknowledge the anger that exists about what is happening to energy prices. I want to ask about what is in store for people in the future. The Scottish Government has a commitment, supported I think by the Parliament, to a dramatic expansion in renewables. That brings us back to the question that Rhoda Grant asked about what we can expect when we generate more of our own energy ourselves. We can all acknowledge the huge scale of investment required both in demand reduction to eliminate fuel poverty and in engineering a low-carbon energy system. A lot of that investment is your business, because it is about buying assets that will carry on generating energy that you can sell so that you can carry on being energy companies. However, if there is a contribution to be made by the taxpayer and the bill payer, people have a reasonable expectation that you will—increasingly, as we have a progressively bigger generating capacity for electricity than we need and we export energy—protect them from rising wholesale prices and that prices will not keep coming back to bite them in the future.

12:15

Are you not worried that if you cannot protect bill payers from future increases, there will be an increasing desire on the part of the public, on whose authority the land that you need to generate energy is regulated, to say "Why are we letting the private sector get all the goodies here? Let's keep a share of this renewables revolution for the public sector"? Are you not worried that if the private sector cannot deliver protection from wholesale price rises in the future, you will be cutting off your nose to spite your face?

Paul Delamare: I will start the conversation. It is very important that we break the link with international oil and gas prices—you have heard from colleagues that that is a big driver in what we are seeing—and renewable, low-carbon energy helps us do that. Wind energy is a big part of it, but we also need base-load energy. That is one reason why EDF Energy is so focused on nuclear investment in Great Britain.

Alistair Phillips-Davies: I will have another go; I do not want to say too much, but I have a couple of points to make on this issue. First, there seems to be a clear will to have a market-driven solution to driving forward the revolution in the energy industry in this country and therefore to bring in private finance. In order to attract the sums of money that are talked about, whether that is £100 million or £200 billion over a relatively short period, there will have to be reasonable rewards, particularly in areas where some of the technologies are relatively risky.

We have a number of programmes or trials in the north of Scotland involving wave and tidal energy, but they are not proven yet and because they are expensive to run they require a reasonable level of remuneration. As you will probably be aware, the wind farms that we build up and down the country get a form of subsidy, because they are not currently economic—that would be clear if they were run on a level playing field against either a coal plant or a gas plant, particularly given the carbon price at the moment. In order to attract the investment that we need to get the £200 billion spend, we need the renewables order—or whatever comes out of the new electricity market review to replace it.

Colleagues around the table have discussed our trying to make people aware of the impact that that significant investment will have on the country. We are really investing in the future, because we are better off and will probably generate energy at the cheapest price just by building gas-fired power stations and buying gas off the Russians, the Norwegians and the Qataris. However, in 10 or 15 years' time, the UK continental shelf will be much more heavily depleted than it is today and there will be significant strain on world resources of fossil fuels, for which we will have to compete in the global market. If we have not made homes more energy efficient and invested in some of the renewables by then, the feeling is that we will pay a significant price. Government policy is trying to level that out, and we obviously respond to Government policy. That is my précis of the current situation.

Patrick Harvie: I am certainly not about to advocate that you should take a short-term, fossil fuel-based approach and just stick with gas—absolutely not. That would leave us entirely dependent on global prices. My point is that if you guys commit your money, and the public commit their money, to investing in the low-carbon renewable energy sources of the future, is there not a reasonable expectation that that will come with some protection against future price increases in the wholesale market, and that, as the proportion of renewables increases in Scotland, we will not hear energy companies still saying year after year "Well, wholesale prices are going up, so your bills are going up"?

Alistair Phillips-Davies: I suppose that we can point to the level of margin that we make in that respect. On the retail side, we are not making particularly high margins. A number of us have said that our businesses are under pressure.

Someone said earlier that there is a perception that people make more money on the generation and retail side of the businesses. I think I heard from Ian Peters that his business has not done so well in the first six months of this year, and I believe that Rupert Steele said something similar. Certainly, in the last full year, our total generation supply business—that is how we manage it—did not do as well as in the previous year. There are two different things there.

The benefits will be seen more in later years, at the end of this decade. I know that that will be of little comfort to the constituents whom Anne McTaggart mentioned, who want real benefits today because they are struggling today. However, we have to face the issue if we want to invest in the future. That is what we are doing today. We are building very long-term investments up and down the country and off its shore. I suspect that the payback from them will come over a longer period.

That is clearly unfortunate given the current austerity measures and other price rises to which we are all subject. An example is the cost of petrol and wheat. A loaf of bread that used to cost 90p or £1 is probably £1.10 or £1.20 now. Your bacon buttie will cost more, and it certainly costs more to fill up your car. When my daughter asks me to stick more petrol in the car that she is learning to drive in, I have to reach deeper into my wallet than I used to.

Patrick Harvie: I accept and understand that the payback on some of those investments is long term. However, if people are being asked to make a contribution, they will be more likely to support that investment if they know that some of the long-term benefit will come back to them at the end of the day, rather than just going to the energy companies. People do not have a sense that they have any kind of shared ownership or a guarantee about protection from future price rises in that long term.

Alistair Phillips-Davies: We have always tried to keep our prices down as much as possible. We stand on our record on pricing. We are still trying to hang on in the current environment. We have not announced any increases and we have made no decision to increase prices, although there are significant pressures. We will hold on for as long as we can. We absolutely put the consumer at the forefront of our considerations. Nobody likes saying to people, “I’d like more money off you.” My name will be on the bottom of the press release and I am the one who will be public enemy number 1 whenever that day comes. The 20,000 people in the company work hard to try to ensure that we deliver for customers—we are very focused on that. I can assure members that customers will be at the top of our mind whenever we come to a board decision in future that we have to put up prices.

Mike MacKenzie: I have a quick question for Rupert Steele. We are under no illusions about why we are here this morning—the reason is the significant price rises that his company recently announced. It has boldly gone where no other company has yet dared to go.

When I read about those significant increases, I immediately wondered whether the company was in trouble or was having difficulties. However, when we look at its profitability, which we heard about earlier, we find that your company is not in trouble. In many ways, you seem to be doing rather better than some of your competitors, so I began to think that taking such a radical step would surely be a huge risk in an efficient or competitive market. We have heard that other prices are increasing, but your increases are way beyond average inflation. If the market were truly competitive and efficient, your retail customers would leave in droves and immediately sign up with one of your competitors. Obviously, you feel that that is not going to happen. I wonder why that is.

Rupert Steele: I certainly would not characterise our position as being “in trouble”, but in the first quarter of 2011 Scottish Power as a whole’s EBIT figure was substantially down on the previous year’s. For the wholesale and retail business, the figure was down 54 per cent, so we are facing headwinds.

As I said earlier, across the supply business—the actual selling of electricity and gas to consumers—we have made around £10 a year on a £1,000 bill over the past two years, in 2009 and 2010. However, wholesale prices have increased significantly since then, especially from March, with the Arab spring and instability in those markets. There was recovery in China and the Fukushima accident, with the consequential increases in gas demand in Japan and Germany. We therefore faced a situation in which our retail business was essentially making nothing, or nothing much, from domestic consumers and there was then a huge increase in costs, so it was inevitable that we would need to act.

We think that our consumers are sensible and will understand that worldwide factors have affected the wholesale markets. They may have read comments that some of our competitors have made about their pricing being under pressure. Most of our customers are probably waiting to see what happens before they make switching decisions, and we think that that is a sensible reaction, in the circumstances.

Mike MacKenzie: I think that we all understand that there are significant underlying reasons why wholesale energy market prices are rising and are likely to continue to rise into the future, but we must have an innovative and efficient market in energy provision so that the consumer gets the best possible deal. That is a real concern. Because you are able to announce such significant price rises in such a short timescale, you might see real concern that providers in Scotland are not operating in the most efficient way, in order to minimise the effects of wholesale price increases and to deliver best value, given all the other circumstances.

Rupert Steele: We know that times are tough for our consumers. That is why we held off announcing a price increase for as long as possible. Wholesale prices rose sharply in March. We buy some of our energy well ahead of time, but we buy some of it closer to time, so we have been absorbing and will absorb the impact of the substantial price rises in the wholesale markets—30 per cent in some cases—from March through to August, when our price changes become effective. We have therefore taken quite a lot of pain, and we will continue to do so through to August, when our prices will be adjusted.

Paul Delamare: It might help the committee to know that, after our winter price-freeze guarantee, which I mentioned at the start, the number of customers who came to EDF Energy increased significantly. Therefore, there are customers who react, and we are keen for more to react. We will probably not have time to discuss many of Ofgem’s reforms, but we support the direction in which it is going. There are many issues about the particular reforms that are being promoted, but we would like to see more customers being engaged.

Ian Peters: It is clear that there is never a good time to put up prices, and we work in a very competitive industry. In the last three months of 2010, 750,000 accounts a month switched between suppliers. That is indicative of the level of competition in the market. We have different approaches to parts of the market, as was discussed earlier. In particular, we have different approaches to how we hedge—Mr Brodie made that point. You will therefore see differences in responses; that is also indicative of a competitive market. Our shareholders want us to grow, but it is not just about profits in the short term. An organisation can truly grow in the long term only if its customer base is growing.

We therefore work as hard as we can to offer the best value prices. We have been the cheapest electricity supplier for most of the past two years and our customer base has grown by about 350,000 over that period, but it is not all about price: it is not a mechanistic market. Service is also a factor and different suppliers will take different approaches to the service and price mix. It is not all just about the one figure, but it is a very competitive market and whenever we think about pricing, we think about what impact it will have on customer growth and satisfaction.

12:30

The Convener: We are tight for time, but Stuart McMillan has not yet had the opportunity to ask a question.

Stuart McMillan: I am not sure whether you heard my questions to the previous panel about tariffs. Do you think that having 400 tariffs is excessive in the current marketplace?

Ian Peters: I tried to find out what the 400 tariffs are. British Gas has narrowed our range of tariffs over the past 12 months and we are down to five core types, although there are certain variations around the fringe. We have been bearing down on the range of tariffs for precisely the reason that you mention. That is good, because a proliferation of tariffs is not necessarily a good thing: look at what happened to the fixed-price mortgage market in the late 1990s. You can go through it and see the direction.

We support Ofgem’s basic point that tariff proliferation drives confusion. Where we would beg to differ is in that we think that Ofgem has gone too far in the opposite direction. Its core proposal to have only one tariff per payment type would, of itself, stop time-of-use tariffs, which are palpably in the customer’s interest. As you have heard—I heard the responses to one of Mr McMillan’s previous questions—the proposal will work against social tariffs and it will take out legitimate online discounts. There is probably an optimal number by supplier for the core tariff range. We could debate for hours whether the optimal number is eight or 10, but it is certainly not 50. We would need to work through that debate with Ofgem, but we would prefer that the position were enshrined in some sort of code rather than hard-wired into licence conditions.

Sara Vaughan: We need to find the right balance between choice for consumers and confusion of consumers. Many products on the market have come about in response to consumer choice. For example, because consumers are worried about prices going up, we offer them a capped tariff; because they want certainty in their pricing, we offer them a fixed tariff; and because they want to buy green energy, we offer them a green tariff. Those tariffs have all come about in response to consumer demand. We talk to our consumer panel, which has 14,000 people on it, when we are considering introducing a new tariff, to see whether it works for them, or when we are considering taking out an old tariff, if it has not worked. A balance has to be maintained.

Ofgem made some fair points, but it has gone too far. Its proposal throws the baby out with the bath water and will stifle innovation and consumer choice. We could do a lot to reduce the confusion for consumers by having a common language for products and components and, possibly, by exploring a common price element in tariffs. We could also ensure that, when consumers buy a tariff and go on to it, they really understand what they are buying into. It would, therefore, perhaps be helpful to have a key-facts description of what the tariff is about, which identifies the risks and sets out for people what they need to do at the end of the terms.

Those are some ideas that we have put forward to Ofgem about how the situation can be improved, because it is clear from the responses that Ofgem is getting that things need to change.

As I said, it is partly about changing the relationship.

Rupert Steele: Our view on this is similar to E.ON’s. It is important that the industry improves the clarity, transparency and understandability of the offers that we put in front of our customers. That may involve key-facts documents, which is a positive and helpful idea, and clear metrics to describe the tariffs. The practices that have grown up over the years are probably not as clear as we all feel they ought to be. There is a real opportunity to make things much clearer.

I am cautious—others might be, too—about Ofgem’s proposal to set a limit of one tariff per payment type. In principle it is quite odd to propose that if a customer wants to buy something and it is a fair thing to offer for sale, the regulator should prevent that because something else is being offered, too. We are not alone in saying that we are worried about that. Consumer Focus’s response to Ofgem listed two advantages of the proposal and nine disadvantages; it had very serious concerns, too.

Stuart McMillan: I am glad that you said what you said in the first part of your answer, Mr Steele, because it certainly ties in with what you said about the benefits system. You said earlier that people do not understand the benefits system, because it is quite complicated. Energy consumers might have access to a PC or a laptop, which means that they have the opportunity to go online. However, if they are confronted with a confusing picture of 400 different tariffs, you can understand why 60 per cent of them do not change provider and have not changed provider since privatisation.

Rupert Steele: It is unlikely that all 400—or whatever the number is—would be applicable to a particular person’s circumstances. For example, there is a heating tariff—radio teleswitch—but if you do not have electric heating in your house you cannot have that equipment. Not all tariffs are applicable. There might be different regional tariffs; one need only look at the tariffs that are applicable to one’s own region. Generally speaking, the number of distinct offerings that a consumer would be looking at is much lower than the overall number of permutations and combinations of what different consumers could look at.

Sara Vaughan: I want to make a quick point on switching, because it is something that I just do not understand. At the time of its probe in 2008, Ofgem told us that 75 per cent of customers who had both gas and electricity had switched, but we are now being told that 60 per cent of customers have never switched. I cannot rationalise those two statements.

Ian Peters: We have independent research that quotes figures as high as 79 per cent. Sara Vaughan makes a valid point.

Alistair Phillips-Davies: More than half the companies that are represented here have lost more than half their original customer base, so the 60 per cent figure is just nonsense—it is clearly incorrect.

Stuart McMillan: Ofgem is in after you, so we will put that question to it.

Paul Delamare: Transparency and simplicity of pricing are absolutely key. I would go further than some of my colleagues at the table and say that there should be a degree of regulation to prevent some of the excessive confusion that can naturally arise. We are keen to work with Ofgem to understand how measures can be put in place to achieve the correct balance, so that there is choice and so that we are not creating barriers to switching by confusing customers and making them walk away.

Alistair Phillips-Davies: I am not sure that regulation of tariffs is the right thing to do. We need to bring understanding to the market. Ofgem has rightly identified a problem, which is that consumers do not necessarily understand everything. We need to be responsive to that. However, it is not about simplicity but about people understanding and being able to compare what is going on. I have a short paper here that we are discussing with a number of consumer groups; we are discussing putting an annual percentage-rate measure in place, so that you will all essentially be able to use a standard metric to see what your pence per kilowatt hour is, or something like that—you will be able to compare all the tariffs. It comes to two sides of a single sheet of paper and, if anyone wants a copy, I will happily leave it with them. It is certainly what is required if we are going to deliver the proposal.

Ofgem is absolutely right to raise the issue, but I think that its solution needs to be tweaked. We should not dumb everything down to a one-size-fits-all solution because that will only bring with it a pile of unintended consequences; indeed, it has been subsequently admitted that Ofgem, Ofgas and others could severely disadvantage people by taking such an approach. For example, many of the billions of pounds that will be invested in smart metering might be wasted. If you have only one type of tariff and cannot offer, say, time-of-day and other more sophisticated tariffs, you will not be able to reap the benefits of that investment and there will be no joined-up thinking. You need to be able to offer different things to different people.

We have eight buckets of products and 14 standard products. Until recently, we had 13; however, we had to add a fixed-price product because when Scottish Power put up its prices someone stuck a Scottish and Southern Energy van on the TV and we got a lot of calls at our call centre. It was most unhelpful but it was a good piece of work by SP's marketing department. As I have said, as a result of all those consumer inquiries, we issued a fixed-price tariff, which now makes 14 overall. Sometimes we put these things in place in response to consumer demand, but there is no doubt that we need to get to the root of the matter and to make consumers understand what is going on. It is probably the one area on which we all agree, but we need a measure that people can be absolutely confident in and which Ofgem can use to regulate. It could, for example, have small, medium and large customers and say, "Do this calculation—and here's the number". Most of us, even those with only primary school math, should be able to understand that.

Paul Williamson: I am with Ian Peters—I cannot see 400 tariffs, either. I wonder whether the message is that Ofgem needs a tighter definition of a tariff. We have five tariff groupings, but perhaps we should count region, payment type, gas and electricity and all those sorts of things as separate.

Stuart McMillan: Mr Phillips-Davies said earlier that switching costs a lot of money. I am sure that you would like people to switch to your company—in fact, I am sure that all the witnesses would like people to switch to them. On the other hand, Mr Delamare said that he would like more people to switch and Mr Peters said that 750,000 customers a month switch. If switching costs more money, will the end costs for the customer turn out to be higher?

Rupert Steele: I do not think so. Switching puts relentless pressure on the management of the companies in the market to be efficient. We know that if, over time, we cannot offer value for money and good service, our customers will desert us. We have to address that; we have to work very hard, knowing that many other companies are snapping at our heels and trying to do better than us. That is what drives innovation and development and makes each of us better in competition with the others.

Alistair Phillips-Davies: There are certainly some indirect costs associated with that. I do not disagree with Mr Steele; after all, competition is what ensures that SSE does not become fat and stupid, and we certainly get some of it. As I said, we are bound to spend money on people typing things into computers and processing bits of paper. My earlier point was that switching levels in the past two or three years have been higher than they were earlier in the noughties.

Stuart McMillan: So costs to the end customer could increase, as a result.

Paul Delamare: There are quite a few other things going on and many different components to take into account. For example, this business has substantial fixed costs. We have invested multiple millions of pounds in a new billing system: the more customers we can put in that engine, the lower the cost will be per customer.

The Convener: Chic Brodie has a final question. Panellists will be allowed to respond with one sentence maximum.

Chic Brodie: My question can be answered in one word, convener.

The Convener: Okay, then. One word.

Chic Brodie: I was taught never to leave a meeting without an action. Without compromising your competitive positions and if the conditions were right, would you join a working panel involving the Scottish Government and others to develop a plan and recommendations to reduce and, indeed, to eradicate fuel poverty in Scotland?

Sara Vaughan: Yes.

Rupert Steele: Yes.

Paul Delamare: Yes, absolutely.

Alistair Phillips-Davies: Yes.

Paul Williamson: Yes.

Ian Peters: Yes.

The Convener: We must end this evidence session. I thank the panellists for their time and members for their questions and suspend the meeting for a few minutes for a witness changeover.

12:45

Meeting suspended.

12:50

On resuming—

The Convener: Welcome back, everybody. We have our third panel here: Alistair Buchanan and Charles Gallacher from Ofgem. They have indicated that they want to go straight to questions with no opening statements, which is a good idea.

Gentlemen, we heard a short time ago from one of the energy companies that, with your proposals for tariff options, you have thrown the baby out with the bath water. Have you?

Alistair Buchanan (Office of the Gas and Electricity Markets): That is an interesting reception. We have had more than 100 responses in the two-month consultation period that we set after our March announcements, including some very positive responses from the big six, so I am a little bit surprised at that reaction.

Some good ideas have been generated by the big six and other groups, particularly consumer groups, with regard to how we might approach simplifying the tariff. The basic premise of tariff simplification has been very widely supported and received. However, if companies find that they cannot stand or cannot manage the simplification of tariffs, they will have the opportunity to take us to the Competition Commission. They would have to take that decision when we outline the tariff proposals in the autumn.

The Convener: The companies stated—or I got the impression, anyway—that they did not recognise the figure of 400 tariffs. They were at pains to demonstrate how few tariffs they had, with one company stating that it had only five different prices. Are you able to break that figure of 400 down, and tell us where it comes from and roughly how it is spread?

Alistair Buchanan: I can definitely do that. I can e-mail you a chart that shows the exact break-up of that figure as soon as the meeting is over. As you will see from the chart, in the past 18 months the number has gone up from around 180 tariffs to just shy of 400. As you will know from talking to your constituents—as you can imagine, a lot of consumers talk to me, either directly or through formal consumer groups—there is great confusion over the multitiered and multidiscounted tariffs that are available.

It is interesting that, in the past 18 months—broadly the period since we did our 2008 probe—the availability and number of tariffs went through the roof, yet switching declined by 25 per cent in the gas sector, so we saw churn falling. We cannot directly correlate those things, but when we look for reasons why there was less confidence in switching in the gas sector, in which churn fell from 20 to 15 per cent—and in the electricity sector, in which churn fell from 19 to 17 per cent—we start to wonder whether we are seeing something in consumers' behaviour that indicates that they are finding tariffs so complex that it is stifling competition and choice. We believe that to be the case, and the evidence that we have received in the past two months has strongly supported that conclusion.

Both *Which?* and uSwitch carried out surveys recently. The most recent survey came out last week, and it was substantial: it covered 4,000 people rather than just 30. From memory, around 80 per cent of those 4,000 people completely confirmed our findings with regard to tariff complexity.

Charles Gallacher (Office of the Gas and Electricity Markets): In dealing with MSP—and indeed MP—approaches and correspondence over the past couple of years, I have found that a dominant theme is constituents who have tried to switch and given up because of complexity.

The Convener: I will ask one final question before I open up the discussion to members. It was stated near the end of the previous evidence session that substantially reducing the number of tariffs could present a risk to the effectiveness of smart metering. I do not know whether you heard that comment, but can you give a direct response to it?

Alistair Buchanan: Yes, and my response has two elements. First, although there is an understandable focus on the evergreen tariff, which is the simple tariff whereby we will be able to look at one sheet of paper—it might have standard credit and direct debit details or perhaps up to four or five different groupings of what the customer is purchasing their power on; there will also be details for the six companies and potentially others, if other companies want to go into the evergreen tariff—some 25 per cent of customers are on a fixed deal, so they are actively choosing what kind of product they want. In the context of fixed deals, I do not envisage complications with regard to smart metering, because the customers already understand the complexities of choice.

The accusation that you set out has been made to us in relation to the green deal package as well as smart metering. We think that if we do not resolve the complexity of tariffs now, there is a chance that tariff complexity will frustrate smart metering and green deal roll-out—so in fact we can look at the situation the other way round. We have to sort the issue out with some urgency, which we will do, so that the smart metering and green deal packages can proceed on their own timelines.

Stuart McMillan: Our witnesses from the six energy companies disputed your claim that 60 per cent of energy customers have never switched supplier. They said that they have seen figures that suggest that up to 79 per cent of people have switched. Can you provide assistance or further information that backs up your claim?

Alistair Buchanan: We can do that. I will send you the empirical data from not just our analysis but the analysis of third parties. We focus on two important issues. The important figure is not the number of times a person has switched but the number of people who are actively being turned off switching. We think that a hard core of about 40 per cent feel totally disenfranchised and uninterested in switching. A huge group of people either will not or do not want to switch. We somehow have to get trust back into that consumer group, to make people want to switch.

I am concerned that a debate about the number of people who have never switched is a slightly tangential issue. There is a more important issue. When we did our probe in 2008, the shocking figure that emerged was that, of the people who switched—it does not matter whether it was 50 or 60 per cent of energy customers—40 per cent switched to a worse product. That is not good for the industry's reputation. Incidentally, it could also be a reason why the switching and churn figure has fallen during the past two years. Consumers have listened to a voice that they trust in the market—we hope that they trust our voice—telling them, "By the way, in 2008 40 per cent of you switched to a weaker deal." In a broad sense, that links into why we are so concerned about selling and mis-selling.

We will give you the figures on switching, and I hope that the companies that were represented on your previous panel said that they would supply their empirical evidence. However, the figure is a tangential issue; the important issues are the number of people who will not switch and the number who switched badly. We need to resolve the situation for both groups.

Stuart McMillan: The fact that people switched to a worse deal takes us to the nub of the issue. There is confusion, because there are so many different tariffs.

Alistair Buchanan: I agree. That is why the simplification of tariffs is essential.

I get asked—and I am sure that Charles Gallacher gets asked—why we do not just throw in the towel on choice and competition. Why not just give up and have a regulated approach, with Ofgem or someone else setting the price? However, we do not get that message from consumers, who like the idea of choice. We have done a number of polls, so this is empirical evidence: 96 per cent of consumers understand that there is choice in energy and 77 per cent say that they know how to switch—it is just that they will not do so. That tells us something about trust and confidence in the industry, which we have to turn round—I have no doubt that we can turn it round. We are not getting the message that we have reached the point where we just say, "Oh, to hell with the experiment on choice and competition—let's go back and regulate the market." The committee heard from consumer groups today; consumer groups have not given me the message that they want us to throw in the towel on competition.

13:00

Stuart McMillan: Do you have any information regarding the number of people from vulnerable groups who have been aggressively sold a new product or aggressively encouraged to switch to a new tariff or a new company and did not realise what they were doing?

Alistair Buchanan: Yes, we have a lot of information. We are concerned about people whom we call sticky customers—people who were with a company before privatisation and liberalisation and have stayed with it since. A legacy, sticky customer gives a company a 6 per cent net margin—we do not regulate margins or prices; I am just giving you an example—while a customer who has been competed for gives a company a net margin of about 1.5 per cent. Clearly, there is a difference between the weight of the importance of each customer to the company.

In March this year, we announced an investigation into Scottish Power with regard to its cost reflexivity on its standard credit charge. The difference between its standard credit charge and the charge on a direct debit customer is more than £200. For the other five companies, it is around £100. We want to know why that is. There might be a good reason—our investigation is on-going.

I want to give you comfort about the fact that this recent price investigation into Scottish Power comes under what is called the licence condition 27 mis-selling regulation. That is a current example of a situation in which we want to be sure that standard credit customers, who typically are vulnerable, are being treated properly.

To go back to the convener's first question, I note that, in the past two months of consultation, some interesting ideas have been put forward to us with regard to vulnerable customers. One of the most interesting has come from the fuel poverty groups, which have asked us to consider whether some form of protection could be made available to customers—they call it a fair trade tariff. They want us to consider whether, if those who can choose to go on to a fixed deal are getting a much better price, there could be a mechanism that would link the two rates, so that the gap does not widen and there is some kind of parallel movement. We will have to think about that suggestion further.

Not surprisingly, there is a lot of interest in the issue of vulnerable customers, to whom Ofgem has a statutory duty. We do not have a statutory duty in relation to fuel poverty; that is a matter of high policy for Government.

Stuart McMillan: We heard this morning that switching costs a lot of money. Have you found that in your previous investigations?

Alistair Buchanan: Switching will be a commercial decision that companies will have to make with regard to their costs. SSE was extremely successful in the five-year period from 2004 to 2009, during which time it won 2 million or

3 million extra customers. With regard to its profit line during that period, its annual statements and dividends showed its shareholders that it could manage that degree of winning custom and customers switching to it. Its market share rose by 5 per cent nationally during that time, which is a lot. That suggests that a company can manage switching while continuing to have a decent financial performance.

Patrick Harvie: You used the term "bad switching" to talk about people switching to something that is objectively less good. What do you mean by that? Is it purely about price?

Alistair Buchanan: It is to do with the fact that, as I said earlier, in our probe in 2008 we found that 40 per cent of normal switchers and 48 per cent of those on prepayment deals switched to a less good deal on price. Price is the main driver behind the switching decision. That finding was so concerning that *Which?* magazine—I am pretty sure that it was *Which?* magazine, but I can confirm that later—conducted a survey in which it asked customers whether they thought that switching over the past year had got them a better deal, and 58 per cent doubted whether it had. That is worrying. What we want is a healthy, successful market in which people feel good about what is going on.

Patrick Harvie: You are making one or two false assumptions that might be generally true but are not always true. My electricity contract was acquired by EDF and I switched because I did not want to buy electricity from a nuclear energy generator; I wanted to buy from one that had a commitment to renewables. Price was not the sole factor in my wanting to switch. It was one of the factors that I considered, but it was not my principal reason for switching. That was not bad switching; it was me exercising a value judgment.

Also, we should not assume that having a certain amount of churn implies that that is what people want. I am perfectly happy with my toothpaste, for example. My toothpaste company comes up with endless new variants, brands, formulations and packaging to get me to change, but I do not particularly want to change. That is not a failure of the market or of competition; it is just a sign that I have got what I want.

Alistair Buchanan: I accept that entirely. I do not normally use the phrase "bad switching". If I used the phrase "bad switching", I apologise. It is very rare for me to use that phrase. I was talking about those customers who got a weaker deal. Some people may switch because they like the Nectar cards that are being offered by a particular company although the price is higher. Some people may want to go green and a green product may cost more. The idea of switching—

Patrick Harvie: I suggest that that is not a weaker deal. Different people make their decisions on the basis of different value judgments.

Alistair Buchanan: Indeed. Unfortunately, when it gets up to the level of 40 per cent, that is concerning. The important factor is that the follow-up analysis asked people whether they had thought that they were going to get a better deal and most consumers who switched had thought that they would. Those who, like you, understand what they are after and want a Nectar card or to be green may be prepared to take a weaker-priced deal.

Patrick Harvie: Okay. My main question is about the long term and relates to a question that I put to the energy companies. We all acknowledge that a substantial amount of investment is required both in demand reduction and in new renewable generation. If you listen to the Scottish Government you will know that it intends Scotland to be generating twice as much electricity as it consumes by the end of the decade, with the equivalent of 100 per cent of electricity consumption being generated by renewables and the equivalent of 100 per cent being generated from other sources. A large part of what Ofgem does is strike a balance in respect of the contribution of bill payers. If Scottish taxpayers and consumers are expected to make a contribution, is there not a reasonable expectation that that will come with a fair deal and some guarantee that they will be protected from long-term price increases, particularly given that this country has a substantial renewable energy generating capacity and is going to be less dependent on imported gas, imported coal and the wholesale prices of electricity and gas? To what extent will the regulation of the market offer that protection from continual long-term price increases at the retail end?

Alistair Buchanan: That is a long and interesting question. Ofgem is responsible specifically for 20 per cent of the bill, which covers the pipes and wires—the monopoly businesses. Following our recent complete reworking of the way in which we set those prices, we have announced that, in the next 10 years, we must find £32 billion out of the £200 billion that Great Britain as a whole needs to spend on pipes and wires. That is a 100 per cent increase in run rate for Scottish and Southern Energy and Scottish Power per annum for each of the next 10 years. It is a vast spend.

We have said to consumers that, for the network part of their bill, there will be a price increase, because we have to renovate the part of the grid that was built after the second world war and then we have to build out the grid to the new providers of generation—typically wind and water, and nuclear in England and Wales. That is the 20 per cent that we are directly responsible for. Broadly, 10 per cent is environmental or sustainability based. The remaining 70 per cent is not directly in Ofgem's control, although we have to monitor the behaviour of the companies.

That leads me on to your concept of a fair deal. The words that we have used are "straight deal". We do not believe that the consumers have had a straight deal from the companies. If you need evidence of that, we have four mis-selling investigations on-going. We have three investigations solely into Scottish Power. That is not good news. We should not be having to carry out such enforcement actions, but we are doing so because we want a fairer deal, so that consumers feel confident in the transparency of the information that they are getting from the marketplace—that is critical.

To focus on the 70 per cent of the bill, how do we seek a fairer deal for the consumer in the long term? To a certain extent, that goes back to policy makers because, in the short term, Great Britain has to find £200 billion to ensure that the lights stay on and we meet our green and renewable energy targets. If we do not, we will face serious issues.

We carried out a major project called project discovery—I have not found anybody so far who does not broadly agree with it. The difficult analysis that came out of that was that bills will go up by 25 per cent between now and 2020 because of the infrastructure build that is needed. I am sure that you have had a lot of people talk about this already today. We know that because of global events, gas prices will go up by 30 per cent between now and next winter. There is tremendous pricing pressure in the short term, which is why customers must believe that the companies are playing straight with them and that the companies are not taking advantage of those short-term upward pricing pressures.

The long term is a matter of high policy that sits on your side of the desk rather than mine. If there is a debate to be had about whether we get a better or fairer deal over 50 years through regulation rather than a market-based approach, high-level policy makers will have to have it. We are a statutory body and we will respond to what is presented to us. At the moment, we are told that Ofgem will be responsible for 20 per cent of the bill because there is a monopoly and therefore it should be regulated and that broadly 70 per cent of the bill will be affected by market instruments and pressures.

Patrick Harvie: The market is the problem, convener.

The Convener: Thank you, Patrick.

John Wilson: I want to follow up your answers to Patrick Harvie's question. I seek assurances from Ofgem about what you envisage. You talked about a 25 per cent increase in bills between now and 2020. Is that 25 per cent of existing bills? I am just trying to work out what you mean by 25 per cent and how that is figured into the other calculations that the energy companies will make in increasing prices.

Alistair Buchanan: That is a very good question. It was the figure that we came out with in February 2010, based on our detailed analysis through project discovery. I might have to come back and correct this, but I am pretty sure that the forward price that we were using for oil was $100 a barrel. We have seen a forward price for this winter of $120. That suggests that the assumptions that we were using back in 2010 were a little bit light and that the figure might be higher than 25 per cent were we to run project discovery again today. However, as a broad indicator to consumers, 25 per cent equals a substantial increase in their bill and they need to know why that is happening. It is happening because there is a concern about security of supply and we have to meet renewables and carbon targets. That is the explanation to the consumer.

13:15

John Wilson: Based on the figures that you have just given us, and taking into account world oil prices as at 2010, at around $100 a barrel—

Alistair Buchanan: Yes—that was in our modelling.

John Wilson: That was in your modelling, but some of the projections that we are getting now use the figure of $150 a barrel.

Alistair Buchanan: Yes.

John Wilson: Using that sort of figure, are we really talking about a 37.5 per cent increase in pricing for consumers in order to meet the demands in terms of the infrastructure?

Alistair Buchanan: I have to be careful not to give a forecast—the governor of the Bank of England gave a forecast for energy prices earlier this year but, in our role, we try not to do that. We were trying to give an indicative increase. You are right, however, about the assumptions that are used within our model. If you play with our model assumptions, you might conclude that the prices for global gas and oil will be higher than we are assuming. We will need gas, as it is the bridge product to the anticipated renewables future—and the nuclear future in England and Wales—and you would have to say that there will be a substantial increase in price.

I make this offer: I am happy to come back to you and to get the guys in our markets team to run the numbers that you have, and we can give you an answer on that basis.

John Wilson: Yes—if you could, please. I will explain what the crucial factor is for me. Whether we are talking about an increase of 25 per cent, 37.5 per cent or, potentially, a higher figure, that is on top of what the energy companies might be projecting. You are basing your model on a price of $100 a barrel. I am sure that the energy companies are doing exactly the same with regard to their costs and projections for rising energy prices.

We are not looking at energy prices based on Ofgem's modelling, in which the energy companies' pricing remains static. I assume that the energy companies' prices will increase, too. The issue is about the overall impact on the consumer. As Patrick Harvie has said, noting the two recent major increases by energy companies, there could, using my model, be something like a 137.5 per cent increase in prices over the next 10 years. Consumers must see some return for that. In particular, those people who are now in fuel poverty and those who will be forced into fuel poverty because of the modelling exercise must be protected at all costs.

Alistair Buchanan: Part of the issue is to do with timing. Project discovery, Ofgem's review, took us to around 2023 or 2024. Our concern as we were doing that project was to do with the tremendous work going on in relation to the 2050 road map, route map or journey—whatever one wants to call it. There was an understandably excited, enthusiastic view about what would happen to fuel prices and about how green our fuel will be post-2025. Our concern was about what things will look like in getting to that point.

I will mention two things as a counterweight to the initial premise that you have made and that our model shows. First, we hope that some fairly dramatic wins in energy efficiency and demand-side management might offset the overall increase in the bill. That is the logic behind what the Government is trying to do on smart meters and on the green deal. Secondly, projecting beyond 2024 or 2025, if international oil and gas prices in particular—and coal prices, too—were to go up to the very high levels that you are talking about, that might spur even quicker development of renewables, whose economics may well start to look much more attractive. Therefore, progress with renewables could be much quicker because of the international fossil fuel price. There could be an effect such as you describe over the next 10 years but, in the longer term, the dramatic pricing pressures on fossil fuels could have some interesting effects on what the pricing and fuel mix picture might look like after 2025.

John Wilson: You have indicated that you have undertaken a number of investigations into energy companies. What sanctions can Ofgem use against energy companies if you find them to be in breach of the regulations?

Alistair Buchanan: If energy companies are in breach of a licence clause or of Competition Commission rules, we can fine them. In the most extreme form, that fine can amount to up to 10 per cent of the global turnover. Therefore, we would be looking at Iberdrola's global turnover—if there were a case.

The Enterprise Act 2002 allows us to force companies to change their behaviours, but there is no associated fine.

Chic Brodie: Good afternoon, gentlemen. We have heard about businesses' margins being—if they were positive at all—fairly small. However, Ofgem reported recently that five of the big six companies understated their profits last year by inaccurately displaying information about their margins. I like one-word answers: is there genuine competition in this industry or not?

Alistair Buchanan: I believe that there is competition. Do I believe that there is enough of it? No.

The Convener: Patrick Harvie referred to your use of the phrase "bad switching", which I know you said you would not normally use. Mr Harvie gave the reasons why he switched, and I am sure that others could do so too. Of the 40 per cent who switched and found themselves in a poorer financial position, what proportion did so unknowingly? What proportion knew but still had other reasons for switching? Has any work been done on that?

Alistair Buchanan: As I said to your colleague, I am sure that the majority thought that they were getting a better price. I do not have the percentages to hand, but I am pretty sure that we have them. I can send them to you.

The Convener: You said that work is continuing in relation to switching, tariffs and so on. In the switching of financial products, there is APR. Could there be an equivalent to APR in the switching of the products that you are responsible for, so that people could at least have a consistent way of measuring the effects?

Alistair Buchanan: There could well be. As I have said, I was pleased by the huge response to the consultation on tariffs. A number of independent suppliers, consumer groups, and members of the big six have, broadly, suggested that what you propose would be useful. We will consider the question carefully.

The Convener: John Wilson asked about your powers and about the sanctions that you can impose. Do you have all the powers that you need, or are there some obvious ones that, ideally, you would want?

Alistair Buchanan: At the moment, there are two powers that we feel we might have to ask the Government for. The first one relates to small and medium-sized enterprises. We are concerned about the behaviour of third-party intermediaries towards small businesses, but we do not have licence powers. We may, therefore, seek such powers.

The second one relates to vulnerable customers. As we consider tariff specifications, we may feel that we need additional powers with regard to vulnerable customers. The Energy Bill is going through Parliament, so I hope that we will at least be able to have a dialogue with the Department of Energy and Climate Change about what we need.

The Convener: I thank Alistair Buchanan and Charles Gallacher for their evidence.

We still have items 2 and 3 to consider, but I suspect that we will do so fairly swiftly.

13:24

Meeting suspended.

13:25

On resuming—

Budget Adviser

The Convener: For item 2, the clerks have circulated a paper about the possibility of appointing a budget adviser. Having had budget advisers for the past couple of years, I would say that I found them very useful. All that we have to decide today is whether we wish in principle to appoint an external budget adviser as part of our scrutiny of the budget for 2012-13. Is that agreed?

Members *indicated agreement.*

John Wilson: I do not disagree, but I seek clarification of the allowances that we are allowed to pay budget advisers. Has there been a decision to increase the amounts that are payable? There were issues in a previous committee that I sat on because the limits on the daily amounts were such that some of the advisers whom we might have wished to use were reluctant to come along.

The Convener: I pass that query to Stephen Imrie.

Stephen Imrie (Clerk): I am happy to advise the deputy convener. I am not aware of any plan to increase the standard day rate, which is outlined in the paper. However, I will enquire of the Scottish Parliamentary Corporate Body whether there are any plans to revisit that.

To be clear, if the committee chooses a candidate who is only available to work beyond the standard terms and conditions, it can ask the corporate body for separate approval to pay a slightly higher day rate. The balance for the committee is cost effectiveness versus the candidate in question. However, you can make a case to go beyond the standard day rate.

The Convener: Thank you. We are agreed in principle about having a budget adviser. SPICe and the clerks will produce a list of possible candidates, and if members have any suggestions that they would like to put forward, they should do so. We will take a decision on who the adviser will be at our next meeting.

Work Programme

13:27

The Convener: The last item is our work programme. Again, the clerks have circulated a paper.

We will have to have our planning meeting here in the Parliament, which makes it a business planning day as opposed to an away day. It will be held late in the recess—in late August or early September. Members have been circulated with a list of potential dates. If anyone has not yet replied, I ask them to do so and we will then get the date tied up. You can see the rough programme in the paper. There will be a bit of committee discussion, but the main part of the day will be three round-table sessions—one on the economy, one on energy and one on tourism, to reflect the three strands of the committee's work.

Chic Brodie: Can we not agree the date now—says he, who did not respond to the initial list of dates? I think that it would be easier for the clerks to plan if we decide on the date now, rather than their having to keep chasing everyone for a date.

The Convener: Mike, can you do Tuesday 30 August? Everybody else has said that that is fine for them.

Mike MacKenzie: Yes.

The Convener: Okay. Thank you for that good suggestion, Chic. On that basis, the business planning day will be on Tuesday 30 August.

I thank everybody for their efforts today. This is our last meeting before the recess. The next one will be in the first week of Parliament in September. Thank you, everybody. Have a good recess, afternoon, and so on.

Meeting closed at 13:29.

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