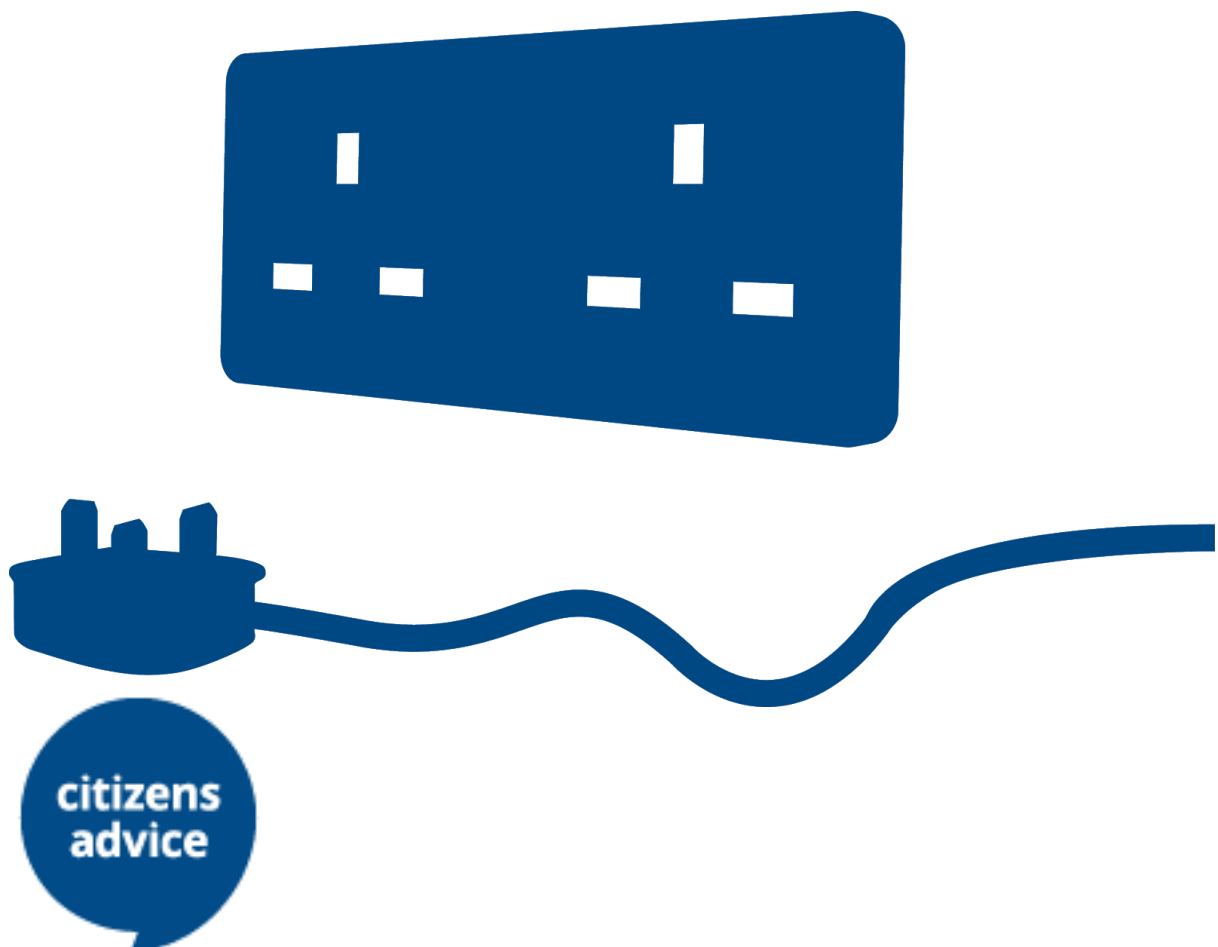


BEIS Hydro Benefit Replacement Scheme and Common Tariff Obligation Consultation

Citizens Advice submission
September 2019



Introduction

Citizens Advice welcomes the opportunity to respond to this consultation as part of its statutory role to represent domestic and small business energy consumers in Great Britain (GB). Our response is not confidential and may be freely published.

In general, we support the retention of the Hydro Benefit Replacement Scheme (HBRS) and the Common Tariff Obligation (CTO) in protecting consumers in the North of Scotland from the higher costs of electricity distribution in that region and from having differentially higher electricity tariffs. The HBRS and CTO are well-established and understood schemes and therefore likely to be administratively efficient. We do have some ongoing concerns regarding the regressive nature of the levy used to provide the HBRS subsidy and regarding the uncertainty in the level of future distribution costs which may either increase the subsidy or negate its necessity. These aspects are explained further below within the detailed answers to the consultation response.

We also support the extension of the use of the HBRS in subsidising Shetland consumers from high distribution costs. The HBRS mechanism provides a familiar mechanism to cross-subsidise Shetland consumers although the concerns with the HBRS as noted for the wider North of Scotland subsidy remain.

There is an opportunity to revisit the HBRS and CTO schemes in due course as part of wider government energy policy reviews looking at the decarbonisation agenda. For instance, we think it would be valuable for the proposed Citizens' Assembly considering how to achieve the UK net zero carbon emissions' target to also review these cross-subsidy schemes to ensure fairness in application.

Consultation questions

1. Do you agree that the policy objectives of the Hydro Benefit Replacement Scheme and Common Tariff Obligation - which are focused on ensuring that consumers in the North of Scotland are not unreasonably disadvantaged by the price differential in electricity distribution costs - remain valid?

The HBRS and the CTO are schemes to ensure that those in the North of Scotland do not pay unduly high bills for electricity compared to consumers in the rest of GB. The HBRS protects domestic and non-domestic consumers in the North of Scotland through a subsidy, levied upon all GB consumers, which effectively reduces the costs to North of Scotland consumers by an aggregate annual amount of £61 million. Without the subsidy, North of Scotland consumers would be paying an even higher amount than at present, which is already the most expensive in the UK at £121 per annum in 2019-20 after the subsidy has been applied¹. This figure is calculated by Ofgem on the basis of a typical GB domestic customer's electricity usage, however, Scotland has a generally higher level of fuel poverty (at 34.9%²) as well as higher numbers reliant on electricity to heat homes as they are off-gas grid³. The fuel poverty rate in the north of Scotland for those off-gas grid, for example, is over 50% of consumers for those in the Highland area, and 70% in the Western Isles⁴. As such, the potential negative impact of higher distribution costs for electricity in the North of Scotland is even greater than the £121 per annum figure suggests.

The CTO ensures that electricity suppliers in the North of Scotland are not able to charge comparable domestic consumers different prices solely on the basis of their location within the region, and therefore protects consumers in remote rural areas or islands from the relatively high costs of supplying electricity.

The HBRS and CTO schemes therefore offer a means to assist those in the North of Scotland who would otherwise be at risk of extremely high electricity bills with the potential for further exacerbation of fuel poverty. The schemes' policy

¹ [BEIS, Hydro Benefit Replacement Scheme and Common Tariff Obligation, July 2019, page 19](#)

² [The Scottish Government, Energy in Scotland, 2016](#)

³ [Citizens Advice Scotland, Off-gas consumers: Updated information on households without mains gas heating, June 2018](#)

⁴ [Citizens Advice Scotland, 'Hot Off The Grid: Delivering energy efficiency to rural, off-gas Scotland', May 2016](#)

objectives are therefore valid in terms of offering such protection to North of Scotland consumers.

2. Do you agree that the Hydro Benefit Replacement Scheme and Common Tariff Obligation remain operationally effective and should be retained?

The HBRS and CTO are efficient schemes in that they are well-established and therefore should be administratively straightforward to operate. At this point, we support the retention of these schemes given the value of these schemes in supporting North of Scotland consumers and the simplicity and familiarity of the schemes. However, there are a number of points we would like to raise on the HBRS:

- The method by which the HBRS subsidy is raised, as a per kilowatt hour levy on all GB consumers' bills, applies the cost irrespective of the ability to pay. In reality, some fuel poor consumers elsewhere in GB, including those reliant on electricity only and/or with above average electricity usage due to vulnerabilities, will be subsidising North of Scotland consumers, whether fuel poor or wealthier consumers. As such, it is a regressive form of subsidy and other methods may be fairer in application, such as general taxation. It would be valuable to revisit the application of the levy at the next review stage within wider considerations of energy policy. We think it would be a valid topic to bring to the proposed Citizens' Assembly⁵ due to consider the wider issue of climate change and the target to achieve net zero carbon emissions in the UK.
- The Distribution Network Operators (DNOs) are currently moving to establish their businesses as Distribution System Operators (DSOs), with an aim to better manage electricity resources to reduce distribution network costs, among other goals. At the same time, there may be increased costs to assist the decarbonisation agenda in providing new infrastructure for the higher usage of electric vehicles or higher take-up of electricity for heating. As such, the distribution network costs for the future will change, with costs potentially reducing due to a more efficient system, or potentially increasing due to higher infrastructure needs. At present, it is not clear whether these different pressures will result in a

⁵ ['Select Committees announce plans for Citizens' Assembly'. 20 June 2019. https://www.parliament.uk/business/committees/committees-a-z/commons-select/business-energy-industrial-strategy/news-parliament-2017/climate-change-and-net-zero-chairs-comments-17-19/](https://www.parliament.uk/business/committees/committees-a-z/commons-select/business-energy-industrial-strategy/news-parliament-2017/climate-change-and-net-zero-chairs-comments-17-19/)

higher, lower, or net no change distribution cost for the North of Scotland or other regions. If the distribution costs for the North of Scotland reduce relatively against other DNOs' costs, it may be valid to cease the HBRS subsidy, and if the costs increase relatively, it may be necessary to increase the levy or look to other mechanisms, such as socialisation of costs via general taxation, to meet any higher subsidy cost. It would be suitable to consider this aspect at the next three year review stage.

3. Do you agree that the Hydro Benefit Replacement Scheme is the most appropriate way to deliver revised funding arrangements for the Shetland cross-subsidy? If not, why not and what other mechanism(s) should be considered?

The higher distribution costs for Shetland consumers are proposed to be subsidised by £27 million per annum using the HBRS as the mechanism to raise the funds and pass them to the distribution company, Scottish Hydro Electric Power Distribution. The HBRS is a suitable mechanism given that it is a well-established method of subsidising consumers with high distribution costs, and due to its operational familiarity and efficiency. As such, we support the use of the HBRS as the subsidy mechanism for Shetland consumers. However, the issues relating to the regressive nature of the levy and the possible changes in distribution costs as DNOs transition to DSOs remain for this subsidy scheme as with the wider HBRS application for North of Scotland consumers. See the answer to Q2 regarding these points and our views on revisiting these aspects of the scheme in the next three year review.

4. Do you agree that the proposed design of the revised funding arrangements for the Shetland cross-subsidy is likely to be effective? If not, what changes or additions should be made?

We believe that the proposed design of the revised funding arrangements is likely to be operationally effective and meet the need to subsidise Shetland consumers. See also our answer to Q2 regarding drawbacks in using such a bill levy scheme.

5. Does the proposed design of the revised funding arrangements for the Shetland cross-subsidy achieve predictability of charges, transparency,

and efficiency of operation? Are there other important aspects that should be taken into account?

We believe that the proposed design of the revised funding arrangements for the Shetland cross-subsidy does achieve predictability of charges, transparency and efficiency of operation. In particular, the HBRS is well-known and clear in application for suppliers and network companies. The proposed methodology to correct for the prior year's over or under subsidy appears to be a practical and efficient way to appropriately adjust the level of subsidy from the estimated amount.

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