PEOPLE'S
ENERGY COMPANY

Cameron Bailey and Jeremy Adams
Retail Financial Stability
10 South Colonnade
Canary Wharf
London
E14 4PU
supplier@ofgem.gov.uk

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People's Energy response to Supplier Licensing Review: reducing credit balance mutualisation

People's Energy supports initiatives that help make supply of energy fairer for consumers. It is not fair if suppliers sit on credit balances over long period of times where this is not justified by the consumption of the consumer and effective management of payment for their consumption over the course of the year.

Our response reflects that People's Energy is a very different supplier. We are the UK's only Community Interest Company energy provider, aiming to benefit our community rather than to make large profits for shareholders. Our aim is to use our assets to fight fuel poverty and therefore benefit consumers in vulnerable situations.

Ofgem's problem statement highlights its concerns with suppliers keeping distortive credit balances and using these to fund risky business strategies. However, it is also true that the benefits of using credit balances as a form of working capital have a positive effect on competition when the supplier is responsible and well run.

The risk to the market is not directly from the payment in advance business model which is used by many suppliers sustainably and in and many other markets without issue. The root causes are where the supplier has unsustainable tariff pricing and business strategies combined with that supplier's ability to manage debit balances and customers not paying.

We note Ofgem has not addressed those serious issues in its proposals to limit mutualisation following supplier failure.

Where a supplier has sustainable business plans and acts responsibly, the rewards to consumers and more widely across the competitive market for operating this business model far outweighs any risk.

People's Energy is concerned that Ofgem's proposals on autorefund and thresholds will threaten our ability to provide affordable energy to fuel poor and vulnerable customers. We would like to work with Ofgem to develop these proposals in implement solutions avoid the unintended consequences of increasing the costs of energy to fuel poor and vulnerable consumers, which do not meet our ambitions or align with Ofgem's aims and objectives.

People's Energy Community Interest Company (no SC656197) is registered at 3 Wester Shawfair, Shawfair Park, Edinburgh, EH22 1FD. People's Energy Community Interest Company is the parent company of The People's Energy Company Limited, No SC522897, which owns People's Energy (Supply) Limited (No 09844617).

Summary of response:

- Ofgem proposes to remove £590m to £1.4bn of working capital from suppliers. However, that comes with disadvantages, and the policy consultation does not consider the wider effects it will have
- Credit in advance is not in itself unsustainable where a supplier acts responsibly and plans appropriately. Payment in advance is a sustainable business model used widely in many other markets, such as telecoms, insurance, software licencing, without distorting competition
- The policies are a threat to responsible suppliers with prudent financial planning and sustainable business models
- As they stand, the proposals are highly likely to force some suppliers to exit the market in either a controlled or uncontrolled way
- The proposals favour existing dominant suppliers whose interest is to restrict market entry by disruptors, with a view to future market consolidation. Those larger suppliers have unsustainable business models which are making losses
- Ofgem needs to allow flexibility in its proposals which allows for suppliers to responsibly manage their cash flows differently
- The cost of guaranteeing credit balances is significant. There is likely to be a requirement to increase the default price cap, negatively impacting consumers and disproportionately benefiting larger suppliers
- There is a risk that the cost of operating a fixed monthly direct debit payment method will become so high suppliers will withdraw fixed direct debit from customers
- The timeline for implementation at the end of summer 2022, combined with Renewables Obligation payments at the end of August presents a major risk of causing supplier failure going into winter 2022. Ofgem should mitigate this risk by phasing in credit balance protections over time, and work with suppliers to change business models in a constructive and sustainable way
- In its model Ofgem does not consider that a significant proportion of customers will not be in credit, which undermines the assumed cash position of the supplier
- If Ofgem proceeds with its current proposals, the cheapest direct debit tariffs will either be removed from the market, or carry higher costs directly from requiring any credit balance is guaranteed
- Autorefund proposals will confuse customers who see a refund and the rise in direct debit shortly afterwards. Proposals need to be based on consumer insight, as the existing proposals will lead to negative consumer experiences
- Implementation cannot come at the same time as faster switching; suppliers are already committing to complex and extensive system changes and people training costs during next summer

People's Energy proposes:

- The automatic refund should only happen within specific months of the year (summer months) rather than throughout the year on the anniversary of the contract of individual customer

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- Suppliers should be allowed to stagger the re-payments within those months
- If implemented, the scheme needs to be introduced in phases, during a carefully managed transition period, in order to minimise the risk of more supplier defaults
- A one size fits all prescriptive autorefund requirement is too simplistic. The autorefund licence requirements need to be principles-based to enable a supplier to provide positive customer outcomes while managing the real-world scenarios where the prescriptive proposals will lead to negative customer experiences
- The Renewables Obligation payments in August should be taken into account when setting supplier thresholds. This proposal needs to come hand-in-hand with proposals for changes to the Renewables Obligation. These cash challenges for suppliers cannot be treated completely independently. There is a real risk that Ofgem is making independent changes, in a way that is not joined up; this would have catastrophic accumulative consequences for an industry that is already struggling, as evidenced by the many companies going out of business over the past couple of year
- In general, we propose a more global review of the industry, including the timing of Renewables Obligation payments and other levies (e.g. Energy Company Obligation payments, Warm Home Discounts) which are all challenging to meet for suppliers, particularly challenger brands growing fast and therefore hitting the thresholds where they become liable to these levies but are still dependent on cash injections as new, early-stage businesses. Piecemeal solutions, like the one proposed here, is likely to stress the industry further

These proposals will materially change the business model known to be used by some suppliers. Ofgem will need to carefully assess whether the indicated timeline to allow the scale of these changes is realistic. An important consideration for the regulator is what it will do when one or more suppliers are unable to adapt to the changes in business model for that deadline; would it prefer to accommodate a longer implementation to allow time to adapt, or prefer to watch those suppliers fail, with the cost of that failure mutualised?

People's Energy call for Ofgem to adapt its proposals to allow for more unique business models, like our own crowdsourced business model. People's Energy is an excellent example of a supplier who entered the market with the sole purpose of supplying affordable energy and being a not-for-profit organisation.

Larger suppliers will use their scale and influence to lobby Ofgem to introduce these, as they have the financial security of being part of a larger group of companies, and have relatively little to lose from the proposals. While they will spin their consultation responses to pretend their motive is to protect consumers, they in fact see these proposals as a major way of maintaining market power, and welcome supplier failure as a way to bolster their declining customer portfolios. Ofgem should not be fooled into supporting these aims.

Ofgem's Forward Work Programme 2021-2022 includes the objective to reduce regulatory burden. However, these proposed licence modifications are counter to that objective.

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Our detailed responses are set out in the attachment to this letter. We would welcome the opportunity to discuss these with Ofgem as it further develops its proposals.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact us, or Kevin Hammond at kevin.hammond@peoplesenergy.co.uk.

This letter and its attachment may be published on Ofgem's website.

Yours sincerely,

David Pike and Dr. Karin Sode
Co-Founders and Joint CEO

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PEOPLE's ENERGY COMPANY

Peoples Energy response:

Question 1: Do you agree with our objectives set out in chapter 1?

We support the objectives, but do not agree with Ofgem's proposals in their current form which would hard consumer trust and outcomes. We have suggested alternative proposals which deliver Ofgem's policy intent and safeguard against those unintended consequences.

Question 2: Do you agree that our proposals meet our objectives as set out in chapter 1? Please provide views on both our autorefund and threshold proposals and any alternatives you consider that meet our objectives that Ofgem should assess.

No.

Ofgem proposes to remove £590m - £1.4bn of working capital from suppliers. However, that comes with disadvantages, and the policy consultation does not consider the wider effects it will have. The policies are a threat to responsible suppliers with prudent financial planning and sustainable business models and will increase the cost of supplying customers who pay by fixed monthly direct debit.

The proposals will have an adverse effect on competition within the energy supply market by disproportionately impacting suppliers who take payment in advance from their customers. That form of payment is not in itself distorting competition and is used positively and without problem in many other markets. It is standard practice for providers of telecoms, broadband, insurance, and software licences to request payment in this way.

Smaller suppliers are going to be more heavily impacted by the costs of these proposals, not only in the costs to administer these changes, but also in increased costs to serve customers by fixed monthly direct debit and cost of protecting customer credit balances.

The proposals lean heavily in favour of larger suppliers, who have the financial backing of parent groups and who have unsustainable pricing and operate unsustainable business models, as evidenced by their large financial losses. The proposals disproportionally affect start-ups who use customer credit responsibly and sustainably but do not have deep resources of established parent companies or capital investors.

Regarding the threshold policy, the cost of guaranteeing credit balances is significant. There is likely to be a requirement to increase the default price cap, negatively impacting consumers but benefiting larger suppliers who are less affected by the threshold proposals and have more to gain from increases to the default tariff cap level.

Larger suppliers see these reforms as an opportunity to push smaller suppliers out of the market and acquire their customers cheaply through the supplier of last resort process. Should Ofgem introduce these proposals, it will harm competition, drive up costs for customers, and disproportionately benefit larger suppliers.

We strongly urge Ofgem to reconsider its intended implementation of the autorefund and threshold proposals, and whether these proposals align with Ofgem's policy objective to *"Ensure that regulatory costs do not unduly hamper good practice, market entry, innovation, and growth"* as it is difficult to see how a Community Interest Company supplier like People's Energy could enter the retail market post implementation of these proposals.

The timeline for implementation at the end of summer 2022, combined with Renewables Obligation payments at the end of August, presents a major risk of causing supplier failure going into winter 2022. Implementation as planned increases the likelihood of more customer credit balances being mutualised because of supplier failure, achieving the opposite of the objectives and policy intent.

As we discuss in greater detail below, responsible suppliers who currently provide sustainable low tariffs and excellent customer service will be significantly affected by these proposals. The likely direct consequence will be that tariff prices will need to increase, as these proposals introduce significant burdens and costs to implement in their current form.

We provide an outline for alternative proposals below, and throughout this response. We would welcome the opportunity to discuss these with Ofgem as it further develops its proposals.

Question 3: Do you agree that our draft Standard Licence Conditions reflect our policy intent?

No.

The proposed licence changes will have unintended consequences which exceed Ofgem's policy intent.

Ofgem should not look to implement its proposed change the existing drafting of standard condition 27.15. Removal of the 'all reasonable steps' wording materially changes what is required to comply with 27.15. For example, a supplier could be in breach of the proposed drafting if it did not reassess a customer's direct debit after receiving a meter reading. The drafting removes a supplier's ability to define what is reasonable or how to avoid poor customer outcomes, such as triggering multiple changes to the amount of a fixed direct debit when multiple meter readings are received in a short space of time. This is especially important when readings can be taken remotely by smart meters.

Ofgem do not explain within the policy consultation why the existing drafting of 27.15 is not already sufficient for it to act where supplies are unfairly holding onto customer credit balances. The existing licence condition 27.15 requires that the amount of any fixed direct debit be based on the best and most current information available, which includes customer consumption and the credit or debit balance of a customer's account. Should the amount of a fixed direct debit be reassessed in the months prior to the autorefund, this will lead to the customer account developing a debit balance until the next reassessment, when the direct debit would have to be hiked to recover the difference. This is neither a positive customer experience, nor delivers the policy intent of the existing licence requirement.

In its 2009 decision to introduce the condition 27 direct debit rules, Ofgem was very clear that it considered specifying a level for automatic refunds would be too prescriptive (paragraph 4.14). It also acknowledged that doing so would inhibit innovation (paragraph 4.17) where the terms of a contact have been clearly explained to a customer.

> *"4.13. We have considered the point made by some respondents that Option B* [the current licence drafting] *did not make it explicit that suppliers should not unnecessarily build up credit in a customer's account. This issue was one of the particular problems identified in the Report. We are satisfied that the proposed condition will address it. If, in accordance with the proposed licence condition, suppliers are using the best available information to calculate direct debit payment levels, a customer should not be unnecessarily building up credit or debit. We expect suppliers to be proactive in the steps they take to ensure this is the case.*
>
> *4.14. While some consumer groups wanted us to specify a level at which automatic refunds would be provided we believe this would be too prescriptive. The appropriate level of credit will vary depending on the time of year when the account is reviewed and on past consumption, for example."*
>
> *"4.17. In addition, we recognise that suppliers may in future wish to develop innovative offerings such as Scottish Power's tariff where interest is paid on higher credit levels. We would not wish to discourage such innovation and hence have allowed an exception to be made to the condition where there are explicit contractual terms covering the issue. The principle behind this is that the supplier will have explained the terms clearly to the customer and that the customer will have consciously signed up to them.*
>
> *4.18. In some cases suppliers sought clarification of what we would consider "reasonable" in the context of the licence drafting. We do not wish to prescribe what suppliers should be doing but are sensitive to concerns about regulatory certainty. We would therefore stress that we would generally expect to take action under this condition where there is evidence of consumer detriment and would then judge whether a supplier's actions were reasonable in the context of the relevant elements of the best practice guidance we have published."*

Ofgem's current proposals force a supplier to refund any credit balance to £0, without providing any leeway to allow a customer the option to carry the credit balance forward to reduce future monthly payments. This risks a customer building up debt the refund is made at a point in time before increased winter usage and future payment levels are not adjusted to take that into account.

We will not support proposals which look to favour suppliers keeping customer accounts in debit. Not only does that adversely impact those customers but, through indebted switch blocking practices, enables suppliers to lock indebted customers into higher priced tariffs unless those customers can afford to settle the debt balance in full.

Ofgem does not consider allowing any flexibility about when the autorefund is made. Ofgem should conduct robust consumer research before introducing prescriptive rules which many customers will find confusing and counterintuitive.

We propose that Ofgem amends the existing licence conditions 27.13 to 27.16 to become a principles-based requirement to return customer credit balances, encompassing all payment methods and frequencies. This would deliver Ofgem's policy intent of returning unjustified credit balances to customers while enable a supplier to provide overall positive customer outcomes for all outlier scenarios too numerous to realistically address using prescriptive regulation.

The licence drafting does not align with other licence requirements, which will lead to poor customer outcomes and experiences. For example, if Ofgem were to implement its current policy, there would be significant customer experience issues where refunds are forced and debit amounts are then shortly due. These include:

- Customers who have separate tariff anniversary dates for gas and electricity. These customers may have two separate refunds or may get a single-fuel refund while being in debt for their other fuel. This would especially impact customers who have a prepayment meter for one fuel and credit meter for the other fuel.
- Customers may receive a refund during the process of switching supplier during the switching window of a fixed term contract, only to be presented with a final bill requiring payment shortly after.
- Standard condition 27.15 requires that a supplier bases a domestic customer's fixed direct debit estimated annual consumption and most accurate information available. If a direct debit reassessment happens three months before a 12-month fixed term tariff ends, annual date the estimated annual cost will include nine months on the supplier's default tariff. This means a customer makes an overpayment for the remaining three months of their fixed tariff, working up a credit which would be eroded should the customer default to the supplier's Standard Variable tariff.
    - The way Ofgem's proposals work with SLC27 would mean a customer experiences an increase in their monthly direct debit at that review, and receive the overpayment built up during the final three months as an annual refund. They would then be in debit by the amount refunded until their next direct debit review.

We note that Ofgem has included something in the proposed licence drafting which seems completely absent from the consultation document; to allow a supplier to deduct the credit balance from the customer's next bill.

Ofgem provided more information at the workshop held on 14 April, explaining that this drafting should enable a supplier to reduce the customer's next direct debit payment by the amount of credit held on the account.

It is impossible to consider whether the drafting meets Ofgem's policy intent without more information on whether that interpretation is correct. It is not clear whether the next bill must be provided by the relevant date, or whether the next bill can be aligned with the customer's preferred billing cycle.

Autorefund:
Question 4: Do you agree that autorefund of credit balances above £0 at the end of 12 months should not be tied to receiving a meter reading from the customer?

Yes.

Requiring an autorefund to be made on a balance calculated from estimated consumption presents risks to both the customer and supplier. We would not support a proposal which risks issuing a fictitious credit balance refund to a customer, only for them to be placed into debt once an accurate meter reading is received. Debt balances are undesirable for both the customer and supplier, and Ofgem should avoid making them an unintended consequence of this proposal.

The current requirements for 27.16 which permit a supplier to refuse to refund a domestic customer's credit balance where it is fair and reasonable to do so should continue.

If Ofgem has evidence that a supplier has not complied with this licence condition, it should act against that supplier. It already has the powers to do so. We do not support additional prescriptive regulatory burden when existing regulation already provides a mechanism to deliver Ofgem's policy intent.

Threshold:
Question 5: Do you agree that suppliers operating a payment in advance business model should face the cost of the risk they pose to the market?

The risk to the market is not directly from the payment in advance business model, which is used by many suppliers sustainably and in and many other markets without issue. The root cause of the risk Ofgem highlights is a where the supplier has unsustainable tariff pricing and business strategies combined with that supplier's ability to manage debit balances and customers not paying.

We note Ofgem has not addressed those serious issues in its proposals to limit mutualisation following supplier failure.

Where a supplier has sustainable business plans and acts responsibly, the rewards to consumers and more widely across the competitive market for operating this business model far outweighs any risk.

All suppliers, regardless of size, use customer credit balances as working capital. Many suppliers such as People's Energy continue to manage this responsibly and can offer sustainable, cheaper tariffs while delivering better customer service than large inefficient incumbents.

The domestic energy supply market has benefitted greatly from the number of new challengers, who have driven down prices while providing better care to their customers, driving up customer service standards in the process. We have the development of new business models, including suppliers who can specialise in serving parts of the market established suppliers do not prioritise. The impact of these proposals will be most severe on suppliers without the financial backing from being part of a large multinational organisation.

Consumers benefit more widely from suppliers with this business model, and Ofgem's policy will have a direct adverse impact on competition through restricting the viability of the payment in advance business model. This will have an adverse effect on the ability of innovative business models such as Community Interest Companies to enter the market.

Question 6: Do you agree with the obligation and compliance approach for thresholds as outlined?

The compliance approach needs to reflect that the suppliers which are at risk of failure and credit balance mutualisation will are likely to be less able manage the administrative burden and less likely to accurately forecast their credit balance position.

Anecdotally we understand that poor billing data is a common trait for suppliers who have failed, and this would impact how accurate a failing supplier's forecast would be.

Question 7: Do you agree that there should be tolerances around the threshold and how do you consider these should be set?

Yes.

It is important that Ofgem works with suppliers to implement these proposals successfully and meet the policy objectives. Allowing tolerances is a sensible way of providing a degree of flexibility while suppliers develop their procedures for compliance with threshold policy.

Broadly speaking, most direct debits will need to be reviewed at some point through the year. Each supplier will operate its own percentage threshold whereby a consumer's direct debit is amended, should that be needed during a year. We propose that Ofgem allows suppliers to align its tolerance with the tolerances it uses to review a customer's direct debit.

Should Ofgem introduce a prescriptive 2.5% threshold, then it would risk that each supplier aligns its direct debit threshold to that. In real terms, this could mean triggering a direct debit review if a monthly dual fuel payment amount were inaccurate by around £2.

Regular small adjustments like that above would not be welcomed by customers but could be an unintended consequence of setting the threshold too low. Any increase in customer confusion and increase in complaints drives the cost of serving customers up.

Question 8: For suppliers: For your fixed direct debit customers what is the average percentage difference between estimated annual bills and actual annual bills for those accounts that ended with a positive credit balance?

In reality, a supplier's portfolio of fixed direct debit estimated annual bills and actual bills does not work like that.

Standard condition 27 requires that a supplier ensures that the fixed amount of the regular direct debit payment is based on the best and most current information available.

People's Energy bills members monthly and asks for meter readings ahead of billing. In line with our procedures, we would review a member's direct debit if required increasing or decreasing during the year.

As such, it is erroneous to compare estimated annual cost with actual annual costs, as these are adjusted to consider any changes in tariff, price, consumption, or other factors, such as application of warm home discount which can affect the customer's overall annual payments.

Question 9: Please provide your view on the credit balance threshold model published alongside this consultation. Do you agree:
a. With the methodology we have used to calculate surplus credit balances in our draft threshold model?
b. That our threshold needs to reflect that consumers who start at different points of the year have different credit balance requirements?
c. That our model methodology accounts for the impact of contract start date on our threshold?

People's Energy proposes that the automatic refund should only happen at the beginning of the summer months, rather than throughout the year on the anniversary of the contract of individual customer.

A supplier should be allowed to stagger the re-payments within those months, which would deliver the same customer benefit while enabling the supplier to manage the refund process around regulated processes for tariff renewal and direct debit reassessments, which would apply at the same time as Ofgem's proposed refund anniversary date.

Implementation:
Question 10: Do you agree that these measures should apply only to domestic consumers?

Yes. There is no evidence to support extending these policies to non-domestic customers.

Question 11: Do you agree with the proposed implementation timings?

No.

Ofgem needs to consider the wider changes happening in the markets, which supplier need to plan for and resource. Ofgem intends to introduce these requirements at the same time that the industry moves to implement faster switching. Ofgem should not underestimate the resources suppliers will need to commit to introduce those changes, and these policies will stretch suppliers further during a difficult time.

If implemented, the threshold policy needs to be introduced in phases, during a carefully managed transition period, to minimise the risk of more supplier defaults. It is far more constructive to gradually work towards protecting all surplus credit balances safely, and without risking increased mutualised costs.

We propose that Ofgem introduces this requirement gradually, building up to its full intended protection of credit balances.

A major concern with the threshold policy is the effect of implementing the new requirements in summer 2022. Ofgem should especially note that the timescale alone threatens the financial stability of smaller suppliers at a key point in time during their financial year.

Complying with the proposals presents a major cost to a supplier, and the proposed timing of this cost comes just before the August Renewables Obligation deadline, constraining cash flow as the supplier prepares to enter the winter period.

It is likely that some will not have the liquid finances available to settle their Renewables Obligation payment in August 2022, or the late payment date in October. Suppliers failing and exiting the market will increase the amount requiring mutualisation, exactly the opposite effect intended by the threshold policy.

Question 12: Do you agree with our assessment of the costs and benefits of our proposals as set out in chapter 5 and appendix 1?

The 2018/19 winter period saw 12 supplier failures, which is an unrepresentative sample to base analysis on. Since then, there has been proportionately fewer supplier exits with less reliance on credit balance mutualisation.

We do not believe that Ofgem has given appropriate consideration to the wider costs and unintended consequences of its proposals as we have explained in this response.

People's Energy Company May 2021