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Dear Sabreena,

LEVELISATION OF PAYMENT METHOD COST DIFFERENTIALS – CALL FOR EVIDENCE

We welcome the opportunity to respond to Ofgem's call for evidence on levelisation of payment method cost differentials and consequent reconciliation. Ofgem is considering whether and how to levelise both charges for prepayment meter (PPM) customers and Standard Credit (SC) customers, with those of Direct Debit (DD) customers as well as considering the approach to reconciliation.

We have provided a detailed response in Annex 1 but summarise our position below.

Our view is that in assessing the options the following objectives should be considered and a balanced approach taken:

- Promoting cost reflectivity within the price cap (before any levelisation)
- Reduce the negative impacts of energy bills on vulnerable customers
- Retain incentives for efficiency and future system cost reduction
- Fairness between suppliers, ie levelisation must be accompanied by reconciliation.

Reconciliation

It is **essential** that any levelisation scheme is accompanied by a reconciliation scheme to maintain a level playing field between suppliers. We propose a bespoke flexible mechanism, potentially differentiating the reconciliation of standing charges from that of unit rates. It is important that the reconciliation scheme covers both standing charges and unit rates for SC and PPM to ensure that this policy is sufficiently flexible to be future proof.

Levelisation between PPM and DD

We support the use of a levelisation scheme to ensure that PPM price caps are no higher than DD price caps at all consumption levels. We consider that to future proof this

approach, the levelisation scheme should be designed to work with both standing charges and unit rates, and the levelisation amounts should be updated on a quarterly basis in line with the price cap. Levelisation should be used to bring PPM price cap levels down to the level of DD but should not be used to increase PPM price cap levels if they are already lower than DD. We acknowledge that this will increase bills for DD customers and although Ofgem has not separately assessed the case for PPM only, this will be lower than the Case 1 impact at an estimated £8-£9 per DD dual fuel average bill.

Levelisation between SC and DD

We support the use of a levelisation/reconciliation scheme to unwind the current cross-subsidy in the cap whereby SC costs are 'smeared' over DD, resulting in competitive distortions. Ofgem should remove the current smearing, resulting in a higher SC vs DD differential, and then use the levelisation/reconciliation scheme to bring the differential back to current levels in a way that does not distort competition. This could also be done for future debt allowances in the price cap. However, we do **not** support the use of levelisation/reconciliation to make further reductions in the differential between SC and DD because of the risk of incentivising inefficient customer and supplier behaviour. There needs to be a meaningful difference between SC and DD to incentivise customers to move away from SC and to incentivise suppliers to encourage customers onto more cost-efficient payment methods.

Yours sincerely,



Richard Sweet
Director of Regulatory Policy

LEVELISATION OF PAYMENT METHOD COST DIFFERENTIALS – SCOTTISHPOWER RESPONSE

Question 1: What do you think the objectives of levelisation should be (eg, full levelisation across payment methods, partial levelisation, anything else)?

The circumstances and impact of levelisation, including the approach to reconciliation need to be considered in detail before a decision can be made and we do not think absolute objectives such as full levelisation are appropriate. In our view the following objectives should be taken into account:

- Cost reflectivity – levelisation should avoid moving away from cost-reflectivity unless there is a strong rationale for doing so
- Fairness between customers – levelisation should help reduce unfairness, in particular as it relates to vulnerable customers
- Efficiency – levelisation should retain incentives for efficiency and future system cost reduction (eg incentives for customers to choose less expensive payment methods).
- Fairness between suppliers – moving away from cost-reflective charging without a reconciliation process would distort competition and therefore levelisation must be accompanied by reconciliation.

Question 2: Should we only focus on PPM levelisation or should we also consider SC?

We cover our views on PPM levelisation and SC levelisation separately below.

PPM to DD levelisation

We think that PPM customers should have costs levelised to those of DD customers only where costs are higher. Ofgem has not proposed this approach to levelisation based on the existence or not of a differential but we consider that this would future proof the policy to continue to achieve its objective. We recognise that a higher proportion of PPM customers may be vulnerable and therefore if either or both of standing charge and unit rates are higher than those of DD customers, levelising these would help. However Ofgem should give some consideration to incentives for customers to move to smart meters (as mentioned in footnote 16 of the call for evidence). Our detailed views are below:

PPM standing charge: Levelise if PPM is higher than DD

Our view is based on the fact that a high proportion of PPM customers are vulnerable and PPM customers find standing charges particularly problematic due to seasonal usage patterns. If gas heating is not used over the summer there is a large standing charge build up to pay off before any heating in the winter. We are particularly concerned about this impact for winter 2023. However, we note that a large portion of the high standing charge for PPM customers is related to the older legacy metering and the higher associated costs. Ofgem should ensure however that there remain incentives for PPM customers to move to smart meters with the advantages this has to customers and suppliers, removing the high costs associated with legacy metering and allowing the supplier to monitor the customer more closely, for example for potential self-disconnections.

PPM unit rate: Levelise if PPM is higher than DD

Although the PPM unit rate is currently lower than DD, in the future, if it were to increase above the DD unit rate, for example due to cost reflective additional allowances, this would lead to further discrepancy between PPM and DD. Therefore, our view is that these should be levelised if Ofgem would like to ensure that it achieves its policy objectives.

SC to DD levelisation

Over time the differential between SC and DD in the price cap is shown in Table 1

Table 1: Differential between SC and DD for the price cap for a dual fuel customer with 2,900 kWh electricity and 12,000 kWh gas

	Period 6	Period 7	Period 8	Period 9a	Period 9b	Period 10a
DD cost	£1,138	£1,277	£1,971	£3,549	£4,279	£3,280
SC cost	£1,223	£1,370	£2,100	£3,764	£4,533	£3,482
Cost difference	£84	£92	£130	£215	£254	£202

When considering whether to levelise SC to DD in either the unit rate and/or standing charge, it is necessary to consider and balance the following factors:

- Cost reflectivity: there is a higher cost to serve SC customers relative to DD

There are higher operating costs to serve SC customers, and higher levels of bad debt associated with SC customers since it is easier to not pay and get into debt. Some of these costs were smeared onto DD customers by Ofgem when it set up the price cap, with a consequent distortion of competition between suppliers with different mixes of customers. The differential between SC and DD increases with wholesale price increases, reflecting the increased cost of bad debt associated with higher bills. Although this increases the competitive distortion, we can also see an argument that with very high wholesale prices the impact of the differential on SC customers is disproportionate. Levelisation (accompanied by reconciliation) provides an opportunity to mitigate the impact on consumers without distorting competition, but the challenge is to find a proportionate, objective price differential that still incentivised SC customers to move to DD.

- Incentives to switch from SC to DD.

This is one of our key concerns. We believe that full levelisation would create longer-term inefficiencies as suppliers would not be incentivised to encourage consumers onto more cost-efficient payment methods and customers would not be incentivised to move to save money. There should remain a difference between SC and DD to incentivise customers to move away from SC.

- Fairness

We have considered the fairness aspect relating to those paying by SC that do pay bills and are not in debt. This is what was behind Ofgem's Case 2, where the bad debt element of both standing charge and unit rate was smeared across DD and we have some sympathy with this perspective. On the other side we have considered whether it is fair for DD customers to bear the additional costs associated with SC which is an inefficient and costly payment method. On balance, we consider that SC customers

have the ability to change payment method to address this and hence on balance our view is that we should limit increases to DD.

- The level of vulnerable customers in this group

Although around 18% of SC customers are categorised as vulnerable, this is not as high as for PPM (27-28%). In addition, 50-60% of vulnerable customers pay by DD. Given that costs of levelising SC would be added to DD customer bills, the relative impact on the two sets of vulnerable customers on SC and DD would need to be weighed carefully in considering further SC/DD levelisation and we are doubtful that it would be beneficial.

Overall our view is that Ofgem should not fully levelise either the SC standing charge or unit rate with DD. However, if Ofgem decides to do partial levelisation, we consider that it is important to retain incentives for SC customers to switch to DD. For suppliers, SC is associated with increased cost and higher risk of bad debt, and for customers, given SC has some additional benefits such as feeling more in control over their finances and in effect providing a monthly or quarterly loan, we would be concerned if Ofgem did not retain a high cost differential since this may even encourage more customers to move to SC which would increase inefficiency.

As stressed above, the approach to reconciliation is significant when considering whether to levelise SC to DD fully or partially. Without a reconciliation mechanism this would further distort the market.

Question 3: If SC is included in levelisation, should some degree of price difference remain, whereby SC is higher than DD to maintain an incentive for customers to go on DD?

Yes, we believe that a price difference should remain for the reasons given above, and also by Ofgem in the call for evidence. There are significant cost implications associated with SC for suppliers and full levelisation could therefore create longer-term inefficiencies as suppliers are not incentivised to encourage consumers onto more cost-efficient payment methods (DD).

In addition, for some customers, SC has additional benefits such as helping customers feel more in control of their finances and cashflow (potentially serving as a source of free credit). Not retaining a cost differential may therefore encourage more customers to move to SC which would increase inefficiency.

We do not believe the price difference between SC and DD should be reduced over and above the current smearing, but if Ofgem does decide to apply some levelisation to SC customers it should:

1. Assess what the minimum efficient differential should be, based on incentives to switch payment methods, and ensure that the SC/DD differential is at least this level; and
2. Undo the current smearing between SC/DD (this should occur even if SC levelisation does not take place since the cost differential and cross subsidisation should be separately acknowledged, re-levelised and reconciled); and
3. Either partially levelise the bad debt element (subject to 1 above ensuring that the differential is a certain size); *or*
4. Partially levelise the unit rate element only;

- a) to acknowledge the higher fixed costs associated with these customers and to retain incentives even for low consumption customers by keeping the standing charge higher
- b) To reduce the impact on SC customers related to wholesale price changes

Overall, (SC bill - DD bill) = £x. Where $x \geq$ Ofgem's assessment of a £ value that would incentivise the majority of customers to move from SC to DD (or not to move back from DD to SC), at a particular level of consumption.

Question 4: After considering the different levelisation options presented (charge type, individual elements of the price cap, extent to which levelisation should occur), are there any further levelisation options that you think should be considered?

Our preferred option assumes that a levelisation mechanism is accompanied by a reconciliation mechanism so that competition in the market is not adversely affected. In our view this is **essential**. Our proposal is as follows:

- a) Ensure PPM, SC and DD price cap tariffs (before levelisation) are fully cost-reflective so as not to distort competition; for SC and DD this would mean unwinding the current cross-subsidies in the PAP, PAAC and COVID true-up allowances;
- b) Levelise PPM with DD if the PPM standing charge and/or unit rates are higher than DD. The key objective for this is fairness (PPM cap \leq DD cap at all consumption levels);
- c) Partially levelise SC and DD to the extent necessary to bring the current SC vs DD price cap differential back down to current levels, ie reversing the impact of (a) above (see Table 2 for details).

Table 2: Existing smearing in the price cap

Debt-related cost	Smearing between SC and DD
Bad debt	Additional SC bad debt costs (relative to DD) are included in payment method uplift percentage allowance (PAP), except that 48% of these additional costs are smeared equally between DD and SC customers, reflected in the separate PAP _{DD} and PAP _{SC} percentage allowances.
Debt administration costs	The PAAC _{DD} and PAAC _{SC} allowances in the price cap cover various administrative costs which are higher for SC than for DD. As with the PAP allowance 48% of the SC costs are smeared equally between DD and SC customers.

It is vital that any partial levelisation between SC and DD preserves the incentive for customers to switch from SC to DD (and not to switch back).

Question 5: Can you provide any evidence on why one levelisation option should be preferred over another?

We think there is a strong case for (i) PPM vs DD levelisation (such that PPM cap \leq DD cap at all consumption levels) and (ii) unwinding the existing SC vs DD cross-subsidies in the price cap and achieving the same thing (in a competitively neutral way) via levelisation. We therefore propose that these two objectives are implemented in April 2024. If Ofgem wanted

to take forward increased SC/DD levelisation (which we disagree with), this should take place after the initial levelisation/reconciliation scheme has been fully established.

As noted above, we would strongly object to *full* levelisation of SC/DD (ie removing any price difference between SC and DD) given the impact this may have on markets, customers (including vulnerable customers) and incentives.

Question 6: Can you provide any evidence of levelisation effects that should be avoided that have not been shown within our analysis?

As we have stated, we support a PPM levelisation mechanism **only** if it is accompanied by a reconciliation mechanism.

Question 7: What are your views on targeting levelisation to particular groups of customers within payment methods (eg customers under the price cap or in vulnerable situations)? Do you have evidence to support your views?

We do not consider that targeting levelisation to particular groups of consumers is practicable. Although the adverse impact of levelisation on DD customers (in terms of increased bills) would be reduced, we see two main issues with targeting:

- Fairness: It is difficult for Government/Ofgem to make decisions on which customer groups should be targeted; it will likely appear unfair to customers who have not been targeted and who may also be considered fuel poor by different metrics.
- Complexity: Targeting is potentially very complex for suppliers to operationalise. We have seen the complexity associated with targeting when we deliver the Warm Home Discount and in considering options for other schemes (such as the social tariff) that aim to target the most vulnerable, in particular ensuring there is robust data to target the appropriate groups.

Question 8: Given the distributional impacts analysis provided above, what is your view on the benefits to consumers on the levelisation of payment methods?

To clarify, the distributional impacts we are referring to in response to this question are between customers rather than between suppliers.

We broadly agree with Ofgem's assessment of the distributional impact on consumers and how the different options proposed impact the groups of customers differently and the insights gained from the assessment.

We would also like to highlight the impact of the PPM standing charge levelisation on gas customers. Gas customers with PPMs often use very little or even no gas over the summer months leading to a build-up in standing charges that must be paid off when the customer wants to use their heating in the winter months. Reducing the standing charge via levelisation would mitigate this impact.

Our view is that the benefits to consumers of a PPM vs DD levelisation/reconciliation scheme are likely to outweigh any negative impact from the distributional effects. Although DD customers will see higher bills and the majority of vulnerable customers pay by DD, the bill increase for DD will be less than the reduction for PPM, and vulnerable customers in aggregate will still benefit.

For SC customers, where full levelisation with DD could dramatically increase system costs and inefficiency, bill payers in aggregate would certainly pay more, and we very much doubt that the benefits even for vulnerable customers would outweigh the costs.

Question 9: Do you agree with our characterisation of the effects on competition? Can you explain why or why not?

We agree with the characterisation of the effects on suppliers of levelisation without reconciliation (as illustrated in Ofgem's Table 15). The level of competitive advantage/disadvantage is potentially very significant and could undermine supplier stability as Ofgem suggests.

Ofgem has not referenced in its assessment the impact of whether the levelisation is market wide or restricted to Standard Variable Tariffs (SVT) but this would also impact the effects on competition as well as on suppliers' targeting of customer types / payment methods.

Question 10: Are there any additional impacts on competition or other areas that we should consider? Can you provide evidence of these?

We have not identified any others at this stage.

Question 11: Do you agree with our assessment on market competition and incentives? Can you explain why or why not?

We comment on the assessment Ofgem has made relating to the level of competition in the retail market.

Competition between PPM tariffs

Ofgem considers that levelisation could reduce competition between PPM tariffs, as levelisation makes it difficult to differentiate on prices. We think this would only be the case if levelisation/reconciliation was applied to SVT tariffs only and not to Fixed Term Contracts (FTCs), in which case we agree this could impact the availability of FTCs for PPM customers. However, if levelisation (accompanied by reconciliation) applied to all tariff types, this would affect competition between payment methods but not within a payment method.

PPM smart versus traditional incentives

We note Ofgem's reference to considering the treatment of costs between smart and traditional meters as part of its review of the operating cost allowance in the price cap, and agree that this is something that Ofgem should review, including in relation to PPM costs. and We can see a number of competing considerations that Ofgem will need to assess to ensure that policy in this area is well thought through and avoid unintended consequences.

- Given the current difficulties that suppliers are facing in getting customers to accept smart meters, there could be a benefit in moving to more cost-reflective price caps, lowering the SMNCC allowance for smart prepayment and increasing the SMNCC allowance for traditional prepayment, such that prepayment customers have a price incentive to accept a smart meter. If this resulted in the traditional prepayment cap rising relative to DD, the levelisation scheme could be used to bring the traditional PPM cap back in line with DD,

with the smart PPM cap receiving a similar discount to maintain the differential between smart and traditional PPM.

- This would however potentially add to the complexity of the levelisation calculations and alongside this, the introduction of further variants of price on the same tariff, particularly linked not just to payment method but also meter type, could arguably introduce significant levels of complexity which could create operational and compliance challenges for suppliers.
- Finally, where customers are in circumstances where a smart meter variant is not available (for example due to technical challenges), consideration needs made of the “fairness” in offering lower prices for customers with smart meters.

Standard Credit incentives

Ofgem is also concerned that levelisation might make SC relatively a more attractive option for consumers. To the extent that this increases the likelihood of debt related costs, it may introduce longer term inefficiencies and higher overall debt related costs for suppliers. These higher costs could lead to higher bills and could make it more difficult for suppliers to enter or remain in the market. We share Ofgem’s concerns in this area and this is a key reason behind our opposition to fully levelising SC with DD.

Market engagement

Ofgem is also concerned that levelising could disincentivise customers from engaging in the market if tariff prices are similar across payment methods. We do not agree with this concern since we do not believe that this was a key driver of switching under ‘normal’ market conditions.

Focus on default tariffs only or both default and fixed tariffs

We consider the levelisation should encompass both default and fixed tariffs and agree with Ofgem that not doing so could lead to the following impacts:

- New FTCs would not be subject to the price cap and therefore it is unlikely that a supplier would be able to offer new SC or PPM FTCs that were below SVT tariffs. In addition, FTC DD tariffs would be able to be offered that were lower than the price cap possibly impacting the objective of levelising PPM to DD.
- This will introduce distortions into the market and impact incentives to switch that differ by payment type. The more DD customers that move off the price cap onto FTCs, the higher the DD SVT tariff would be.

Question 12: Are there any other impacts on your organisation or the market that we have not considered?

Ofgem has not considered the potential operational impacts and/or reporting requirements in its assessment. What these would be will depend on the approach taken to implementation, and the requirements for auditing and compliance. These have the potential to lead to appreciable costs for suppliers.

Since our preferred solution is across all tariffs (SVT and FTC) there is the potential for complex reporting requirements. Ofgem should consider the approach to auditing and reporting on this as part of its assessment including how it would apply to any pre-existing FTCs. If Ofgem were to undertake full SC levelisation consideration should be given as to ease of implementation in adjusting and creating FTCs for example, a consistent differential could mitigate operational impacts.

Question 13: If costs are not reconciled, what would the impact of payment method levelisation be on your organisation, where relevant?

The precise impact on ScottishPower is difficult to calculate without knowing the nature of the levelisation approach and how ScottishPower's mix of payment methods compares with the industry average (or revenue-weighted industry average). [3<]

Question 14: Do you consider that the costs of levelisation should be reconciled between suppliers? What are your views on the reconciliation mechanisms presented?

It is essential that any levelisation scheme is accompanied by reconciliation to avoid the risk of distorting competition between suppliers (and potentially other unintended consequences).

As explained above, the current smearing of bad debt costs in the price cap from SC to DD (via the PAP and PAAC and the additional COVID true-up) is a form of levelisation which distorts competition and risks adverse consequences for consumers. A levelisation scheme accompanied by reconciliation would allow Ofgem to include additional bad debt allowances in the price cap in a way that avoids smearing SC-related costs across DD and hence avoids this sort of distortion of competition between suppliers.

This approach to reconciliation could also be used to provide more cost reflective adjustment allowances in other areas and avoid creating winners and losers between suppliers and consequent competitive distortions.

Our preference is for a bespoke reconciliation mechanism that has the following characteristics:

- The delay in recovery is limited. For volumetric reconciliations (which depend on settlement data) there is a balance between delay in recovery and administrative costs of revising payments through multiple settlement runs.
- Minimises cost of administration to the extent possible – this could mean using data directly from Elexon / Xoserve and limiting the operational / reporting requirements.
- Easy to monitor, track and forecast impact on business
- Easy for the administrator to enforce payment from suppliers where payment is due, to avoid risks of late or non-recovery.

We consider that Ofgem should have a mechanism that covers both fixed, per customer reconciliation (for standing charges) and volumetric reconciliation (for unit rates). A summary of the calculations behind such a reconciliation scheme is provided in Annex 2. Volumetric reconciliation can require multiple settlements to reflect the settlement runs which true-up

customer consumption volumes. The number and frequency of settlements required is a trade-off between the speed of recovery and the number of true-ups needed. For example, the FIT scheme has 5 reconciliation runs.

Reconciliation of standing charge levelisation is simpler since it relies only on the number of meter points on each payment method and does not require volumetric settlement data. Due to the different nature of these reconciliation mechanisms, we propose that Ofgem considers different timescales for reconciliation of the different elements linked to the characteristics and requirements of the mechanism.

- Standing charge reconciliation, based on number of meter points per payment method, could be done relatively promptly meaning that (in the case of PPM vs DD standing charge levelisation), pure PPM suppliers do not have to wait too long to recover costs. Being simpler, it should also be quicker to implement than unit rate reconciliation.
- Unit rate reconciliation could be done at R1 or R2 settlement runs which would mean a delay in recovery. A decision could be made as to whether any further reconciliation true-up is required beyond R2, balancing administrative costs with accuracy.

We consider that this hybrid approach would work well.

Question 15: Are there any other reconciliation mechanisms that you think we should consider that we have not discussed?

Ofgem could consider looking at the LCCC reconciliation mechanism as part of its consideration of reconciliation.

Question 16: Is there anything else Ofgem should consider with regards to levelising costs across payment methods?

ScottishPower has long advocated a levy approach whereby Ofgem collects money from suppliers via a levy mechanism and then uses the money raised to compensate suppliers where they have been unable to recover efficiently incurred costs under the price cap. If Ofgem were to proceed with a levy mechanism, this could potentially be used as the basis for a reconciliation scheme to be used in conjunction with levelisation.

We see a levy mechanism as offering two significant opportunities:

- Costs can be recovered from all customers, whether on FTC or SVT, enabling fairer recovery of historic debt costs when, for example, large numbers of customers have switched back from SVT to FTC.
- Supplier compensation can reflect the specific circumstances of the supplier, ie it does not need to be 'one size fits all' as in the price cap.

We would propose:

- a levy imposed on suppliers in respect of all domestic customers (SVT and FTC) eg via an uplift to DUoS charges;

- disbursement of the proceeds of that levy to suppliers in proportion to the actual costs incurred, to the extent that variations in actual costs are the result of non-efficiency factors (determined via RFI).

We think Ofgem could use its existing powers to introduce a levy through a modification to the gas and electricity supply licences. This would involve adding two new licence conditions as follows:

Condition X – Suppliers to make claims in relation to excess costs to Ofgem, which Ofgem then considers/approves (“approved claims”);

Condition Y – Direction to DNOs to increase distribution charges for domestic customers by an amount necessary to cover the amounts of approved claims, and remit claims to suppliers.

In our view there is no particular difficulty with Ofgem modifying the licence to make provision for suppliers to submit excess cost claims for assessment by Ofgem for the purposes of Condition X.

We think the legal basis allowing a modification of the SLC in relation to Condition Y is found in section 7(3A) of the 1989Act¹, which provides that:

“Conditions included in a transmission licence or a distribution licence by virtue of subsection (1)(a) may require the holder, in such circumstances as are specified in the licence– (a) so to increase his charges for the transmission or distribution of electricity as to raise such amounts as may be determined by or under the conditions; and (b) to pay the amounts so raised to such licence holders as may be so determined.”

A similar template applies to the SoLR scheme. As such, the Distribution SLC, condition 38B, requires electricity distributors to pay suppliers for any valid Last Resort Supply Payment claims.

In summary, we think Ofgem has the power under the Acts to introduce a levy scheme through a modification of the SLCs to take account of extraordinary costs on a forward looking basis.

We believe that Ofgem should make an “in principle” decision on this as soon as possible so consultation and active sector engagement can begin to take place.

¹ Also in section 7B(5)(b) of the Gas Act 1986.

PAYMENT METHOD LEVELISATION/RECONCILIATION SCHEME

We set out below how we envisage the payment method levelisation and reconciliation scheme might operate. In essence, Ofgem sets the levels of cross subsidy each quarter so as to achieve its policy objectives in terms of adjusting payment method price differences, whilst at the same time ensuring that the overall position across all suppliers nets out as closely as possible to zero. In the interests of simplicity the description below ignores the impact of multiple settlement runs on volumetric data.

The key parameters for the levelisation process are as follows:

$u_{i,k}$	adjustment to unit rate for payment method i ($i = 1..3$) in period k
$s_{i,k}$	adjustment to standing charge for payment method i ($i = 1..3$) in period k
$v_{i,j,k}$	GWh supplied to customers on payment method i by supplier j ($j = 1 .. N_s$) in period k
$m_{i,j,k}$	Number of meter points on payment method i served by supplier j in period k

Under the reconciliation process, the amount paid by (or paid to) supplier j in period k , is $R_{j,k}$, calculated as follows:

$$R_{j,k} = \sum_{i=1}^3 V_{i,j,k} u_{i,k} + M_{i,j,k} s_{i,k}$$

The reconciliation amounts paid to/by suppliers are unlikely to balance out exactly to zero and there will be a residual amount. The (cumulative) residual for period k , X_k is given by:

$$X_k = \sum_{i=1}^3 (V_{i,k} u_{i,k} + M_{i,k} s_{i,k}) + X_{k-1}$$

where $V_{i,k}$ and $M_{i,k}$ are the total volumes and meter point numbers summed across all suppliers:

$$V_{i,k} = \sum_{j=1}^{N_s} v_{i,j,k} \quad M_{i,k} = \sum_{j=1}^{N_s} m_{i,j,k}$$

As noted above, Ofgem will set the values of $u_{i,k}$ and $s_{i,k}$ for period k so as to achieve its payment method levelisation objectives. However, in doing so, it will also need to ensure that the predicted cumulative residual (total payments to/from suppliers, plus any residual from the previous period) balances out to zero:

$$\hat{X}_k = \sum_{i=1}^3 (\hat{V}_{i,k} u_{i,k} + \hat{M}_{i,k} s_{i,k}) + X_{k-1} = 0$$

where $\hat{V}_{i,k}$ and $\hat{M}_{i,k}$ are Ofgem's forecasts of $V_{i,k}$ and $M_{i,k}$ in period k . These could be based on the most recent available actual values for a previous period (with seasonal adjustment as appropriate for energy volumes).

Any variance between actual volumes and meter numbers ($V_{i,k}$ and $M_{i,k}$) and Ofgem's forecasts ($\hat{V}_{i,k}$ and $\hat{M}_{i,k}$) will be reflected in X_k , the residual for period k .