Sabreena Juneja, Head of Price Cap Policy
Price Protection Policy
Ofgem
10 South Colonnade
London
E14 4PU

Email to: priceprotectionpolicy@ofgem.gov.uk

18 May 2023

Dear Sabreena

Levelisation of payment method cost differentials: a call for evidence

EDF is the UK's largest producer of low carbon electricity. EDF operates low carbon nuclear power stations and is building the first of a new generation of nuclear plants. EDF also has a large and growing portfolio of renewables, including onshore, offshore wind and solar generation, and energy storage. With around six million electricity and gas customer accounts, including residential and business users, EDF aims to help Britain achieve net zero by building a smarter energy future that will support delivery of net zero carbon emissions, including through digital innovations and new customer offerings that encourage the transition to low carbon electric transport and heating.

EDF welcomes the opportunity to comment on Ofgem's Call for Evidence on the levelisation of payment method cost differentials. EDF is committed to ensuring fair outcomes for all customers including those in vulnerable circumstances.

It is welcome that Ofgem is exploring how to ensure that payment methods are appropriate in terms of price for all customers. However, in doing so Ofgem must ensure this does not result in any perverse or unwelcome impacts for energy customers and does not add unnecessary complexity to an already very complex price regulation regime.

EDF would, therefore, recommend that Ofgem focus on the following specific objectives:

- **Incentivising the switch to smart prepayment by making it the cheapest payment method:** Customers must have incentives to switch to a smart prepayment meter and gain the superior experience and lower cost to serve and support that it brings. Ofgem must therefore take steps to ensure that smart prepayment is the cheapest payment method on an ongoing basis. Any solution developed must be simple and proportional recognising that from October this year prepayment will already be the cheapest payment method for most customers. EDF does not agree that legacy prepayment should be levelised to the same level as smart prepayment in the longer term. Rather Ofgem should use any changes to support the smart meter roll-out and encourage customers paying by legacy prepayment meters to upgrade to smart prepayment.

- **Standard credit should be the highest cost payment method:** Standard credit should not be levelised to the same level as other payment methods, recognising that this carries the highest working capital and debt costs. Doing so would result in customers no longer being incentivised to switch to more cost-efficient payment methods which would increase supplier bad debt and increase customer bills.
- **A focus on simplicity should mean that any changes are limited to standing charges:** This is the key aspect that is still higher for all prepayment customers and will make any ongoing levelisation much simpler to operationalise. This could also provide wider benefits if standing charges were equalised across all payment method by aiding customer engagement and understanding of energy prices.
- **Ofgem must consider wider social policy changes:** Customers on all payment methods that are financially vulnerable will continue to need support to ensure their energy bills are affordable. This can only be tackled effectively through wider government social policy initiatives including the DESNZ work on a new social tariff. Therefore, Ofgem should not undertake any activities which could make later policy developments, including changes to the price cap, unnecessarily complex.
- **Ofgem should explore wider competitive impacts:** If any changes are implemented it would be sensible to explore wider competitive impacts. For example, there is already a smearing of some costs between standard credit and direct debit in the current price cap which could cause competitive distortions. If any levelisation regime is enacted Ofgem should consider how such issues can be overcome.

To meet these objectives, Ofgem's focus should be on ensuring any solution is simple to implement. Potential options to consider in isolation or as a combination of approaches include:

- Varying the Default Tariff Cap debt allowance so lower for all prepayment customers;
- Varying the EBIT % allowance by payment method to reflect the varying working capital requirements – which are significantly lower for prepayment customers as they pay upfront, and higher for standard credit customers as their payment terms are longer than those faced by suppliers for costs;
- Remove legacy infrastructure costs from all prepayment customers and socialise across all consumers as a public good;
- Government to fund any reductions as a social good;
- Simple levy on all energy customers to fund any reductions as a social good.

EDF would welcome more detailed industry discussion on the best approach(es) to take forward once Ofgem has clearly outlined their intentions for any regulatory changes that are to be undertaken.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Nicola Pope, or myself.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely

John Mason
Senior Manager - Senior Manager (Price Regulation and Market Dynamics)

Attachment

Levelisation of payment method cost differentials: a call for evidence

EDF's response to your questions

Q1. What do you think the objectives of levelisation should be (e.g., full levelisation across payment methods, partial levelisation, anything else)?

The objective of any levelisation should be to make smart prepayment the cheapest payment method for domestic customers as this will bring a number of consumer, societal and net zero advantages.

Smart meter technology has allowed suppliers to innovate and offer a superior customer experience. This includes more convenient ways to pay, real-time monitoring of when customers cease making payments and greater visibility for customers on their consumption and costs, all of which helps us provide more proactive support to customers facing payment difficulty. Smart meters also support wider net zero ambitions by providing the tools for consumers to understand when and how they are using energy to become more energy efficient. This is why when installing a prepayment meter, we are committed to installing smart prepayment meters where possible.

Smart prepayment meters also have a lower cost to serve as they can largely be managed remotely with automatic meter readings negating the requirement for expensive site visits. Alternative smart prepayment top-up mechanisms will also enable the withdrawal of the costly legacy prepayment infrastructure in the longer term.

EDF does not agree that legacy prepayment should be levelised to the same level as smart prepayment in the longer term as customers must have incentives to switch to a smart meter and gain the superior experience and the lower cost to serve that it brings. Ofgem should use any changes to support the smart meter roll-out and encourage customers paying by legacy prepayment meters to upgrade to smart prepayment.

Q2. Should we only focus on PPM levelisation or should we also consider SC?

Standard credit costs should not be levelised to the same level as other payment methods, as this payment method carries the highest working capital and debt costs.

In contrast to other payment methods, standard credit has no automatic mechanism (whether that be advance top-up or bank instruction) to collect payment from the customer rather it is dependent on the customer taking action to pay their bill. If the cost of standard credit were to be equivalent to direct debit customers would have less incentive to switch to more cost-efficient payment methods. This would lead to increased bad debt across suppliers which means higher customer bills and ultimately it may make it more difficult for suppliers to enter or remain in the market if they are unable to recover payment from their customer base.

Q3. 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, EDF agrees. Standard credit costs should not be levelised to the same level as other payment methods, as this payment method carries the highest working capital and debt costs. Doing so would result in customers no longer being incentivised to switch to more cost-efficient payment methods which would increase supplier bad debt and increase customer bills.

Q4. 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?

Yes. Smart prepayment should be the cheapest payment method. However, this must be considered in the context of UNC modification 0840 and the fact that from October for all but the lowest consuming, customers with a prepayment meter will already be cheapest payment method, and even in those cases, the price differential when compared to direct debt will be small. Based on the Standing Charges in Table 3 of the Call for Evidence for a dual fuel customer the difference in cost for prepayment when compared to direct debit would be a maximum of £0.97 a week and would only ever reach that peak if the customer had zero consumption.

Ofgem's focus should be on ensuring any solution is, therefore, simple to implement. Potential options to consider in isolation or as a combination of approaches include:

- Varying the Default Tariff Cap debt allowance so lower for all prepayment customers;
- Varying the EBIT % allowance by payment method to reflect the varying working capital requirements – which are significantly lower for prepayment customers as they pay upfront, and higher for standard credit customers as their payment terms are longer than those faced by suppliers for costs;
- Remove legacy infrastructure costs from all prepayment customers and socialise across all consumers as a public good;
- Government to fund any reductions as a social good;
- Simple levy on all energy customers to fund any reductions as a social good.

As low consumption users experience the greatest potential detriment the reduction must be in the standing charge rather than unit rate. This should also be simpler to implement.

Q5. Can you provide any evidence on why one levelisation option should be preferred over another?

Yes. A focus on simplicity should mean that any changes are limited to standing charges. This is the key aspect that is still higher for all prepayment customers and will make any ongoing levelisation much simpler to operationalise. This could also provide wider benefits if standing charges were equalised across all payment methods by aiding customer engagement and understanding of energy prices.

Q6. Can you provide any evidence of levelisation effects that should be avoided that have not been shown within our analysis?

Yes, Ofgem should avoid making changes that are unnecessarily complex. The key to levelisation is simplicity which is why any changes should be limited to standing charges. This is the key aspect that is still higher for all prepayment customers and will make any ongoing levelisation much simpler to operationalise.

Ofgem must also ensure that they do not undertake any activities that could make later policy developments, including changes to the price cap such as the review of operational and debt costs, more complex. Levelisation is also not a mechanism that can effectively resolve underlying wider social issues including energy affordability and this must be tackled directly through broader government initiatives such as the development of a social tariff.

Q7. What are your views on targeting levelisation to particular groups of customers within payment methods (e.g. customers under the price cap or in vulnerable situations)? Do you have evidence to support your views?

EDF does not agree that levelisation should target groups of customers within a payment method as this would be at best complex and most likely an impossible task. Ofgem's own distributional analysis indicates that it is not possible to use levelisation to target particular groups of customers effectively. For example, for each levelisation model in the call for evidence both financially vulnerable customers and those with higher incomes may benefit or may be disadvantaged - the only difference is in the latter case this will be in absolute terms and in the former case where income is lower, it will be as proportion of a customer's total energy costs.

Customers on all payment methods that are financially vulnerable will continue to need support to ensure their energy bills are affordable, and this can only be tackled effectively through wider social policy initiatives such as DESNZ work on a new social tariff. Ofgem should not undertake any activities which could make later policy developments, including changes to the price cap, more complex.

Q8. Given the distributional impacts analysis provided above, what is your view on the benefits to consumers on the levelisation of payment methods?

Ofgem's distributional analysis indicates that levelisation cannot be used with certainty to target vulnerable customers specifically whatever form it takes. This means that levelisation is not an appropriate vehicle to attempt to address wider affordability issues. Where financially vulnerable customers require additional support to manage their energy costs this should be achieved through wider government social policy including the work in progress with DESNZ for a new social tariff.

Q9. Do you agree with our characterisation of the effects on competition? Can you explain why or why not?

If smart prepayment became the cheapest payment method the impact on competition would be minimal as after the introduction of UNC modification 0840 in October prepayment will already be the cheapest payment method for most prepayment customers, whether on smart or legacy meters. This will mean that the market dynamic and contract options for suppliers and the incentives for customers to switch to a different payment method will remain constant.

Q10. Are there any additional impacts on competition or other areas that we should consider? Can you provide evidence of these?

Yes. There is already a smearing of some costs between standard credit and direct debit in the current price cap which could cause competitive distortions as suppliers with more customers on standard credit may not be able to recover their costs. If any levelisation regime is enacted Ofgem should consider how such issues can be overcome.

Q11. Do you agree with our assessment on market competition and incentives? Can you explain why or why not?

We agree that levelising standard credit with direct debit would reduce the incentive for customers on standard credit to switch to more secure payment methods and for this reason standard credit should not be levelised to the same level of other payment methods. Doing so would result in customers no longer being incentivised to switch to more cost-efficient payment methods which would increase supplier bad debt, increase customer bills, and ultimately could make it unviable for suppliers to continue to operate.

EDF recognise that customers on standard credit that are financially vulnerable will continue to need support to ensure their energy bills are affordable, but this should be targeted through wider government initiatives such as a new social tariff.

Q12. Are there any other impacts on your organisation or the market that we have not considered?

EDF has not identified any further impact on our organisation not already considered elsewhere in our response. However, until there is more clarity on Ofgem's regulatory intentions it is not possible to answer this accurately.

Q13. If costs are not reconciled, what would the impact of payment method levelisation be on your organisation, where relevant?

If costs are not reconciled the impact of payment method levelisation would vary dependent on what payment methods were levelised and how. This could most severely limit the ability to recover expenses in the case of standard credit where the cost to serve is much higher.

Q14. Do you consider that the costs of levelisation should be reconciled between suppliers? What are your views on the reconciliation mechanisms presented?

The costs of levelisation should be reconciled if suppliers are unable to recover the costs to serve for a payment method to prevent an unfair competitive advantage or disadvantage to suppliers with dominance in a particular payment method type.

The reconciliation mechanisms presented in the call for evidence would be very complex and expensive to implement. EDF recommend a simpler approach is considered. For example, the government could fund reductions, or there could be a simple levy on all energy customers to fund any reductions as a social good.

Q15. Are there any other reconciliation mechanisms that you think we should consider that we have not discussed?

Yes. There are reconciliation mechanisms that would be simple to implement that could avoid the requirement for a new complex and expensive approach. These include:

- Government to fund any reductions as a social good;
- Simple levy on all energy customers to fund any reductions as a social good.

Depending on the approach taken it may also be possible to at least levelise prepayment costs while continuing to ensure that the payment method is cost reflective. For example, by:

- Varying the Default Tariff Cap debt allowance so lower for all prepayment customers;
- Varying the EBIT % allowance by payment method to reflect the varying working capital requirements – which are significantly lower for prepayment customers as they pay upfront, and higher for standard credit customers as their payment terms are longer than those faced by suppliers for costs.

EDF
May 2023