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Dear Sabreena,

**Re: Levelisation of payment method cost differentials: A Call for Evidence**

Thank you for the opportunity to contribute to Ofgem's developing thinking in this area. As Ofgem is aware, Utilita is a primarily smart prepay supplier. We have contributed actively to the debate through the introduction and development of both the Prepayment Charge Restriction (PCR) and the broader Default Tariff Cap (DTC). Utilita is in a unique position, and while this submission is non-confidential, we would welcome an opportunity for a more confidential discussion with you and your team on the expected, potentially detrimental impacts on our business of some of these proposals, if not implemented appropriately.

As a supplier who is uniquely placed in respect of smart prepay, we do have significant relevant data within our business – on potential benefits for prepay customers and also around debt and the increasing problem of debt for prepay customers. There are many areas around prepay in which false assumptions persist – whether in terms of benefits available, the levels of difficulty and demands facing prepay customers and their suppliers or costs of supply. We would be happy to discuss how we could best assist Ofgem in this respect.

We have provided a large number of in-depth submissions to Ofgem previously, which should be considered restated here, although we would be happy to provide copies of submissions on request. We would normally wish to take a more structured approach and highlight specific examples with copies, however, the pressure on suppliers at present as a result of Ofgem requirements in respect of consultations, RFIs and ongoing engagements around MCRs at present - along with the short deadline on this important matter – has prevented us doing this due to limited resource. If you would find additional highlights helpful – please let me know and we can discuss a timeline for provision. In answering the specific questions below, we have taken a brief, shorthand type approach, recognising that this is the first stage in the process. If, as a result, our answers lack clarity, we would be happy to explain further.

This submission is non confidential. We have focused on the specific questions for the bulk of this submission, but Ofgem must take the most stringent care that – if these proposals are implemented – specialist suppliers such as Utilita are not placed at a competitive disadvantage. Historically, Ofgem has failed to allow specialist suppliers such as Utilita to recover our efficient costs and make a normal profit. This approach is not acceptable and cannot continue. We welcome the fact that in this Call for Evidence (CfE) Ofgem has not only called out this danger but has started to consider potential actions to address. This is positive.

We are strongly supportive of Levelisation in principle, but believe it is essential that it is implemented correctly to ensure that consumers obtain the maximum competitive benefits and a level playing field is

maintained between suppliers. On this basis, our preference is for a full Levelisation approach with issues around supplier reconciliation properly addressed.

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

If levelisation is to take place, it ought to be full levelisation. The purpose of the price cap is to prevent excessive prices, at a level where it is economical for suppliers to operate, not to determine the efficient level of cost for different payment methods.

We believe that there is no reason a Direct Debit (DD) customer should receive more protection than a prepay customer, or a prepay customer receive more protection than a standard credit customer. It is therefore our view that a single price cap for customers best meets the intention of the Domestic Gas and Electricity (Tariff Cap) Act 2018 (DTC Act) - prevention of excessive prices. However, we also recognise the political and social pressures which apply and fully support a funded levelisation.

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

For the reason given above, there is no logical justification for levelising only selected payment methods; the protection offered by price capping should apply equally to customers paying by standard credit, which is the most disengaged customer group containing the largest absolute number of vulnerable customers.

Customers also do not understand why a price cap designed for consumer protection varies by payment method and would therefore be in favour of the backstop offered by the price cap applying equally to all.

If Ofgem were to levelise all payment types (which we support), then we believe that the best way to do this is to also produce a single price cap - within which competition for all payment types can operate successfully - and the outcome would be the same for the consumer.

**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?**

Again, the purpose of price capping is not to determine a theoretical level of perfect efficiency by payment method, but to protect all customers while simultaneously enabling suppliers to recover their efficient costs of supply plus a normal (reasonable) profit. In practice this means that the price cap will be set at a level where an efficient supplier could price a DD product below the levelised price cap, thereby maintaining the incentive for customers to select the economically efficient payment method.

**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?**

As described above, there seems little point in partial levelisation as this does not best achieve the purpose of price capping where the option of full levelisation is available. Ofgem could go further and levelise across distribution regions. If the approach of levelisation is to be applied, consumers may also find this a helpful reduction in complexity. However, in the short-term, even if Ofgem is minded to only levelise for prepay consumers then we still see this as a positive step forward, providing the option is properly funded and reconciled as required.

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

Full levelisation of unit rates and standing charges will offer equal protection to all customers. Partial levelisation does not achieve either the intention of the DTC Act or the intention of levelisation, as any divergence for different payment methods necessarily discriminates between customers on an irrelevant basis i.e., the payment method chosen by the customer. While Ofgem must have regard to licence holders recovering efficient costs, this obligation can be met by setting the price cap at a level adequate to meet this objective, using, if necessary, a supplier reconciliation.

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

Cross subsidies already exist within the current price cap structure, creating a type of levelisation, but one that is distortionary due to the way in which it is applied. The effect on Utilita is apparent in its published accounts and RFIs provided to Ofgem. Levelisation must be properly funded and reconciled to avoid unintended consequences, adverse incentives, and market distortion.

**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?**

The intention of Parliament when it accorded powers to Ofgem to set a price cap was not to target certain customer groups only. The price cap is supposed to provide equal protection to all, including those who may only just miss out on much Government support.

While it is true that some customers undoubtedly need extra support in meeting energy costs, this can be much better achieved through specific measures such as a social discount, and the compounding effect of a targeted price cap and a social discount may create perverse incentive for energy users such that energy subsidies are not lost. Price capping ought to focus, as it is intended to, on protecting all disengaged customers equally, not particular disengaged customers only.

In practice, attempting to target groups of customers is likely to be operationally difficult to implement for both suppliers and the entity that is tasked with socialising the costs, as customers may move between groups, data issues will arise and hence such attempted targeting is likely to be inherently inaccurate.

Targeted support via a robustly defined and accurately implemented Social Discount is Utilita's preferred solution for those consumers who can be identified as needing additional support.

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

Full levelisation is likely to result in both prepayment and standard credit customers paying less than they would otherwise do. As most financially vulnerable customers utilise one of these payment methods, the distributional impact would improve the financial situation for most vulnerable customers.

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

As described above, the purpose of the DTC Act is to protect customers from excessive prices, not to attempt to determine a perfect level of efficiency and set the price cap at that level. As the energy crisis has recently illustrated beyond doubt, most of the costs of energy supply are not incurred or controlled by energy suppliers and the supplier margin is, and always will be, small.

Competition and levelisation can coexist by setting the single levelised price cap at a level that enables suppliers to compete beneath the level of the cap applied. Such an approach protects disengaged customers from exploitation, in the form of either supernormal profit or inefficient operation of suppliers, and maintains competitive incentives for suppliers, including the incentive to offer cheaper prices for administratively less expensive payment methods.

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

Levelisation, specifically levelisation of prepay will contribute towards addressing the social stigma associated with prepay. It is evident that with the new smart technology - which has been a gamechanger - smart prepay is a good product choice to consider for all consumers, including DD. Properly implemented levelisation, properly funded and robustly reconciled will drive increased price competition. This in turn will help consumers struggling to budget and reduce bad debt.

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

Please see answer to question 9.

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

Ofgem mentions in passing the possibility of levelising between default and fixed tariff prices. Utilita does not believe such an approach would be practicable or consistent with the aims of the DTC Act. Ofgem also refers to the lack of fixed prepay tariff offerings before the energy crisis; the reason is not lack of competition, as there are many suppliers that would offer such tariffs, but due to the prepay price cap being set below cost, and so preventing even efficient prepay suppliers from recovering their efficient costs.

Ofgem has incorrectly assumed the effect of below cost price capping, i.e., no fixed price deals available below the price cap, to be a symptom of lack of competition; this is not the case - while prepay price capping remains so far below the efficient costs of energy supply, competition for prepay customers will continue to be curtailed.

It is important to ensure that Ofgem's policies in relation to fixed price regulation are joined up, with a reduction in potential barriers and risks and key enablers addressed. Ensuring that suppliers who offer Fixed price contracts hold enough capital to cover the associated risks such as unexpected SVT (when customers may roll onto an SVT tariff due to a paucity of attractive Fixed price contracts at renewal) will naturally increase the cost - bringing the price differential down and creating a more robust market.

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

Without reconciliation, depending on the exact levelisation approach adopted, levelisation would likely present an existential risk to Utilita as the efficient costs of supply to prepay customers could not be recovered. Please also note our introductory remarks.

Ofgem has a duty under S1(6) of the DTC Act to ensure that suppliers can recover their efficient costs as well as creating an environment in which competition and innovation can also exist. On this basis, Ofgem is required to properly reconcile and mutualise the costs of a policy of Levelisation or it will force all suppliers to converge on the average.

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

There is no reason regulatory policy should arbitrarily reallocate profits between energy suppliers in a way that bears no relation to either operating efficiency or customer utility created. Without reconciliation, however, this will be the effect of levelisation; efficient suppliers may well be forced into bankruptcy for no legitimate reason. Furthermore, without reconciliation, even efficient suppliers will be incentivised to ruthlessly cut costs associated with and service offered to customer groups that are loss making. Suppliers will have no incentive to acquire customers in these groups and will actively avoid them, rather than compete for them by keen pricing and improved service and functionality.

A new mechanism based on the EPG administered by Xoserve and Elexon, which has ready access to information on supplier retailed energy and number of supply points, would provide an accurate and timely reconciliation mechanism.

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

A new mechanism based on the EPG administered by Xoserve and Elexon, which have ready access to information on supplier retailed energy and number of supply points, would provide an accurate and timely reconciliation mechanism.

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

It will be important to consider relative timelines. For example, the DTC is subject to levelisation, then the appropriately tailored reconciliation will need to operate in equivalent timelines. This will be especially important given the recent decisions and consultation around strengthening financial resilience. These changes will otherwise risk imposing financial stresses on suppliers which are not within their control and the costs of which they have not been allowed to recover.

We appreciate that the answers to this submission have been necessarily brief within the timelines, but we hope this submission has been helpful. As noted above, we would be happy to meet and explain our thinking further.

Yours sincerely,

By email only

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