Consultation

Changing standing charges for prepayment meters and debt-related costs across payment methods

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Response deadline:	2 January 2024
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This is our statutory consultation on proposals for adjusting (or 'levelising') standing charges for Prepayment Meter (PPM) and Direct Debit (DD) customers, which would make them more equal or equitable (but less cost-reflective). Our proposals also include sharing debt-related costs across Standard Credit (SC) and DD customers. We would like views from people and/or organisations with an interest in customer service, consumer protections, vulnerability and debt. We particularly welcome responses from consumers, energy suppliers, consumer groups and charities. We would also welcome responses from other stakeholders and the public.

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at ofgem.gov.uk/consultations. If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

Any enquiries related to the text of this publication should be sent to Ofgem at:

10 South Colonnade, Canary Wharf, London, E14 4PU.

This publication is available at www.ofgem.gov.uk. Any enquiries regarding the use and re-use of this information resource should be sent to: psi@nationalarchives.gsi.gov.uk

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Executive Summary

Under the default tariff cap ('the cap'), we have typically followed the principle of cost-reflectivity. We consider that this has generally provided benefits to consumers, allowing costs to reflect the efficient cost to serve. However, this typically results in Prepayment Meter (PPM) and Standard Credit (SC) customers paying higher bills, relative to Direct Debit (DD) customers, and has led to standing charges doubling in the past year.

In light of the cost-of-living crisis and rising energy bills, taken together with wider concerns around fairness for PPM and SC customers and further research on the heightened vulnerability of these cohorts, we have considered the case for 'levelisation'. This is the process of adjusting costs between payment methods to make charges more equal or equitable but less cost-reflective. We have also begun our review, through a Call for Input, on the role of standing charges in the retail market.[1]

The Chancellor announced in the Spring Budget[2] that the Energy Price Guarantee (EPG)[3] would support PPM customers so that they do not pay a premium for their energy. This is achieved by a discount to the PPM standing charge. The EPG is due to end in March 2024 and the government requested that we report, by autumn 2023, on regulatory options to remove cost premiums associated with the PPM payment methods. Within our Forward Work Programme, we committed to continue to work with the Department for Energy Security and Net Zero (DESNZ) to develop policy options to enable levelisation of prices for PPM customers, under the priority of ensuring fair prices.[4]

We have looked at differentials between payment methods and, as noted above, broadly consider them to be appropriate on a cost-reflective basis. However, they may result in detriment for specific groups of customers, particularly PPM and SC customers. Although the simplest approach to implement, we do not think there is a case for 'full levelisation' (ie removing the payment method differential by making standing charges and unit rates equal across all payment methods) as it would lead to PPM customers paying more, contrary to the detriments identified. In our levelisation proposals, we aim to address features of payment methods where we consider cost-reflectivity leads to detriment for consumers. The first is the difference in standing charges between PPM and DD, due to higher operating costs but leading to PPM customers incurring more debt during periods

[1] Ofgem (2023), Standing charges – call for input https://www.ofgem.gov.uk/publications/standing-charges-call-input
[2] HM Treasury (2023), Spring Budget. https://www.gov.uk/government/publications/spring-budget-2023
[3] DESNZ (2023), Energy Price Guarantee. https://www.gov.uk/government/publications/energy-bills-support/energy-bills-support-factsheet-8-september-2022
[4] Ofgem (2023), 2023/24 Forward Work Programme, page 11. https://www.ofgem.gov.uk/publications/202324-forward-work-programme

of low or nil consumption. The second is in the allocation of debt-related costs, based on observed debt risks by payment method, but where customers under the most financial stress (particularly SC customers) have to pay the majority of the burden, leading to higher debt-related costs than necessary.

We published a Call for Evidence (CfE)[5] in April 2023 seeking views on our approach to levelisation. Further to this, we published a policy consultation in August 2023 on levelising the cost of standing charges on PPM.[6] The policy consultation sought views on the case for change and our initial proposals for levelisation, as well as options for the reconciliation mechanism. Feedback provided showed strong support for our case for the introduction of levelisation, primarily based on the protection of vulnerable consumers and fairness. Based on these considerations, many respondents also highlighted that it was 'fair' to levelise debt-related costs and noted the need to support SC customers.

We considered the feedback and evidence we received and carried out further analysis to develop our levelisation proposals. We propose proceeding with first levelising PPM and DD standing charges from April 2024, followed by a second stage in which we propose levelising DD and SC debt-related costs, not allocating any of the debt-related costs to PPM customers. This second stage would be implemented no earlier than October 2024. Our proposals would be supported by a market-wide reconciliation mechanism, to ensure that PPM and SC customers benefit from innovation and customer service and to prevent suppliers from significantly gaining or losing from the implementation of levelisation. The mechanism would support diversification of business models – allowing suppliers, who chose to specialise in certain (more expensive) customer groups to earn a fair return.

We consider there to be a case to implement our proposals given the heightened vulnerability of PPM and SC customers that, due to a broadly cost-reflective price cap, typically pay higher bills than equivalent DD customers. Our updated Impact Assessment demonstrates benefits to customers as a whole from our proposal of reduced levels of debt-related costs in the market of £3.7m. Our income weighted analysis shows a net saving of £201m, demonstrating a saving for consumers with the greatest need.

We welcome views and evidence on this statutory consultation and request written responses, sent to priceprotectionpolicy@ofgem.gov.uk by 2 January 2024. We will consider all responses and publish our decision in early 2024.

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[5] Ofgem (2023), Levelisation of payment cost differentials: a call for evidence. https://www.ofgem.gov.uk/publications/levelisation-payment-method-cost-differentials-call-evidence

[6] Ofgem (2023), Levelling the cost of standing charges on prepayment meters. https://www.ofgem.gov.uk/publications/levelling-cost-standing-charges-prepayment-meters

1. Introduction

Chapter summary

This chapter sets out what we are consulting on, the consultation process and how to respond. It provides an overview of each of the chapters in the consultation and related publications.

1.1 The recent cost-of-living crisis has raised concerns over Prepayment Meters (PPM) and the premiums that consumers pay for using this payment method.

1.2 PPM customers currently have the highest proportion of disabled, chronically sick and low-income customers of any payment method. At present, they pay slightly lower unit rates but higher standing charges than Direct Debit (DD) customers, driven by fixed operational costs. The approval of Uniform Network Code (UNC) modification 840,[7] which equalised the allocation of unidentified gas costs between PPM and DD/Standard Credit (SC) customers, made PPM unit rates slightly lower than DD, reflecting the cash efficiency of this payment method.

1.3 Currently, the SC cohort has a higher proportion of disabled, chronically sick, and low-income customers than DD. SC customers pay the highest standing charges and unit rates due to both fixed operational costs (causing the standing charge differential) and higher debt-related costs (most of which scale with consumption so are charged through the unit rate). Historically, we have taken a broadly cost-reflective approach to the allocation of debt related costs, enabling suppliers to recover efficient costs. This, however, results in those most at risk of generating bad debt, paying the highest bills, and ultimately generating higher total debt.

1.4 The cost-reflective approach has also resulted in significant increases to standing charges for domestic customers since 2021. Alongside this consultation, Ofgem has recently launched a Call for Input (CFI) to better understand the impact of and seek views on the role of standing charges in the retail energy market, and how this could/should change in the future.[8] While the outcome of this consultation will influence the relative magnitude of standing charges for different

[7] Ofgem (2023), Decision to approve Uniform Network Code (UNC) 840: Equalisation of prepayment and non-prepayment AUG factors. https://www.ofgem.gov.uk/publications/decision-approve-uniform-network-code-unc-840-equalisation-prepayment-and-non-prepayment-aug-factors
[8] Ofgem (2023), Standing charges – call for input. https://www.ofgem.gov.uk/publications/standing-charges-call-input

payment methods, the contributing factors to those standing charges, and how standing charges may evolve in the future, is considered in the CFI.

1.5 The Chancellor announced in the Spring Budget[9] that the Energy Price Guarantee (EPG)[10] would support PPM customers so that they do not pay a premium for their energy. This is currently achieved by a discount to the PPM standing charge. The EPG is due to end in March 2024 and the government requested that we report, by autumn 2023, on regulatory options to remove cost premiums associated with the PPM payment methods.

1.6 In April 2023, we published a Call for Evidence (CfE) on approaches to the levelisation of payment method cost differentials.[11] Levelisation is the process of adjusting costs between payment methods to make charges more equal or equitable. We presented our initial analysis on consumer impacts by payment method, with a focus on distributional impacts, as well as supplier impacts. There was broad support for levelisation but a range in views on the approach that we could take. The responses are available on the Ofgem website.

1.7 Following this, we published a policy consultation in August 2023 on levelling the cost of standing charges on prepayment meters which sought views on the case, considerations and initial proposals for levelisation as well as options for the reconciliation mechanism.[12] Within this policy consultation, we considered the interaction of levelisation with the allowance for Additional Support Credit (ASC) that we introduced for an initial 12 month period from October.[13]

1.8 We received 19 responses from a range of stakeholders. These included 9 from suppliers and supplier bodies, 7 from charities and consumer groups and 3 from individuals. There was overall support for the need for levelisation, the case for change and our reconciliation proposals, however there was limited support for our preferred option to levelise PPM and DD standing charges only. We address feedback to our policy consultation throughout the rest of this document.

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[9] HM Treasury (2023), Spring Budget. https://www.gov.uk/government/publications/spring-budget-2023
[10] Department for Energy Security & Net Zero (2023), Energy Price Guarantee. https://www.gov.uk/government/publications/energy-bills-support/energy-bills-support-factsheet-8-september-2022
[11] Ofgem (2023), Levelisation of payment method cost differentials: a call for evidence. https://www.ofgem.gov.uk/publications/levelisation-payment-method-cost-differentials-call-evidence
[12] Ofgem (2023), Levelling the cost of standing charges on prepayment meters. https://www.ofgem.gov.uk/publications/levelling-cost-standing-charges-prepayment-meters
[13] Ofgem (2023), Allowance for additional support credit bad debt costs. https://www.ofgem.gov.uk/publications/allowance-additional-support-credit-bad-debt-costs

What are we consulting on?

1.9 The purpose of this statutory consultation is to seek views on our updated proposals for how and what to levelise. We are proposing to levelise PPM and DD standing charges, supported by standing charge reconciliation, and, following industry design and build, to levelise debt-related costs between DD and SC customers, which affects unit rate and standing charge and requires standing charge and unit rate reconciliation.

1.10 In Chapter 2, we provide context and discuss the updated case for change and our aims for levelisation. Chapter 3 sets out our considerations and proposals for levelisation and provides an overview of stakeholder feedback on the options presented in the policy consultation we published in August. Our proposals are supported by an updated Impact Assessment (IA) in Annex 3.

1.11 In Chapter 4, we set out our considerations and proposals for applying levelisation to uncapped contracts, as well as an overview of stakeholder feedback on our proposals in the policy consultation. Chapter 5 outlines our proposals around targeting specific groups when levelising, removing regional differences and the treatment of smart PPM.

1.12 In Chapter 6, we provide further details of the levelisation reconciliation mechanism, including our appointment of an operator. Finally, Chapter 7 discusses key interactions with other Ofgem workstreams, including our work on the operating costs review, debt-related costs review and standing charges.

1.13 This consultation also proposes licence modifications to enable levelisation and reconciliation of both standing charge and unit rates (set out in Annex 2). Our consultation also includes a proposed step-by-step description for the implementation of our proposals in the default tariff cap ('the cap') models (Annex 4).

1.14 This consultation does not include the implementation detail, including in the cap models, for unit rate levelisation and reconciliation. The implementation of unit rate levelisation in the cap models, and the detailed design of a unit rate reconciliation mechanism, depend on further industry work which cannot be delivered for April 2024. A further consultation on the implementation of unit rate levelisation in the cap models will be performed prior to its implementation. Stakeholders will be consulted on unit rate reconciliation through the enabling code modification process in due course.

Related publications

1.15 The main documents relating to the cap and/or levelisation are:

- Gas Act 1986: https://www.legislation.gov.uk/ukpga/1986/44/
- Electricity Act 1989: https://www.legislation.gov.uk/ukpga/1989/29/
- Domestic Gas and Electricity (Tariff Cap) Act 2018: https://www.legislation.gov.uk/ukpga/2018/21
- 2018 decision on the cap methodology ('2018 decision'): https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview
- Energy Prices Act 2022: https://www.legislation.gov.uk/ukpga/2022/44

1.16 The main documents relating to this consultation are:

- Levelisation of a payment method cost differentials: a call for evidence: https://www.ofgem.gov.uk/publications/levelisation-payment-method-cost-differentials-call-evidence
- Levelling the cost of standing charges on prepayment meters: https://www.ofgem.gov.uk/publications/levelling-cost-standing-charges-prepayment-meters
- Price cap – Call for Input on the allowance for debt-related costs: https://www.ofgem.gov.uk/publications/price-cap-call-input-allowance-debt-related-costs
- Price cap – Call for Input on the Operating Cost Allowances Review: https://www.ofgem.gov.uk/publications/price-cap-call-input-operating-cost-allowances-review
- Allowance for additional support credit bad debt costs: https://www.ofgem.gov.uk/publications/allowance-additional-support-credit-bad-debt-costs
- Standing Charges - Call for Input: https://www.ofgem.gov.uk/publications/standing-charges-call-input

Consultation stages

1.17 This statutory consultation is open between 23 November to 2 January 2024. We will consider responses to inform our decision in early 2024.

Table 1: Consultation Phases

Stage 1 (Complete)	Stage 2 (Complete)	Stage 3 (Current)	Stage 4	Stage 5
Call for Evidence	Policy Consultation	Statutory Consultation inc. standing charge implementation	Decision	Consultation on unit rate levelisation implementation
April 2023	August 2023	November 2023	Early 2024	Late 2024

How to respond

1.18 We want to hear from anyone interested in this consultation. Please send your response to the person or team named on this document's front page.

1.19 We have asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

1.20 We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data and confidentiality

1.21 You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

1.22 If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

1.23 If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.

1.24 If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

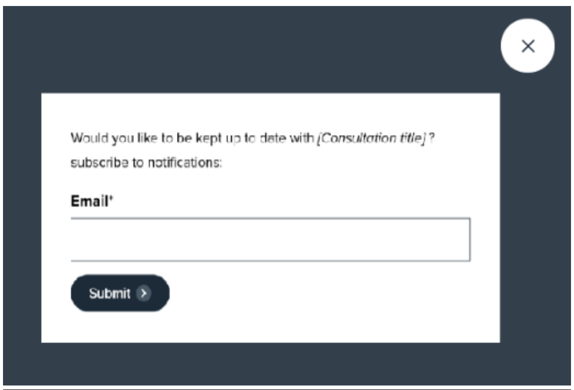
1.25 We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

Please send any general feedback comments to stakeholders@ofgem.gov.uk

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. Ofgem.gov.uk/consultations



Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:

Upcoming > **Open** > **Closed** (awaiting decision) > **Closed** (with decision)

2. Case for change and levelisation scope

Chapter summary

We provide a recap of the context provided in our policy consultation (ie an overview of our consumer objectives and framework and payment method differentials under the price cap), as well as stakeholder feedback. We also set out our updated case for the introduction of levelisation and our updated policy aims for the levelisation process.

Questions

Q1. Do you have any comments or views on our updated case for the introduction of levelisation of payment methods?

Q2. Do you agree with our levelisation policy aims?

Introduction and recap of policy consultation

Ofgem's consumer objectives and framework

2.1 Ofgem's principal objective is to protect the interests of energy consumers, including having regard to the interests of vulnerable consumers.[14] In making decisions on cost allocation within the cap, Ofgem must balance its principal objective with the five duties to 'have regard to' under the Domestic Gas and Electricity (Tariff Cap) Act 2018 ('the Act')[15] and our wider vulnerability duties. Additionally, Ofgem has powers to amend Standard Licence Conditions (SLCs) for gas and electricity suppliers under the Act. To effect levelisation, we envisage using a range of our statutory powers in view of our various duties and there are references to these powers and duties throughout this consultation and its appendices.

2.2 We consider that our proposals on levelisation relate primarily to the 'Fair Prices' factor of our Consumer Interests Framework.[16]

Historical payment method differences payment methods under the cap

2.3 Before the introduction of the cap in 2019, suppliers of PPM and SC customers experienced higher costs, which were subsequently passed on to these cohorts of

[14] Our principal objective, and vulnerability duty, are contained in the Gas Act 1986 and the Electricity Act 1989. How we interpret and apply our vulnerability duty is also informed by other sources, such as the Equality Act 2010 and human rights law.
[15] Domestic Gas and Electricity (Tariff Cap) Act 2018. https://www.legislation.gov.uk/ukpga/2018/21/contents
[16] Ofgem (2023), Forward Work Programme, pages 7-8. https://www.ofgem.gov.uk/publications/202324-forward-work-programme

customers. This does not mean that the payment method differentials precisely reflected the underlying cost differences, but suppliers were able to recover costs as they saw fit.

2.4 The principle of cost-reflectivity has broadly continued under the cap; the cap calculates effective unit rates and standing charges for customers on different payment methods. This is done so that consumers face prices that reflect cost to serve and so that an efficient supplier can recover its costs, leading to accurate price signalling and efficiency incentives. We set a single cap level for all suppliers at a stringent efficiency level. We now consider that it may be in customers' interests to move away from this consumer impacting cost-reflectivity as it may be producing negative outcomes for some consumers.

2.5 As a result of the current approach, standing charges have more than doubled since October 2021 and, typically, SC customers pay the highest costs, followed by PPM customers, and DD customers pay the least (evidenced in Table 2). This is because:

- PPM customers incur higher operational costs, including higher infrastructure costs. This fixed cost increase is reflected in a higher standing charge.
- SC customers incur higher fixed operational costs, primarily due to the higher cost of billing, and higher variable costs, primarily due to higher debt-related costs which scale with consumption. These are reflected in higher unit rates and standing charges.

Table 2 - Cap levels for cap period 11b

Cap Level	DD	SC	PPM
At nil consumption	£303	£347	£367
At typical consumption	£1,928	£2,058	£1,960

2.6 We provided more detail on the mechanics of the cap and highlighted payment method differentials over time in our policy consultation.[17] We also outlined the principles on which the cap is based and noted that we have made some updates to the cap on a non-cost-reflective basis, where this was judged to be in customers' interests.

[17] Ofgem (2023), Levelling the cost of standing charges on prepayment meters. https://www.ofgem.gov.uk/publications/levelling-cost-standing-charges-prepayment-meters

The case for change

Recap of research included in the policy consultation on consumer vulnerability and payment method choice

2.7 As outlined in the policy consultation, our previous research, carried out between November and December 2022, demonstrated higher financial vulnerability among PPM and then SC and DD customers.[18] Of the customers surveyed, a higher percentage of households that pay for their energy by PPM say they are recipients of government benefits (62%) than SC (48%) and DD (31%). In addition, PPM customers are more likely to be households with income lower than the UK median. However, we also note that DD is the most popular payment method and so the total number of vulnerable individuals/ households paying by DD is higher than other payment methods. For example, of the total number of benefit recipients, DD remains the most popular payment method (59%) compared with SC (25%) and PPM (31%).

2.8 In responses to the same survey, only 17% of consumers stated that they chose their current payment method because they thought it was cheaper than alternatives. We have found consumers primarily used SC due to the perceived additional control provided by being able to pay on receipt (41%) while PPM customers noted ease of budgeting as the main driver for using this payment method (42%).[19] It is also important to recognise that some consumers do not have the same level of choice when it comes to selecting payment methods, for example in the research many PPM customers selected a negative or passive reason for paying by PPM.

Recap of policy consultation case for change

2.9 As part of the policy consultation, we considered that the principle of cost-reflectivity has generally provided benefits to customers. However, it has also resulted in higher standing charges for PPM customers, due to the higher operational costs associated with traditional PPM, which is a cost that cannot be avoided by reducing usage. Consequently, there are unintended consequences associated with higher standing charges as PPM customers may be more likely to

[18] Ofgem (2023), Consumer Impacts of Market Conditions survey- Wave 3 (Nov/Dec 2022). https://www.ofgem.gov.uk/publications/consumer-impacts-market-conditions-survey-wave-3-novdec-2022
[19] Ofgem (2023), Consumer Impacts of Market Conditions survey- Wave 3 (Nov/Dec 2022), page 26. https://www.ofgem.gov.uk/publications/consumer-impacts-market-conditions-survey-wave-3-novdec-2022

ration or self-disconnect, which could have adverse effects on health and wellbeing.

2.10 Our draft Impact Assessment (IA), published as part of our policy consultation, showed that the overall impacts and benefits of levelisation to consumers and the market were finely balanced. This was because, while levelisation would benefit PPM customers by reducing their standing charges, this would be balanced with higher standing charge costs to DD customers.

Stakeholder feedback

2.11 To our policy consultation, stakeholders strongly supported our case for the introduction of levelisation, primarily based on protection of vulnerable consumers and fairness. Respondents highlighted the increased vulnerability of many PPM customers relative to DD. Some consumer groups also emphasised that self-disconnections, which are far more prevalent among PPM customers, can have negative impacts on health and wellbeing. One supplier also highlighted lack of choice of payment method for some PPM customers, echoing our consumer research. On the other hand, another body highlighted that the ability to budget and control costs are key reasons expressed by customers who actively choose PPM, which can help to avoid a further build-up of debt. They said that charging these customers for their additional cost to serve is therefore unfair.

2.12 Two suppliers disagreed with our case for levelisation. One noted that the UNC modification 840 had largely reduced the payment method differential. Another commented that they considered levelisation to be a narrow solution to helping low-income households pay for their energy. These responses are explored further in Chapter 3.

2.13 Three consumer groups and one supplier advocated for greater support for SC customers and highlighted the need to consider the allocation of debt-related costs within the cap. Multiple consumer groups commented on the unfairness of debt-related costs being allocated based on which payment methods are most likely to incur debt. This can be seen to place a higher burden on fuel poor households which in turn results in a higher total debt risk. One supplier commented that the consideration of levelisation of debt-related costs should not delay implementation of PPM standing charge levelisation.

2.14 One supplier said we should take into consideration the varying costs of serving customers on different payment methods, particularly costs that are not the result of efficiency factors. They further outlined that the levelisation process could be implemented to address some of the payment method cost differentials to create a fairer pricing mechanism. We acknowledge that there is a case to evaluate whether operating costs allowances still reflect the costs a notional supplier would incur. However, consideration of whether these allowances are still appropriate will be carried out under the operating costs review and we will ensure that we are aligned with the work carried out under this review.

Updated case for change following policy consultation feedback

2.15 In July 2023, we carried out further consumer research to support any updates to our case for change. The research found increased vulnerability amongst SC customers relative to DD customers.[20] In particular, it found that 21% of SC customers have fallen behind on their energy bills compared to 9% of DD customers. This reflects a doubling in the proportion of SC customers falling behind on their energy bills since November/December 2022. In addition, 30% of SC customers indicated that they struggled to pay household costs other than energy, compared to 19% of DD customers.

2.16 Our updated case for change has considered this research and stakeholder feedback received through the policy consultation. Currently, under the cost-reflective payment method uplift in the cap, debt-related costs are higher on average for SC customers than DD or PPM customers. Many SC customers are under financial stress, our consumer research has found that affordability issues affect 48% of households paying by standard credit.[21] Higher prices can therefore heighten the risk of SC customers incurring further debt. This would increase the total debt in the market and result in greater debt-related costs to be met by customers as a whole. We consider that SC alone is a poor proxy for bad debt as it is also generated by DD customers and there are real advantages to all customers for it to be shared more equally by DD and SC customers. Therefore, we consider there to be a case for levelising DD and SC debt-related costs (while not allocating any of the bad debt to PPM customers); this would avoid increased costs for SC customers who are struggling to pay and benefit customers as a whole due to lower levels of debt in the market.

2.17 We also continue to consider there to be a case that PPM customers should not pay a premium, given the heightened vulnerability of this cohort, particularly as

[20] Ofgem (2023), Household Consumer Impacts of Market Conditions Survey- Wave 4. https://www.ofgem.gov.uk/publications/consumer-impacts-market-conditions-survey-wave-4-july-2023
[21] Ofgem (2023), Household Consumer Impacts of Market Conditions Survey- Wave 4, page 17. https://www.ofgem.gov.uk/publications/consumer-impacts-market-conditions-survey-wave-4-july-2023

some customers do not actively choose this payment method. Currently, PPM customers pay higher standing charges, leading to these customers incurring more debt during periods of low or nil consumption. In turn, this could increase the level of self-disconnections which would have negative impacts on health and wellbeing.

2.18 Based on these identified detriments for PPM and SC customers, we present below our updated aims for levelisation. In Chapter 3, we have also assessed the impact of the updated options on all customers.

Policy considerations and guiding aims

Recap of policy consultation position

2.19 In the policy consultation, we set out the following guiding aims for how levelisation could operate: levelisation should be enduring and responsive to policy changes; levelisation should be applied to cap and non-cap tariffs; PPM standing charges should be equal to or less than DD; we should consider whether to allocate debt-related costs more broadly across payment methods; and suppliers should be able to recover notionally efficient costs.

Stakeholder feedback

2.20 Respondents were broadly supportive of the policy aims. In particular, that PPM customers should not pay a premium and that levelisation should be enduring. Respondents were also generally supportive of implementing a reconciliation mechanism to enable suppliers to recover efficient costs when serving customers on a range of payment methods.

2.21 One supplier disagreed with the aims, considering that any levelisation proposal would increase standing charges for the majority of consumers at a time of high bills (as a result of the majority of consumers under the cap being DD customers). They expressed concern that applying levelisation to uncapped tariffs would set a precedent for price regulating uncapped tariffs. Although we acknowledge the financial disadvantage to the majority of consumers who pay by DD, we consider that levelisation would directly financially benefit PPM and SC consumers who are more likely to be vulnerable on average, and we expect DD customers would receive broader market benefits. We also note that other respondents to the consultation were supportive of the reconciliation mechanism being applied to both capped and uncapped tariffs.

2.22 One supplier commented that levelisation needs to be proportionate, considering the benefits along with the costs to ensure that there would be a net benefit of the policy overall. In assessing the policy, we have considered the impact of consumers as a whole. Within our updated IA, we have carried out income weighted analysis that illustrates a net saving for customers taken as a whole for all policy options presented. Our assessment has also found that all options results in a reduction in the volume of industry debt and therefore debt-related costs. This benefits consumers as a whole by reducing costs to supply and improving supplier financeability.

Updates to our aims following analysis and policy consultation feedback

2.23 Our principal objective is to act in the interests of all consumers (including both default and non-default tariff customers) as a whole. In doing so, we will pay regard to the need to support competition and switching, incentivise efficiency, ensure financeability of efficient suppliers and consider any impacts to public spending. We assess our policy options against these interests in the updated IA.

2.24 To guide us in achieving this, we propose the following as the aims against which we have assessed our options for the levelisation process, with the initial two aims being the focus:

- **Customers that pay by PPM should not pay a premium.** With the levelisation process, we aim to mitigate the unintended harms associated with higher standing charges for PPM customers.
- **All customers that have the ability to build debt should contribute equally to debt-related costs.** This means that our proposal would spread debt-related cost allowances between DD and SC customers and not to PPM customers who do not normally incur material debt.

2.25 We have also assessed our options against the following secondary aims that we will also pay regard to:

- **The SC premium should be reduced but maintained to incentivise efficient payment methods.** This is supported by further consumer research undertaken following the policy consultation, highlighting higher vulnerability among SC customers. The second primary aim will reduce the SC premium, by lowering the level of debt-related costs SC customers pay. We consider efficient payment methods should continue to be incentivised as, payment in arrears under SC, can increase the risks of late or non-payment. This payment method also increases working capital costs for suppliers, which can have implications for financeability.

- **Levelisation should be enduring and responsive to policy changes.** This means that the process should be designed to work through the cap and any future alternative methodology. It should also be able to adapt to any cap changes as a result of interlinked workstreams.
- **There should be limited or no gap in support for PPM customers following EPG removal.** From April 2024, the EPG support provided by the government will come to an end and the ASC bad debt allowance will increase the standing charge for PPM customers, unless this is addressed through our levelisation policy.
- **The solution should be proportionate**, minimising the intervention, risks of unintended consequences, and administration costs to achieve the desired outcome.

2.26 We outline options that deliver against these aims in Chapter 3.

3. Levelisation options and proposal

Chapter summary

We set out our options for levelisation; this includes our proposal to proceed with a first phase levelisation of PPM standing charges against DD, followed by a second phase in which we levelise debt-related costs between SC and DD.

We also provide an overview of stakeholder feedback relating to the options presented in the policy consultation and other considerations we received feedback on.

Questions

Q3. Do you agree with our proposed approach to levelisation?

Q4. Do you have any views on the proposed amendments to SLC 28AD and model changes under Annex 9?

Introduction and considerations

3.1 When considering how to undertake levelisation of payment method differentials, there are several variables to consider.

3.2 **Payment method:** There are three different payment methods to consider levelisation of: PPM, DD and SC.

3.3 **Charge types:** There are two components of the cap through which levelisation can occur: effective unit rates and/or standing charges. Throughout this consultation we refer to levelising 'standing charges'. In practical terms, we are referring to the Benchmark Maximum Charges[22] at nil-Consumption allowed under the cap. This is the maximum a supplier is allowed to charge a consumer at nil-consumption under the cap, and is therefore the implied standing charge cap. For the avoidance of doubt, any reference in this document to levelise 'standing charges' refers to the levelisation of the Benchmark Maximum Charges at nil-Consumption. It is important to note that the cap sets an upper limit on charges (including both the unit rate and standing charge). Although as most suppliers price in line with the implied unit rate and standing charge under the cap, we think this approach best delivers the policy intent to levelise standing charges for relevant customers.

[22] The 'Benchmark Maximum Charges' is the maximum that a supplier is able to charge a consumer on a standard variable tariff at the Benchmark Annual Consumption Level, Charge Restriction Region, Benchmark Metering Arrangement and Payment Method.

3.4 Standing charges and unit rates can be considered individually or together:

- Unit rates – by levelising unit rates, the savings or costs from levelisation of each payment method would be larger or smaller depending on consumption.
- Standing charges – by levelising standing charges, costs or savings would be constant regardless of consumption, as the standing charge applies to all, although this would typically benefit low consumption customers the most (as a proportion of their bills).

3.5 **Levelisation extent:** We can either fully levelise bills or just aspects of them. We considered full levelisation in our Call for Evidence but decided against it at this early stage as it resulted in an increase in costs to PPM customers. The options we have maintained all levelise specific aspects of bills.

3.6 **Levelisation scope:** Levelisation can either apply to all contracts, just capped contracts or targeted at a subsection of customers. The inclusion of uncapped contracts in levelisation is considered in Chapter 4 - Uncapped Contracts, and targeting is discussed in Chapter 5 - Other Considerations.

Recap of options from policy consultation

3.7 In our policy consultation, we proposed three options, with an initial preference of Option 2:

- **Option 1 - Do nothing:** No levelisation between payment methods.
- **Option 2 – Levelise PPM & DD standing charges and levelise ASC bad debt costs:** Our initial proposal was to fully levelise PPM and DD standing charges and levelise the PPM ASC (discussed in Chapter 2) across all payment method standing charges, supported by a reconciliation mechanism (discussed in Chapter 4). This would end the standing charge differential so that all consumers on DD and PPM pay the same standing charge rate. We focussed on standing charge levelisation as, following the UNC modification 840 which equalised unidentified gas allocations, PPM unit rates are cheaper than DD.
- **Option 3 - Option 2 plus levelise debt-related costs:** We also consulted on, in addition to Option 2, the levelisation of specific debt-related costs in the payment method adjustment across all payment methods. This would reduce the cost differential between SC and DD.

3.8 We proposed to maintain regional tariff differentials and proceed with the creation of a supplier reconciliation mechanism and appoint an operator to develop the system at risk, pending final decision.

Levelisation Options

3.9 Following our policy consultation, we have reviewed stakeholder feedback and performed further analysis resulting in updates to the options presented in the policy consultation. These are presented below.

Option 1 – Do nothing

Stakeholder Feedback

3.10 Overall, there was limited support for Option 1 from suppliers, consumer groups and charities. Two suppliers supported Option 1 as they considered levelisation and the reconciliation mechanism to have potentially distortive effects.

3.11 One of these suppliers thought that we have taken a fundamentally incorrect approach to levelisation and should instead focus on identifying cost to serve smart PPM customers and use this as the benchmark for the PPM cap level. They felt that introducing a mechanism to enable recovery of costs associated with traditional PPMs was enabling outdated costs to be recovered and reducing the incentive to move towards the more efficient smart PPMs, which benefits customers and suppliers.

3.12 We recognise that there may be a case to introduce smart PPM as an independent payment method. This is being considered through the operating costs review. While we recognise our duty to incentivise suppliers to improve efficiency, we do not agree that the cost to serve smart PPM should be used as the benchmark for all PPM customers. An underlying principle of the cap is that a notionally efficient supplier should be able to recover efficient costs. We recognise that smart prepay has advantages for customers but do not agree that an efficient supplier would be reasonably able to serve all prepay customers through smart meters. While we are careful not to disincentivise it, incentivising smart pre-pay is not a specific aim of levelisation.

3.13 The other supplier thought that UNC Modification 840 has reduced the PPM premium sufficiently and that we should re-engage with government to understand their appetite for levelisation following this change. Further, they thought that levelisation risks the feasibility of the fixed term contract market by introducing a potentially volatile and unpredictable cost. They proposed that we instead introduce a fixed levelisation value, with 12 months' notice of any changes to the value, which would reduce the payment method differential.

3.14 While we recognise these concerns, multiple other suppliers actively stated that they were not concerned about forecasting levelisation costs. Suppliers face a multitude of variables in their tariff pricing, and we consider that they should be able to forecast levelisation with sufficient accuracy such that the risk to suppliers, and the fixed term contract market, is not prohibitive. The number of customers on each payment method is relatively static over time (especially short periods of time). The expected amount to levelise per customer depends on cap levels, which we expect most suppliers forecast anyway.

Updated Analysis

3.15 As this option is 'no levelisation', it forms our base cap levels which we use to assess Options 2 and 3 against. Dual fuel cap levels are presented at the 2023 typical domestic consumption levels (TDCV) for cap period 11b.

Table 3: Base Case Cap levels – Dual Fuel 11b

	DD illustrative cap levels	SC illustrative cap levels	PPM illustrative cap levels
Total Level	£1,928	£2,058	£1,960
Yearly Standing Charge	£303	£347	£367
Yearly Unit Rate	£1,626	£1,711	£1,593

3.16 It therefore results in no income-weighted financial benefit (using income to assess the effective impact on customer finances of costs/benefits) or reduction in bad debt. Payment method price differentials are maintained and therefore the inherent risks associated with more vulnerable cohorts paying higher prices will persist.

3.17 This option would not directly financially disadvantage customers that pay by DD, and no additional administration costs would be incurred.

3.18 It is, however, likely not to be as much in consumers interests as the potential system benefits of reducing debt-related costs and working capital would not be realised. The market would continue to impose higher prices (relative to if levelisation were implemented) on the cohorts who are least able to pay. This risks creating a vicious cycle where overall debt increases, increasing the costs that go into the market and are ultimately borne by all customers.

3.19 Further, by changing payment method, consumers could still directly financially benefit regardless of their existing payment method under all other presented levelisation options, at most consumption levels (PPM becomes cheaper under both Options 2 and Option 3 than any currently available cap level). This has the potential to financially advantage all customers, including those currently paying by DD, as they could change payment method in the future.

3.20 We recognise the risks in financially incentivising PPM as the payment method may not suit all consumers (as raised by a consumer group in our consultation, paying by PPMs requires more proactivity from the customer and potentially increases the risk of self-disconnection). However, some financially vulnerable consumers could benefit from the budgeting advantages that PPMs provide. This is particularly impactful for customers with smart meters who can move between payment methods with relative ease.

3.21 Similarly, reducing the SC price cap may enable consumers who previously chose DD on price grounds to switch to SC and support our objective to incentivise switching. However, as discussed in our Impact Assessment (IA), we do not foresee a material increase in switching. Overall, reducing payment differentials could help customers choose the payment methods which suits them best, with a lower financial impact.

3.22 Finally, this option does not deliver against any of the guiding aims:

Table 4: Assessment of Option 1 against policy aims

Aim	
Customers that pay by PPM should not pay a premium.	×
The SC premium should be reduced but maintained to incentivise efficient payment methods.	×
Levelisation should be enduring and responsive to policy changes.	N/A
All customers that have the ability to build debt should contribute equally to debt-related costs.	×
There should be limited or no gap in support following EPG removal.	×
Solution should be proportionate, minimising the intervention and administration costs to achieve desired outcome.	N/A

Option 2 - Levelise PPM & DD standing charges and ASC bad debt

<u>Stakeholder Feedback</u>

3.23 There was some but limited support for Option 2. Two suppliers and another organisation preferred it due to proportionality and deliverability for April 2024. They highlighted that, following the UNC Modification 840, levelising PPM standing charges delivers against the stated policy intention of removing the PPM premium without introducing the complexity of unit rate levelisation.

3.24 The remaining respondents, other than the two that preferred Option 1, preferred Option 3. Many, however, supported it as an initial step that could be implemented while working through the greater complexities of Option 3.

3.25 Consumer bodies broadly thought that Option 2 did not go far enough, particularly highlighting the increasing vulnerability of SC customers and the need for levelisation to support these customers. One proposed that if we proceed with standing charge levelisation, we should also levelise SC standing charges. This would introduce a universal standing charge which has bill simplicity and improved consumer understanding advantages. We considered this option in detail however we decided against it as there is less evidence of harm to SC customers resulting from standing charges. It would also result in a larger increase to DD customers and less savings to PPM customers.

3.26 One consumer group, while supportive of levelisation, cautioned against making PPM materially cheaper than DD and, in doing so, creating a financial incentive for consumers to switch to a payment method that may be unsuitable for their needs. They commented that paying by DD allows consumers to plan finances more effectively and switching to PPM may increase the risk of self-disconnection. While we recognise the risk to some consumers, our evidence shows that 42% of PPM customers choose it to help them budget so PPM may equally help some consumers plan their finances more effectively.

Updates following analysis and policy consultation feedback

3.27 Following our policy consultation, we reviewed the process we have been following to levelise standing charges. In particular, we considered whether the separate adjustment for the ASC cost was necessary.

3.28 ASC is applied exclusively to the standing charge so in the levelisation of the standing charge, ASC costs are being levelised between DD and PPM customers. Therefore, we do not think that this extra step is proportionate given the additional delivery complication, especially as ASC is a time limited intervention.

3.29 Most importantly, removing the separated ASC levelisation results in a greater consumer benefit. The primary impact of doing so is to prevent SC customers from contributing to this cost, now preferential due to the increased vulnerability in this cohort relative to DD. This equates to a c.£2 saving for SC customers.

Updated Analysis

3.30 The updated Option 2 (ie levelise PPM and DD standing charges) would result in the following cap levels for cap period 11b at typical domestic consumption values (with the change against baseline provided in brackets):

Table 5: Option 2 Cap levels - Dual Fuel 11b

	DD illustrative cap levels	SC illustrative cap levels	PPM illustrative cap levels
Total Level	£1,939 (+£11)	£2,058 (+£0)	£1,907 (-£54)
Yearly Standing Charge	£314 (+£11)	£347 (£0)	£314 (-£54)
Yearly Unit Rate	£1,626 (£0)	£1,711 (£0)	£1,593 (£0)

3.31 This option removes the PPM/DD differential through levelising standing charges, maintaining current protections for PPM customers (through the EPG) at minimum cost to DD customers and the system as a whole. Having the same standing charge between these payment methods simplifies tariff structure/improves consumer understanding and ability to compare tariffs and therefore engage in the market. This in turn supports competition.

3.32 Under this option, there is no impact to the tariff structure (ie the presence of a standing charge and unit rate) or how costs are recovered between these. We are seeking views on these considerations in the CFI on standing charges.

3.33 As Option 2 only impacts standing charges, it can be implemented by April 2024 through a simple, and cost-reflective, reconciliation mechanism. However, this option may be less future proof as it does not necessitate the development of a unit rate reconciliation mechanism which means that the PPM premium could re-emerge should PPM unit rates increase relative to DD.

3.34 This option is proportionate in that it minimises the intervention and associated administration costs to remove the PPM premium. It does not, however, directly deliver against the aim that the SC premium should be reduced (although does indirectly through the increase to the DD cap level).

3.35 The option financially disadvantages DD customers, the cohort with the highest number of low-income customers (although far less than it advantages PPM customers). However, the argument discussed in 3.19 applies: following levelisation, most customers who currently pay by DD could switch to PPM to achieve a lower cost than they are currently paying. Further, they may be able to choose a payment method that is more suited to them with lesser financial consequences.

3.36 As discussed in the updated IA, our analysis suggests that the magnitude of the savings available are unlikely to drive material numbers of customers to switch and drastically impact the number of DD customers (and the cost per customer).

3.37 Option 2 introduces the following broader market impacts which are explained further in the updated IA. At a high level:

Table 6: Analysis of Option 2

Income Weighted Analysis[23]	Admin Costs[24]	Bad Debt[25]	Working Capital[26]
£103m net saving	c.£1.5m	£0.3m net saving	£1.5m net saving

3.38 This option does not scale with consumption meaning that support is proportionally lower for high consuming SC and PPM customers.

3.39 In summary, Option 2 delivers against some of the following guiding aims of levelisation but does not deliver the aim of reducing the SC premium:

Table 7: Assessment of Option 2 against policy aims

Aim	
Customers that pay by PPM should not pay a premium.	✓
The SC premium should be reduced but maintained to incentivise efficient payment methods.	×
Levelisation should be enduring and responsive to policy changes.	✓
All customers that have the ability to build debt should contribute equally to debt-related costs.	×
There should be limited or no gap in support following EPG removal.	✓
Solution should be proportionate, minimising the intervention and administration costs to achieve desired outcome.	✓

Option 3 - Option 2 plus levelisation of debt-related costs

Stakeholder Feedback

3.40 There was strong support for Option 3 from consumer groups/charities and suppliers. This was primarily due to a perception that it was 'fair' to levelise debt-related costs and the need to support SC customers.

[23] Uses income to assess the effective impact on cost savings/benefits of our policies on consumer finances.
[24] Calculates the costs associated with administering the policies.
[25] Calculated the amount that we expect bad debt to decrease by.
[26] Linked to the reduction in bad debt, we assess the reduction in suppliers working capital.

3.41 Only 2 respondents that supported levelisation disagreed with Option 3. They opposed it on proportionality grounds and the perceived need to retain DD incentives. Many respondents, however, suggested adjustments to Option 3.

3.42 Two suppliers proposed partial bad debt levelisation to maintain the DD incentive (one of which proposed at least £100 as the necessary differential). Consumer groups opposed the underlying rationale of this, citing non-price reasons as the drivers for payment method choice.

3.43 Most consumer groups thought we should levelise further. One thought we should levelise PPM unit rates, noting that PPM unit rates are currently no higher than DD but could be in the future. Another thought that we should levelise SC standing charges also and partially levelise unit rates.

3.44 One, however, thought that PPM customers should not bear the burden of bad debt generated, primarily, by SC and DD customers and that we should therefore remove PPM customers from bad debt levelisation.

3.45 Multiple respondents commented that we should consider phased implementation so as not to allow Option 3 to delay Option 2.

Updates following analysis and Policy Consultation Feedback

3.46 We assessed the variants proposed in the policy consultation, in particular reviewing their impact on the cap level and performing income weighted analysis to understand whether they were likely to benefit consumers as a whole.

3.47 As a result, we considered the following variant of Option 3 in which we:

- Levelise PPM and DD standing charges as per the updated Option 2 (without the separated ASC bad debt adjustment).
- Levelise DD and SC debt-related costs (not allocating any of the debt-related costs to PPM customers). In the policy consultation, we proposed sharing debt-related costs equally between all customers. This updated approach means that PPM customers, who have the highest proportion of financially vulnerable customers, will not be made to pay for bad debt that their cohort does not typically accrue. DD and SC customers are able to pay for their energy after using it and are therefore able to generate debt. While we recognise that there are exceptions (for example the use of ASC where there is material risk of self-disconnection and customer harm), PPM customers must pay for their energy before using it and therefore do not typically generate debt. The ability to accrue debt is, in effect, a service provided to DD and SC

and therefore the costs associated with this service, the debt-related costs, should be levied on only these cohorts, rather than also on PPM customers who do not have access to this service.

Updated Analysis

3.48 Option 3 results in the following cap levels (with change against baseline provided in brackets). Impacts are shown at TDCV but as unit rates are affected, the costs/savings will be greater for high consuming SC and DD customers (PPM unit rate unaffected). We have performed sensitivity analysis to show the impact at difference consumption levels and present this in Appendix 3 – Updated Impact Assessment.

Table 8: Option 3 Cap levels – Dual Fuel 11b

	DD illustrative cap levels	SC illustrative cap levels	PPM illustrative cap levels
Total Level	£1,951 (+£23)	£2,013 (-£45)	£1,907 (-£54)
Yearly Standing Charge	£315 (+£13)	£340 (-£7)	£314 (-£54)
Yearly Unit Rate	£1,635 (+£10)	£1,673 (-£38)	£1,593 (£0)

3.49 The updated Option 3 results in the greatest increase to DD customers (compared to the other options) where there are currently the highest number of vulnerable customers. As discussed against previous options, we consider that this is justifiable due to total system benefits and as, at most consumption levels, these customers have the potential to achieve a lower total cost than currently available by changing payment method. The lowest achievable cost to consumers (the PPM cap) is the same for Options 2 and 3.

3.50 Option 3 is the most complex to implement, requiring a comparatively expensive and phased implementation approach.

3.51 However, this option impacts consumers as a whole most, as shown by the largest income weighted net saving. Option 3 also benefits the market as a whole the most, evident in the highest expected reduction in bad debt and working capital:

Table 9: Analysis of Option 3

Income Weighted Analysis	Admin Costs	Bad Debt	Working Capital
£201m net saving	c.£4.4m	£0.7m net saving	£4.1m net saving

3.52 Option 3 also smooths debt-related costs across all customers that can generate them, potentially correcting for inaccuracies in current allocations.

3.53 A (smaller) SC/ DD differential is maintained which should keep the financial incentive for customers to move to/ remain on more efficient payment methods.

3.54 In summary, this option best delivers against our guiding aims. It benefits SC and PPM cohorts where there is a higher proportion of customers with disabled, chronically sick and low-income vulnerabilities:

Table 10: Assessment of Option 3 against policy aims

Aim	
Customers that pay by PPM should not pay a premium.	✓
The SC premium should be reduced but maintained to incentivise efficient payment methods	✓
Levelisation should be enduring and responsive to policy changes	✓
All customers that have the ability to build debt should contribute equally to debt-related costs	✓
There should be limited or no gap in support following EPG removal	✓
Solution should be proportionate, minimising the intervention and administration costs to achieve desired outcome	✓

Analysis performed on Options

3.55 Alongside consideration of stakeholder feedback, we have performed the following analysis (more detail can be found in Appendix 3 – Updated Impact Assessment):

3.56 **Income Weighted Analysis –** Using income to assess the effective impact on cost savings/benefits of our policies on consumer finances, specifically those on low income (vulnerability characteristic), relative to disposable income. Both Option 2 & 3 result in a net saving of £103m and £201m respectively.

3.57 **Total Debt** – We assess that levels of total debt will decrease, as a result of both Option 2 and 3, by £12.2m and £33.5m respectively.

3.58 **Bad Debt and Working Capital** – We assess that levels of bad debt will decrease, as a result of both Option 2 and 3, by £0.3m and £0.7m. We also assess that levels of working capital will decrease, as a result of Option 2 and 3, by £1.5m and £4.1m respectively, resulting in lower costs to consumers and improved supplier resiliency and stability which should benefit the market as a whole.

3.59 **Administration Costs** – We assess the costs associated with administering the policies to be c.£1.5m for Option 2 and c.£4.4m for Option 3.

3.60 **Competition Assessment** – As identified in the policy consultation, our analysis continues to indicate that there will be no material impact on competition (positive or negative).

3.61 **Self-Disconnections** – Due to the relatively small savings for PPM consumers and therefore small associated increase in consumption, the reduction in PPM self-disconnections has been determined to be positive but negligible.

3.62 **Health and Wellbeing** – The negligible reduction in self-disconnections means improvements to health and wellbeing, from the reduction in self-disconnections, are also positive but negligible.

Levelisation Proposal: Levelise PPM and DD Standing Charges and levelise debt-related costs between SC and DD

3.63 We propose proceeding with the implementation of the updated Option 3 as it best delivers against our aims of levelisation, and our analysis shows it best benefits consumers as a whole.

Implementation proposal

Phasing

3.64 There were mixed views on phasing the implementation of levelisation with most respondents agreeing that standing charge levelisation should be implemented on 1 April 2024. Two suppliers preferred phased implementation as it would allow time to design the most appropriate solution. One supplier thought that the standing charge and unit rate levelisation should be implemented simultaneously and in full but also supported an iterative development and implementation to capture the additional drivers of costs over and above payment method.

3.65 This statutory consultation details our proposal to proceed with Option 3 - levelisation of PPM and DD standing charges and debt-related costs between SC and DD customers. Unit rate levelisation and reconciliation is dependent on further industry design and build and is not deliverable for April 2024. We therefore propose a staged implementation in which we levelise standing charges from April 2024 to ensure no gap in support for PPM customers following the end of standing charge levelisation through the EPG. We would then proceed with development of the unit rate levelisation following development of the associated systems and processes. This would be in (earliest) October 2024. These timelines are driven by industry code modification and system build processes.

3.66 The administration costs of the scheme broadly align to the bad debt savings that suppliers would experience as a result of the scheme. Therefore, we do not propose any adjustments to existing price cap allowances for administration costs. However, any variance to this should be covered by existing uncertainty allowances under the price cap.

Implementation in SLCs

3.67 We are proposing to introduce levelisation via an amendment to SLC 28AD. We are planning to introduce a new levelisation cost allowance 'L' – which would be offset against the pre-levelised cap levels to calculate the post-levelised cap levels. The proposed SLC changes are detailed in Appendix 2. These proposed changes enable both standing charge and unit rate levelisation.

3.68 We propose including a provision in the SLC to allow us to set the levelisation allowance to zero, following a brief consultation, if required. We expect to only use this in exceptional circumstances where we have evidence that it is within consumers' interests. We have included this provision as levelisation is a novel intervention, as such, it is prudent to monitor the effect and maintain the ability to intervene if needed.

Implementation in the Price Cap Models

3.69 As noted above, a detailed approach to unit rate levelisation is dependent on further industry build which may not be deliverable for April 2024. Hence this consultation provides our proposal for the implementation of phase one of Option 3, ie standing charge levelisation, in the price cap model.

3.70 The implementation of unit rate levelisation (the second phase of Option 3) in the cap model will be developed alongside the code modification process for unit rate reconciliation. A consultation on any further model changes will be run prior to implementation.

3.71 To support phase one of Option 3, we are proposing the introduction of a new Annex – Annex 9 – where the levelised cap levels are calculated. The pre-levelised price cap would be taken from the existing overview price cap model and used within Annex 9 to calculate the post levelised price cap levels and the levelisation allowance. This calculation will equalise the standing charge for DD and PPM for each fuel and region using relevant number of customer accounts.

3.72 A new benchmark that will levelise 'raw' nil consumption level will be calculated as a result, and we expect that suppliers will comply with new benchmark. Further details are provided within Appendix 5.

3.73 The existing quarterly Tariff & Customer account Request for Information (RFI) will be used to inform the number of customer accounts on each payment method for the price cap calculation. To promote transparency, the aggregate customer accounts will be published and included for each cap announcement in our model. A summary of these customer account volumes is provided in Table 11 below:

Table 11: Summary of Customer Accounts by Payment Method and Fuel Type (October 2023)

Tariff Type	Fuel Type	DD	PPM	SC
Single Rate	Electricity	17,792,556	3,551,372	4,628,976
Single Rate	Gas	16,720,774	3,184,531	4,173,389
Multi Rate	Electricity	2,006,329	502,088	560,987
Single & Multi Rate	Electricity & Gas	36,519,659	7,237,991	9,363,352

Implementation On Bills

3.74 There will be no change to customer experience following the introduction of levelisation. As the current EPG legislation does for PPM, the associated cost/ saving will be applied directly to the consumer bill.

4. Uncapped tariffs

Chapter summary

We set out our considerations and proposals for applying levelisation to uncapped contracts, including our proposal to include uncapped contracts in the reconciliation mechanism customer accounts but not to introduce an SLC requiring suppliers to reflect levelisation aims in their uncapped contract pricing.

We also provide an overview of stakeholder feedback against our initial proposals presented in our policy consultation.

Questions

Q5. Do you agree with our proposal to include uncapped contract numbers in the levelisation reconciliation?

Q6. Do you agree with our proposal not to introduce an SLC requiring suppliers to offer the same standing charge on equivalent DD and PPM tariffs?

Introduction and considerations

4.1 As outlined in Chapter 3, we are proposing to levelise PPM and DD standing charges and to levelise the debt-related costs between DD and SC customers.

4.2 In our policy consultation, we stated that our preference is to levelise both capped and uncapped contracts. Uncapped contracts are all domestic contracts not covered by the cap, including fixed term contracts and derogated variable tariffs.[27] This was our preference as it mitigates the risk that capped PPM and SC tariffs become materially cheaper than what suppliers can offer on uncapped contracts (as capped tariffs would be subsidised by DD and uncapped contracts would not).

4.3 It also supports the policy aim that levelisation should be enduring and responsive to change. If the cap is removed or changed in the future, levelising uncap ed contracts enables levelisation to continue (although an alternate benchmark for the efficient cost to serve would need to be developed).

[27] In November 2018, we set out our decision that the cap should apply to all standard variable tariffs (SVTs), but we provided a route for suppliers to apply for derogations for renewable electricity and renewable gas SVTs that have been chosen by customers in SLC 28AD.25. In January 2019, we granted enduring derogations for tariffs held by three suppliers (Good Energy, 100Green and Ecotricity).

4.4 For capped contracts, levelisation will be performed through adjustment of the cap level and we describe changes to the cap model in Appendix 5 for consultation. For uncapped contracts, we stated in our policy consultation that our initial preference was to levelise by including uncapped customer accounts in the reconciliation mechanism and introducing an SLC requiring suppliers to offer the same standing charge on equivalent DD and PPM tariffs.

4.5 Including uncapped customer accounts in the reconciliation mechanism means that suppliers should face levelised costs, which in the competitive section of the market, should result in levelised tariff pricing.

4.6 Introducing an explicit SLC would go further and ensure that suppliers are pricing uncapped contracts in line with levelisation aims. Without this, suppliers can take commercial decisions that deviate from the levelisation aims.

Stakeholder feedback

Include uncapped contracts in reconciliation customer accounts

4.7 There was overarching support for including uncapped contracts in reconciliation. Four of five respondents that commented agreed that all domestic consumers should be included so that the market is not distorted by levelisation.

4.8 One disagreed, expressing serious concern regarding their ability to forecast levelisation costs and warned that their inclusion would risk the feasibility of the fixed term contract market. They requested that Ofgem introduce a long-term levelisation cost forecasting mechanism, and commit to not changing levelisation charges without long notice periods, without which suppliers would have to remove some offerings and build a levelisation risk premium into others, reducing tariff choice and driving up cost to consumers.

4.9 Multiple suppliers commented to the contrary, actively expressing no concern regarding their ability to forecast levelisation costs.

Introduce an SLC requiring suppliers to reflect reconciliation aims in their uncapped contract pricing

4.10 Seven out of ten respondents supported the introduction of an SLC to require levelisation aims to be reflected in uncapped contract pricing. Some saw it as lower priority than capped contract levelisation so could be introduced later.

4.11 Three suppliers disagreed with the introduction of an SLC:

- One thought it would be disproportionate and that competitive pressures would ensure reconciliation costs/benefits are reflected in tariff pricing.
- Another warned of the unintended consequences of Ofgem directly price regulating the uncapped contract market.
- The third opposed the inclusion of uncapped contracts in levelisation and therefore did not support the introduction of an SLC.

Our proposal on uncapped contracts

Include uncapped contracts in reconciliation customer accounts

4.12 We maintain our policy consultation proposal to include uncapped contracts in the reconciliation customer accounts to avoid the following market distortions:

- Uncapped PPM and SC tariffs becoming uncompetitive as they would not be subject to the same levelisation discount as equivalent capped contracts.
- The cost of levelisation being borne by a decreasing number of DD customers, as DD customers switch away from the cap at a disproportionate rate to SC and PPM. This may occur as uncapped DD tariffs would not bear the cost of levelisation so become cheaper than capped contracts. DD customers are also, on average, more engaged and likely to switch as cost effective uncapped contracts become available.

4.13 We are also proposing to exclude contracts agreed prior to the publication of our decision associated with this statutory consultation as we do not expect these contracts to have included the costs associated with levelisation. This is discussed further in Chapter 6- Payment Reconciliation Mechanism.

Do not introduce an SLC requiring suppliers to reflect reconciliation principles in their uncapped contract pricing

4.14 Despite our initial preference to introduce an SLC, and broad support for this in the policy consultation, we are proposing not to introduce an SLC requiring suppliers to reflect reconciliation principles in their uncapped contract pricing.

4.15 The uncapped contract market has traditionally closely reflected the underlying cost to serve, with some acquisition tariffs being below cost. The inclusion of uncapped contract customer accounts in the reconciliation mechanism will levelise the costs faced by suppliers in line with our levelisation aims.

4.16 We expect competitive pressure to be sufficient to ensure suppliers reflect the levelised costs in the pricing of their uncapped contract tariffs, resulting in levelised uncapped contracts.

4.17 Further, SLC 27A states that 'Any difference in terms and conditions as between payment methods for paying Charges for the Supply of Electricity/Gas shall reflect the costs to the supplier of the different payment methods'. The costs associated with levelisation/ reconciliation contribute to the different cost to serve payment methods. Therefore, to be compliant with SLC 27A, suppliers are already required to reflect reconciliation costs and benefits in their tariff pricing.

4.18 We do, however, recognise that the consumer outcomes may not be as uniform if we introduced an explicit SLC and that some differentials may remain resulting from supplier specific differences in cost to serve between payment methods.

4.19 On balance, we consider our proposal to be proportionate against the risks and practical issues with introducing an SLC, including:

- Risk of unintended consequences from direct price regulation of the uncapped contract market. We broadly do not price regulate the competitive section of the market and are concerned that doing so will harm competition and innovation due to perceived risk of future interventions and potential supplier hesitancy to launch innovative tariffs. Our CFI on standing charges discusses how standing charges may develop in the future, including discussion of, for example, block tariffs[28] and zero standing charge tariffs. There is a risk that an SLC requiring suppliers to offer the same standing charge on equivalent tariffs contributes to suppliers' hesitancy to explore and introduce such offerings, limiting tariff variance and consumer choice.
- The complexities of assessing compliance with an SLC, particularly the allocation of debt-related costs between payment methods as this is a contribution to tariff price so total price alone does not evidence compliance.
- An SLC may be ineffective and open to gaming, such as through block tariffs to circumnavigate the SLC's intent. Foreseeable gaming risks could be addressed through detailed and extensive SLC drafting, but this increases complexity and compliance burden, which may be disproportionate.

[28] A 'block tariff' is a tariff where energy is charged at different rates for different consumption levels. Some Suppliers offer tariffs with no standing charge, rather charge an effective standing charge through higher priced initial units of energy.

5. Other levelisation considerations

Chapter summary

This chapter outlines our proposals around targeting specific groups when levelising, regional differences and treatment of smart PPM.

Questions

Q7. Do you have any views on our other considerations related to levelisation, regional levelisation and treatment of smart PPM?

5.1 In our policy consultation, we highlighted other considerations within the scope of levelisation and asked for supplier feedback on whether there are any further considerations that we should explore.

Targeted levelisation

5.2 Targeted levelisation would involve levelising costs by payment method with consideration of different customer vulnerability characteristics. This approach would target eligible customers and reduce the total cost to be shared, reducing the impact on bills for DD customers.

5.3 In our policy consultation, we presented our preference not to proceed with targeted levelisation. We had concerns over our ability to effectively target within the timescales proposed to implement levelisation by April 2024.

Stakeholder Feedback

5.4 There was very strong support for our proposal not to target levelisation, with eight of nine responses agreeing. Most respondents noted targeting would be too complex and time consuming to implement for April 2024, and that implementation in April 2024 is the priority. Most respondents also noted their support for a government-led affordability intervention such as a social tariff.

5.5 The one respondent that disagreed with our proposal noted the barriers related to targeting levelisation but thought it could be possible in the future if Ofgem and government work together to better collect vulnerability data on consumers.

Our proposal on targeting

5.6 We maintain our proposal from the policy consultation not to target levelisation, noting the overwhelming stakeholder support and the practicalities around effectively targeting within our implementation timescales.

Regional levelisation

5.7 Currently, standing charges and unit rates vary dependent on region, for both capped and uncapped tariffs; these are driven through the regional variations in network charges and reflect the cost to serve consumers in different regions. The implementation of a national cap would remove these regional differences.

5.8 In our policy consultation, we proposed not to remove the regional differences because of the complexity to reconcile. Additionally, we outlined the broader market context of reforms looking to increase locational variation in tariffs and improve locational cost and demand signalling, intended to ultimately reduce total system cost. Introducing a national cap would be contrary to the direction of these reforms. Further, it may increase delivery mechanism costs and inevitably delay an April 2024 implementation.

Stakeholder Feedback

5.9 There was strong support for our proposal not to remove regional differences, with seven out of ten responses supporting this position. Respondents cited the added complexity and potential delay to the April implementation date as key factors for their support of our proposal.

5.10 The remaining three respondents who disagreed with our proposal thought that locational differences by network region are unfair and lack transparency for customers.

Our proposal on regional differences

5.11 Our proposal is not to remove regional differences, unchanged from our policy consultation position.

5.12 We note that stakeholders generally supported retaining regional differences. We consider that amending this to a singular charge would introduce an extra layer of complexity and potentially conflict with market reforms.

Treatment of smart PPM

5.13 Smart PPMs are increasingly being used over traditional PPM; they do not require special infrastructure investment to provide prepayment services and therefore have a significantly lower cost to serve.

5.14 In our policy consultation, we proposed not to treat smart PPM differently from the overall PPM payment method as we do not currently identify smart PPM as an independent payment method in the cap methodology. Additionally, the role of smart PPMs will be considered within our upcoming operating cost review.

Stakeholder Feedback

5.15 We received several responses from stakeholders who emphasised the importance of smart PPM when asked about other considerations. A few stakeholders emphasised the importance of separating smart and traditional meters to make this the cheapest payment method, thereby incentivising switching to smart meters.

5.16 Some respondents considered that levelisation could be used to differentiate traditional and smart PPMs and it could be used to support smart meter rollout. There was a view, more generally, surrounding cost-reflectivity and, splitting PPM into smart and traditional, would help to solve discrepancies between smart PPM and DD pricing and incentivise moving away from traditional meters.

5.17 One respondent believed that we should accelerate the operating costs review and use smart PPM costs as a benchmark for all PPM customers, as to do otherwise would allow recovery of out of date costs.

Our proposal on smart PPM

5.18 Our proposal is to not treat smart PPM differently from PPM, in line with our policy consultation position. As discussed in Chapter 3, we acknowledge the benefits of smart PPM for consumers and suppliers and that there may be a case to introduce smart PPM as an independent payment method. This is, however, being considered through the operating costs review.

5.19 While we recognise our duty to incentivise suppliers to improve efficiency, we do not agree that the cost to serve smart PPMs should be used as the benchmark for all PPMs as we do not consider that an efficient supplier would be reasonably able to serve all PPM customers through smart meters. While we are careful not to disincentivise it, incentivising smart pre-pay is not a specific aim of levelisation.

6. Payment reconciliation mechanism

Chapter summary

This chapter sets out details relating to the levelisation reconciliation mechanism. A reconciliation mechanism is required to prevent individual suppliers from significantly gaining or losing from the implementation of levelisation.

In October 2023, we selected the Retail Energy Code Company (RECCo) as the standing charge (non-volumetric) reconciliation operator so that, if we decide to proceed with levelisation, we would be able to implement a standing charge reconciliation mechanism. To this end, REC modification R0147 has been raised which we expect to set out the detailed code operation for the reconciliation mechanism from 1 April 2024. We will work further with industry to define the requirements, operator(s) and implementation date for unit rate (volumetric) reconciliation.

Questions

Q8. What are your views on our updated options including the need for a reconciliation mechanism and phasing of implementation?

Q9. Do you agree with our proposal to exclude fixed term contracts agreed prior to our decision date from our levelisation proposal?

Q10. Do you agree with our proposal for suppliers not to carry out, at their expense, an audit of their systems, processes and data to be used in reconciliation?

Reconciliation mechanism proposal

Recap of policy consultation reconciliation mechanism proposal

6.1 In the policy consultation, we set out our proposal to introduce a new mechanism for the reconciliation of levelisation costs to avoid distorting supplier competition. The new mechanism would be billpayer, not government, funded. We proposed implementing a reconciliation by difference mechanism, invoiced a month in arrears.

6.2 Ofgem would be responsible for calculating the levelised cap and the levelisation allowance for standing charge and unit rates. These rates would be calculated and provided to the reconciliation operator and suppliers on a quarterly basis.

6.3 We proposed using a daily rate adjustment to levelise standing charges and a volumetric reconciliation based on estimated consumption to levelise unit rates. This volumetric amount would not be reconciled to actual consumption. We planned to select a reconciliation operator shortly after the policy consultation who would be responsible for invoicing the charges on a monthly basis.

6.4 A summary of our preferred approach for implementing the new mechanism presented within the policy consultation is provided in Table 12.

Table 12: Policy consultation reconciliation mechanism proposal summary

Topic	Proposal
Mechanism	New mechanism is required
Type of mechanism	Reconciliation by difference
Standing Charge Reconciliation	Based on a daily rate adjustment
Unit Rate Reconciliation	Reconciliation will be based on estimated consumption and not adjusted to actual consumption
Invoicing Cadence	Monthly
Levelised cap calculation	Ofgem calculate quarterly

Stakeholder feedback

Mechanism requirement, operator, and type, levelisation rate calculation and invoicing cadence

6.5 Most respondents agreed with our preferred positions on the reconciliation mechanism, type of mechanism, invoicing cadence, the responsible party for levelisation rate calculation and mechanism operator. One response highlighted that Ofgem should take steps to compensate suppliers who incur higher debt from SC customers through the reconciliation mechanism. Another supplier considered it critical that any reconciliation process can accurately determine supplier obligations and validate reconciliation amounts.

6.6 One stakeholder also stated they would like the mechanism to take account of daily customer movements. Another agreed that it should be operated by an existing industry party such as the Retail Energy Code Company (RECCo).

6.7 One respondent did not agree and argued that the reconciliation mechanism be ruled out as the approach distorts competition by advantaging legacy suppliers over challengers and carries significant moral hazard by reducing suppliers to engage their customers and manage their debt. The supplier stated that the proposals severely damage the incentive to get customers off costly payment methods and makes it hard to forecast fixed tariffs due to levelisation 'tax'. The supplier further stated that if levelisation is implemented on a reconciliation approach, it should be time-limited and incentivise smart prepay.

6.8 Opposing views were submitted about invoicing cadence. One respondent thought that the more money that is being passed through reconciliation, the greater the necessary cadence. Another response encouraged Ofgem to pursue levelisation and further consider the challenges of cross subsidisation but thought the solution is complex and time-consuming, requiring significant administration from a service delivery body and suppliers. One consumer group commented that the additional working capital requirements for suppliers who had not yet bought sufficient energy to cover demand had not been considered with the invoicing timings and would be worse with a unit rate solution. As well as this, they stated that without a 12-month forecast of levelisation allowances, fixed price contracts are likely to be higher due to increased pricing risk.

6.9 Respondents agreed that all domestic supply points should be subject to the reconciliation amount.

Approach to reconciliation

6.10 All suppliers who provided comments agreed that a daily rate should be used to reconcile standing charges differences. There was only limited support for estimated consumption to be used for the unit rate reconciliation. Instead, the preference was that any unit rate reconciliation would be applied to actual consumption and therefore adjusted following the initial estimated settlement based on meter reads.

Fixed contracts

6.11 There were mixed views in response to how existing fixed contracts should be treated. A consumer group and one supplier thought that there should be a derogation to allow them to increase existing fixed price contracts to recover costs. Another consumer group and two suppliers said that all fixed contracts pre-April 2024 should be included. One of the suppliers stated that fixed contract supplier cost needs to be understood and included in the IA or a cut-off point provided so that suppliers can price uncertainty into future contracts. Another supplier said that existing fixed tariffs should be excluded as this could result in losses that suppliers cannot recover.

General

6.12 A respondent stated that Ofgem needs to work with the reconciliation operator to understand the impact of not including a reconciliation mechanism. They also commented that the operating costs review should set out how the existing cross subsidy will be treated under any revised payment method uplift and whether and how this interacts with the reconciliation process.

6.13 One respondent did not agree with the assumption that the reconciliation mechanism will be implementable on 1 April 2024. They also highlighted issues which occurred with the Market Stabilisation Charge (MSC), including calculation verification, sufficient time for disputes and time to unwind following a successful dispute. To date, we have not seen any indications to put the implementation date in doubt and note the lessons learned from MSC.

Updated Analysis

6.14 As part of our assessment into whether there is a need for a reconciliation mechanism, we have updated the supplier impact modelling provided in the policy consultation based on Options 2 and 3 without a reconciliation mechanism. We have also carried out the analysis on actual supplier data but have not included here due to confidentiality reasons. Within the model, we considered four theoretical suppliers to illustrate this impact, as shown in the table below:

Table 13: Proportion of consumers by payment methods for hypothetical suppliers

Supplier	DD	PPM	SC
A	33%	33%	33%
B	90%	5%	5%
C	5%	90%	5%
D	5%	5%	90%

6.15 The percentage impact on revenue is provided within the table below. For both options, the supplier with a majority of DD consumers experiences an increase in revenue whereas the supplier with a majority of PPM and SC consumers experiences a decrease in revenue. This continues to show that there is a significant risk to specialist PPM and SC suppliers' stability if levelisation is implemented without a reconciliation mechanism. Without these suppliers, consumers would not see the customer service and market innovation benefits that specialist suppliers provide, who, without reconciliation, would have less revenue to attract and serve these consumers.

Table 14: Option impacts on supplier revenues

Supplier	Option 2 Revenue Impact	Option 3 Revenue Impact
A	-0.7%	-1.3%
B	0.4%	0.8%
C	-2.4%	-2.5%
D	-0.1%	-2.1%

Our updated proposal on the Payment Reconciliation Mechanism

Mechanism requirement and type, levelisation rate calculation and invoicing cadence

6.16 Based on the updated options presented in Chapters 3, 4, and 5, stakeholder responses and updated analysis, we are proposing to implement a new enduring reconciliation by difference mechanism to ensure that supplier stability and market diversity is maintained from the implementation of levelisation. We appreciate that reconciliation mechanisms may have downsides and may not be appropriate in all circumstances. However, in this specific case, we consider it to be the correct mechanism to implement, particularly due to the impact on payment method specialist suppliers.

6.17 We do not think that suppliers should be treated differently through the mechanism, which will be based on numbers and volumes associated with payment methods. Under our options, differences between more efficient payment methods will remain, which should continue to incentivise suppliers to manage their customers' payment methods.

6.18 As discussed in Chapter 4, the reconciliation mechanism will apply to all capped and uncapped tariffs for domestic consumers.

6.19 The levelised cap and levelisation allowances should be calculated by Ofgem for each fuel, region and payment method and provided to the reconciliation operator and industry on a quarterly basis. We do not think that levelisation allowances can or should be set for a longer period as suppliers should be reasonably able to forecast them and we do not consider that it will have a significant impact on the risk associated with fixed term contracts.

6.20 We propose that invoicing should be carried out monthly by the reconciliation operator based on supplier data, which should include daily changes in the number of customers associated with each payment method. We consider that monthly invoicing balances the administrative costs with the capital implications of the levelised cap.

Approach to reconciliation

6.21 We propose to implement a fixed daily charge for the standing charge difference. For unit rate reconciliation, we continue to propose an estimated unit rate solution. We continue to favour an estimated consumption solution as it provides the best balance between the administrative costs and the accuracy of the mechanism, however, we appreciate that further industry design is required in the coming months to design the appropriate process. To date, we have not identified any unintended consequences of phased implementation. A unit rate reconciliation operator(s) should be identified and selected based on the industry design.

Fixed contracts

6.22 We modelled the potential impact on suppliers with existing fixed priced contracts and have assessed that suppliers could be negatively impacted by up to £20 million if reconciliation includes customer accounts on existing fixed contracts. Additionally, we have identified that there is a risk that suppliers could agree new fixed term contracts which would avoid incurring the levelisation charge, resulting in increased profits. To balance these two impacts, we propose that any fixed term contracts for all payment methods agreed prior to the decision date are not included within the reconciliation mechanism. Any fixed term contracts agreed from the decision date onwards will be included within the mechanism. We do not think that allowing suppliers a derogation to open existing contracts is an appropriate option to mitigate the inclusion of existing fixed contracts within the reconciliation mechanism. We consider that the negative impact to consumers for whom prices would increase, both in terms of the direct financial impact and the potential damage to their trust in their supplier and the market would likely be unproportionate to the financial advantage to those who would see a saving.

Reconciliation Operator

6.23 On 10 October 2023, RECCo was selected as the standing charge reconciliation operator. As the standing charge reconciliation operator, RECCo is required to develop industry processes, as well as design, build, test, and deliver a functional system that will enable the facilitation of payments between suppliers to allow for standing charge levelisation with a daily rate adjustment. The selection of RECCo is 'at risk' until a decision is made, in order to allow for any positive decision to be implemented in a timely and effective manner.

Summary of updated options

6.24 A summary of our preferred approach for implementing the new mechanism presented within the statutory consultation, subject to our final decision, is provided in Table 15.

Table 15: Updated reconciliation mechanism proposal summary

Topic	Proposal
Mechanism	New mechanism is required
Type of mechanism	Reconciliation by difference
Standing Charge Reconciliation	Based on a daily rate adjustment
Unit Rate Reconciliation	To be developed and consulted on separately
Invoicing Cadence	Monthly
Levelised cap calculation	Ofgem on a quarterly basis
Standing Charge (Non-Volumetric) Reconciliation Operator	RECCo
Unit rate (Volumetric) Reconciliation Operator	To be identified and selected following industry working groups
Phasing	Standing charge levelisation implemented in April 2024 and the unit rate at a later date
Fixed Tariffs	Fixed tariffs agreed before decision date will be excluded from the reconciliation mechanism
Capped and Uncapped Tariffs	All included within the reconciliation mechanism
Non-Domestic Sites	Not included in the reconciliation mechanism

Code modification

6.25 For levelisation to be operated effectively, we consider that it would need to be underpinned by a consistent set of industry arrangements. We envisage that the standing charge reconciliation mechanism will be introduced through a modification to the Retail Energy Code (REC) supported by an SLC. We note that the development of the reconciliation mechanism is outside of Ofgem's immediate control. It is subject to modifications progressing through the REC and modification R0147 has been raised which we expect to set out the detailed code operation.

6.26 In due course, we will consider the change proposal R0147 alongside the changes to the SLCs. Subject to our decision, any further changes that will be required for unit rate reconciliation will need to be developed under the appropriate code and will be considered at a later date when unit rate levelisation phase is to commence.

SLC and guidance document

6.27 As discussed in Chapter 4, there was strong support for SLCs to be introduced for levelisation. We are proposing to introduce the levelisation and reconciliation mechanism via an amendment to SLC 28AD which will introduce levelisation through changes to the price cap methodology and associated annexes. We are using the existing condition under the Default Tariff Cap Act because levelisation is a policy which sets the charges under the price cap and reconciliation is a consequential process which is required to allow levelisation to function in a competitive market. The drafting includes a provision to set the levelisation price cap rates to zero. We would do this following a brief consultation, if required, and only expect to use this in exceptional circumstances where we have evidence that it is within consumers' interests. We consider this is needed as levelisation is a novel intervention so prudent to monitor the effect and maintain the ability to intervene if needed. The proposed SLCs to satisfy policy intent have been provided in Appendix 2. A guidance document will be published next year to support the implementation and delivery of the scheme.

Controls on data and audit provisions

6.28 The data returns for the reconciliation process will determine what charges are owed by or to suppliers. Hundreds of millions of pounds may flow across the system annually, therefore, we need to ensure that the data is as accurate as possible.

6.29 We need to balance the need for robust systems and controls against the fact that all the operational overheads of the scheme will ultimately be borne by consumers. We propose in the SLC that data is verified by a named company director or other authorised person, so that a named individual with sufficient seniority can assure Ofgem and the reconciliation operator that their data is accurate.

6.30 We expect that the REC will include a disputes process if any party believes that the charges applied to them are materially wrong. Non-compliance with the reconciliation mechanism would also be a breach of the REC and SLCs and may be subject to Ofgem compliance or enforcement action. We would likely consider, among other relevant things, the sums of money involved when deciding how to prioritise action in this area.

6.31 Given these controls, we do not necessarily consider it to be required that suppliers fund a specific audit of their data. Instead, they should keep records of the data to allow Ofgem or other industry bodies to retroactively review data to ensure quality and accuracy.

Reconciliation system controls

6.32 We are working with industry to finesse the design and development of the reconciliation system and will closely and carefully review REC modification R0147 prior to any approval. If needed or warranted by circumstances, we may consider using our Significant Code Review powers.

6.33 As described herein, the integrity of the system and supplier interests are protected. The proposed SLC updates sets out that domestic suppliers participate in reconciliation and pay any charges owed in a timely manner. The SLCs further require that the scheme data provided is verified by a named statutory director or company officer. This provides for additional internal supplier controls on the data and additional courses of action should the data prove to be materially inaccurate.

6.34 Non submission of data and/or non-payment of invoices under the reconciliation scheme should be considered an Event of Default under the REC, as well as a breach of the SLCs. We expect that failure to pay invoices on time will result in escalation to the REC Performance Assurance Board (PAB) within 21 days. The PAB has the power to request that suppliers are barred from registering new customer supply points via the Central Switching Service, resulting in an immediate restriction on trade for defaulting parties. Ofgem will consider further action in these cases, if required.

6.35 The REC is a multi-party contract between suppliers. If any supplier fails to abide by the REC, including the reconciliation system, parties do have recourse to the courts for damages. In extreme circumstances, such recourse provides a legal backstop to the reconciliation system.

6.36 We expect there to be a mutualisation process introduced via a modification to the REC for any outstanding invoices from failed suppliers. If a supplier does exit the market through Supplier of Last Resort (SoLR) then liabilities (and credits) under the reconciliation system, from the point at which the SoLR occurred, will attach to the new supplier as normal.

7. Interactions with other workstreams & next steps

Chapter summary

We discuss our interactions with other Ofgem workstreams, including the operating costs review, debt-related costs review and standing charges review.

7.1 As outlined in our policy consultation, the levelisation workstream has interactions with several other Ofgem workstreams. These workstreams include the operating costs review, debt-related costs review and standing charge review. We are actively working with these workstreams to ensure the implementation of any levelisation policy is consistent with the necessary requirements of these and other related workstreams.

Operating costs review

7.2 As outlined in the Price cap – Programme of Work: Update in April,[29] Ofgem is launching a review of the cost-related allowances in the cap, including:

- The Core operating costs allowance - a supplier's own costs of retailing energy;
- The Smart Metering Net Cost Change (SMNCC) allowance - net cost of installing and operating smart meters as part of the transition for the smart meter rollout; and
- The Payment Method Uplift (PMU) - allowances for the additional costs of serving customers who pay by different payment methods.

7.3 As set out in the May 2023 operating costs review call for input,[30] there are several reasons we set out for undertaking a review of the operating cost allowances. These include the age of the data used to set the allowances and the number of changes the market has gone through since the allowances were set.

7.4 The operating costs review aims to consider whether changes to the allowances are appropriate and whether the allowances continue to reflect the efficient costs a notional efficient supplier may incur. We are considering:

- Market changes;

[29] Ofgem (2023), Price Cap – Programme of Work: Update. https://www.ofgem.gov.uk/publications/price-cap-programme-work-update
[30] Ofgem (2023), Price cap – Call for input on the Operating Cost Allowances Review. https://www.ofgem.gov.uk/publications/price-cap-call-input-operating-cost-allowances-review

- Regulatory changes; and
- Up to date data and benchmarks.

7.5 We expect that any changes to the operating cost allowance to be complementary to levelisation. As the operating cost review is scheduled to be delivered after we publish our decision on levelisation, we would expect any changes to the allowance to flow into the levelisation calculations.

7.6 Should the review result in structural changes to the cap, such as changing the way that bad debt is assigned in the payment method uplift, we would assess whether our levelisation calculations need to be changed in response. Even in a scenario where bad debt is levelised by an equivalent amount to that calculated in the payment method uplift, our current approach/model should still accommodate this.

Debt-related costs review

7.7 We are undertaking a review of debt-related costs, with a view to considering whether we should make an adjustment to the debt-related costs allowance in the cap. During this review, we have gathered a range of evidence, including RFIs sent to suppliers, a CFI,[31] published in April 2023, and a policy consultation[32] published in October 2023 seeking views from all stakeholders. We published a decision in parallel setting out our proposals to introduce an initial 12-month allowance for bad debt associated with ASC given to PPM customers.[33] If levelisation proceeds, as the ASC allowance is on the standing charge element of the PPM cap, it will levelise ASC across PPM and DD customers from April 2024.

7.8 While the workstreams are separate under the review, we have set out our proposals for calculating debt-related costs and these would form inputs into Option 3. Unit rate levelisation under Option 3 will be implemented at a later date than April 2024 therefore any adjustment to the unit rate for debt-related costs will not be included within the levelisation mechanism until unit rate reconciliation is implemented. Until then, we will consider adjustments to the debt allocation outside levelisation.

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[31] Ofgem (2023), Price cap- Call for input on the allowance for debt-related costs. https://www.ofgem.gov.uk/publications/price-cap-call-input-allowance-debt-related-costs
[32] Ofgem (2023), Additional debt-related costs allowance policy consultation. https://www.ofgem.gov.uk/publications/additional-debt-related-costs-allowance-policy-consultation
[33] Ofgem (2023), Price cap – Allowance for additional support credit bad debt costs. https://www.ofgem.gov.uk/publications/allowance-additional-support-credit-bad-debt-costs

7.9 Whilst highly unlikely, there is the potential that the debt-related costs review results in a change to our benefits case such that we no longer deem that debt-related costs levelisation is in consumers' interests. While we do not foresee this materialising, should it be the case, we would re-consult on the levelisation of debt-related costs and consider stakeholder feedback alongside the updated benefits case.

Standing Charge Review

7.10 We recognise the impact that increasing standing charges will have on some customers, and that adding fixed costs to customers' bills may disproportionately impact those on lower incomes. For this reason, we have decided to undertake a programme of stakeholder engagement to ensure that we are doing all we can to minimise these negative impacts on customers.

7.11 In the Standing Charges CFI,[34] which was published on 16 November 2023, we set out what standing charges are, why they have increased, and how we expect them to change in the future, examining how potential changes might affect different types of customers.

7.12 This consultation and the Standing Charges CFI are complimentary. The outcome of this consultation will influence the relative magnitude of standing charges for different payment methods. The contributing factors to these standing charges, and how they may evolve in the future, is considered in the CFI.

Next steps

7.13 We welcome any written comments by 2 January 2024, sent to priceprotectionpolicy@ofgem.gov.uk. Please include detail and supporting evidence in your comments wherever possible. We will carefully consider stakeholder feedback following the close of this statutory consultation. We plan to publish a decision in early 2024.

[34] Ofgem (2023), Standing charges – call for input. https://www.ofgem.gov.uk/publications/standing-charges-call-input

Appendices

Appendix 1 – List of consultation questions

Chapter	Question
Chapter 2: Case for change and levelisation scope	1. Do you have any comments or views on our updated case for the introduction of levelisation of payment methods? 2. Do you agree with our levelisation policy aims?
Chapter 3: Levelisation options and proposal	3. Do you agree with our proposed approach to levelisation? 4. Do you have any views on the proposed amendments to SLC 28AD and model changes under Annex 9?
Chapter 4: Uncapped tariffs	5. Do you agree with our proposal to include uncapped contract numbers in the levelisation reconciliation? 6. Do you agree with our proposal not to introduce an SLC requiring suppliers to offer the same standing charge on equivalent DD and PPM tariffs?
Chapter 5: Other Levelisation Considerations	7. Do you have any views on our other considerations related to levelisation, regional levelisation and treatment of smart PPM?
Chapter 6: Payment reconciliation mechanism	8. What are your views on our updated options including the need for a reconciliation mechanism and phasing of implementation? 9. Do you agree with our proposal to exclude fixed term contracts agreed prior to our decision date from our levelisation proposal? 10. Do agree with our proposal for suppliers not to carry out, at their expense, an audit of their systems, processes and data to be used in reconciliation?

Appendix 2 – Proposed SLC modifications

Standard conditions of gas/electricity supply licence proposed changes and rationale

A2.1 The below table summarises proposed changes to the SLCs along with the description and rationale for change.

SLC paragraph	Change	Description and rationale
Electricity - 28AD.7 Gas - 28AD.6	Addition of a Levelisation Allowance (L) to the maximum charge	The addition of this term allows for a Levelisation Allowance to be added to the benchmark Maximum Charge for each cap period, consumption level (nil/typical), meter type (single rate/multi-register), region and payment method.
Electricity - 28AD.14A Gas -28AD.13A	Levelisation Allowance Definition	This clause provides the definition of the Levelisation Allowance.
Electricity - 28AD.14B Gas -28AD.13B	Levelisation Allowance set to zero	This clause provides the Authority the ability to set the levelisation allowance to zero, following a brief consultation, when required via a written statement.
Electricity - 28AD.16 Gas - 28AD.15	Addition of Annex 9	Annex 9 has been added to the list of Annexes that can be amended in writing following a consultation when a significant and unexpected change of circumstance or mathematical error is identified.
Electricity - 28AD.21A Gas -28AD.20A	Addition of Annex 9	Annex 9 has been added to the list of annexes for which the Authority may use to determine revised Benchmark Maximum Charges.
Electricity - 28AD.39A Gas -28AD.32A	Addition of an obligation to interact with Levelisation Reconciliation Mechanism	This obligation has been added so that the suppliers (i) provide relevant data to the Authority and to the Reconciliation Operator and (ii) pay the Reconciliation Operator any charges.
Electricity - 28AD.39B Gas -28AD.32B	Addition of guidance document	Addition of a clause so that the Authority may publish guidance for the Levelisation Allowance or Levelisation Reconciliation Mechanism.
Electricity - 28AD.40 Gas -28AD.33	Addition of definitions	Addition of the Levelisation Allowance, Levelisation Charges, Levelisation Policy, Levelisation Reconciliation Mechanism, Reconciliation Operator and Verified Data descriptions to be used in other clauses.
Electricity - Annex 9 Gas - Annex 9	Addition of the Methodology for Levelisation Allowance annex	Inclusion of a link to the additional annex which sets out the methodology for the levelisation allowance.

A2.2 We have included relevant SLC sections below and the changes we propose to make. New text is red double underlined.

Standard conditions of electricity supply licence

Calculation of the Benchmark Maximum Charges for 28AD Charge Restriction Periods

28AD.7 For each 28AD Charge Restriction Period, the Authority will calculate the Benchmark Maximum Charge for each:

(a) Benchmark Annual Consumption Level;

(b) Charge Restriction Region;

(c) Benchmark Metering Arrangement; and

(d) Payment Method

in accordance with the following formula:

$$ChargeMax_{i,j,k,l,p} = (WC_{i,j,k,l} + NC_{i,j,k,l} + PC_{i,j,k,l} + AA_{i,j,k,l,p} + OC_{j,k,l,p} + PA_{i,j,k,l,p} + E_{i,j,k,l,p} + H_{i,j,k,l,p} + L_{j,k,l,p})$$

where (the following units all being in pounds sterling):

$ChargeMax_{i,j,k,l,p}$	means the Benchmark Maximum Charge in Charge Restriction Region *i*, in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for Benchmark Metering Arrangement *l*, and Payment Method *p*;
$WC_{i,j,k,l}$	means the Wholesale Cost Allowance in Charge Restriction Region *i*, in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for Benchmark Metering Arrangement *l*, calculated in accordance with paragraph 28AD.8;
$NC_{i,j,k,l}$	means the Network Cost Allowance in Charge Restriction Region *i*, in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for Benchmark Metering Arrangement *l*, determined in accordance with paragraph 28AD.9;
$PC_{i,j,k,l}$	means the Policy Cost Allowance in Charge Restriction Region *i*, in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for Benchmark Metering Arrangement *l*, calculated in accordance with paragraph 28AD.10;
$AA_{i,j,k,l,p}$	means the Adjustment Allowance in Charge Restriction Region *i*, in Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for Benchmark Metering Arrangement *l*, for Payment Method *p* calculated in accordance with paragraph 28AD.10A;

$OC_{j,k,l,p}$ means the Operating Cost Allowance in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for Benchmark Metering Arrangement *l*, for Payment Method *p* calculated in accordance with paragraph 28AD.11;

$PA_{i,j,k,l,p}$ means the Payment Method Adjustment in Charge Restriction Region *i*, in Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for Benchmark Metering Arrangement *l*, for Payment Method *p* calculated in accordance with paragraph 28AD.12;

$E_{i,j,k,l,p}$ means the Earnings Before Interest and Tax Allowance in Charge Restriction Region *i*, in Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for Benchmark Metering Arrangement *l*, for Payment Method *p*, calculated in accordance with paragraph 28AD.13;

$H_{i,j,k,l,p}$ means the Headroom Allowance in Charge Restriction Region *i*, in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for Benchmark Metering Arrangement *l*, for Payment Method *p* calculated in accordance with paragraph 28AD.14.

$L_{j,k,l,p}$ means the Levelisation Allowance in Charge Restriction Region *i*, in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for Benchmark Metering Arrangement *l*, for Payment Method *p* calculated in accordance with paragraph 28AD.14A.

Levelisation Allowance

28AD.14A For the purposes of 28AD.7, the Levelisation Allowance in Charge Restriction Region i, in 28AD Charge Restriction Period j, at Benchmark Annual Consumption Level k, for Benchmark Metering Arrangement l and for Payment Method p is an adjustment to the amounts paid by customers on different Payment Methods, subject to paragraphs 28AD.14B and 28AD.16, calculated in accordance with the methodology set out in Annex 9.

28AD.14B If the Authority has published a statement in writing to terminate or suspend the Levelisation Policy, the value of the Levelisation Allowance is zero.

28AD.16 The Authority may from time to time, and following consultation, amend the methodology set out in Annex 2, Annex 3, Annex 4, Annex 5, Annex 8 or Annex 9 by way of a statement in Writing, where the Authority considers that either:

(a) there has been a significant and unanticipated change of circumstances such that Annex 2, Annex 3, Annex 4, Annex 5 ~~or~~ , Annex 8 or Annex 9 no longer reflects an efficient level of any of the Wholesale Cost Allowance, Network Cost Allowance, Policy Cost Allowance, Smart Metering Net Cost Change ~~or~~ , Adjustment Allowance or Levelisation Allowance; or

(b) there is a typographical or mathematical error in any of Annex 2, Annex 3, Annex 4, Annex 5 ~~or~~ , Annex 8 or Annex 9 such that an amendment is necessary in order to ensure the proper functioning of the relevant methodology.

28AD.21A In the event of exceptional circumstances, and the Authority taking steps set out in paragraph 28AD.16(a) in making amendments to the methodology set out in Annex 2, Annex 3, Annex, 4, Annex 5 ~~or~~ ~~,~~ Annex 8, or Annex 9, the Authority may:

(a) determine revised Benchmark Maximum Charges which shall apply for the remainder of a 28AD Charge Restriction Period j (for which the Authority has already published the Benchmark Maximum Charges pursuant to paragraph 28AD.19(c) or paragraph 28AD.21), replacing the Benchmark Maximum Charges previously published from a date specified by the Authority by way of a statement in Writing, by calculating such values in accordance with paragraph 28AD.7;

(b) in so determining the revised Benchmark Maximum Charges which shall apply for the remainder of a 28AD Charge Restriction Period j from the date specified by the Authority pursuant to paragraph 28AD.21A(a), take into account any modification made to SLC 28AD, notwithstanding that any such modification may not have come into effect at the time of publication of the updated Benchmark Maximum Charges in accordance with paragraph 28AD.21(c), provided that any such modification has come into effect by no later than the date specified by the Authority pursuant to paragraph 28AD.21A(a); and

(c) publish such Benchmark Maximum Charges so calculated in the format specified in Annex 6.

Obligation to interact with the Levelisation Reconciliation Mechanism

28AD.39A The licensee must ensure that it participates in and complies with the terms of the Levelisation Reconciliation Mechanism, including:

(a) Submission of relevant Verified Data to the Authority and Reconciliation Operator, as required in a timely and accurate manner, and

(b) Pays into the Reconciliation Mechanism any Levelisation Charges notified to it by the Reconciliation Operator

Guidance

28AD.39B The Authority may issue, from time to time, guidance for the purposes of paragraphs 28AD.14A and 28AD.39A.

Definitions for condition

28AD.40 In this condition:

'Levelisation Allowance' means an amount calculated to adjust the amount paid by customers on different Payment Methods in Charge Restriction Region i, in 28AD Charge

Restriction Period j, at Benchmark Annual Consumption Level k, for Benchmark Metering Arrangement l and for Payment Method p. The aforementioned amount would be calculated by the Authority for the periods and within the timeframes specified in this condition 28AD in accordance with the methodology set out at Annex 9;

'Levelisation Charges' means, for the purposes of this condition 28AD, those charges calculated from the Levelisation Allowance for the purposes of levelisation, and notified to the licencee on a monthly basis as calculated by the Reconciliation Operator;

'Levelisation Policy' means an adjustment to the cap on Payment Methods derived by the operation of Relevant Maximum Charge in paragraph 28AD.7;

'Levelisation Reconciliation Mechanism' refers to obligations, processes and/or systems of that name set out, or to be set out, in the Retail Energy Code or such other document designated under standard licence conditions from time to time**;**

'Reconciliation Operator' means Retail Energy Code Company (RECCo), or other such industry body or bodies, which the Authority has notified the licencee to have been selected, to develop or administer existing and future iterations of the Levelisation Reconciliation Mechanism**;**

'Verified Data' means data requested by the Authority for the purposes of levelisation and reconciliation which is accompanied by a statement from a named Statutory Director or authorised company officer confirming that they have taken all reasonable steps to satisfy themselves that the return is a true and accurate reflection of the data held by the licensee used for its customer billing purposes. The Authority may share the aforementioned data with the Reconciliation Operator for the purpose of, amongst other things, Levelisation Charge calculations;

Annex 9 – Methodology for determining the Levelisation Allowance

.xlsx file available at https://www.ofgem.gov.uk/publications/changes-prepayment-meter-standing-charges-and-other-debt-costs

Standard conditions of gas supply licence

Calculation of the Benchmark Maximum Charges for 28AD Charge Restriction Periods

28AD.6 For each 28AD Charge Restriction Period, the Authority will calculate the Benchmark Maximum Charge for each:

(a) Benchmark Annual Consumption Level;

(b) Charge Restriction Region; and

(c) Payment Method

in accordance with the following formula:

$$ChargeMax_{i,j,k,p} = (WC_{j,k,p} + NC_{i,j,k,p} + PC_{j,k} + AA_{i,j,k,p} + OC_{j,k,p} + PA_{i,j,k,p} + E_{i,j,k,p} + H_{i,j,k,p}) + L_{j,k,l,p}$$

where (the following units all being in pounds sterling):

$ChargeMax_{i,j,k,p}$	means the Benchmark Maximum Charge in Charge Restriction Region *i*, in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, and Payment Method *p*;
$WC_{j,k,p}$	means the Wholesale Cost Allowance in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for payment method *p*, calculated in accordance with paragraph 28AD.7;
$NC_{i,j,k,p}$	means the Network Cost Allowance in Charge Restriction Region *i*, in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for payment method *p*, determined in accordance with paragraph 28AD.8;
$PC_{j,k}$	means the Policy Cost Allowance in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, calculated in accordance with paragraph 28AD.9;
$AA_{i,j,k,p}$	means the Adjustment Allowance in Charge Restriction Region *i*, in Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for Payment Method *p* calculated in accordance with paragraph 28AD.10A;
$OC_{j,k,p}$	means the Operating Cost Allowance in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for payment method *p*, calculated in accordance with paragraph 28AD.10;
$PA_{i,j,k,p}$	means the Payment Method Adjustment in Charge Restriction Region *i*, in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for Payment Method *p* calculated in accordance with paragraph 28AD.11;
$E_{i,j,k,p}$	means the Earnings Before Interest and Tax Allowance in Charge Restriction Region i, in 28AD Charge Restriction Period j, at Benchmark Annual Consumption Level k, for Payment Method p, calculated in accordance with paragraph 28AD.12;
$H_{i,j,k,p}$	means the Headroom Allowance in Charge Restriction Region i, in 28AD Charge Restriction Period j, at Benchmark Annual Consumption Level k, for Payment Method p calculated in accordance with paragraph 28AD.13;
$L_{j,k,l,p}$	means the Levelisation Allowance in Charge Restriction Region *i*, in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for Benchmark Metering Arrangement *l*, for Payment Method *p* calculated in accordance with paragraph 28AD.13A.

Levelisation Allowance

28AD.13A For the purposes of 28AD.6, the Levelisation Allowance in 28AD Charge Restriction Period j, at Benchmark Annual Consumption Level k, for Benchmark Metering Arrangement l and for Payment Method p is an adjustment to the amounts paid by customers on different Payment Methods, subject to paragraphs 28AD.13B and 28AD.15, calculated in accordance with the methodology set out in Annex 9.

28AD.13B If the Authority has published a statement in writing to terminate the Levelisation Policy, the value of the Levelisation Allowance is zero.

28AD.15 The Authority may from time to time, and following consultation, amend the methodology set out in Annex 2, Annex 3, Annex 4, Annex 5~~,~~ ~~or~~ Annex 8 or Annex 9 by way of a statement in Writing, where the Authority considers that either:

(a) there has been a significant and unanticipated change of circumstances such that Annex 2, Annex 3, Annex 4, Annex 5~~,~~ ~~or~~ Annex 8 or Annex 9 no longer reflects an efficient level of any of the Wholesale Cost Allowance, Network Cost Allowance, Policy Cost Allowance or Smart Metering Net Cost Change, Adjustment Allowance or Levelisation Allowance; or

(b) there is a typographical or mathematical error in any of Annex 2, Annex 3, Annex 4, Annex 5~~,~~ ~~or~~ Annex 8 or Annex 9 such that an amendment is necessary in order to ensure the proper functioning of the relevant methodology.

28AD.20A In the event of exceptional circumstances, and the Authority taking steps set out in paragraph 28AD.15(a) in making amendments to the methodology set out in Annex 2, Annex 3, Annex, 4, Annex 5, ~~or~~ Annex 8, or Annex 9~~,~~ the Authority may:

(a) determine revised Benchmark Maximum Charges which shall apply for the remainder of a 28AD Charge Restriction Period j (for which the Authority has already published the Benchmark Maximum Charges pursuant to paragraph 28AD.18(c) or paragraph 28AD.20), replacing the Benchmark Maximum Charges previously published from a date specified by the Authority by way of a statement in Writing, by calculating such values in accordance with paragraph 28AD.6;

(b) in so determining the revised Benchmark Maximum Charges which shall apply for the remainder of a 28AD Charge Restriction Period j from the date specified by the Authority pursuant to paragraph 28AD.20A(a), take into account any modification made to SLC 28AD, notwithstanding that any such modification may not have come into effect at the time of publication of the updated Benchmark Maximum Charges in accordance with paragraph 28AD.20(c), provided that any such modification has come into effect by no later than the date specified by the Authority pursuant to paragraph 28AD.20A(a); and

(c) publish such Benchmark Maximum Charges so calculated in the format specified in Annex 6.

Obligation to interact with the Levelisation Reconciliation Mechanism

28AD.32A The licensee must ensure that it participates in and complies with the terms of the Levelisation Reconciliation Mechanism, including:

(a) Submission of Verified Data to the Authority and Reconciliation Operator, as required in a timely and accurate manner, and

(b) Pays into the Reconciliation Mechanism any Levelisation Charges notified to it and on the date specified for payment, by the Reconciliation Operator

Guidance

28AD.32B The Authority may issue, from time to time, guidance for the purposes of paragraphs 28AD.13A and 28AD.32A

Definitions for condition

28AD.33 In this condition:

'Levelisation Allowance' means an amount calculated to adjust the amount paid by customers on different Payment Methods in Charge Restriction Region i, in 28AD Charge Restriction Period *j*, at Benchmark Annual Consumption Level *k*, for Benchmark Metering Arrangement *l* and for Payment Method *p*. The aforementioned amount would be calculated by the Authority for the periods and within the timeframes specified in this condition 28AD in accordance with the methodology set out at Annex 9;

'Levelisation Charges' means, for the purposes of this condition 28AD, those charges calculated from the Levelisation Allowance for the purposes of levelisation, and notified to the licencee on a monthly basis as calculated by the Reconciliation Operator;

'Levelisation Policy' means an adjustment to the caps on Payment Methods derived by the operation of Relevant Maximum Charge in paragraph 28AD.7;

'Levelisation Reconciliation Mechanism' refers to obligations, processes and/or systems of that name set out, or to be set out, in the Retail Energy Code or such other document designated under standard licence conditions from time to time;

'Reconciliation Operator' means Retail Energy Code Company (RECCo), or other such industry body or bodies, which the Authority has notified the licencee to have been selected, to develop or administer existing and future iterations of the Levelisation Reconciliation Mechanism;

'Verified Data' means data requested by the Authority for the purposes of levelisation and reconciliation which is accompanied by a statement from a named Statutory Director or authorised company officer confirming that they have taken all reasonable steps to satisfy themselves that the return is a true and accurate reflection of the data held by the licensee used for its customer billing purposes. The Authority may share the aforementioned data with the Reconciliation Operator for the purpose of, amongst other things, Levelisation Charge calculations;

Annex 9 – Methodology for Levelisation Allowance

.xlsx file available at https://www.ofgem.gov.uk/publications/changes-prepayment-meter-standing-charges-and-other-debt-costs

Appendix 3 - Updated Impact Assessment

3A.1 This Appendix sets out the updated Impact Assessment (IA) for our levelisation options. It describes our approach as well as assessment of revised levelisation options in response to policy consultation and includes updated potential impacts under each option based on further analysis.

Summary

3A.2 In light of the cost-of-living crisis and rising energy bills, taken together with wider concerns around fairness for PPM and SC customers and further research on the heightened vulnerability of these cohorts, we have considered the case for 'levelisation'. This is the process of adjusting costs between payment methods to make charges more equal or equitable but less cost-reflective.

3A.3 Our updated IA has assessed the impacts of three levelisation options:

i. Option 1 – do nothing.
ii. Option 2 – levelise DD & PPM standing charges.
iii. Option 3 – Option 2 plus sharing debt-related costs equally between DD and SC (across unit rate and standing charge) only.

Please refer to Chapter 3 for further details.

3A.4 The results of our updated analysis are summarised below:

i. **Income Weighted Analysis –** Using income to assess the effective impact on cost savings/benefits of our policies on consumer finances, specifically those on low income (vulnerability characteristic), relative to disposable income. Both Option 2 & 3 result in a net saving of £103m and £201m respectively.
ii. **Total Debt** – We assess that levels of total debt will decrease as a result of both Option 2 and 3 by £12.2m and £33.5m respectively.
iii. **Bad Debt and Working Capital** – We assess that levels of bad debt will decrease as a result of both Option 2 and 3 by £0.3m and £0.7m. We also assess that levels of working capital will decrease as a result of Option 2 and 3 by £1.5m and £4.1m respectively, resulting in lower costs to consumers and improved supplier resiliency and stability which should benefit the market as a whole.
iv. **Administration Costs** – We assess that the costs associated with implementation will be c.£1.5m for Option 2 and c.£4.4m for Option 3.

v. **Competition Assessment** – As identified in the policy consultation, our analysis continues to indicate that there will be no material impact on competition (positive or negative).

vi. **Self-Disconnections** – Due to the relatively small savings for PPM consumers and therefore small associated increase in consumption, the reduction in PPM self-disconnections has been determined to be positive but negligible.

vii. **Health and Wellbeing** –The negligible reduction in self-disconnections means improvements to health and wellbeing, as a result of the reduction in self-disconnections, are also positive but negligible.

3A.5 Our recommendation is to support levelisation with a reconciliation mechanism based on our assessment of supplier revenues without a reconciliation mechanism. Whilst some suppliers would benefit without a reconciliation mechanism, particularly those with a large proportion of DD consumers, other suppliers, particularly those with a large proportion of PPM consumers, would lose. In the case of specialist PPM suppliers, levelisation without a reconciliation mechanism, would affect their business case and could damage competition so, to mitigate substantial harm to supplier financial resilience and the knock-on effects that would have on the market as a whole, we are recommending levelisation with a reconciliation mechanism.

3A.6 Our analysis has highlighted that despite being a redistributive policy, levelisation under both Option 2 and 3 results in a positive benefits case (large positive distributional impact) which is greatest under Option 3. The benefits and costs identified for both Options 2 and 3 assessed against Option 1 (do nothing) are summarised in **Table 3A.1** below, with a reconciliation mechanism.

Table 3A.1: Summary of levelisation benefits and costs (with a reconciliation mechanism) compared against Option 1 (do nothing)

Levelisation Options	Benefits	Costs
Option 2	• PPM consumers pay less (£54 per annum) benefitting the payment method cohort with the greatest proportion of vulnerability • Reduces the DD to SC differential from £130 to £119, increasing the number of tariffs consumers might consider • Net saving of £103m from income weighted analysis, demonstrating positive impact on disproportionately vulnerable PPM cohort • Reduction in bad debt of £0.3m • Reduction in working capital of £1.5m	• Significant supplier revenue impacts and the negative knock-on impacts to competition (if no reconciliation mechanism) • DD consumers pay more (£11 per annum), negatively impacting more people than positively impacted • Admin costs of 3p per consumer – equivalent to approx. £1.5m
Option 3	• PPM & SC consumers pay less (£54 and £45 per annum respectively) benefitting the payment method cohorts with the greatest proportion of vulnerability • Reduces the DD to SC differential from £130 to £62, increasing the number of tariffs consumers might consider • Net saving of £201m from income weighted analysis demonstrating positive impact on disproportionately vulnerable SC & PPM cohort • Reduction in bad debt of £0.7m • Reduction in working capital of £4.1m	• Significant supplier revenue impacts and the negative knock-on impacts to competition (if no reconciliation mechanism) • DD consumers pay more (£23 per annum) negatively impacting more people than positively impacted • Admin costs of 9p per consumer – equivalent to approx. £4.4m

Scope and approach to this impact assessment

Scope

3A.7 This IA sets out the options Ofgem is proposing for levelisation. These options have been refined based on responses to our recent policy consultation.

3A.8 Within the scope of the IA are the impacts on consumers and suppliers as well as an assessment of levelisation on the market as a whole. In addition, we consider the impacts against Ofgem's statutory duties.

3A.9 We present financial impacts to demonstrate the requirement for a reconciliation mechanism. We have assessed the real impact on suppliers using data from the quarterly supplier Request for Information (RFI) returns but since this is confidential, we instead present supplier impacts against hypothetical suppliers with varying payment method customer bases.

Approach

3A.10 Our approach to this IA is based on Ofgem's current guidance on impact assessments.[35] We are considering the impacts described in **Table 3A.2**.

3A.11 The impacts of each levelisation option are presented relative to the baseline scenario (Option 1).

[35]Ofgem (2020), Impact Assessment Guidance. https://www.ofgem.gov.uk/publications/impact-assessment-guidance

Table 3A.2: Structure of our updated impact assessment

Category	Sub-Category
Impacts on consumers	Direct financial impact on fixed and standard variable tariff (SVT) consumers
	Income weighted distributional impacts
	Impact on vulnerable consumers
Impacts on suppliers	Direct impact on suppliers' costs
	Bad debt and working capital impacts
Impact on competition and innovation	Impact on price competition
	Impact on non-price competition
	Impact on market entry and exit
	Impact on innovation
	Overall conclusions on competition impacts
Wider impacts	Impact on inflation
	Environmental impacts
	Security of supply
	Public Spend
	Public Sector Equality Duty (Equalities Act 2010)

Baseline scenario

3A.12 Our baseline scenario against which any impacts of levelisation will be measured, are the published cap levels at Typical Domestic Consumption Value (TDCV) for charge restriction period ("cap period") 11b, from 1 January to 31 March 2024.[36] The GB average effective unit rates and standing charges for this cap period are shown below in **Table 3A.3**. This IA evaluates the impact of our options against this baseline.

[36] The earliest that levelisation will be implemented is 1st April 2024 and therefore the impacts presented may change and will change on a quarterly basis.

Table 3A.3: Cap Period 11b Unit Rates and Standing Charges[37]

Fuel Type	Energy Charge Type	DD	PPM	SC
Single Rate Electricity	**Unit Rate (p/kWh)**	28.62	28.17	30.12
Single Rate Electricity	**Standing Charge (£/day)**	0.53	0.60	0.60
Gas	**Unit Rate (p/kWh)**	7.42	7.24	7.81
Gas	**Standing Charge (£/day)**	0.30	0.40	0.35
Multi Register Electricity	**Unit Rate (p/kWh)**	27.61	25.91	27.64
Multi Register Electricity	**Standing Charge (£/day)**	0.53	0.60	0.60

3A.13 The cap levels for cap period 11b are shown in **Table 3A.4** below.

Table 3A.4: Cap Period 11b Cap Levels

	DD	PPM	SC
Single Rate Electricity (2,700 kWh)	£967	£981	£1,032
Gas (11,500 kWh)	£961	£980	£1,025
Dual Fuel	£1,928	£1,960	£2,058
Multi Register Electricity (3,900 kWh)	£1,272	£1,231	£1,297

[37] The cap level is broken down into two components – the unit rate which is based on benchmark consumption (3100kWh) and the standard charge which is based on nil consumption. Suppliers are permitted to choose their own unit rate and standing charge as long as the total amount charged to a customer at benchmark consumption is equal to or below the published cap level.

Summary of quantitative and qualitative assessment

3A.14 The following section outlines the assessments undertaken to identify the related impacts on consumers, suppliers, the market and any other groups or areas that Ofgem should have regard to.

Impacts on consumers

Direct financial impact on fixed and standard variable tariff (SVT) consumers

3A.15 We have considered the impact of the levelisation options on fixed and standard variable tariff consumers, compared to our baseline (Option 1 - do nothing).

3A.16 The number of accounts by payment method for single rate tariffs based on the latest Tariff and Customer Account RFI (October 2023) are shown in **Table 3A.5** below.

Table 3A.5: Customer Accounts by tariff type, fuel type and payment method

Tariff Type	Fuel Type	DD	PPM	SC
Single Rate	**Electricity**	17,792,556	3,551,372	4,628,976
Single Rate	**Gas**	16,720,774	3,184,531	4,173,389
Multi Rate	**Electricity**	2,006,329	502,088	560,987
Single & Multi Rate	**Electricity & Gas**	36,519,659	7,237,991	9,363,352

3A.17 Based on the customer accounts above, DD is the most popular payment method at 68.7%, followed by SC at 17.6% and PPM at 13.7%.

Option 2 – Levelise PPM & DD standing charges

3A.18 The impacts of this option for cap period 11b are shown in **Table 3A.6** and **Table 3A.7** below.

Table 3A.6: Option 2 - Unit Rates and Standing Charges

Fuel Type	Energy Charge Type	DD	PPM	SC
Single Rate Electricity	**Unit Rate (p/kWh)**	28.62	28.17	30.12
Single Rate Electricity	**Standing Charge (£/day)**	0.55	0.55	0.60
Gas	**Unit Rate (p/kWh)**	7.42	7.24	7.81
Gas	**Standing Charge (£/day)**	0.31	0.31	0.35
Multi Register Electricity	**Unit Rate (p/kWh)**	27.61	25.91	27.64
Multi Register Electricity	**Standing Charge (£/day)**	0.55	0.55	0.60

Table 3A.7: Option 2 - Cap Levels & Impacts per consumer

	DD	PPM	SC
Single Rate Electricity (2,700 kWh)	£972	£960	£1,032
Single Rate Electricity Impact	£4	-£21	£0
Gas (11,500 kWh)	£968	£947	£1,025
Gas Impact	£7	-£33	£0
Dual Fuel	£1,939	£1,907	£2,058
Impact against baseline per consumer	£11	-£54	£0
Multi Register Electricity (3,900 kWh)	£1,277	£1,211	£1,297
Multi Register Electricity Impact	£5	-£20	£0

3A.19 Under Option 2, PPM becomes the cheapest payment method. The differential between DD & SC payment methods is reduced slightly from £130 to £119.

3A.20 Overall, the total net consumer impact of Option 2 should be zero. The impacts presented above are an average of the regional impacts and therefore these impacts do not net to zero due to rounding errors. The regional impacts of Option 2 can be found in the Regional Price Cap Levelisation Model.

Variation by Cap Period

3A.21 The impacts presented above are relative to Cap Period 11b however impacts will vary by cap level (specifically driven by the difference between DD & PPM at nil consumption and the payment method proportions of customer accounts). The dual fuel impacts at TDCV for Cap Period 9b to 11b are shown in **Table 3A.8** below.

Table 3A.8: Option 2 – Unit Rate and Standing Charge Impacts by Cap Period

	9b	10a	10b	11a	11b
DD - Dual Fuel Cap Levels	£4,288	£3,288	£2,082	£1,845	£1,939
PPM - Dual Fuel Cap Levels	£4,316	£3,283	£2,035	£1,808	£1,907
SC - Dual Fuel Cap Levels	£4,533	£3,482	£2,211	£1,959	£2,058
DD - Unit Rate Impacts	£0	£0	£0	£0	£0
PPM - Unit Rate Impacts	£0	£0	£0	£0	£0
SC - Unit Rate Impacts	£0	£0	£0	£0	£0
DD - Standing Charge Impacts	£9	£9	£9	£11	£11
PPM - Standing Charge Impacts	-£43	-£42	-£42	-£54	-£54
SC - Standing Charge Impacts	£0	£0	£0	£0	£0

Option 3 – Option 2 plus sharing bad debt equally between DD and SC (across unit rate and standing charge) only.

3A.22 The impacts of this option for cap period 11b are shown in **Table 3A.9** and **Table 3A.10** below.

Table 3A.9: Option 3 - Unit Rates and Standing Charges

Fuel Type	Energy Charge Type	DD	PPM	SC
Single Rate Electricity	**Unit Rate (p/kWh)**	28.79	28.17	29.45
Single Rate Electricity	**Standing Charge (£/day)**	0.55	0.55	0.59
Gas	**Unit Rate (p/kWh)**	7.46	7.24	7.63
Gas	**Standing Charge (£/day)**	0.32	0.31	0.34
Multi Register Electricity	**Unit Rate (p/kWh)**	27.95	25.91	26.62
Multi Register Electricity	**Standing Charge (£/day)**	0.55	0.55	0.58

Table 3A.10: Option 3 - Cap Levels & Impacts

	DD	PPM	SC
Single Rate Electricity (2,700 kWh)	£978	£960	£1,010
Single Rate Electricity Impact	£10	-£21	-£23
Gas (11,500 kWh)	£973	£947	£1,003
Gas Impact	£12	-£33	-£23
Dual Fuel	£1,951	£1,907	£2,013
Impact against baseline	£23	-£54	-£45
Multi Register Electricity (3,900 kWh)	£1,292	£1,211	£1,250
Multi Register Electricity Impact	£20	-£20	-£47

3A.23 Under Option 3, PPM becomes the cheapest payment method. The differential between DD & SC is significantly reduced from £130 to £62.

3A.24 Overall, the total net consumer impact of Option 3 should be zero. The impacts presented above are an average of the regional impacts and therefore these impacts do not net to zero due to rounding errors. The regional impacts of Option 3 can be found in the Regional Price Cap Levelisation Model. In addition, the consumption values used to calculate impacts will affect the total net consumer impact. This will be further explored in the consultation on unit rate levelisation implementation.

Variation by Consumption

3A.25 Since Option 3 affects unit rates, there will be a range of impacts depending on consumer consumption levels. The range of impacts for each fuel type (electricity and gas) are presented in **Figure 3A.1 & Figure 3A.2** below.

3A.26 For both electricity and gas, the following trends are observed:

a. The cost impact to DD consumers increases with consumption, from £5 to £13 for electricity and from £7 to £15 for gas.
b. The savings impact to SC consumers increases with consumption, from £4 to £38 for electricity and from £2 to £33 for gas.
c. The savings impact to PPM consumers is the same regardless of consumption.

Figure 3A.1: Option 3 - Electricity - Impacts by Payment Method & Consumption

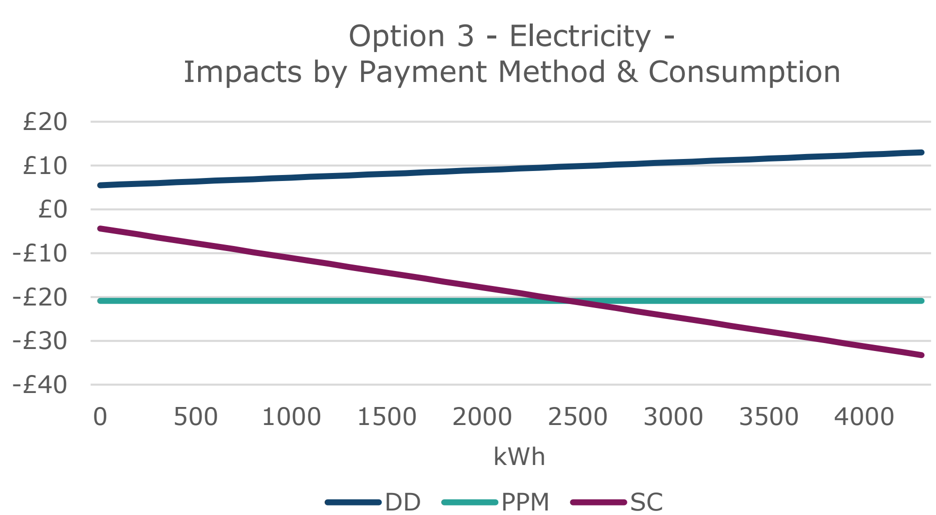
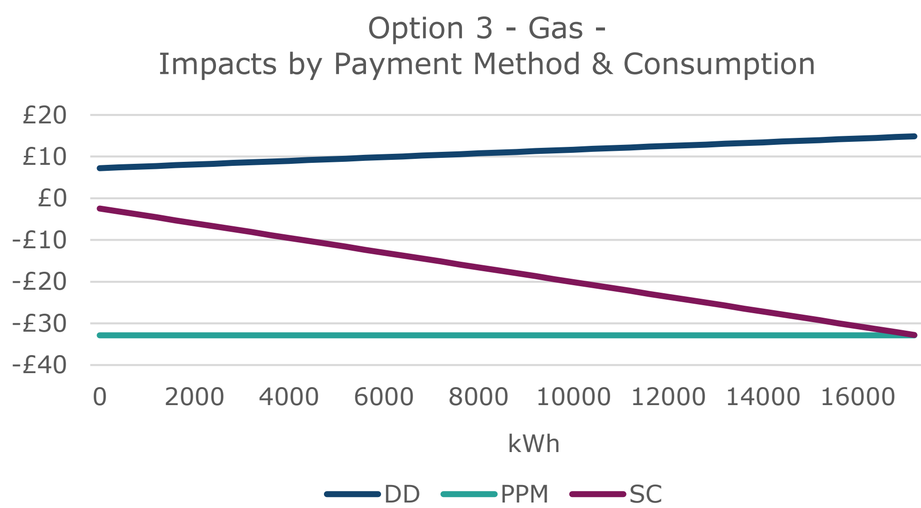


Figure 3A.2: Option 3 - Electricity - Impacts by Payment Method & Consumption



3A.27 The impacts presented above are based on assuming the same consumption for each payment method. In reality, consumptions will vary between payment methods and therefore impacts will vary. This will be further explored in the consultation on unit rate levelisation implementation.

Variation by Cap Period

3A.28 The impacts presented above are relative to Cap Period 11b however impacts will vary by cap level (specifically driven by the difference between DD & PPM at nil consumption, the difference between DD & SC debt-related costs, individual payment method consumption values and the payment method proportions of customer accounts). The dual fuel impacts at TDCV for Cap Period 9b to 11b are shown in **Table 3A.11** below.

Table 3A.11: Option 3 – Unit Rate and Standing Charge Impacts by Cap Period

	9b	10a	10b	11a	11b
DD - Dual Fuel Cap Levels	£4,314	£3,308	£2,095	£1,856	£1,951
PPM - Dual Fuel Cap Levels	£4,316	£3,283	£2,035	£1,808	£1,907
SC - Dual Fuel Cap Levels	£4,431	£3,404	£2,162	£1,915	£2,013
DD - Unit Rate Impacts	£24	£18	£11	£9	£10
PPM - Unit Rate Impacts	£0	£0	£0	£0	£0
SC - Unit Rate Impacts	-£95	-£71	-£42	-£36	-£38
DD - Standing Charge Impacts	£10	£10	£10	£13	£13
PPM - Standing Charge Impacts	-£43	-£42	-£42	-£54	-£54
SC - Standing Charge Impacts	-£6	-£7	-£7	-£7	-£7

Income-weighted distributional impacts

3A.29 Since publishing our policy consultation, we have refined our distributional impacts model. The main differences are more recent data (2020 vs. 2017) and refreshed consumer archetypes (derived from the updated data).[38] In addition, we have further refined this analysis by taking consumer income into consideration. This income-weighted analysis considers how a £1 cost or saving has a different marginal utility depending on income. In weighted analysis, financial benefits for lower income households are given a higher social value than the equivalent benefits for higher income households. Distributional weights have been applied to equivalised household disposable income deciles in line with the Green Book guidance published by HMT.[39]

3A.30 In doing so, we have implicitly considered the impact on a subset of vulnerable consumers (specifically those on low incomes), by weighting impacts relative to their household income. We have used Ofgem's consumer archetypes which are described in **Table 3A.12** below.

[38] Ofgem consumer archetypes (to be published Jan '24). Superseded archetypes can be found at Ofgem (2020), Ofgem Energy consumer archetypes - Final report. https://www.ofgem.gov.uk/publications/impact-assessment-guidance
[39] See Annex 3 of HM Treasury (2022), The Green Book. https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government/the-green-book-2020

Table 3A.12: Consumer Archetypes

Archetype	Characteristics
A1	lowest income; mains gas; retired; 75+ years old; single adults; owner-occupied/local authority; urban; not early adopters; no internet connection; below poverty line
A2	low income; housing association/local authority; retired/unoccupied; couples and single adults; disability benefits; mobility disability; 45-64 years old; prepayment meter; below poverty line
A3	off gas; low income; high electricity consumption; retired; couples and single adults
B4	low income; electric heating; communal heating; retired/unoccupied; 45+ years old; purpose-built flats; owned/local authority; disability benefits; below poverty line; CWP eligible; WHDS eligible; high electricity consumption; poor EPC rating; not early adopters
B5	low income; mains gas; 65+ retirees; semi-detached; owner occupied; not early adopters; low electricity consumption; WFP eligible
B6	low income; purpose-built flats; couples/single adults; large age range 25-75+; low scheme eligibility; mains gas; good EPC rating; low gas consumption
C7	lower-middle income; mains gas; average fuel consumption; disability benefits; retired/unoccupied; 55+ years old; 50% mobility disability; 13% wheelchair users; high scheme eligibility; not early adopters
C8	lower middle-income; couples/single adults; full-time employed/retired; mains gas; private rented; low fuel consumption
C9	lower-middle income; large families; couples/single mothers; private/local authority rented; BAME; mains gas; good EPC; high fuel consumption; prepayment meter
D10	lower-middle income; mains gas; couple/single adult woman; retired 65+; not early adopters; WFP eligible; high gas consumption
D11	middle income; single child families; mains gas; good EPC rating; average consumption; prepayment meter
D12	middle income; families; couple or single-mother; disability benefits; CWP eligible; WHDS eligible; prepayment meter; high gas/electric consumption
E13	average income; electric heating; purpose-built flats; single child families; good EPC rating; low levels of engagement; BAME
E14	middle income earners; electric heating; communal heating; purpose-built flats; young couples/single adults; BAME; good EPC rating; well-educated; low market engagement
F15	middle income; no children; couples/single adults; owner-occupied; terraced; low gas/electricity consumption; not early adopters
F16	middle income; large families; full-time or self-employed; electric heating; high electricity consumption
G17	upper middle income; no children; homeowners; rural and urban; 50% not adopters; bulk LPG heating; renewable systems; employed and retired mix
G18	upper middle income; no children; rural; poor EPC rating; oil heating; not early adopters
H19	upper-middle income; no children; 45+ years old; self-employed; unconventional housing; unknown EPC; oil heating; renewable systems
H20	high income; single child families; ECO eligible; full-time employment; early adopters
I21	high income; no children; full-time employment; mains gas; average fuel consumption; large disposable income
I22	high income; no children; full-time employed; detached; mains gas; high gas consumption; large homes
J23	high income; large families; mains gas; ECO eligible; high gas consumption; large homes
J24	highest income; families; rural; large homes; highest electricity consumption; poor EPC rating; ECO eligible; oil heating

3A.31 We have considered the income-weighted distributional impacts of the levelisation options. If we sum income-weighted impacts across archetypes, we can see that Option 3 is the most beneficial to all consumers, but that both options generally benefit vulnerable consumers from lower income households. These impacts are outlined in **Table 3A.13** below.

Table 3A.13: Income Weighted Savings by Option

Income	Option 1	Option 2	Option 3
Very Low (A1 – B6)	-	-£121m	-£255m
Low (C7 – D12)	-	-£73m	-£94m
Medium (E13 – F16)	-	+£30m	+£36m
High (G17 – H20)	-	+£15m	+£29m
Very High (I21 – J24)	-	+£46m	+£83m
Overall Impact	-	-£103m	-£201m

3A.32 The overall impacts above are derived from the disaggregated impacts listed in **Table 3A.14** below, which are then income weighted to produce the impacts listed in **Table 3A.15.** The above values represent the sum of the annual equivalised impacts per household, multiplied by the number of households per payment method per archetype decile.

Table 3A.14: Distributional Impacts per Household by Archetype (£)

Archetype	DD Option 2	SC Option 2	PPM Option 2	DD Option 3	SC Option 3	PPM Option 3
A1	4.76	0.00	-11.46	10.64	-15.90	-11.46
A2	3.95	0.00	-20.40	9.28	-12.68	-20.40
A3	2.71	0.00	-1.89	10.47	-11.64	-1.89
B4	1.92	0.00	-5.89	8.37	-13.70	-5.89
B5	8.51	0.00	-1.10	20.99	-9.55	-1.10
B6	5.41	0.00	-12.50	11.37	-10.93	-12.50
C7	8.38	0.00	-3.55	21.61	-7.98	-3.55
C8	5.80	0.00	-12.24	12.77	-10.15	-12.24
C9	4.85	0.00	-16.78	12.77	-14.82	-16.78
D10	9.13	0.00	-0.21	24.10	-7.83	-0.21
D11	4.32	0.00	-19.23	11.23	-15.20	-19.23
D12	4.62	0.00	-21.21	13.34	-12.62	-21.21
E13	2.14	0.00	-4.58	8.82	-13.24	-4.58
E14	2.39	0.00	-3.07	7.67	-9.79	-3.07
F15	8.37	0.00	-2.98	19.29	-7.35	-2.98
F16	2.38	0.00	-4.30	10.86	-12.50	-4.30
G17	2.80	0.00	-2.74	10.57	-8.51	-2.74
G18	3.29	0.00	-0.36	11.66	-7.77	-0.36
H19	2.53	0.00	-1.25	10.79	-17.20	-1.25
H20	8.87	0.00	-3.40	23.33	-5.51	-3.40
I21	8.92	0.00	-1.45	22.39	-7.03	-1.45
I22	8.51	0.00	-0.52	24.77	-13.63	-0.52
J23	9.20	0.00	-2.51	25.52	-5.16	-2.51
J24	2.70	0.00	-0.63	12.98	-19.41	-0.63

Table 3A.15: Annual Equivalised Impacts per Household (Weighted) by Archetype (£)

Archetype	DD Option 2	SC Option 2	PPM Option 2	DD Option 3	SC Option 3	PPM Option 3
A1	26.41	0.00	-63.58	59.04	-88.27	-63.58
A2	19.39	0.00	-100.13	45.54	-62.22	-100.13
A3	11.31	0.00	-7.89	43.62	-48.51	-7.89
B4	7.39	0.00	-22.70	32.29	-52.82	-22.70
B5	26.09	0.00	-3.37	64.34	-29.28	-3.37
B6	23.19	0.00	-53.61	48.79	-46.89	-53.61
C7	19.52	0.00	-8.28	50.35	-18.59	-8.28
C8	15.38	0.00	-32.48	33.88	-26.93	-32.48
C9	10.35	0.00	-35.86	27.29	-31.66	-35.86
D10	20.33	0.00	-0.47	53.66	-17.43	-0.47
D11	9.21	0.00	-41.02	23.94	-32.41	-41.02
D12	9.19	0.00	-42.20	26.56	-25.12	-42.20
E13	4.66	0.00	-9.98	19.24	-28.89	-9.98
E14	5.86	0.00	-7.54	18.82	-24.04	-7.54
F15	19.70	0.00	-7.00	45.40	-17.29	-7.00
F16	3.68	0.00	-6.65	16.80	-19.34	-6.65
G17	6.73	0.00	-6.59	25.37	-20.43	-6.59
G18	6.62	0.00	-0.72	23.49	-15.67	-0.72
H19	5.51	0.00	-2.73	23.50	-37.46	-2.73
H20	10.15	0.00	-3.89	26.68	-6.31	-3.89
I21	8.69	0.00	-1.41	21.81	-6.85	-1.41
I22	12.22	0.00	-0.75	35.58	-19.58	-0.75
J23	8.37	0.00	-2.29	23.22	-4.69	-2.29
J24	2.36	0.00	-0.55	11.36	-16.98	-0.55

3A.33 Since Option 1 is the "do nothing" option, there are no impacts to the current cap levels and therefore no income-weighted distributional impacts as a result.

3A.34 For Option 2, the distributional impacts are the same within payment methods across all archetypes. This is due to this levelisation option impacting standing charges only.

3A.35 For Option 3, the distributional impacts vary by payment method and archetype due to this levelisation option impacting both unit rates and standing charges.

Debt Impacts

3A.36 As part of our updated analysis, we have also considered the impact of levelisation on consumer debt volumes by assessing the impact changing consumer bills may have on existing consumer debt, by payment method. We define debt as money owed, with or without a repayment plan, for greater than 91 days. Our assessment is based on debt levels across all domestic consumers from Q3 2023.[40]

3A.37 Our assessment on debt impacts only considers those consumers already in debt and therefore does not account for the impact on debt for consumers not already in debt. Despite this, we expect levelisation would not result in more consumers getting into debt. This is due to a number of factors but most importantly the additional cost on DD consumers is relatively small, DD consumers account for 23% of total debt and finally those DD consumers that do go into debt, a large proportion will be offered alternative payment methods to repay their debt which are now cheaper as a result of levelisation.

3A.38 Our approach was to first identify the total amount of debt and the number of consumers in debt for each of the payment methods. Using the impacts for each payment method under each option, we calculated the impact this would have on the total amount of debt. For those consumers paying more, we assumed the entirety of the additional cost would contribute towards the total amount of debt. For those consumers paying less, we calculated an elasticity of debt repayment and assumed a portion of any savings would contribute towards the total amount of debt. In order to estimate the elasticity, we collected data on Household Debt Inequalities from ONS.[41] This gave us descriptive statistics on the proportion of people with debts, going from no debt and arrears only to 4 major types of debt. In the central scenario, we assumed people in arrears-only would dedicate 80% of their income to repay arrears. On the other side of the spectrum, we assume that people with four major types of debt would dedicate only 10% of their additional income to repay their energy debt. The result was that, on average, customers in debt would dedicate 40% of their additional income to repay their energy debt.

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[40] Ofgem (2023), Debt and arrears indicators. https://www.ofgem.gov.uk/publications/debt-and-arrears-indicators

[41] Office for National Statistics (2016), Household Debt Inequalities: Wealth in Great Britain, July 2012 to June 2014, Table 16. https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/debt/articles/householddebtinequalities/2016-04-04

3A.39 Overall, the impact of levelisation shows a decrease in total debt over a 12-month period for Options 2 and 3. The results of this analysis are shown **Table 3A.16** below.

Table 3A.16: Total Debt Impact by Option

	Option 1	Option 2	Option 3
Overall Impact	-	-£12.2m	-£33.5m

3A.40 As described within the supplier impacts section below, a decrease in overall debt results in a proportional decrease in bad debt and therefore suppliers recover more debt and reduce their working capital which is a benefit that should be passed through to all consumers.

Impact on vulnerable consumers

Disability

3A.41 Ofgem's latest consumer research has shown that 44% of PPM consumers, 33% of SC consumers and 29% of DD consumers have a long-term disability or illness in the household.

Pensionable Age

3A.42 Ofgem's latest consumer research has shown that 31% of DD consumers are of pensionable age. This is compared with 17% of SC consumers and 11% of PPM consumers.

Low Income

3A.43 Ofgem's latest consumer research has shown that 64% of PPM consumers and 51% of SC consumers have a household income of less than £30,000. This is compared with 41% of DD consumers.

Rurality

3A.44 Ofgem's latest consumer research has shown that DD consumers make up the largest proportion of rural consumers – 83% - whilst PPM and SC consumers account for 10% and 7% respectively.

Vulnerable Consumers – Overall

3A.45 The consumer research presented above shows that for all but rurality, there are large proportions of PPM or SC consumers that exhibit one (or more) of the vulnerability characteristics. The levelisation options presented introduce savings for these cohorts of consumers at the expense of DD consumers, which, as shown above, are less likely to exhibit one or more vulnerability characteristic.

Self-disconnections, health and well-being

3A.46 'Self-disconnection' is defined as interruption to electricity or gas supply by consumers on PPMs because of a lack of credit on the meter or account. Each of the levelisation options proposed results in an approximate £50 reduction in cost to PPM consumers. Our original hypothesis was that this additional £50 would be used to increase energy consumption and therefore PPM consumers would be less at risk of self-disconnecting. This would translate into a reduction in self-disconnections. This impact is likely to be greater for those with lower demand as they will receive a greater proportional benefit from levelisation.

3A.47 To test this hypothesis, we identified an appropriate income elasticity of demand[42] and applied that to the £50 reduction in cost to understand the change in PPM consumers energy consumption. The results of this assessment were that PPM consumers would only increase their consumption by a few kWh, a very small and almost negligible change. For this reason, we have concluded that levelisation will not have any material impacts on self-disconnections.

3A.48 Further to the assessment above, we also hypothesised that, due to a reduction in self-disconnections, there would be an increase in health and wellbeing amongst PPM consumers from levelisation. Given the assessment into self-disconnections has shown a negligible effect, the same is true for health and wellbeing.

Cost-benefit analysis

3A.49 The design of this policy is such that the gains for PPM and SC customers would be covered by DD customers. Therefore, the direct savings of these proposals in the first two tariff types are offset by increases in cost in the latter. However, there are some small additional benefits from increased consumption and health benefits from PPM customers who tend to be on lower incomes and experience higher levels of vulnerability.

3A.50 Although the impact of these changes is negligible, we also found that there are significant distributional benefits associated with these proposals. On a per capita basis, the cost increase is much smaller than the benefits. For example, while a

[42] An estimated elasticity of 0.14 was taken from "Estimating income and price elasticities of residential electricity demand with Autometrics", Pellini, E., Energy Economics, vol. 101(C), 2021.

typical DD customer should experience an increase of £23 in energy bill under Option 3, a consumer in a PPM or SC tariff should experience a reduction of £54 and £45 respectively. Customers paying by PPM and SC tend to have lower incomes than those paying by DD and so this has a progressive distributional impact as measured when we equivalise by household disposable income. Using Ofgem's consumers' archetypes, we found that the net income-weighted distributional impact would be between £103m and £201m, depending on the options. It is important to note that this is only after financial benefits for lower income households are given a greater weighting than the equivalent benefits for higher income households and does not represent a net reduction in consumer bills.

3A.51 Finally, a reduction in the energy bill for PPM and SC consumers would reduce bad debt by around £0.3m and £0.7m per year for Option 2 and 3 respectively. This results in a reduction in working capital of £1.5m and £4.1m per year for Option 2 and 3 respectively. This would offset the administration costs of the policy, including the implementation of a reconciliation mechanism.

3A.52 In conclusion, since levelisation results in transfers between consumers, we found relatively small net benefits related to changes in consumer debt, bad debt, working capital and self-disconnections, however collectively these elements sum to a meaningful impact. Suppliers' impacts would be passed through to consumers by offsetting the administration costs. In addition to the direct costs and benefits there is a much more significant positive distributional impact from levelisation.

Impacts on suppliers

Direct impact on suppliers without a reconciliation mechanism

3A.53 The focus of historic price caps has been to allocate costs between payment methods, with impacts in the interest of customers as a whole. Whilst these have been considered, levelisation is a much larger intervention and the primary aim is to change the allocation of costs between groups of customers.

3A.54 Our recommendation is to support levelisation with a reconciliation mechanism whereby any additional revenue is returned, and any lost revenue is recouped.

3A.55 We have assessed the impact on a range of actual suppliers using data from the quarterly supplier RFI returns. There are a large range of percentage change impacts on supplier EBITs (from +0.5% to -2.7%) which could have significant knock-on impacts to the profitability and resilience of suppliers with different business models and therefore competition within the market from specialist suppliers. This forms the basis for recommending a reconciliation mechanism alongside the levelisation options, but for the purposes of this IA, we have presented four non-confidential hypothetical suppliers, each with a different ratio of DD, PPM and SC consumers to illustrate the supplier revenue impacts associated with each levelisation option. For our analysis, we have assumed that each hypothetical supplier has 1 million consumers and the number of consumers on DD, PPM and SC will vary for each supplier depending on the applied payment method proportions.

3A.56 In order to calculate the revenue impact, we calculate the revenue associated with Option 1 and use this as our baseline. We then calculate the revenue associated with Option 2 & 3 and calculate the difference relative to the baseline revenue.

3A.57 The impacts of the levelisation options on our hypothetical suppliers are presented below in **Table 3A.17**.

Table 3A.17: Hypothetical Supplier Revenue Impacts without a reconciliation mechanism

Supplier	DD	PPM	SC	Option 2 - Revenue Impact	Option 2 - % change	Option 3 - Revenue Impact	Option 3 - % change
1	33%	33%	33%	-£14.3m	-0.7%	-£25.5m	-1.3%
2	90%	5%	5%	£7.2m	0.4%	£15.3m	0.8%
3	5%	90%	5%	-£47.8m	-2.4%	-£49.5m	-2.5%
4	5%	5%	90%	-£2.1m	-0.1%	-£42.3m	-2.1%

3A.58 To conclude, our assessment of the impact on suppliers without a reconciliation has shown that for those suppliers with a large PPM consumer base, the impact on revenue, and by association profit or loss, would be significant and therefore, in order to protect these suppliers and market innovation, a reconciliation mechanism to support levelisation is recommended.

Direct impact on suppliers' costs

3A.59 We expect supplier administration costs to increase as a result of levelisation. The exact cost is associated with the design and implementation of the reconciliation mechanism and any ongoing monitoring and support.

3A.60 The administration costs associated with levelisation implementation are likely to be between 3p and 9p per consumer and therefore these costs can be considered immaterial compared to current costs to consumers.

3A.61 Other impacts on supplier costs are unclear. We expect the primary impact to result from differences in suppliers' consumer base payment method split.

3A.62 There will also be costs associated with the reconciliation mechanism, which will be administered by an existing industry party. The rough order-of-magnitude cost estimates for implementation and ongoing support are shown in **Table 3A.18** and **Table 3A.19** below.

Table 3A.18: Cost estimations for reconciliation mechanism implementation

Option	Industry Body Costs	Supplier Costs (Ofgem Estimates)	Ofgem Costs	Cost per Consumer
Option 1	-	-	-	-
Option 2	£0.65m	£0.4m	£0.4m	£0.03
Option 3	£2.0m	£1.6m	£0.75m	£0.09

Table 3A.19: Annual cost estimations for reconciliation mechanism ongoing support

Option	Industry Body Costs	Supplier Costs (Ofgem Estimates)	Ofgem Costs	Cost per Consumer
Option 1	-	-	-	-
Option 2	£0.3m	£0.2m	£0.25m	£0.02
Option 3	£1.1m	£0.8m	£0.4m	£0.07

Bad debt and working capital impacts

3A.63 As stated above in the Consumer Impacts section, the impact of levelisation on consumer debt is an overall reduction. Reducing overall consumer debt has the knock-on benefit of reducing bad debt, which accounts for approximately 2%[43] of all debt. We define bad debt as debt on energy bills that cannot be recovered and is ultimately written off by energy suppliers.

3A.64 The annual reduction in bad debt for each levelisation option is presented below in **Table 3A.20**.

Table 3A.20: Bad Debt Impacts by Option

	Option 1	Option 2	Option 3
Bad Debt Impact	-	-£0.3m	-£0.7m

3A.65 In reducing bad debt, there is also likely to be a reduction in bad debt administration (the cost associated with recovering debt before it is written off to bad debt) costs. Using data from the debt-related costs RFI, we estimate that debt-related administration costs are equivalent to 10.3% of total bad debt. Therefore, we estimate that bad debt administration costs would be reduced by £0.03m and £0.07m for Option 2 and 3 respectively. These are small enough amounts to be considered negligible overall.

[43] We estimate the long term relation between Total Debt and Bad Debt by taking a 12 month moving average of the ratio of both trends from Ofgem's retail monitoring stats. We pick up the last three months observations of available data, which results in a ratio of 2%.

3A.66 In addition to reducing bad debt, an overall reduction in total debt reduces suppliers' working capital costs.

3A.67 In order to calculate the working capital impact, we start with the total debt reduction and apply a cost of capital (12.3%[44]).

3A.68 The annual reduction in working capital costs for each levelisation option is presented in **Table 3A.21** below.

Table 3A.21: Working Capital Impacts by Option

	Option 1	Option 2	Option 3
Working Capital Impact	-	-£1.5m	-£4.1m

3A.69 Summing both the bad debt and working capital impacts gives the overall annual impact across the market, presented in **Table 3A.22** below.

Table 3A.22: Combined Bad Debt and Working Capital Impacts by Option

	Option 1	Option 2	Option 3
Overall Impact	-	-£1.8m	-£4.8m

Impact on competition and innovation

Impact on price competition

3A.70 It is possible under either Option 2 or 3 that levelisation could have a positive impact on competition insofar as it widens the pool of potential tariff types that a consumer may consider affordable. In particular, a consumer may consider SC (under Option 3) and PPM tariffs (under Options 2 & 3) that they would not otherwise be willing or able to pay for. However, we do not expect this effect to be large. This is because the impact of levelisation on bills is small as a proportion of the total bill paid. For example, the impact for a TDCV PPM consumer is 3% of their annual bill under Options 2 and 3. Given the latest evidence on switching elasticities in the energy sector[45] (which show that switching is relatively inelastic), we consider the bill impact of levelisation is unlikely to drive material volumes of switching between different tariff types.

3A.71 Under Option 2 and 3, levelisation of prices across SC and DD tariffs may lead to a reduction in price-related competition across different payment methods, as

[44]Ofgem (2023), Amending price cap methodology for Earnings Before Interest and Tax (EBIT) allowance decision. https://www.ofgem.gov.uk/publications/amending-price-cap-methodology-earnings-interest-and-tax-ebit-allowance-decision

[45] "Estimating income and price elasticities of residential electricity demand with Autometrics", Pellini, E., Energy Economics, vol. 101(C), 2021.

tariff differentials are minimised, prices converge and price competition itself is lessened. However, the extent to which levelisation could have a negative impact on price competition, in practice, depends on the extent to which the different payment methods acted to constrain each other in the first place. This, in turn, depends in part on the extent to which consumers view different payment methods as close substitutes.

3A.72 Qualitatively, the different payment methods have different product characteristics with DD being likely viewed as the most convenient payment method. In contrast, PPM and SC methods may provide an easier way for consumers to budget and manage their expenditure. The fact that a price differential of 7% exists and has been maintained between payment methods, may be an indicator of a lack of substitutability between payment methods and suggest consumers do not view the products as close substitutes.

Impact on non-price competition

3A.73 We do not expect there to be significant impacts on non-price competition under Option 2. To the extent that levelisation does result in a reduction in price-related competition across different payment methods under Option 3, this may lead to an enhanced emphasis on non-price related parameters of competition such as consumer service parameters (eg ease of contact, ease of managing bills and ease of making payments). Suppliers may develop their consumer service offerings in response to try to compete for consumers who prefer a particular payment mechanism and may seek to differentiate their product offering in this way.

Impact on market entry and exit

3A.74 We do not expect there to be significant impacts on market entry and exit under Option 2. Insofar as levelisation under Option 3 makes SC tariffs a more viable option for consumers who would otherwise use DD tariffs, and results in material volumes of switching from DD to SC, it may increase the size of debt-related costs for suppliers with respect to their SC products. To the extent that this ultimately represents an increased costs for suppliers, it could deter entry to (or investment in) the market or precipitate exit from the market for marginal participants.

3A.75 It is not possible to quantify, ex-ante, the materiality of this possible increase in debt-related costs. However, firstly we note that it would require material volumes of switching, which as explained above, is unlikely to occur as a response to the decrease in price differentials between DD and SC. A further potential impact on market entry and exit under both Options 2 and 3 derives from the fact that the majority of fixed term tariffs are DD tariffs; as of October 2023, 92% of fixed term tariffs were DD compared to 8% SC and 0% PPM. Levelisation therefore closely represents a reduction in SVT prices at the expense of an increase in fixed term tariff prices.

3A.76 This relative price effect could give rise to potential competition effects in the case of new entrants and/or challenger brands that have a larger proportion of fixed term tariff (and therefore DD tariff) consumers and a relatively limited back book of SVT consumers, compared to the more established and incumbent suppliers. As noted in the paragraphs above, however, the asymmetric impact on tariffs for challenger suppliers is not expected to be large due to the relatively small impact of levelisation as a proportion of consumers' annual energy bills as well as the reconciliation mechanism. Ofgem has a duty to facilitate access to the network for new generation capacity, in particular removing barriers that could prevent access for new market entrants and of electricity from renewable energy sources. Our assessment of levelisation on market entry has identified the impact of levelisation on market entry to be immaterial.

Impact of fixed tariffs

3A.77 In October 2023, approximately 10% of total customer tariffs were fixed but we expect this to change as the market stabilises. As competition will likely increase through efforts to capture new customers, our proposal includes a reconciliation mechanism accounting for both fixed and SVT tariffs, which is crucial for levelisation to work. It avoids any perverse incentives for suppliers to offer non-competitive tariffs against suppliers with a large SVT base.

3A.78 As the policy supports SC and PPM tariffs, it may indirectly impact competition by increasing supplier debt resilience, especially for those with a significant number of SC and PPM customers (accounting for 75% of debt (£m) in February 2023). Because tariffs have been designed to have a net zero impact and reconciliation would prevent distortions, the competition impact on fixed tariffs should be negligible.

Impact on innovation

3A.79 As described with non-price parameters of competition, to the extent that levelisation does result in a reduction in price-related competition across different payment methods under Option 3, this may lead to an enhanced emphasis on other parameters of competition. This may include innovation in how products are provided, for example with respect to consumer service platforms and consumer contact channels.

3A.80 One supplier was concerned that levelisation could dis-incentivise suppliers from installing smart PPMs by enabling cost recovery of traditional PPMs infrastructure. Following levelisation, suppliers would be no more able to recover these costs, so we do not agree that levelisation results in a perverse incentive away from smart PPMs.

3A.81 In fact, levelisation may support innovation through promoting the uptake of smart meters. Although we do not expect these options to drive material volumes of switching between different tariff types, switching to PPM would be the most likely since PPM would be consistently the cheapest payment method available. As well as the capital requirement advantages already discussed, this could support the uptake of smart meters as the majority of new PPM installations are smart.

Overall conclusions on competition impacts

3A.82 While there are theoretical impacts on competition arising from Option 3, and to a lesser extent Option 2, which could potentially affect competition in both positive and negative ways, our initial assessment is that both options are unlikely to have a material effect on competition. This is owing to the very small impact on annual bills that either levelisation option is expected to have and limited evidence that different payment method tariffs acted to constrain each other in the first place.

Risks, assumptions and limitations

Risks

3A.83 The consumer impacts calculated in this IA are based on TDCVs and therefore for Option 3, which changes unit rates as well as standing charges, impacts will vary based on actual consumption values.

Assumptions

3A.84 We have assumed in our main options analysis that the impacts within payment method groups are based on current TDCVs – 2,700kWh for single rate electricity, 3,900kWh for a multi register electricity and 11,500kWh for gas.

Limitations

3A.85 The vulnerability data we have used as part of this IA does not give a complete picture of vulnerability across the population. We have been able to interrogate vulnerability characteristics in isolation, including but not limited to, low income, disabled, rurality, pensionable age (please see consumer archetypes in **Table 3A.12** for details of these vulnerability characteristics). However, this does not allow for a holistic assessment of the impacts of levelisation on the vulnerable population as a whole.

3A.86 In assessing the consumer impacts of levelisation, we have focused on the effects on individuals' finances, in particular additional expenditure or savings as a result of levelisation. The impacts of levelisation are heavily dependent on the baseline cap levels – our analysis is based on the price cap levels for cap period 11b.

Wider Impacts

Impact on inflation

3A.87 Our assessment into the impact of levelisation on inflation is that levelisation will have no material impact on inflation.

Environmental impacts

3A.88 As stated previously, the relatively small monetary impacts, combined with income elasticities of demand, mean there is unlikely be to a material impact on consumers consumption. We therefore do not foresee any environmental impacts associated with the levelisation options presented in this statutory consultation.

Security of Supply

3A.89 Ofgem has a duty to protect security of supply to existing and future consumers. Levelisation reduces total debt, bad debt and supplier working capital which results in improved supplier resiliency and, as a result, security of supply.

Public Spend

3A.90 We are required to exercise our functions under the Domestic Gas and Electricity (Tariff Cap) Act 2018 with a primary focus on protecting consumers on default rates, while having regard to specified considerations (see s. 1(6) of that Act). Following the coming into force of the Energy Prices Act 2022, those specified considerations to be taken into account include 'the need to set the cap at a level that takes account of the impact of the cap on public spending'. This consideration reflects the fact that, while the Government's Energy Price Guarantee (EPG) is in force, the cap level affects the levels of payments by Government to energy suppliers. Given that the EPG scheme ends prior to the introduction of the levelisation policy[46], we have assessed the impact to this as nil.

[46] The EPG scheme ends on 31st March 2024 and is not expected to be needed after this date, see: https://commonslibrary.parliament.uk/research-briefings/cbp-9714/

Public Sector Equality Duty (Equalities Act 2010)

3A.91 Ofgem has a legal duty to consider the impact of our policies on people with protected characteristics under the Public Sector Equality Duty (PSED).46 The main objective of the PSED is to:

- Eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under this Act.
- Advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it.
- Foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

3A.92 Our assessment is that the main objective of this policy (Ofgem's vulnerability duty) overlaps with the PSED for the following portrayed characteristics: age and disability. Our assessment of benefits identifies the impact of our policy in these groups, and it therefore covers our requirement to undertake an Equalities Impact Assessment.

3A.93 For other protected characteristics such as race, religion, or sexual orientation, we have not identified any potential for discrimination or adverse impacts. Some of the distributional impacts on these groups are included implicitly, where relevant, in the distributional impacts reported in **Table 3A.14**.

Appendix 4 - Levelisation Methodology

A4.1 To support understanding of the levelisation process and options, below is a draft step-by-step guide to the model for Option 2 and our proposed Option 3.

A4.2 Option 2 – Levelise DD & PPM at nil consumption

- Calculate the difference between DD & PPM at nil consumption
- If PPM is greater than DD at nil consumption - make DD & PPM at nil consumption the same by proportionally (based on customer accounts taken from the latest quarterly Tariff and Customer Account RFI) redistributing the difference between DD & PPM at nil consumption
- The result of this is that DD & PPM cap levels are the same at nil consumption

A4.3 Option 3 – Option 2 plus sharing debt-related costs equally between DD and SC only (across unit rate and standing charge)

- Start with the outputs from Option 2 above – DD & PPM the same at nil consumption
- Calculate the debt-related costs for DD and SC by adjusting the Payment Method Adjustment Percentage (PAP) to isolate debt-related costs at TDCV and nil consumption
- Remove the adjusted PAP amounts from DD and SC at TDCV and nil consumption
- Add the adjusted PAP amounts back equally and proportionally (based on customer accounts taken from the latest quarterly Tariff and Customer Account RFI and consumption proportions) to DD and SC at TDCV and nil consumption
- The result of this is that the debt-related costs are the same at TDCV and nil consumption and contribute the same amounts at TDCV and nil consumption to the DD & SC cap levels

Appendix 5 - Introduction of Annex 9 – Levelisation allowance methodology and levelised cap levels

A5.1 Introducing levelisation requires changes to be made to the price cap modelling suite. We propose to introduce a new annex to calculate the levelisation allowance for each payment type, metering arrangement and region. This proposed new annex also presents the final benchmark consumption levels with which suppliers must comply.

A5.2 In the table below, we provide an overview of the required changes to support Option 2 (as Option 3 develops further we will consult on how to incorporate it into the price cap modelling suite). We have also published the proposed new annex alongside this consultation.47

A5.3 The table below outlines the structure of the proposed new annex:

Type	Tab	Description
Output	1a Levelised DTC	This tab shows the output of the levelisation of PPM and Other (DD) payment method nil consumption for each region by applying the (+ve or -ve) levelisation allowance to the relevant original price cap nil consumption value. It presents the adjusted benchmark consumption level for each payment method and region by subtracting the original nil consumption value and adding the levelised nil consumption value. It also shows the original (unlevelised) SC values for completeness.
Calculation	Nil levelisation allowance	This tab performs the calculation of the payment differential between PPM and Other (DD) payment method. Using the payment method differentials, it calculates the levelisation allowance term (*L*) for each payment method and region when PPM nil consumption is greater than Other (DD) nil consumption. It does this for both single and multi-rate electricity meters and gas.
Input	3a DTC	This tab uses as its inputs the outputs from the default tariff cap overview model tab 1a. This includes all other terms except L.
Input	3b Customer Accounts	Tab containing customer account numbers (provided quarterly via Tariff and Customer Account RFI) by region and payment method. This is to calculate the proportion of customer accounts by payment method and region to facilitate the calculation of the levelised nil consumption values.

[47] Ofgem (2023), Changes to prepayment meter standing charges and other debt costs https://www.ofgem.gov.uk/publications/changes-prepayment-meter-standing-charges-and-other-debt-costs

Appendix 6 - Privacy notice on consultations

Personal data

A6.1 The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

A6.2 Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. ie a consultation.

4. With whom we will be sharing your personal data

We may share consultation responses with officials from the Department of Energy Security and Net Zero and HM Treasury.

5. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for 6 months after the project, including subsequent projects or legal proceedings regarding a decision based on this consultation, is closed.

6. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete

- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at https://ico.org.uk/, or telephone 0303 123 1113.

7. Your personal data will not be sent overseas.

8. Your personal data will not be used for any automated decision making.

9. Your personal data will be stored in a secure government IT system.

10. More information For more information on how Ofgem processes your data, click on the link to our "Ofgem privacy promise".