OVO Energy
1 Rivergate
Temple Quay
Bristol BS1 6ED

policy@OVOenergy.com
www.OVOenergy.com

Sabreena Juneja
Price Protection, Ofgem
priceprotectionpolicy@ofgem.gov.uk
By email only

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Dear Sabreena,

OVO response to Consultation on Levelling the cost of standing charges on prepayment meters

Thank you for the opportunity to respond to this consultation. We support the aim of abolishing the prepayment meter poverty penalty and called for this, alongside the abolition of standing charges in our Ten Point Plan published in September 2022[1]. We were therefore pleased to see the government take action to address the PPM charge differential. We recognise that abolition of standing charges would be a matter for the government and have recently called for the removal of the standing charge for the most vulnerable customers this winter which could be facilitated through the EPG mechanism. Longer term, we support the removal of the standing charge for all customers, to ensure they have greater control of their bills through changes in consumption habits, alongside the implementation of a social tariff to support low income households with high usage.

LEVELISATION PROPOSALS AND CONSIDERATION

Our preference would be to see a removal of the standing charge for all customers and a lower unit rate for prepayment customers[2]. However, in the context of these proposals and the requirement to have a mechanism in place by April 2024 we agree that Ofgem should, as a minimum, implement Option 2, to deliver the government's aim to remove the PPM premium post-EPG. We are also supportive of the PPM levelisation being achieved through a market-wide (outside of the price cap) cost recovery mechanism.

We are highly supportive of Ofgem implementing Option 3, as this creates a mechanism that will enable fair cost recovery by Suppliers while also managing the tariff differentials between payment methods. We have not established a clear position on what we believe the level of tariff differential between payment types should be, but we are clear that if regulation of differentials result in tariffs not being cost reflective, there must be a

[1] https://company.ovo.com/ovos-10-point-plan-to-address-the-national-energy-crisis/
[2] ibid.

mechanism to ensure suppliers can recover reasonable costs incurred.

We note that a proportion of SC additional bad debt costs are already allocated to DD customers under the price cap, which as Ofgem implies in the consultation document, creates a distortionary effect in the market - overcompensating suppliers who have a high proportion of direct debit customers, and undercompensating other suppliers. We believe that this approach is unjust and creates market distortion. We would therefore be supportive of steps taken to remove this distortive effect from the industry, and view the mechanism outlined in Option 3 as a sensible approach to achieve this.

It is widely acknowledged that the cost of living crisis being experienced by our customers is leading to an increase in bad debt. Our data shows that the vast majority of the increase in bad debt relates to SC customers, and so the observed differential in bad debt rates between payment types is increasing. We believe that Ofgem should take calculated steps to ensure that suppliers who incur high bad debt costs from SC customers are the same suppliers who are compensated through cost recovery for those same costs.

We therefore fully support Option 3 being implemented at the earliest opportunity. This will give Ofgem a mechanism to ensure that suppliers are able to recover costs incurred while also ensuring that the tariff differentials between payment types do not result in customer detriment.

We believe that Option 3 provides better protection to SC customers who are not able to engage with the market, whilst retaining some degree of differential to incentivise DD payment for those who have options regarding their payment choices. As the impact assessment shows, 37% of SC households include customers in vulnerable circumstances for whom lower bills resulting from levelisation would provide a direct benefit. Implementing Option 3 would maintain alignment of DD/PPM cap levels, has no greater impact on the DD price cap than Option 2, and provides a benefit to vulnerable SC households who are also at risk of hidden self-rationing akin to self-disconnection in PPM households.

MECHANISM CAN BE USED TO TRUE UP HISTORIC MISALLOCATION OF COSTS

As Ofgem has recognised in this consultation, and has noted above, there has been historical misallocation of costs which has had a distortionary impact. We would urge Ofgem to utilise this reconciliation mechanism to true-up that misallocation and provide a retrospective redistribution that ensures appropriate levels of cost recovery for suppliers with “non-average” proportions of DD and SC customers. Addressing uncertain and inequitable cost recovery will support suppliers in returning to reasonable profitability and ensuring an investable sector. We also recognise that implementation of Option 3 in time for April 2024 would be challenging. As outlined above, the misalignment of cost recovery between suppliers that would be a result of a delay to implementation of Option 3 could be addressed by using the mechanism to deliver a retrospective true up.

PAYMENT RECONCILIATION PROCESS OPTIONS AND CONSIDERATIONS

We support the use of a reconciliation by difference mechanism and the aim to ensure that costs are recovered in a reasonable timeframe after being incurred. We agree that there is a balance to be struck between the accuracy of using actual consumption and the simplicity of using an estimated consumption approach. We believe that the issues associated with misaligned cost recovery warrant swift implementation and so would support the simpler, and therefore lower implementation costs, of an estimated consumption approach.

It is difficult for us to provide indicative administration costs at this time without further understanding of the details of the mechanism design and data requirements necessary for the chosen operator. We would urge Ofgem to ensure that low level design requirements are shared as soon as possible to enable us to assess any impact on systems and processes.

We believe that Option 3 provides the most appropriate solution and delivers against the Fair Prices pillar of Ofgem's Consumer Interests Framework through fair distribution of costs and minimising consumer welfare risks for both SC and PPM customers. We would urge that the need to ensure a solution is in place for April 2024 and a desire for simplicity does not preclude implementation of Option 3 given the ability to phase implementation. We note Ofgem's concerns that implementing Option 3 may put April 2024 delivery at risk, and if this were to prove the case we would support a phased implementation on the basis that delivery of the full solution for Option 3 is delivered in a timely manner for implementation at the earliest opportunity, likely July 2024.

We would be happy to discuss our response further, and should you have any questions please contact policy@OVOenergy.com.

Kind regards,

Nicola Roberts
Senior Regulation Manager, OVO