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

Email to: priceprotectionpolicy@ofgem.gov.uk

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Dear Sabreena

Levelling the cost of standing charges on prepayment meters

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

EDF support many of the initial proposals in Ofgem's consultation on 'Levelling the cost of standing charges on prepayment meters' which are mainly a proportional response to the benefits levelisation can deliver in terms of appropriate pricing for domestic customers. Ofgem must continue to ensure, based on the benefits to customers, that levelisation and any reconciliation mechanism is simple, proportional and continues to incentivise the switch to cost efficient payment methods. EDF would, therefore, make the following key points:

- **Levelisation should incentivise the switch to smart prepayment by making it the cheapest payment method -** EDF support levelising prepayment and direct debit standing charge costs as this is a simple and proportional response recognising that the differential between direct debit and prepayment costs will be minimal once UNC modification 0840 is implemented. However, it is disappointing that the proposals do not look to differentiate smart and legacy prepayment in the longer term given the superior experience and lower cost to serve that smart metering will bring. While the Default Tariff Cap OPEX cost review is ongoing, Ofgem should take the opportunity to use levelisation to support the smart meter roll-out and encourage customers paying by legacy prepayment meters to upgrade to smart prepayment.

- **Incentivising the switch to cost efficient payment methods -** standard credit should continue to reflect that it is the highest cost payment method, given that this carries the highest working capital and debt costs. Customers should continue to be incentivised to switch to lower risk and cost-efficient payment methods as this will ultimately reduce bad debt and, therefore, customer bills for all.

- **A focus on simplicity and proportionality should mean that any changes are limited to levelising standing charges -** as this will make any ongoing levelisation much simpler to operationalise. We do not agree that bad debt costs should be levelised across payment methods through the standing charge and unit rate as this approach would introduce significant additional complexity with limited benefits to the consumer.

- **Levelisation and reconciliation of standing charges should apply to capped and new uncapped contracts to enable fair competition for levelised payment methods -** however, while we support a simple daily fixed reconciliation amount Ofgem must also consider potential unintended consequences of this approach as it could also lead to standing charges for fixed prepayment contracts converging around the Default Tariff Cap level. We do not support the application of levelisation to fixed contracts that were agreed prior to the new changes coming into effect as it could result in suppliers being unable to recover their costs.

- **Affordability cannot be tackled through levelisation -** we agree with Ofgem that customers on all payment methods that are financially vulnerable will continue to need support to ensure their energy bills are affordable and that this can only be tackled effectively through wider government social policy initiatives. Therefore, with continuing wider pressures on customers finances, the Government and Ofgem must not lose sight of tackling underlying affordability issues, through a meaningful, government funded social tariff, and providing additional targeted support this winter to customers that need it most.

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

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

Yours sincerely

K Watson

Keith Watson
Senior Manager Customers Policy and Regulation

Attachment
Levelling the cost of standing charges on prepayment meters
EDF's response to your questions

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

We agree that there is a case for levelisation of payment methods, particularly in the case of levelising prepayment with direct debit.

The objective of any levelisation should, however, be to make smart prepayment the cheapest payment method. Therefore, while we support the case made by Ofgem, it is disappointing that the proposals do not commit to separate smart and legacy prepayment in the longer term. From a cost perspective, smart prepayment meters once delivered at scale should have the lowest cost to serve. Alternative smart prepayment top-up mechanisms will, for example, enable the withdrawal of the costly legacy prepayment infrastructure in the longer term.

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

While we recognise that there is a wider Default Tariff Cap OPEX cost review that is ongoing, Ofgem should in the interim use levelisation to support the smart meter roll-out and encourage customers paying by legacy prepayment meters to upgrade to smart prepayment.

Q2. Do you have any views on our proposed policy considerations for levelisation? Are there any additional ones we should consider?

We broadly agree with Ofgem's proposed policy considerations, and in our view levelisation options should be assessed against three key objectives:

- **Simplicity:** A focus on simplicity should mean levelisation should be limited to (fully) levelising standing charges. This is typically where prepayment costs are higher and will make any ongoing levelisation much simpler to operationalise, monitor and reconcile. This will also aid customer engagement and understanding of prices i.e. if a charge were only partially levelised a consumer would be unlikely to understand that there was any equivalence in cost if they were to compare tariffs for example.

- **Proportionality:** The cost benefits to consumers from levelisation are likely to be very small in absolute terms (no more than £1 a week) and as a proportion of a customer's total energy bill. Therefore, any levelisation option adopted must be proportional and must not be overly costly or complex to implement, otherwise this risks perverse outcomes if the benefits of levelisation are cancelled out, through the additional charges from implementing the policy being added to customer bills.

- **Incentivising the switch to cost efficient payment methods:** Standard credit should continue to reflect that it is the highest cost payment method, given that this carries the highest working capital and debt costs. Customers should continue to be incentivised to switch to cost-efficient payment methods, including smart prepayment, otherwise there is a risk that levelisation could increase bad debt and ultimately customer bills.

Q3. Do you agree with our initial preference to levelise PPM and DD Standing Charges?

Yes, EDF agrees.

Levelising prepayment and direct debit standing charges is a proportional response to the higher prices that some prepayment customers may face when the Energy Price Guarantee (EPG) ends in 2024. The standing charge is typically where costs are higher for prepayment customers when compared to direct debit, and from October this year with the introduction UNC modification 0840, the Default Tariff Cap will be £51 lower than it would have otherwise been, leaving the average prepayment cost only £26 more expensive than direct debit. This option would remove this differential. This solution should also be relatively simple to operationalise including from a regulatory-compliance and reconciliation perspective.

However, as set out in our response to question 1, it is disappointing that the proposals do not look to differentiate smart and legacy prepayment in the longer term given the superior experience and lower cost to serve that smart metering will bring.

Q4. Do you think we should also levelise the bad debt charges across PPM, DD and SC, which would reduce the differential between SC and DD? Please provide any evidence /data that may benefit consumers as a whole.

No EDF do not agree.

As this proposal would impact the unit rate as well as the standing charge it would be more complex to operationalise and, therefore, much more expensive to implement than option two, yet provide little benefit. Based on Ofgem's impact assessment the financial benefit to consumers is minimal, at most around £0.63 a week (£33 a year) for a standard credit customer of typical domestic consumption. This proposal[1] would also result in prepayment continuing to be slightly higher cost than direct debit for a dual fuel customer which is counter to the Government and Ofgem's policy intent.

Ofgem must ensure that incentives remain for customers to switch to more cost-efficient payment methods. Standard credit has the highest working capital and debt costs. In contrast to other payment methods, standard credit has no automatic mechanism (whether that be advance top-up or bank instruction) to collect payment from the customer, rather it is dependent on the customer taking action to pay their bill. The levelisation of bad debt across all payment methods would reduce customers incentives to switch to the more cost-efficient payment methods of prepayment or direct debit. This could lead to increased bad debt across suppliers which means higher customer bills for all.

Q5. How should we ensure that levelisation transfers are correctly applied to customers on tariffs not covered by the cap (ie uncapped)?

In the case of levelisation of prepayment and direct debit standing charges Ofgem could enforce this obligation for uncapped contracts through a licence condition mandating that the standing charge of an equivalent fixed tariff is no higher for prepayment customers than for those on direct debit, taking into account regional variations. This will also make it easy to measure compliance as it can be verified purely by comparing the standing charge rate of equivalent uncapped tariffs.

In the case of levelising bad debt across all payment methods, as the current proposal would include partially levelising rates it would be much more difficult to require and monitor compliance to ensure that levelisation transfers are correctly applied to customers on uncapped tariffs. This is because suppliers would have to provide a detailed breakdown of their cost stacks for each fixed tariff to be able to provide assurance that the element of cost that must be levelised (in this case bad debt) is in fact spread equally across payment methods. The complexity and cost to manage compliance for unit rate levelisation on an enduring basis is therefore unlikely to be proportional for this purpose at this time.

Q6. Do you agree with our proposal not to levelise across regions?

Yes, EDF agree.

Q7. Do you agree with our proposal not to target levelisation?

Yes, at this time.

[1] Based on table 2A.8 in Ofgem's draft impact assessment option 3 would result in a dual fuel customer on prepayment paying £3 more annually than a customer on direct debit.

Q8. Should we set new licence conditions to ensure suppliers pass the costs/benefits through to all customers?

Yes. Levelisation of standing charges should apply to capped and uncapped contracts to enable fair competition by ensuring that domestic customers on a levelised payment method are able to access competitive fixed tariffs.

However, as set out in our response to question 11, while we support a simple daily fixed reconciliation amount Ofgem must also consider potential unintended consequences of this approach, such as standing charges for prepayment fixed contracts converging around the Default Tariff Cap level.

Q9. Do you have any views on our other considerations?

EDF has no further views or comments.

Q10. What are your views on the reconciliation mechanism, the type of mechanism, invoicing cadence, and mechanism operator?

A simple and cost-effective reconciliation mechanism is required to ensure that suppliers do not lose or gain from levelisation based on the breakdown of their customer base by payment type. We agree that it should be run by an existing industry party such as RECCo, and that reconciliation should be by difference and apply to the standing charge only. We would also support monthly invoicing as an appropriate billing frequency.

The reconciliation mechanism must also account for movements in supplier customer numbers on a daily basis using settlements data.

Q11. Do you have any views on our preferred approach of a fixed reconciliation amount to reconcile standing charges levelisation and a volumetric reconciliation amount based on estimated consumption to reconcile unit rate levelisation?

Yes. Having a fixed reconciliation amount based on the difference between the Default Tariff Cap and levelised cap tariff rates to reconcile standing charges for both capped and uncapped contracts would seem appropriate.

In the case of capped contracts this should mean supplier losses and gains from levelisation can be reconciled more or less accurately. In the case of uncapped contracts this offers a straightforward solution as there will be a single reconciliation rate. If suppliers were to submit differentials to the mechanism operator for each of their fixed contracts this would be overly complex and costly to implement. This solution will also prevent suppliers gaming any new system as it will deter suppliers from falsely inflating differentials between different payment types to financially gain from levelisation.

However, as the reconciliation rate will be set by Ofgem based on the Default Tariff Cap, it is also likely to mean that reconciliation of standing charges for uncapped contracts may be less accurate than for capped contracts as suppliers will have different pricing methodologies for fixed contracts, and additionally uncapped contract standing charges will not change on a quarterly basis, but the reconciliation rate would. Ofgem must also consider potential unintended consequences of this approach, such as standing charges for prepayment fixed contracts converging around the Default Tariff Cap level.

We do not support unit rate levelisation or reconciliation. However, if unit rates were to be reconciled, we would not support a volumetric reconciliation based on estimated consumption as this would not be accurate and suppliers would carry significant risk if the estimated consumption figure used was too low or gain financially if the estimated consumption figure were too high. The complexity and cost to implement reconciliation to actual consumption when compared to the benefits case presented for unit rate levelisation means that this is unlikely to be a proportional response at this time.

Q12. Do you agree that all domestic customers should be included within the reconciliation mechanism?

Yes, if capped and uncapped contracts are levelised all domestic customers should be included in the reconciliation mechanism to ensure that suppliers cannot gain or lose financially based of the breakdown of their customers by payment type. However, the reconciliation mechanism should only apply to standing charges and not unit rates in all instances.

Q13. Can you provide an estimate of implementation and ongoing costs on your organisation of the different levelisation options and approaches?

At this stage we are unable to provide definitive figures for the cost of different levelisation approaches. However, the types of costs we will incur are likely to be similar to those incurred for the government support schemes such as the Energy Price Guarantee. These costs include:

- **Payment calculation and reconciliation:** Building robust platforms to calculate levelisation charges and payments at a customer level. If Ofgem adopt unit rate levelisation this should incorporate granular consumption data for accurate reconciliation. However, this would be a significant effort, the cost of which is unlikely to be proportional to the benefit at this time.
- **Financial reporting, audit, and control:** Costs associated with ensuring the accurate implementation of this scheme for our customers and implementing any associated changes to our accounting policy.
- **Operational costs:** for implementation, managing ongoing compliance, and potential increased customer engagement.

Q14. Do you have any comments on potentially phasing the implementation of the reconciliation mechanism?

We do not support unit rate levelisation. However, if unit rates were to be reconciled it would be much more complex to design the mechanism and we agree that a phased implementation would be required. Certainly, it would not be feasible for unit rate reconciliation to be in place by the 1 April 2024.

Q15. What considerations should we take to tariffs that exist prior to the implementation of levelisation?

We do not support existing fixed tariffs that existed prior to the implementation of levelisation being included in the supplier obligation. Historic variables in standing charges across payment types would make this reconciliation incredibly onerous and depending on pricing strategy on historic fixed deals could result in losses suppliers are unable to recoup.

Q16. Are there any other financing impacts on your organisation that we have not considered as part of Chapter 4 or the IA?

Yes. If levelisation were to be applied to fixed contracts agreed before April 2024, Ofgem must consider the financial impact to suppliers of being unable to recover funds payable into the levelisation framework.

Q17. Are there any other considerations for the reconciliation mechanism we have not explored?

EDF has no further comments.

EDF
September 2023