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Sent by email to: priceprotectionpolicy@ofgem.gov.uk

Re: Consultation on levelling the cost of standing charges on prepayment meters. NON-CONFIDENTIAL RESPONSE.

Dear Sabreena,

Thank you for the opportunity to provide views and evidence on levelling the cost of standing charges on prepayment meters.

Levelisation of PPM and DD rates would ensure that some of the most vulnerable customers on PPM do not pay more than they would if they were on DD. While there is a higher cost to serve for PPM customers, as seen in the DTC methodology, we consider it to be appropriate to charge PPM customers the same as DD customers – particularly given the backdrop of the cost-of-living crisis. Customers on PPM may not have chosen their payment type, i.e., they may be on PPM due to their debt profile, and a recent Utilita white paper¹ found that 86% of customers prefer PPM as their payment type.²

However, levelling DD and PPM is critically dependent on an effective supplier reconciliation process being implemented and we are pleased to see that Ofgem is now consulting on the detail of a reconciliation process.

On levelling debt related costs across all consumers, we consider that this is a more complex question (than levelling standing charges across PPM and DD) and Ofgem needs to consider customer impacts and implementation issues further. Given this, Ofgem should prioritise the levelisation of PPM with DD for it to be implemented by 1 April 2024 with a

¹ Pay As You Go: The solution to helping end self-disconnection – An Industry RED FLAG Report, Utilita, November 2022.

² Press release: <https://www.centrica.com/media-centre/news/2023/british-gas-is-first-to-cut-prepayment-prices>

supplier reconciliation mechanism in place to ensure no efficient suppliers is negatively impacted financially.

A partial levelisation or adjustment to SC may proceed alongside PPM levelisation if it isn't at the expense of implementing PPM levelisation by 1 April 2024.

Addressing these pricing issues is the right thing to do for vulnerable customers, but Ofgem should not stop here. Energy bills are too complicated – they should be simple and straightforward. We think it's right to abolish the standing charge from the price cap. This will go a long way to streamlining bills and making them more transparent. Moving to a flat national pricing tariff – which is the same wherever you live in the UK – removes further unnecessary variations from bills. The impact of this change would need to be carefully studied but we think it's something the regulator should look at.

We have responded to each of the consultation questions in the Appendix.

Yours sincerely,

Essie Barnett
Regulatory Manager

Appendix – responses to consultation questions

Case for change

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

In our response to Ofgem's Call for Evidence on levelisation of payment method cost differentials we proposed that Ofgem equalise both standing charge and unit rate for DD and PPM so that there is zero differential between the two prompt-payment methods.

Levelisation of PPM and DD rates would ensure that some of the most vulnerable customers on PPM do not pay more than they would if they were on DD. While there is a higher cost to serve for PPM customers, as seen in the DTC methodology, we consider it to be appropriate to charge PPM customers the same as DD customers – particularly given the backdrop of the cost-of-living crisis. Customers on PPM may not have chosen their payment type, i.e., they may be on PPM due to their debt profile, and a recent Utilita white paper³ found that 86% of customers prefer PPM as their payment type. Equalising both the standing charge and unit rate across PPM and DD will ensure both these sets of customers will not be unjustly penalised for their payment type.⁴

We support levelising DD and PPM, although this is critically dependent on an effective supplier reconciliation process being implemented. We have responded separately on the reconciliation process that Ofgem has proposed in the section on Payment reconciliation process options and considerations below.

Levelisation proposals and considerations

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

We agree with Ofgem's policy considerations.

Ofgem should equalise both standing charge and unit rate for DD and PPM so that there is zero differential between the two prompt-payment methods. Ofgem is right to consider whether to allocate debt costs more broadly within payment methods, but this should not delay implementing PPM levelisation.

Ofgem has recognised that 'to ensure that suppliers are incentivised to offer services to customers on all payment methods, they should expect to be able to recover notionally efficient costs irrespective of the proportion of customers they have on each payment method.'⁵ This is why levelising DD and PPM tariffs is critically dependent on an effective supplier reconciliation process being implemented.

³ Pay As You Go: The solution to helping end self-disconnection – An Industry RED FLAG Report, Utilita, November 2022.

⁴ Press release: <https://www.centrica.com/media-centre/news/2023/british-gas-is-first-to-cut-prepayment-prices>

⁵ Levelisation of payment method cost differentials: a call for evidence, Page 24.

The detail of the reconciliation mechanism will be important to ensure that suppliers are accurately compensated under the reconciliation. Ofgem is right that the cap will support this process by identifying the cost differential to be levelised and that updates to the price cap will need to be considered.

Finally, we agree that levelisation will require a supplier reconciliation mechanism that is effective across all tariffs – not just those under the DTC.

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

We proposed that Ofgem consider an additional option to equalise both standing charge and unit rate for DD and PPM so that there is zero differential between the two prompt-payment methods. We also consider it to have the added benefit of being simplest for customers to understand – i.e., if a customer is on one of the prompt payment types of PPM or DD, their tariff will be the same.

Ofgem has not considered this option or set out its reason for discounting it. Ofgem has found that “On an absolute basis, a greater number of vulnerable customers exist on DD than PPM”⁶. It is why we propose levelising PPM with DD across both unit rate and standing charge to ensure vulnerable customers across both payment types pay the same.

In the absence of our preferred option we consider that levelising PPM and DD standing charges is a step in the right direction as it would ensure that some of the most vulnerable customers on PPM do not pay higher standing charges than they would if they were on DD. However, levelising DD and PPM tariffs is critically dependent on an effective supplier reconciliation process being implemented.

4. 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.

We consider that this is a more complex question (than levelising standing charges across PPM and DD) and Ofgem needs to consider customer impacts and implementation issues further.

Customer impacts

An appropriate differential between DD and Standard Credit (SC) customers should remain to incentivise SC customers to move to either DD or PPM. This differential is needed as SC customers are more likely to accumulate a bad debt cost and it is important that customers are not incentivised to move to or remain on SC when they would otherwise choose a payment method with lower bad debt risk. If more customers remained on SC this would make it harder for suppliers to recover debt costs, who would then need to recover these costs through an uplift to the Default Tariff Cap bad debt allocation – ultimately leading to higher costs for customers across all payment types.

⁶ Ibid, Page 25.

We do not have a strong view on the exact differential that should remain between DD and SC but consider a differential of at least £100 per annum is required to incentivise customers to move away from SC.

Given that, we consider that Ofgem's proposal to reduce the DD to SC differential from £129 to £85 may reduce the current incentive for customers to move away from SC. We propose that Ofgem also considers an option to retain a £100 differential in its final impact assessment including modelling the impact of customers switching between tariff types. Ofgem should also note that by levelising PPM and DD standing charges (Option 2), customers that prefer not to pay by DD would already be able to access energy at the lowest price through PPM tariffs.

Implementation

Ofgem should prioritise the levelisation of PPM with DD for it to be implemented by 1 April 2024 with a supplier reconciliation mechanism in place to ensure no efficient suppliers is negatively impacted financially.

A partial levelisation or adjustment to SC may proceed alongside PPM levelisation if it isn't at the expense of implementing PPM levelisation by 1 April 2024.

Ofgem should also consider responses to question 8 below given the additional complexity of implementing a reconciliation process for option 3. An enduring process would ensure that any reconciliation accurately calculates levelisation payments and allows suppliers to validate their obligation. Given the differences in supplier business models that exist in the current market a robust process is crucial so that suppliers can have confidence in the process.

The existing cross subsidy

The current differential between DD and SC under the DTC reflects the higher cost to serve for SC customers to some extent. But the current differential does not fully reflect the bad debt costs attributable to SC customers as these costs are currently split between SC and DD customers in a ratio of 68:32.

Ofgem has not set out in detail how the reconciliation amount will be calculated under Option 2 or Option 3.⁷ Or whether the reconciliation amount will also take account of the existing cross-subsidy between DD and SC. Our view is that the current cross-subsidy between DD and SC should also be addressed as part of implementing a supplier reconciliation mechanism and Ofgem should make this clear in the statutory consultation.

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

We agree in principle with Ofgem's proposal to introduce a licence condition requiring suppliers to offer the same standing charge on comparable DD and PPM tariffs.

⁷ Ofgem do note that it will calculate the 'reconciliation rate' by 'substituting the levelised cap from the default price cap'. Levelling the cost of standing charges on prepayment meters, Page 45.

However, we are concerned that Ofgem's proposed definition of 'equivalent' tariffs would have unintended consequences for suppliers' ability to offer a range of uncapped tariffs. We encourage Ofgem to engage with suppliers to understand this. As drafted the requirement does not appear to meet Ofgem's policy intent which is to ensure that PPM customers standing charge is not higher than a comparable DD tariff.

For example, in defining 'equivalent' tariffs Ofgem should not preclude suppliers from offering more than one DD tariff on the same day, in the same region and for the same fixed period. As currently worded 'equivalent' DD tariffs could be required to have the same standing charge even if they differ in other ways e.g. eligibility or other tariff characteristics.⁸

Ofgem should also consider how to treat uncapped DD tariffs that are not available to PPM customers. Including clarifying the reporting requirement for tariffs that do not have an 'equivalent' PPM tariff.

Given these concerns it will be crucial that Ofgem allows suppliers the opportunity to comment on the specific wording of any licence condition in the forthcoming Statutory Consultation.

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

We agree that removing regional differences would be likely to increase the complexity and cost to reconcile as well as not being deliverable by April 2024. Whilst Ofgem considers this outside the scope of the current policy consultation we would encourage Ofgem to carefully study this option including, as it suggests, alongside wider considerations in its future market design workstream.

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

While there may be merit in targeting levelisation to groups within payment methods, this is likely to be a highly complex exercise to ensure all distributional impacts are captured in a thorough cost-benefit analysis, and complex and costly for suppliers to implement. Therefore, we propose that Ofgem implements levelisation and supplier reconciliation first. Once implementation of supplier reconciliation is complete, Ofgem should then consider conducting a full cost benefit analysis on whether levelisation should be targeted at certain groups taking into account other considerations such as the impact of a future social tariff.

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

We agree with Ofgem's finding that "The ability for customers to switch between levelised and non-levelised tariffs would have implications for the movement of customers and the impact on market competition."⁹ It is why we support a supplier reconciliation mechanism that is effective across all tariffs – not just those under the DTC.

⁸ For example, if two tariffs were available on the same day and same region but with different eligibility criteria (i.e. an EV tariff vs an 'all customers' tariff) the licence condition should not be drafted in such a way to require those tariffs to have the same standing charge.

⁹ Levelisation of payment method cost differentials: a call for evidence Publication Date: 26 April 2023.

Under Option 3 Ofgem has proposed a requirement 'that suppliers would reflect the costs/benefits associated with levelisation in their tariff pricing, resulting in a reduced payment method differential between non-capped tariffs.'¹⁰ It also proposes that this requirement could be formalised through a principles-based licence condition.

Ofgem needs to consider further how such a licence condition would work in practice and we encourage Ofgem to engage with suppliers to work through this.

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

Ofgem sets out some considerations for compliance for uncapped tariffs within other considerations.

We would encourage Ofgem to continue to consider the compliance process alongside any proposals it makes. Given the range of variables that affect fixed term contract pricing it may be difficult for Ofgem to monitor compliance of a licence condition linked to Option 3. Option 2 appears simpler, but Ofgem should consider further the definition of 'equivalent tariffs' as noted in our response to question 5.

Any compliance process will need to balance the need for Ofgem to ensure that suppliers implement this in a consistent way against the burden of compliance. We encourage Ofgem to work with suppliers to consider these issues.

Payment reconciliation process options and considerations

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

We agree with Ofgem's proposal to create a monthly reconciliation by difference mechanism. We previously proposed that Ofgem co-opt an existing reconciliation mechanism such as Warm Home Discount or Feed in tariffs which may help ensure a reconciliation mechanism is implemented by October. We understand Ofgem's reasons for proposing a new mechanism run by an existing industry party and encourage Ofgem to ensure that this party is able to deliver a working solution by April 2024.

In addition to a timely delivery, it is critical that any reconciliation process is able to accurately determine supplier obligations. It is also important that the reconciliation amounts can be validated by suppliers so that they can be confident of the amounts they are required to contribute.

11. 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?

A fixed reconciliation amount (p/day) would be an appropriate solution for levelisation of standing charges. We agree with Ofgem that audits of supplier systems will be required to ensure this process is robust.

¹⁰ Consultation – Levelling the cost of standing charges on prepayment meters, Paragraph 3.48.

For unit rates Ofgem has proposed a volumetric reconciliation based on estimated consumption, we are concerned that this approach would not be sufficiently accurate. We recognise that there would be additional data requirements for an alternative approach; to reconcile deemed to actual consumption. However, these data requirements need to be weighed against the need to avoid suppliers being under or over funded. Whilst we would support an audit mechanism to ensure that funding methods are correct and validate payment references this is not a replacement for a reconciliation and true up mechanism.

We recognise that Ofgem is concerned about the costs of system build and data requirements. We expect Ofgem to consider this option in its final impact assessment and allow suppliers to input on the costs and benefits of alternative approaches once further detail is available.

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

Yes, we agree.

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



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

We agree that Ofgem should prioritise the levelisation of PPM with DD for it to be implemented by 1 April 2024 with a supplier reconciliation mechanism in place to ensure no efficient suppliers is negatively impacted financially. A partial levelisation or adjustment to SC may proceed alongside PPM levelisation if it isn't at the expense of implementing PPM levelisation by 1 April 2024.

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

Our view is that all domestic customers should be included within the reconciliation mechanism. Exempting existing tariffs may leave some disengaged customers outside of the levelisation mechanism.

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

As Ofgem set out in Chapter 4 both option 2 and 3 would mean a 'supplier with a majority of PPM and SC consumers experiencing a decrease in revenue. This could pose a significant risk to PPM and SC supplier stability if levelisation is implemented without a reconciliation mechanism.'¹¹ This is why it is crucial that Ofgem implements levelisation by 1st April 2024 including a robust supplier reconciliation mechanism.

¹¹ Consultation – Levelling the cost of standing charges on prepayment meters, Paragraph 4.2.

Ofgem also notes that ‘Reconciliation options that do not include a redistribution mechanism may result in small gains or detriments to suppliers.’¹² Ofgem needs to understand the full extent of any potential gains or detriments and consult with suppliers on the need for a redistribution mechanism. We note that Ofgem proposes to appoint an operator of the reconciliation mechanism shortly. It is crucial that Ofgem works with this operator to understand the reconciliation process and the impact of not including a redistribution mechanism.

Ofgem rightly note that operating costs review is complementary to the levelisation process and that levelisation should be updated after its completion. As part of this review Ofgem should set out clearly how the existing cross subsidy will be treated under any revised payment method uplift and whether and how this interacts with the reconciliation process. The result of the existing cross-subsidy is that any efficient supplier with a larger proportion of SC customer will under-recover through the Default Tariff Cap allowance, and any efficient supplier with largely DD customers will over-recover.

¹² Ibid, Page 40.