Energy UK

The voice of the energy industry

Ofgem
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Dear Price Protection Team,

We welcome Ofgem bringing forward this policy consultation on the consumer cost levelling and the energy supplier recovery of standing charges for customers on prepayment (PPM) meters. In this response we also include reflections on how the Additional Support Credit (ASC) decision and the proposed PPM levelling approach interact.

The impact of fast-growing customer energy debt,[1] the revised guidance for ASC customer provision[2] and planned changes to the obligations on installing involuntary PPM meters[3] mean that most, but not all, of our supplier members support a market-wide (outside of the price cap) cost recovery mechanism[4]. Energy UK has consistently set out this position in response to prepayment and levelisation consultations[5].

We encourage Ofgem to set out a clear route to ending the use of legacy prepayment meters which could be used to strengthen the benefits case for levelisation and reduce the risk of incentivising legacy meter types.

The consumer case for levelisation and smart prepayment

The levelling mechanism, which includes the significant cost of legacy prepayment meter services, ensures that costs will not be solely recovered from just prepayment meter customers but instead from across the whole customer base[6]. The basis for applying the levy across all customers, beyond those covered by the price cap supports PPM customers equitable engagement with the market.

The ability to budget, control and reduce costs are often expressed as reasons by customers for choosing PPM and it also offers the opportunity to manage and avoid a further buildup of debt. It is currently at odds with basic fairness that those customers that value a PPM as it provides a reasonable service adjustment (and are more likely to be in fuel poverty and vulnerable) are

[1] Energy customer debt and arrears have increased by more than 107% over the last five years. The total debt and arrears across electricity and gas existing for more than three months has soared to £2.25 billion in Q1 2023. https://www.ofgem.gov.uk/publications/debt-and-arrears-indicators
[2] https://www.ofgem.gov.uk/publications/allowance-additional-support-credit-bad-debt-costs
[3] https://www.ofgem.gov.uk/publications/statutory-consultation-involuntary-ppm
[4] Octopus is concerned about the impact on customers of the proposed approach and has suggested alternative approaches to Ofgem as previously footnoted in Energy UK responses on this issue.
[5] https://www.energy-uk.org.uk/publications/energy-uk-response-to-ofgems-levelisation-of-payment-types-consultation/ and https://www.energy-uk.org.uk/publications/energy-uk-response-to-statutory-consultation-on-involuntary-ppm/
[6] This would be the case when the Energy Price Guarantee (EPG) would no longer cover the ASC that is notionally allocated to bills from April 2024

expected to pay for their additional cost to serve. This is particularly the case for smart prepayment which has only a slightly higher cost to serve than direct debit customers and does not require the higher cost to serve that is attached to legacy PPM. In contrast to legacy PPM, levelising smart PPM price cap with DD does not risk incentivising customers to choose meter options with higher system costs, which are ultimately passed on to the consumer.

Ofgem and the Government should consider ending legacy prepayment alongside the introduction of the levelling mechanism. It should do this without delaying its plans for the implementation of the levelling mechanism by April 2024. This would drive efficient costs for customers who ultimately will pay for these measures via bills. A universal shift of legacy PPM to smart PPM would improve the customer experience through access to better supplier support alongside strengthening the overall case for levelisation.

Most of our members do not see a compelling case for Option 3 (levelling the bad debt charges across PPM, DD and Standard Credit), which would further reduce the cost reflective differential between Standard Credit and DD.

ASC and levelisation

The UNC 840 modification to socialise unallocated gas costs more evenly across payment types reduces the scale of the PPM cost differential. Most of our members think there is still some need for levelling, such as standing charges that include the cost of the ASC allowance, but some see it as no longer necessary. ASC's impact on bad debt levels is to some extent uncertain and will be impacted by unknown factors such as wholesale price movements and government support decisions, meaning it could yet be larger than anticipated. As a result, the levelisation levy and a possible true-up approach should reflect caution. However, the approach in general and uncertainty here could make it more difficult to forecast costs and therefore make it harder for suppliers to offer price fixed rates.

Ofgem's preferred approach of only leveling the standing charge reflects energy suppliers' preference of simplicity to support reduced delivery risks, particularly for the short term. The risk of PPM unit rates having a noticeable premium for customers above DD unit rates appears low, but nonetheless should be considered by Ofgem in the future development of unit rate price cap allowances. The reversal of the UNC modification or the apportioning of ASC debt to unit rates, although unlikely, could cause reconsideration. However, if it is to be useful, the proposed volumetric unit rate levelisation mechanism needs to use actual rather than estimated volumes due to the level of inaccuracy created by estimates.

A further issue is that Ofgem's ASC decision does not seek to reflect the emerging bad debt indicators. Emerging indicators suggest why ASC bad debt increases above the 7% rises seen in 2021-22 are likely. For example, the evidence of higher ASC requests and increased self-disconnections reflect customer cohorts where bills are fundamentally unaffordable[7]. Ofgem should ensure that the 'float' level is optimally calibrated to ensure the levy mechanism facilitates prompt cost recovery.

[7] Utilita evidence of increased PPM self-disconnections set out below and demand for Additional Support Credit showing an increase of 1,100%.

A final concern with the process is that the definition and clarity of 'bad debt' differs between suppliers and these definitions will need to be harmonised to ensure fair cost recovery on an equal basis.

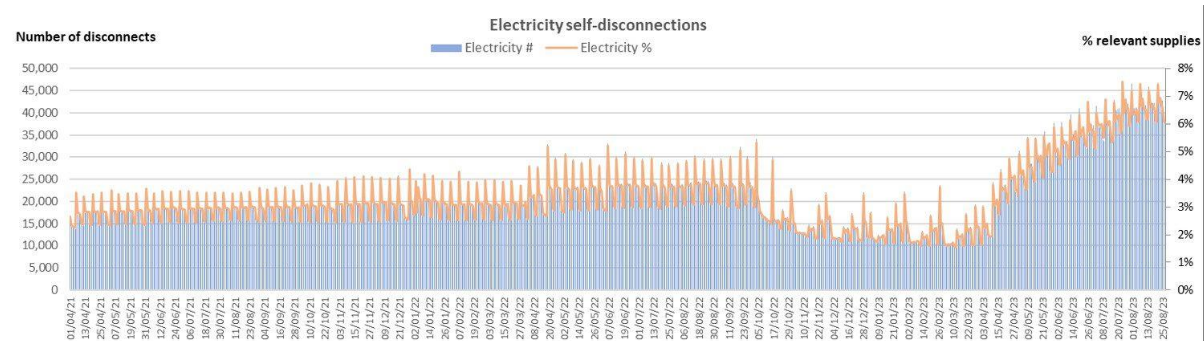
Energy UK principles for levelisation

Within the context of the options set out by Ofgem in this consultation and the objective of having a solution in place by April 2024, the initial position set out by Ofgem for levelisation[8] appears to perform the necessary functions. However, there are issues against the principles Energy UK previously set out. These principles were:

- Levelising the tariffs should align with broader social/regulatory objectives. This is clearest with smart prepay and direct debit levelisation.
- It should only be done if it results in incentives that will be net positive or net neutral from a system perspective.
- The costs should be recovered fairly in a way that doesn't result in market distortions that adversely impact competition.

Proposed new license conditions to require a relative positioning of uncapped Direct Debit (DD) and PPM standing charges need careful consideration of the definitions of 'equivalent' tariffs. This will be necessary in order to minimise the impact on suppliers' ability to price their fixed tariffs and avoid forcing consumers onto more expensive tariffs (ensuring there is no levelling upwards requirement).

The levelisation mechanism also appears to reflect a shift in Ofgem's approach to supplier cost recovery in a price capped market. While prepayment customers incur additional costs to serve, it seems timely for a risk-based reevaluation of how these costs are recovered – however it is important to recognise that this only represents one cohort of customers that have additional costs to serve. Ofgem should be clear on whether all suppliers should be able to recover efficient costs where they have higher cohorts of customers that are more expensive to serve regardless of payment mechanism. As a result, we urge Ofgem to ensure it addresses cross subsidisation holistically and ensure that it promotes competition on an equal basis in the OPEX review. The regulator will need to consider how all suppliers can recover efficient costs under a single price cap.



8 An enduring market-wide levelising downwards of PPM standing charges to align with direct debit. This includes bad debt related to Additional Support Credit (ASC) with tailored reconciliation process serviced by an appointed administrator.

We encourage Ofgem to pursue levelisation and further consider the challenges of cross subsidisation

There is already cross subsidisation within the price cap and now this mechanism adds to it and includes a reconciliation mechanism. As a result, there are further considerations for Ofgem's approach for reconciliation on an enduring basis. Alongside pursuing a marketwide cost recovery mechanism, we encourage Ofgem, to in future work, holistically consider the options and the risks for managing cross subsidisation and reconciliation.

The initial position proposed by Ofgem, although simpler than some of the options, is still complex and time-consuming. Ofgem's initial position will require significant administration from a service delivery body and from suppliers themselves. It is just one aspect of a wider regulatory approach needed to ensure a fair cost to serve customers that need additional support, while maintaining customer incentives on efficient energy use and system costs. Most of our members support the levelling mechanism and we suggest there should be further efforts to consider cross subsidisation and a predictable reconciliation process when supplier cost allowances vary from the actual customer costs that suppliers incur.

Beyond PPM there is a wider ability to pay problem for customers across payment methods and Energy UK support the introduction of a social tariff or discount and potentially the planned OPEX review should include a consideration of price cap cost reflectivity and fair cost to serve (whilst also giving energy suppliers incentives to seek and tailor services to all customer types). These workstreams should seek stable and holistic interventions. Ofgem needs to ensure that both cost efficiency for customers and the wider benefits of market innovation are supported by a simplified and predictable supplier cost recovery. This is important for fairer, smarter and lower carbon energy systems.

Please do get in touch if you would like to discuss this response in further detail.

Kind regards

Ed

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