

By email only: priceprotectionpolicy@ofgem.gov.uk

2 January 2024

RECCo response to: Changing standing charges for prepayment meters and debt-related costs across payment methods.

We welcome the opportunity to respond to this consultation. Our non-confidential response represents the views of the Retail Energy Code Company Ltd (RECCo) and is based on our role as operator of the Retail Energy Code (REC). RECCo is a not-for-profit, corporate vehicle ensuring the proper, effective, and efficient implementation and ongoing management of the REC arrangements. We seek to promote trust, innovation and competition, whilst maintaining focus on positive consumer outcomes. We are committed to ensuring that RECCo is an “*intelligent customer*”, ensuring efficacy and value-for-money of the services we procure and manage on behalf of REC Parties, including those which constitute the REC Code Manager.

In November 2023 Ofgem selected RECCo to act as the standing charge (non-volumetric) reconciliation operator. As such, we are in the process of developing industry processes, including the design, build, test and delivery of systems that will facilitate payments between suppliers. This work is being undertaken on an ‘at risk’ basis pending the outcome of this statutory consultation, to facilitate the reconciliation mechanism having effect from 1 April 2024. At the time of submitting this response, we are on track to meet that deadline.

Whilst we note the concerns that the levelisation policy is a departure from the usual principle of cost-reflectivity, in effect redistributing cost from one group of consumers to another, we agree that it is equally important that Ofgem has regard to fairness. In the absence of an effective social tariff that could allow financial support to be targeted directly towards qualifying households, it seems reasonable that Ofgem has regard to the types of consumers who typically if not universally fall into the different charge categories currently available. We accept that payment method is not an accurate indicator of financial vulnerability, but in the absence of more granular consumer data it may provide the best proxy currently available. Moreover, the basis for standing charges has already deviated from the principle of cost-reflectivity. As noted in the recent call for input on standing charges, those charges now include ‘policy costs’, such as the mutualisation of Supplier of Last Resort (SoLR) payments that could have been allocated in a different way. Indeed, the risk of supplier failures would ideally be borne wholly by the failed companies’ investors who make informed decisions about such risk versus the potential rewards of investment, rather than by consumers, most of whom had no relationship with the failed supplier(s). The wider review of standing charges is therefore welcome and should be similarly conducted through a lens of fairness rather than simply cost reflectivity. We believe that both Ofgem and suppliers must clearly communicate the consequences of this policy change to the different types of consumers – those likely to benefit cost reductions and those likely to incur cost increases.

We are happy to discuss any of the points raised in this response.

Yours sincerely,

Jon Dixon
Director, Strategy and Development

Appendix: RECCo response to consultation questions

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

We recognise that any intervention in the normal operation of the market can have unforeseen consequences, such as an adverse effect on competition; however, that is the prevailing paradigm in the domestic energy market, given the continued imposition of the default tariff cap. It therefore seems appropriate that Ofgem seek to balance the usual principle of cost-reflectivity with that of ‘fairness’.

Whilst the premium that PPM consumers have traditionally paid as part of their standing charges is a relatively small proportion of the overall bill, the justification for that premium appears to have weakened in recent years. At the same time, the overall regressive effect of standing charges has been compounded by the inclusion of unrelated non-infrastructure costs such as the Supplier of Last Resort levy. We recognise that, to an extent, levelisation will be detrimental to those direct debit consumers who will pay a higher standing charge as a result. However, we believe that the policy is likely to be more impactful for PPM consumers than the simple zero-sum game would suggest, both in term of the proportionate effect on bills and in mitigating some of the wider issues that standing charges can influence, such as the scale and frequency of payment top-ups, and the ability to clear outstanding debt.

While the effect of the levelisation policy may be marginal in terms of the overall difference it makes to consumer bills, as a consumer-centric organisation we consider it is welcome that Ofgem is factoring fairness into its thinking. In the absence of a social tariff or more targeted financial support for vulnerable consumers directly from government, it seems appropriate that Ofgem does what it can when it can, and the levelisation of standing charges is one such opportunity.

Q2: Do you agree with our levelisation policy aims?

Yes, we broadly agree with the stated aims of the levelisation policy, being that:

- 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;
- [Ofgem] should consider whether to allocate debt-related costs more broadly across payment methods; and,
- suppliers should be able to recover notionally efficient costs.

We are not yet convinced that the proposals around the reallocation of debt are appropriate, as this may increase costs to those consumers who may be no better off but exhibit desirable behaviours such as choosing a more cost-efficient payment method and managing to maintain those payments. We also share the concern of some respondents to the earlier Ofgem levelisation consultation that this could dilute the incentive to switch from Standard Credit to direct debit, though we recognise this option is not available to all.

We consider that it may be appropriate to add a further aim, which is to explicitly recognise and balance the trade-off that can exist between cost-reflectivity and fairness. We would also suggest that the third aim could

appropriately be limited to making PPM standing charges “equal to” DD, omitting “less than” as the latter implies the policy could go beyond simply ensuring the ‘fairness’ of charges, straying closer to being a ‘subsidy’ which should be a matter for government.

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

Yes. In the context of the policy aims referenced above, we consider that the general approach to levelisation is appropriate. We note that this is intended to be an enduring scheme and have no doubt that further improvements may be made in future, either in light of operational experience or in line with policy developments.

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

We have no specific comments on SLC28AD or Annex 9, other than to note that the legal text of REC Change Proposal R0147 will be revised to achieve greater consistency with the proposed licence modifications.

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

Yes. As confidence in the stability and/or predictability of wholesale energy prices returns, it is likely that retail suppliers will revert to offering fixed-term domestic contracts. As noted in the consultation, if such contracts were exempted from the reconciliation mechanism, it is likely that the cost of levelisation would fall upon a decreasing number of DD consumers.

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?

Yes. While there have been a number of interventions in the retail market, such as the prohibition on offering acquisition only tariffs, these have generally been time limited. Indeed, the default tariff cap was itself intended to be a short-term measure **but** looks to be an increasingly ingrained feature of the GB energy market. In contrast, levelisation is intended from the outset to be an enduring arrangement.

Whilst in the absence of a prescriptive licence obligation suppliers may not be required to offer the same standing charge to DD and PPM consumers, fixed term tariffs will continue to be influenced both by the cap and by consumer expectation. If uncapped contracts are included in the reconciliation mechanism, we agree that competitive pressures should ensure that suppliers pass through those costs, effectively extending levelisation to fixed contract tariffs without the explicit requirement to do so.

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

As there can be material differences in the applicable standing charge from region to region, we agree that those differences should be reflected in reconciliation. This requirement has been captured in the design of the reconciliation scheme and will be reflected in the data submissions from suppliers being developed under the REC as part of Change Proposal R0147.

We agree with the proposed treatment of Smart PPM being no different to that of traditional PPM for the purposes of levelisation, to the extent that the default tariff cap does not differentiate between them. However, the design of the reconciliation arrangements is future-proofed insofar as suppliers will be asked to separately submit the number of Smart and traditional PPMs on their portfolio, allowing for a separate reconciliation adjustment if that becomes necessary, i.e., if future tariff cap allowances differentiate between them.

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

We agree that a reconciliation method is necessary to mitigate the disproportionate effect that the levelisation policy change would have on suppliers whose portfolios contain greater than market average numbers of PPM consumers. In the absence of such reconciliation, the ability of some suppliers to recover costs would be impacted and competition between suppliers would be distorted, ultimately to the detriment of all domestic consumers.

We agree that the phasing of implementation is a pragmatic approach. This will ensure that there is a scheme in place to replace the Energy Price Guarantee when it expires on 31 March 2024, while keeping options open to tackle the more complex problem of potentially levelising volumetric charges. While it is stated that unit rate levelisation will be no earlier than October 2024, we note the timetable on page 10 indicates that the consultation on the implementation of unit rate levelisation is not expected until 'late 2024'. We would therefore welcome further clarity on the likely timing of future phases.

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

We note that suppliers could be negatively impacted by up to £20 million if reconciliation includes customer accounts on existing fixed contracts and suppliers have no means of passing through such cost. However, we agree that a derogation allowing those fixed contracts to be re-opened could undermine consumer confidence in the security that such contracts offer and may generally set an unhelpful precedent. Therefore, while it may introduce additional complexity, a differentiation between those contracts entered into pre- and post-decision on this statutory consultation does seem to be a relevant and reasonable basis to treat those contracts differently for the purposes of reconciliation. This should also be a diminishing issue as consumers roll-off pre-decision contracts and enter new ones, which should not be exempt from the reconciliation scheme. However, for completeness it may be appropriate for Ofgem to publish the numbers and renewal profile of those fixed contracts as this may help preserve data integrity and assist future modelling.

Q10: 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?

Yes. We agree that this requirement could have placed a large administrative overhead on suppliers, which would ultimately be passed through in higher costs to consumers. It could also have delayed the implementation of the scheme to the extent such audits may have been required in advance. As noted in the consultation, there are a number of regulatory measures that should ensure the timely and accurate provision of data, let alone the possibility that the false submission of data could constitute fraud.