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Dear Sabreena

Changes to prepayment meter standing charges and other debt costs

We fully support the proposal to introduce levelisation and reconciliation as a means to mitigate the affordability concerns of Prepayment (PPM) customers and to more fairly apportion debt-related costs between Standard Credit (SC) and Direct Debit (DD) customers, acknowledging the outcome of consumer research conducted by Ofgem into consumer vulnerability and payment method choice.

We support Ofgem in its proposal to implement Option 3 – A first phase levelisation and reconciliation of PPM standing charges against DD, followed by a second phase in which debt-related costs between SC and DD are levelised and reconciled.

We acknowledge that this proposal represents a shift from Ofgem's previous minded to position of only levelising PPM standing charges. Ofgem is correct to include debt related costs within its final policy proposal, ensuring that SC customers benefit from a reduction in costs and ensuring all customers capable of accruing debt pay their fair share of the costs.

We urge Ofgem to minimise the time lag between the first and second phase implementation of levelisation and reconciliation, acknowledging that a mechanism operator for phase 2 has yet to be appointed. Whilst we appreciate that delivery of phase 2 by April 2024 is highly unlikely, implementation must be prioritised to ensure that the changes are made as soon as possible. We stand ready to assist Ofgem in any way we can to ensure the successful delivery of phase 2 in a timely manner.

The current layering of costs onto the SC bill represents a fundamental inequity which levelisation and reconciliation must address. The increasing debt burden is a societal problem, and all customers capable of incurring debt should pay their fair share of the costs regardless of which payment method they have selected. Whilst cost reflectivity is a sensible position on which to develop a price control framework, fairness and equitability must be prioritised given the ongoing economic impacts being felt by customers and suppliers.

Not only will these policy measures provide much needed relief to SC customers and more fairly spread costs between all customers, they will ensure that efficient suppliers are able to recover their costs more effectively, utilising reconciliation to mitigate the current market distortions which the implicit levelisation of costs via the price cap has introduced.

The successful implementation of levelisation and reconciliation will therefore benefit all customers; those who are more likely to be vulnerable will see a reduction in their bill amount, suppliers who

have struggled to recover their costs effectively due to the design of the price cap and their specific customer mix will be able to provide a higher level of service than they otherwise would, and competition overall will increase as higher cost customers who have previously been marginalised from cheaper offers (and who are more likely to be vulnerable) will be able to access the benefits of a more competitive market.

We provide a response to the specific questions asked within the consultation in Appendix 1.

Appendix 1

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

1. We support the updated case for change provided within the consultation and Ofgem's primary and secondary aims in achieving the policy intent. As we outlined within our response to the previous consultation, we believe that the introduction of levelisation and reconciliation, and the intent to utilise it as a means to both mitigate the affordability concerns of prepayment (PPM) customers and more equitably share the cost of debt between payment methods is a crucial step in mitigating some of the more acute effects of the cost of living crisis and resolving some of the unintended consequences that a focus on cost reflectivity under a one-size-fits-all price cap has introduced. Importantly, levelisation and reconciliation allows the principle of cost reflectivity to be maintained in terms of the costs suppliers recover, whilst reducing the impact of that cost reflectivity on customers who are least able to afford it. Levelisation and reconciliation avoids perverse incentives that otherwise exist to reduce the quality of service or pursue more aggressive debt collection activity in an attempt to meet an artificial one-size-fits-all efficiency benchmark, which doesn't truly reflect the underlying costs of supplying different types of customer.

Q2. Do you agree with our levelisation policy aims?

2. Yes. We set out further thoughts against each policy aim below:

Customers that pay by PPM should not pay a premium

3. Whilst cost reflectivity is an important basis upon which to develop a price control framework, Ofgem is correct to determine that the costs of serving different types of customer should be more equitably distributed given the impact that energy market volatility and the ongoing cost of living crisis has had on customer affordability. As its analysis shows, PPM customers are more likely to be vulnerable than their DD counterparts, and the increased risk that self-rationing and self-disconnection poses to this customer group means that we must take all appropriate measures to reduce the cost burden in an equitable way and remove the PPM premium to ensure that PPM customers can manage their bills on a sustainable basis. However, whilst we agree that PPM customers should not pay a premium, it is essential that the underlying cost differences are reflected in the revenue suppliers recover (from customers themselves or via a reconciliation mechanism).

All customers that have the ability to build debt should contribute equally to debt-related costs

4. We completely agree that all customers who have the ability to build debt should contribute to the recovery of those costs. Placing the burden of increasing bad debt costs primarily upon

SC customers, when Ofgem has already recognised via other consultations (such as the Covid-19 true up) that it is difficult to identify the specific origin of that debt, increases the risk of non-payment and debt spiral for that customer segment.

5. SC customers, as Ofgem analysis has already shown, are more likely to be vulnerable than customers who pay by DD and are much more likely to fall behind on their bills¹. Expecting these customers, via the principle of cost reflectivity, to pay an ever-increasing share of the cost of debt further weakens their affordability and contributes to the escalating debt problem.
6. Conversely, customers who do pay their bills on time should not be penalised for the simple reason that they share the same payment method as a number of customers who don't pay. Debt costs are effectively already being levelised amongst SC customers between those who do pay their bills on time and those who don't.
7. It is worth noting that SC is the default payment method when it comes to move-ins. This process is a significant driver of debt across the industry, which increases the in-equitability when these costs are spread across all SC customers.
8. The current layering of debt costs onto the SC bills is therefore inequitable and must be remedied. The socialisation of debt costs between payment methods as a means of mitigating the acute impacts of the cost-of-living crisis and volatility within the energy market, via levelisation, will ensure that customers are protected from unnecessary financial detriment as much as possible.
9. Levelisation and reconciliation of debt-related costs will also remove the competitive distortion introduced by the price cap and ensure that suppliers with a higher proportion of SC customers are able to recover their non-efficiency costs more effectively.

The SC premium should be reduced but maintained to incentivise efficient payment methods

10. We agree that a strong incentive to switch from SC to DD should remain, however we should be mindful of not imposing excessive penalties onto SC customers and instead explore other options (such as Ofgem/Industry led media campaigning for example) to encourage customers to switch to cheaper payment methods alongside the price signal.

Levelisation should be enduring and responsive to policy changes

11. We agree. As Ofgem have acknowledged on numerous occasions, there is a need to review the current framework of price controls we currently have in place, with a view to developing a forward-looking, future proof landscape of progressive regulation that allows for innovation. Levelisation and reconciliation should complement and enhance the price cap for as long as it remains in place. Should an alternative future methodology be designed, Ofgem should review the impact that it has on levelisation and reconciliation to ensure that the measure continues to operate as intended.

There should be limited or no gap in support for PPM customers following EPG removal

¹ 'Evidence on Consumer Vulnerability' Paragraph 2.20 – 'Levelling the cost of standing charges on prepayment meters – Ofgem'

12. We agree that there should be no gap in support for PPM customers following the removal of EPG, and that the costs associated with the ASC allowance should be shared across all payment methods equitably.

The solution should be proportionate

13. We agree. Any regulatory intervention should be proportionate to the specific market issue that it attempts to remedy and minimise any unintended consequences of the intervention as much as possible. It is worth noting however that given the scale of the problem that levelisation and reconciliation seeks to address, a proportionate solution does not reduce the scale of the required intervention.

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

14. We agree with the approach Ofgem is taking to levelisation and believe the variant of Option 3 that Ofgem is proposing to proceed with is the best option to ensure that its policy aims are achieved.
15. Whilst the illustrative impact shows a modest increase to DD charges as a result, analysis (including the previous assessments conducted by Ofgem) shows that customers who choose this payment method are more able to manage the increased costs versus those who pay via SC. DD will continue to be the cheapest method of payment (behind PPM whose customers are more at risk of self-rationing and self-disconnection), providing a price incentive for customers on SC to change their method of payment.

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

16. No additional comment.

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

17. Yes, the ongoing cost of living crisis is a societal problem, and the recovery of debt-related costs should not fall solely onto an ever-decreasing pool of SVT customers (as more customers switch away onto fixed products), just because it's easier to implement via price cap allowances. Excluding uncapped contracts would create an ever-increasing premium for capped products, most likely to be paid by the energy customers least able to afford it. This issue is broader than the price cap – the levelisation of costs must include all customers, including those who switch away and would otherwise avoid contributing, to ensure an equitable share of costs between all customers.
18. Levelisation across capped and uncapped contracts is essential to ensure that costs are fairly apportioned between payment methods, and between fixed and variable tariff types. Reconciliation must then be used to ensure that suppliers only recover their efficient costs based on their specific customer mix and avoid windfall gains and losses as a function of that customer mix.
19. Levelisation and reconciliation should not require suppliers to increase their pricing unless those suppliers are using the over-recovery that the price cap allows for in certain circumstances (based on a customer mix that under-indexes on PPM/SC customers) to cross

subsidise the true cost of the contracts they are offering, or have developed a business model around only servicing customers on DD (and thus marginalising customers for whom DD is not an appropriate payment method).

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?

20. Given the complexities involved in designing regulation to address this, and the precedent it may set in regulating the un-capped tariff market, we understand why Ofgem have proposed to not introduce an SLC. That being said, Ofgem should continue to monitor the outcome of this approach and the impact that the inclusion of non-capped contracts in the reconciliation mechanism has on pricing differentials between capped and non-capped products.

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

21. We broadly support the decisions Ofgem has taken in respect to regional levelisation and the treatment of Smart PPM.
22. We agree with Ofgem that it wouldn't be appropriate to use Smart PPM costs as the efficient benchmark for all PPM customers to ensure that suppliers cannot recover "out of date" costs. This would ignore the inherent cost differences between the two meter types and the diverse range of customer mixes present across the market. It is incorrect to assume that it would drive efficiencies and increase the speed of the smart roll out; it would instead only serve to penalise suppliers on the basis of their customer mix and further harm competition.
23. Under this proposal, suppliers with a smaller proportion of traditional PPM meters would be provided with a competitive advantage; those with a higher proportion of PPM customers would see their losses increase and have to adjust their pricing strategies accordingly to ensure they remain financially viable.
24. Whilst we agree that we must incentivise customers to switch to smart, there are already regulations designed to deliver this (and penalise suppliers who fail to deliver). Removing the ability of suppliers to recover the efficient costs associated with serving PPM customers would harm the financial resilience of suppliers with a larger proportion of traditional PPM customers and provide no benefit to the roll out of Smart to customers who have yet to consent to a meter exchange, or are unable to have one due to current technical limitations. We are pleased that Ofgem have recognised this within their policy proposals.

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

25. The approach Ofgem is taking is sensible, and reconciliation is critical to ensuring that the costs which are recovered by suppliers reflect the underlying costs to serve of their respective customer base. This will ensure that no competitive distortions are introduced as a result of the policy measures. As Ofgem's analysis shows, levelisation without reconciliation will lead to the under/over recovery of costs, which would have a material impact on supplier revenues (both positive and negative).
26. The proposal to phase the implementation, by first introducing Standing Charge levelisation (and reconciliation), with the levelisation and reconciliation of debt related costs coming at a

future point will ensure that both measures receive the appropriate development time and focus.

27. We would however caution against unnecessary delay in respect of debt related costs. This policy measure is paramount to ensuring that SC customers are protected from unnecessary financial burden and we would expect Ofgem to appoint a mechanism operator and begin development once a decision has been made in respect of this consultation. If the decision is made to implement the policy proposals following the proper level of scrutiny, it should not be subject to implementation drift or further unnecessary delay to ensure that customers can benefit as soon as possible.
28. Levelisation and reconciliation has potential to mitigate several of the major flaws in the current price cap design. Standing charge levelisation is a sensible first step but, overall, is fairly limited in its impact. The real focus for Ofgem should now be on delivering full levelisation as quickly as possible, before the end of 2024 at the latest.

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

29. Yes we agree.

Q10. Do you 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?

30. Yes we agree.