

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

2 January 2024

Sent by email to: [priceprotectionpolicy@ofgem.gov.uk](mailto:priceprotectionpolicy@ofgem.gov.uk)

Dear Sabreena,

**Re: Changing standing charges for prepayment meters and debt-related costs across payment methods<sup>1</sup> - non-Confidential version**

We support prepayment meter (PPM) and direct debit (DD) tariffs being levelised and for debt related costs to be partially levelised. However, our support for any levelisation is critically dependent on an effective supplier reconciliation process being implemented as part of and at the same time as the main levelisation proposals. As Ofgem sets out, the supplier reconciliation mechanism 'is required to allow levelisation to function in a competitive market'.<sup>2</sup> Suppliers must be able to recover their efficient costs in order to finance their licensed activities and compete effectively for domestic supply contracts. Without an effective supplier reconciliation mechanism suppliers would be impacted according to their customer base, including potential substantial harm to specialist suppliers. The supplier reconciliation would also benefit consumers by avoiding an unintended impact whereby suppliers 'would have less revenue to attract and serve these consumers'.<sup>3</sup> Given these factors, the inclusion of an effective supplier reconciliation mechanism is required in order for Ofgem to meet its duties under the Domestic Gas and Electricity (Tariff Cap) Act 2018 ('the Act').<sup>4</sup>

Retail suppliers have typically looked to maintain a price differential between different payment methods to reflect the underlying costs of serving customers using those different payment methods. The price cap embedded a differential through the operating costs allowances but did not implement full cost reflectivity.<sup>5</sup> Ofgem is proposing to use levelisation to make tariffs 'more equal or equitable but less cost-reflective' thereby exacerbating the existing cross subsidy. Ofgem appears to recognise that this may lead to some consumers making less 'efficient' decisions. However, it believes this will be offset by

---

<sup>1</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#)

<sup>2</sup> Ibid, Paragraph 6.27.

<sup>3</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#), Paragraph 6.15.

<sup>4</sup> <https://www.legislation.gov.uk/ukpga/2018/21/contents>

<sup>5</sup> [Appendix 8 - Payment Method Uplift \(ofgem.gov.uk\)](#), Paragraph 2.39.

positive impacts on the disproportionately vulnerable Standard Credit and Pre-Payment meter cohorts and reductions in bad debt and working capital.

We agree that levelisation is likely to benefit these customer cohorts and note that Ofgem's latest estimate shows there are £2.9 billion of arrears across the domestic energy market (by the end of Q3 2023), an increase of £0.3 billion since Q2 2023.<sup>6</sup>

The cost-of-living crisis is still putting pressure on consumer finances, and we know that many of our customers will still struggle with their household bills this winter. British Gas has committed £100 million since the start of the crisis with the biggest voluntary support package from an energy company. British Gas Energy Support Fund provides grants of up to £1,500 for British Gas and Scottish Gas customers struggling with energy costs. Additionally, the British Gas Energy Trust continues to support all UK energy consumers with grants, advice centres and Post Office Pop Ups.<sup>1</sup> British Gas also provides further direct support itself. ~~3~~

Ofgem is right that levelisation is a 'novel intervention' and we agree that it would be prudent to monitor the effect. Ofgem should be mindful of the risk that completely levelised prices may lead to consumers making less 'efficient' decisions resulting in higher overall costs which will ultimately be borne by consumers as a whole. This could arise, for example, if the intervention under consideration incentivised customers to choose a PPM tariff because it is the cheapest even though it is not the lowest cost payment method for suppliers to provide. Similarly, there may be a risk of customers staying on or switching to a higher cost to serve Standard Credit (SC) tariff if the differential between SC and DD is eroded too much by levelisation (even at a small premium to DD, customers may still choose SC to manage cash flow requiring inefficient cross subsidy from other customers).

We suggest that:

- PPM and DD tariffs should be levelised ensuring 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 recognised by Ofgem 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.
- Debt related costs may be partially levelised. However, 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. Our view is that Ofgem should retain a tariff differential of at least £100 to avoid inefficiently incentivising customers to use higher cost payment types.

We emphasise that our support for the equalisation of payment types, as set out above, is predicated on there being an effective and appropriate supplier reconciliation mechanism in place that ensures all suppliers are not impacted financially solely because of their customer portfolio.

---

<sup>6</sup> [Energy price cap: additional debt costs review consultation | Ofgem](#), Executive Summary

A supplier reconciliation mechanism should also address the distortive impacts of a cross-subsidy that exists today between DD and SC customers. Bad debt costs are largely restricted to SC customers, yet under the current DTC methodology bad debt costs are allocated across SC and DD customers in a ratio of 68:32. The result of this cross-subsidy is that any efficient supplier with a larger proportion of SC customer will under-recover through the DTC allowance, and any efficient supplier with a higher proportion of DD customers than Ofgem's methodology assumes will over-recover.

This market distortion exists today but should be addressed by Ofgem in the forthcoming operational costs allowances review and considered in its decision on the additional debt costs review consultation.<sup>7</sup> Levelisation would then provide a mechanism for Ofgem to reduce the impact of a cost reflective cap methodology on consumers. Given these interactions and their timing Ofgem should ensure that the unit rate reconciliation is implemented as soon as possible and not later than April 2024.

We respond to each of the consultation questions in the Annex to this response.

Yours sincerely,

Alun Rees

**Head of Wholesale and Retail Market Design and Policy**

---

<sup>7</sup> [Energy price cap: additional debt costs review consultation | Ofgem](#)

## Appendix – responses to consultation questions

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

Ofgem has set out that its proposals on levelisation relate primarily to the ‘Fair Prices’ factor of its Consumer Interests Framework. Ofgem’s description of ‘Fair Prices’ is that:

‘Costs are efficient and fairly distributed. Undue price discrimination is prevented and action to minimise consumer welfare risks (e.g. fuel poverty and self-disconnection) is supported.’<sup>8</sup>

Whilst this description clearly includes both a cost efficiency and a protection of consumer welfare objective Ofgem now recognises that it may need to trade off these objectives:

‘We now consider that it may be in customers’ interests to move away from this consumer impacting cost-reflectivity as it may be producing negative outcomes for some consumers.’<sup>9</sup>

By ‘consumer impacting cost-reflectivity’ we take Ofgem to mean that it may, through levelisation, remove some elements of cost reflective pricing. Ofgem appears to recognise that this may lead to some consumers making less ‘efficient’ decisions. For example, choosing a Pre-Payment Meter (PPM) tariff because it is the cheapest whereas it is not the lowest cost payment method for suppliers to provide. Or staying on a Standard Credit (SC) tariff because of reduced incentives to pay by Direct Debit (DD).

However, 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 recognised 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.

On levelising debt related costs across all consumers, we recognise the findings of Ofgem’s research that some SC customers are under financial stress and that affordability issues affect 48% of households paying by standard credit. Reducing the allocation of debt related costs that SC customers pay would reduce costs for those SC customers under financial stress. However, those customers may also make savings by switching to cheaper payment types and this would lead to lower industry wide costs, especially if they switch to DD tariffs.

On the other hand, we recognise that debt is growing industry wide, with current energy debt and arrears over £2.6bn.<sup>10</sup> Levelisation will provide a mechanism for Ofgem to reduce the impact of increases in debt related costs on customer groups whilst ensuring that suppliers are able to recover the costs that they incur.

Whilst we consider some reductions in ‘consumer impacting cost-reflectivity’ may be appropriate, it is critical that Ofgem is clear this will only be possible if it can implement a

---

<sup>8</sup> [Forward Work Programme 2023-24 \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/publications/forward-work-programme-2023-24)

<sup>9</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#), Paragraph 2.4.

<sup>10</sup> [Additional debt-related costs allowance policy consultation | Ofgem](#), Executive Summary

supplier reconciliation process concurrently as part of the same modifications which will allow suppliers to continue to recover their efficient costs.

Ofgem's analysis of supplier impacts shows that without a supplier reconciliation process a supplier with predominantly standard credit customers would be faced with a 2.1% fall in revenue because of Option 3.<sup>11</sup> Using Ofgem's example this would mean that a supplier with 1 million customers would face a £42m reduction in revenue; this is clearly a potentially material impact.<sup>12</sup> On the other hand, a supplier with predominantly direct debt customers would see an increase in revenue of £7.2m on the same basis.<sup>13</sup>

Because of these differential supplier impacts the levelisation rules cannot not work – and Ofgem cannot meet its statutory duties – without an effective reconciliation mechanism being included as part and parcel of the proposals. The price cap is intended to allow suppliers to recover the costs of a notionally efficient supplier including a specific mechanism to account for differences in the payment method mix of a suppliers' customers. Levelisation on its own prevents recovery of the costs of a notionally efficient supplier in the way that the price cap intends; it does this by setting the cap at a non-cost-reflective level. The reconciliation remedies this by netting out gains and losses made by individual suppliers as a result of levelisation; so that suppliers recover their costs (and are thereby able to finance their licensed activities) in the way that the price cap intends.

Given the potential scale of impact on supplier revenue Ofgem should also consider that the levelisation rules would not work without the reconciliation because of their potential impact on competition. Levelisation would result in the cap being set too low for some suppliers and too high for others. This would prevent some suppliers from competing effectively for domestic supply contracts i.e. levelisation would constrain their ability to price below the cap. Meanwhile, those suppliers for whom the cap was set too high would face limited competitive constraints from the constrained suppliers.

In addition to the impact on suppliers, levelising prices without a supplier reconciliation would create wider issues for consumers by preventing suppliers from recovering efficient costs when serving PPM and Standard Credit customers. This is recognised by Ofgem who set out that the reconciliation is appropriate 'particularly due to the impact on payment method specialist suppliers.' Also noting that without a reconciliation these suppliers 'would have less revenue to attract and serve these consumers'.<sup>14</sup> However, we consider that these same arguments apply to all suppliers who serve affected customers and require sufficient revenue to serve them.

An effective supplier reconciliation mechanism should also address the distortive impacts of a cross-subsidy that exists today between DD and SC customers. Bad debt costs are largely restricted to SC customers, yet under the current DTC methodology the bad debt cost that is largely attributed to SC customers is allocated across SC and DD customers in a ratio of 68:32. The result of this cross-subsidy is that any efficient supplier with a larger proportion of SC customers will under-recover through the DTC allowance, and any efficient supplier with largely DD customers will over-recover.

---

<sup>11</sup> A supplier reconciliation process a supplier with predominantly PPM customers would be faced with a 2.5% fall in revenue.

<sup>12</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#), Table 3A.17.

<sup>13</sup> Ibid

<sup>14</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#), Paragraph 6.15.

This market distortion exists today but could be addressed by Ofgem in the forthcoming operational costs allowances review and considered in its decision on the additional debt costs review consultation.<sup>15</sup> Levelisation would then provide a mechanism for Ofgem to reduce the impact of a cost reflective cap methodology on consumers.

As such, it is evident that levelisation and the reconciliation mechanism are inextricably linked to one another. Levelisation would not work without an effective reconciliation mechanism and the reconciliation mechanism is unnecessary in the absence of levelisation. Because of this close linkage it is essential that levelisation and the reconciliation mechanism are implemented simultaneously and together as part of the same set of modifications.

## 2. Do you agree with our levelisation policy aims?

We agree with Ofgem's policy aims with the exception of:

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

Allocation of debt related costs should retain an element of cost reflectivity to ensure that customers face the right incentives to choose an appropriate payment method.

Ofgem should also include a requirement for an effective supplier reconciliation as a policy aim; this is a cornerstone of its levelisation policy.

### Levelisation policy aims

The primary policy aims that Ofgem has set out are:

- *'Customers that pay by PPM should not pay a premium.*
- *All customers that have the ability to build debt should contribute equally to debt-related costs.'*<sup>16</sup>

We first would note that it is important that Ofgem places these policy aims within the context of the proposed supplier reconciliation. The levelisation rules would not work without the inclusion of an effective reconciliation mechanism and that that linkage is so strong that without the reconciliation mechanism, levelisation should not be implemented. We set out the reasons for this in response to question 1 above. Ofgem should therefore consider an effective supplier reconciliation method as a primary policy aim. As Ofgem notes this process will ensure 'supplier stability and market diversity is maintained from the implementation of levelisation'<sup>17</sup>.

Given this context, we agree with the first aim. 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 or because they are in rented accommodation and have

---

<sup>15</sup> [Energy price cap: additional debt costs review consultation | Ofgem](#)

<sup>16</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#), Paragraph 2.24.

<sup>17</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#), Paragraph 6.16.



inherited a prepayment meter from previous tenants regardless of their own financial circumstances.

The second aim appears arbitrary and ignores important differences between DD and SC tariffs. It also contradicts Ofgem's secondary aim that 'the SC premium should be reduced but maintained to incentivise efficient payment methods.' Given this is a 'primary policy aim' we would expect Ofgem to explain it more clearly.

In doing so Ofgem should acknowledge that DD and SC customers do not have an equal ability to build up debt. DD is a prompt payment method with billing typically on a monthly cycle. ☹

SC allows customers to pay in arrears on receipt of their bill. ☹

Ofgem should also acknowledge that the current price cap means that both DD and SC customers already contribute to debt related administration and bad debt costs<sup>18</sup>. This cost sharing approach was set out in Ofgem's 2018 decision and equated to an SC premium of £75 which equated to approximately 32% of debt related administration and bad debt costs being allocated to DD customers.<sup>19</sup> This policy aim therefore appears to go further than the original cap approach by indicating that all debt related costs, including working capital, should be shared equally among credit customers. This cannot be justified in terms of cost reflectivity and it is not clear what the justification is.

We propose that Ofgem's primary policy aim should be to retain an element of cost reflectivity to ensure that customers face the right incentives to choose an appropriate payment method. Subject to this Ofgem may set out its secondary aims in terms of the benefits of levelisation of debt related costs that it has identified in its impact assessment.<sup>20</sup>

### 3. Do you agree with our proposed approach to levelisation?

We agree that PPM and DD tariffs should be levelised and that debt related costs should be partially levelised. But this is critically dependent on an effective supplier reconciliation mechanism being implemented, as set out above.

#### Standing charge levelisation

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.

However, our view is that 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. Equalising both standing charges and unit rates would make consumers' choices simpler and be socially progressive. Ofgem's Option 3 leads to PPM tariffs being below DD tariffs

---

<sup>18</sup> Working capital costs are allocated directly to SC customers.

<sup>19</sup> [Appendix 8 - Payment Method Uplift \(ofgem.gov.uk\)](#), Paragraphs 2.39 onwards.

<sup>20</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#), Table 3A.1.

whereas historically PPM customers have paid a premium.<sup>21</sup> Ofgem has set out that it does 'not foresee a material increase in switching'.<sup>22</sup> However, an increase in switching could undermine the benefits of levelisation if consumers choose a Pre-Payment Meter (PPM) tariff because it is the cheapest whereas it is not the lowest cost payment method for suppliers to provide. Ofgem also rightly identifies the risk in 'financially incentivising PPM as the payment method may not suit all consumers'.<sup>23</sup>

If Ofgem does not equalise PPM and DD standing charges and unit rates as we recommend and PPM becomes cheaper than DD, Ofgem should closely monitor switching between payment types post levelisation. Should it identify unintended consequences of levelisation it should include levelisation of the unit rate for DD and PPM in the subsequent consultation on unit rate levelisation implementation. Levelisation of both unit rates and standing charges for PPM and DD tariffs would 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.

### Unit rate levelisation

We agree that debt related costs should be partially levelised and that this should be implemented in a second phase with a further consultation on implementation.

Partial levelisation means that 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.

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 to £62 may reduce the current incentive for customers to move away from SC.

Ofgem's view appears to be that DD and SC tariffs are not close substitutes:

'The fact that a price differential of 7% exists and has been maintained between payment methods, may be an indicator of a lack of substitutability between payment methods and suggest consumers do not view the products as close substitutes.'<sup>24</sup>

As Ofgem is aware the current payment type differential is set by the DTC. In order to understand whether this differential is indicative of a lack of substitution between payment types Ofgem would need to consider evidence on consumer switching behaviour. Even if Ofgem were correct and DD and SC have not been close substitutes historically, it remains the case that a customer considering switching to a DD tariff will be further incentivised by a significant tariff differential. Reducing the differential to £62 would reduce the differential to

---

<sup>21</sup> [Retail market indicators | Ofgem](#)

<sup>22</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#), Paragraph 3.21.

<sup>23</sup> Ibid, Paragraph 3.20.

<sup>24</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#), Paragraph 3A.72.



3% (as a percentage of the period 11b SC price cap). Ofgem should consider that even at a small premium to DD, customers may still choose SC to manage cash flow. Such a significant decrease clearly has the potential to affect customers' tariff choices and our view is that Ofgem should retain a tariff differential of at least £100.

As in the case of the PPM-DD differential, Ofgem should keep this under review by monitoring switching between payment types post levelisation.

#### Administration costs

Ofgem estimates supplier costs of £0.4m for implementation of the standing charge reconciliation and £1.6m for implementation of the unit rate reconciliation. Ofgem also estimates costs that will be incurred by the industry body and by itself.

Ofgem does 'not propose any adjustments to existing price cap allowances for administration costs. However, any variance to this should be covered by existing uncertainty allowances under the price cap'.<sup>25</sup>

We fundamentally disagree that uncertainty allowances should cover any variance in costs arising from these requirements. Ofgem is currently reviewing the operating costs allowances and should consider any increase in elements of these allowances as part of that review.

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

Ofgem propose to introduce levelisation and the reconciliation mechanism via an amendment to SLC 28AD. We emphasise that our support for the equalisation of payment types, as set out above, is predicated on there being an effective supplier reconciliation mechanism in place that ensures all suppliers are not impacted financially solely because of their customer portfolio. Given this we agree that Ofgem should include both these requirements in SLC 28AD.<sup>26</sup>

It is also important to note that proposed SLC 28AD.14A (which implements levelisation and proposed SLC 28AD.32A (which implements the reconciliation mechanism) are extremely closely linked. They are linked because the levelisation requirements would not make sense without the reconciliation mechanism. This linkage is so strong that the proposed licence conditions are interdependent by which we mean that SLC 28AD.32A would not work without SLC 28AD.14A. We set out the reasons for this linkage in our response to question 1 above.

#### Proposed amendments to SLC 28AD.16 (a)

Proposed amendments to licence condition 28AD.16(a) mean that Ofgem may amend Annex 9 where a 'significant and unanticipated change of circumstances' mean that it 'no longer reflects an efficient level' of the Levelisation Allowance.<sup>27</sup>

---

<sup>25</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#), Paragraph 3.66.

<sup>26</sup> Ofgem rightly says that the modification relating to reconciliation is consequential to its decision on levelisation (and, to be clear, we take that to include the possibility that it is also incidental or supplemental within the meaning of section 1(5) of the Act).

<sup>27</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#)

We support a review clause for the levelisation allowance and have set out above that Ofgem should monitor any unintended consequences of levelisation including the impact on switching between tariff types. However, the wording of this licence condition does not provide clear guidance as to the circumstances under which the levelisation allowance would be reviewed, given that the allowance itself is not set at an efficient, by which we read cost reflective, level. Ofgem should remedy this.

#### Proposed SLC 28AD.14B

As a general principle, Ofgem should exercise its powers in a fair and lawful manner, including properly consulting stakeholders who are impacted. The consultation states that this condition will be used in *exceptional circumstances* where there is *evidence that it is within consumers' interests*.<sup>28</sup> As in the case of proposed amendments to SLC 28AD this wording does not provide clear guidance as to the circumstances under the licence condition would be used. Ofgem should remedy this.

This point is exacerbated by the fact that there is no guarantee of a consultation. Indeed, the proposed drafting simply gives Ofgem the ability to set the levelisation amount to zero by publishing a statement. Setting the levelisation allowance to zero still requires an adjustment to Annex 9 and should therefore also be subject to a comparable procedure.

Levelisation impacts both consumers – who pay levelised prices – and suppliers who must participate in the reconciliation mechanism. This means that setting the levelisation amount to zero would also impact consumers and suppliers particularly if implemented without sufficient notice. This alone should be a reason for a guaranteed consultation set out in the licence; we ask Ofgem to implement this.

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

Yes, we support a supplier reconciliation mechanism that is effective across all tariffs – not just those under the DTC.

#### 6. 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?

We agree that Ofgem should balance any compliance process which would allow it to ensure that suppliers implement levelisation in a consistent way against the burden of compliance. We also note Ofgem's reference to existing licence condition 27A and welcome the clarification that to be compliant with SLC 27A, suppliers are already required to reflect reconciliation costs and benefits in their tariff pricing.

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

#### Other considerations

---

<sup>28</sup> Ibid, Paragraph 3.68.

Licence condition 28AD.40 - which sets out the definitions for condition 28AD - currently implements a requirement for suppliers to treat Relevant 28AD Warm Home Discount Customer as though their payment method is Direct Debit.

This requirement dates to the implementation of the default tariff cap (DTC) when customers on the existing safeguard tariff fell within the scope of the DTC. The licence applied the DTC to those customers at DD rates, regardless of whether they paid by DD or SC. The aim was to protect a subset of SC customers 'from an appreciable change in the level of protection they receive'.<sup>29</sup>

Especially now that levelisation is being implemented, we no longer believe that it is appropriate for a subset of customers in receipt of the Warm Home Discount and who pay by Standard Credit to pay DD rates when others pay by SC rates. This extra discount creates an artificial barrier to customer switching. It would be simpler and fairer for customers to only have levelisation and reconciliation without this extra discount and complication. The cost of providing this extra discount also falls disproportionately on suppliers with more eligible customers, thereby distorting competition. ⚡

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

A supplier reconciliation is critical and must be in place from the implementation of the levelisation allowance as discussed in our response to question 1.

#### Standing charge reconciliation

Ofgem should consider an effective supplier reconciliation method as a primary policy aim. As Ofgem notes this process will ensure 'supplier stability and market diversity is maintained from the implementation of levelisation'<sup>30</sup>.

We agree that the standing charge reconciliation should be in place by 1<sup>st</sup> April 2024. However, Ofgem should consider the impact of a delay to implementation of the reconciliation. It is essential that any such delays are avoided (or, that if they do occur, it will be critical that any such a delay does not have an impact on supplier payments and receipts).

⚡

#### Unit rate reconciliation timetable

We agree with the phasing that Ofgem suggests for the reconciliation processes. Delivery of the unit rate reconciliation by October 2024 is reasonable. The unit rate reconciliation is needed not only to facilitate levelisation of debt related costs but because it interacts with other work areas and specifically the Additional debt costs review.<sup>31</sup> In the absence of unit rate levelisation Ofgem is proposing to allocate additional debt costs, incurred in cap periods 8 – 11, equally among credit customers; whilst acknowledging that it may consider an alternative allocation at the true up stage when unit rate levelisation is implemented.

---

<sup>29</sup> [Default Tariff Cap - Overview Document \(ofgem.gov.uk\)](#), Page 9.

<sup>30</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#), Paragraph 6.16.

<sup>31</sup> [Energy price cap: additional debt costs review consultation | Ofgem](#)

Ofgem rightly recognises that its proposed allocation will impact suppliers depending on their customer base. Specifically, they estimate that proposed equal allocation to credit customers will increase suppliers EBIT in a range of 0.1 – 0.8% during April 2024 to March 2025. Whereas an allocation consistent with the price cap methodology would increase EBIT by 0.2 – 0.6% during the same period. Finally, an allocation based on reported costs would lead to a range of -0.2% and 2% during the same period.<sup>32</sup>

This analysis indicates a significant range of outcomes for individual suppliers. Furthermore, Ofgem notes that it ‘did not take into account variations between any individual supplier's own costs and notionally efficient costs’ in carrying out its analysis. This is a partial view at best and, even without accounting for variation in suppliers own costs, is consistent with Ofgem’s own view that:

*‘Those with a higher-than-average proportion of customers on standard credit (or PPM) may under-recover their costs and those with higher-than-average proportion on direct debit may over-recover.’<sup>33</sup>*

Given these significant supplier impacts we urge Ofgem to ensure that levelisation of debt related costs supported by a cross supplier reconciliation is implemented as soon as possible and not later than April 2024.

#### Unit rate reconciliation design

We note that Ofgem considers further industry design is required but we do not agree with Ofgem’s position to favour an estimated consumption solution and we are concerned that this approach would not be sufficiently accurate. Debt related costs scale with consumption, for example in the event of colder weather, consumption will increase which will in turn drive an increase in customer bills and levels of debt. Therefore, any underestimate of consumption would lead to costs being excluded from the reconciliation or overstated if volumes are higher than expected, which would lead to supplier detriment or gain. Ofgem needs to understand the extent of this detriment or gain and should include this in its modelling of supplier impacts in the proposed consultation on unit rate levelisation implementation.

---

<sup>32</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#), Paragraph 7.28.

<sup>33</sup> [Changes to prepayment meter standing charges and other debt costs | Ofgem](#), Paragraph 7.28.