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2 January 2024

Dear Sabreena

Changing standing charges for prepayment meters and debt related costs across payment methods

EDF is the UK's largest producer of low carbon electricity. EDF operates low carbon nuclear power stations and is building the first of a new generation of nuclear plants. EDF also has a large and growing portfolio of renewables, including onshore, offshore wind and solar generation, and energy storage. With around six million electricity and gas customer accounts, including residential and business users, EDF aims to help Britain achieve net zero by building a smarter energy future that will support delivery of net zero carbon emissions, including through digital innovations and new customer offerings that encourage the transition to low carbon electric transport and heating.

EDF agrees that there has been a case for examining the options for eliminating or reducing the differentials between certain payment methods. However, as Ofgem's analysis has identified, the amount by which costs can be reduced for customers through levelisation is proportionally very small (less than £1 a week). Based on this fact, Ofgem's levelisation policy must be a proportional and simple response to the benefits levelisation can deliver in terms of appropriate pricing for domestic customers.

We are concerned that since the original consultation Ofgem is beginning to consider levelisation as a means to tackle wider affordability concerns within the domestic market, something it is ill-suited to address. As noted above, levelisation can only lower energy costs by an insignificant amount in proportion to customers' total bills. Therefore, we do not agree that it will genuinely help customers who are struggling to pay their bills. Affordability can only be genuinely tackled through wider government initiatives, including the introduction a meaningful, government funded social tariff, and providing additional targeted support to customers that need it most.

With this in mind, we urge Ofgem to consider the below when implementing any final levelisation policy:

- **Customers that pay by prepayment should not pay a premium:** EDF supports levelising prepayment and direct debit standing charge costs (option 2). Option 2 is a simple and proportional response that will ensure that prepayment customers do not return to paying

more than Direct Debit customers following the end of the Energy Price Guarantee (EPG) in April.

- **Volumetric levelisation and reconciliation is not proportional:** EDF strongly opposes option 3. As demonstrated by the EPG, volumetric levelisation creates significant operational difficulty for suppliers. Given the known complexities, Ofgem's case for volumetric levelisation is significantly overstated in the case of standard credit. The costs are clear, but the benefits are either minimal or highly speculative. Ofgem's justification for unit rate levelisation can only be proportional if reconciliation is based on estimated consumption. However, as this would not be accurate, suppliers could carry significant financial risk, or gain financially, if the estimated consumption figure were too high or too low. Both outcomes are unacceptable for suppliers as they defeat the object of a reconciliation mechanism, which intends to ensure there are no winners or losers from this new policy.
- **Non-prepayment customers must not pay a premium:** Ofgem has not fully considered the implications of unit rate levelisation for customers on direct debit, particularly high energy users where, in absolute terms, most vulnerable customers sit. Ofgem assumes that customers on direct debit could choose to switch to prepayment to achieve a lower cost. However, this is not an option if a prepayment meter is not safe and reasonably practicable for that customer. For example, if a customer relies on a continuous supply of electricity to power medical equipment, or has a mental health condition that means they could not safely operate a prepayment meter. Ofgem must assess the risk to the most vulnerable customers on direct debit if they do not have access to the cheapest payment method to ensure any implementation achieves the intended impact without customer detriment.
- **Smart prepayment should be the cheapest payment method:** It is disappointing that the proposals do not aim to incentivise smart prepayment, given the superior experience that it will bring to customers. While the Default Tariff Cap (DTC) OPEX cost review is ongoing (which we understand will examine the case for whether smart prepayment should be a separate payment method under the DTC), Ofgem should take the opportunity to use levelisation to support the smart meter roll-out and encourage customers paying by legacy prepayment meters to upgrade to smart prepayment.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Nicola Pope, or myself.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely



Keith Watson

Senior Manager Customers Policy and Regulation

Attachment

Changing standing charges for prepayment meters and debt related costs across payment methods

EDF's response to your questions

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

We accept that proportionally there is higher financial vulnerability among prepayment customers and those on standard credit when compared to direct debit customers. We agree that levelisation will provide some support for customers, particularly low users on prepayment meters, and the solution put forward by Ofgem to levelise prepayment and direct debit standing charges is a simple and proportional response that will ensure that prepayment customers do not pay a premium (option 2).

EDF strongly opposes option 3. Given the complexities of unit rate levelisation, Ofgem's case for levelisation of bad debt is significantly overstated in the case of standard credit. The direct benefit to standard credit customers is very small (less than a £1 a week), therefore we do not agree that it will genuinely help customers who are struggling to pay their bills. The wider benefits regarding debt reduction set out in the Impact Assessment are also highly speculative, and there is no guarantee that customers would put a proportional amount of the monies saved from levelisation toward their energy bill (especially as they may choose to prioritise other bills). The reduction in working capital, which is based on assumptions about debt reductions (among others), is also highly assumptive, and it is unlikely that reductions in working capital would almost exactly match the administrative costs of the scheme. Conversely, a reduced incentive to switch to direct debit could also lead to an increase in debt overall as more customers remain on or move to an unsecured payment method.

Significantly, Ofgem's case for unit rate levelisation has not considered the detrimental impact to customers on direct debit sufficiently where, in absolute terms, most vulnerable customers sit. While we recognise that levelisation will reduce costs for standard credit customers more than it will increase costs for direct debit customers, this is based on average consumption only – the risk to higher using customers must also be analysed in more depth.

Ofgem assumes that customers on direct debit could choose to switch to prepayment to achieve a lower cost. However, this is not an option if a prepayment meter is not safe and reasonably practicable for that customer. Under the Supply Licence (SLC28), suppliers must not install a prepayment meter if it would not be safe for the customer. This excludes prepayment as an option for some of the most vulnerable customers, many of which could be high users of energy, for example if they rely on a continuous supply of electricity due to medical equipment, have a chronic health condition that would be exacerbated should there be a loss of supply, or have a mental health or other condition that could mean they are unable to operate a prepayment meter. Ofgem must therefore also assess the risk to the most vulnerable customers on direct debit from unit rate levelisation if they no longer have access to the cheapest payment method.

Ultimately, however, Ofgem appears to be seeking to tackle the affordability challenge currently facing the domestic market through its levelisation policy, for which it is ill-suited. Affordability cannot be tackled through levelisation as financial vulnerability exists across all payment methods, levelisation can also only lower energy costs by a proportionally insignificant amount when compared to customers' total bills. Affordability must be tackled through wider government initiative's including the introduction a meaningful, government funded social tariff, and providing additional targeted support to customers that need it most.

Q2. Do you agree with our levelisation policy aims?

We support many of the policy aims set out in the consultation document. However, we would provide comments on the below:

Customers that pay by prepayment should not pay a premium: We agree. However, it is disappointing that the proposals do not look to differentiate smart and legacy prepayment in the longer term. The switch to smart prepayment should be incentivised given the superior experience that it brings to customers. While the DTC OPEX cost review is ongoing, Ofgem should take the opportunity to use levelisation to support the smart meter roll-out and encourage customers paying by legacy prepayment meters to upgrade to smart prepayment.

All customers that have the ability to build debt should contribute equally to debt-related costs: We agree that customers who have the ability to build debt should contribute debt related costs. However, we do not agree that it is in turn clear that customers should contribute to debt related costs equally, where they do not contribute to that debt equally. For example, the debt propensity for customers on secured payment methods, such as direct debit, is less than for those on unsecured methods like standard credit.

As set out in our response to question 1, it is vital Ofgem also consider the detrimental impact of the levelisation of debt related costs to customers on direct debit. Especially given, in absolute terms, most vulnerable customers pay by Direct Debit. Furthermore, Ofgem must guard against unintentionally disincentivising customers from moving to secured payment methods like Direct Debit. We note that such disincentives could also lead to an increase in debt overall as more customers remain on or move to an unsecured payment method.

The solution should be proportionate: We agree. However, as set out in our response to question 3, unit rate levelisation is not proportional to the benefits to consumers. Ofgem's own justification for unit rate levelisation is that it is only proportional if reconciliation is based on estimated consumption. However, using estimated consumption would not be accurate, as estimates are a) subject to potentially different methodologies across suppliers and b) differ from outturn consumption. Suppliers would, as a result, end up carrying significant financial risk, or gaining financially, if the estimated consumption figure were too high or too low. Both outcomes are unacceptable for suppliers as they defeat the object of a reconciliation mechanism, which intends to ensure there are no winners or losers from this new policy.

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

We support Ofgem's proposal to levelise prepayment and direct debit standing charges. This is a simple and proportional response within the current construct of the Default Tariff Cap that will ensure that prepayment customers do not pay a premium (option 2).

We strongly oppose levelisation of unit rates (option 3) as this approach would introduce significant additional complexity that is not proportional to the limited benefit provided to the consumer. The complexities of unit rate levelisation are clear, based on the development of various government schemes that supported customers through the energy crisis, such as the EPG, which has created significant ongoing operational difficulty as it required a specific bespoke calculation for every customer based on their usage.

It would also be much more difficult to apply effectively through the Default Tariff Cap, especially for customers supplied on a multi-rate tariff as consumption would have to be apportioned accurately between different unit rates.

Unit rate levelisation is particularly concerning from a reconciliation perspective, especially as, unlike EPG, it is likely to be for limited sums of money on a per customer basis. Ofgem indicates it prefers reconciliation based on estimated consumption. However, as set out in Q2, using estimated consumption would not be accurate and consumption figures can change materially between estimated and actual billing. Additionally, the approach taken to estimate consumption will likely vary between suppliers.

Suppliers could carry significant financial risk, or may gain financially, if the estimated consumption were too high or too low and may under or over recover costs. For example, if a supplier had more prepayment customers than direct debit customers, and the estimated consumption was too low, they would under-recover from the reconciliation mechanism, or over-recover if the estimated consumption were too high. This could potentially defeat the object of a reconciliation mechanism, which must ensure that suppliers do not lose or gain financially from levelisation. As a matter of first principles, suppliers should not be expected to charge less than their costs if they cannot have certainty that they will eventually be recouped.

The alternative would be to use actual consumption. However, this would make the levelisation process a very protracted, complex, and more expensive process, particularly as the settlement period is 14 months, and as demonstrated by the EPG, suppliers would have to provide data and potentially payments to the reconciliation mechanism operator several times over before a final accurate financial position is reached. This is unlikely to be proportionate at this time.

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

Supply Licence condition 28AD – proposed changes in red

Draft Supply Licence	EDF comment
<p><i>L i, j, k, l, p, means the Levelisation Allowance in Charge Restriction Region i, in 28AD Charge Restriction Period j, at Benchmark Annual Consumption Level k, for Benchmark Metering Arrangement l, for Payment Method p calculated in accordance with paragraph 28AD.14A.</i></p>	<p>The formula must be updated to include (i) for Charge Restriction Region (to reflect the description and Ofgem’s policy intent to maintain regional differential in prices).</p>
<p>28AD.14B If the Authority has published a statement in writing (following consultation) to terminate or suspend the Levelisation Policy, the value of the Levelisation Allowance is zero.</p>	<p>In line with the intent set out in the policy, the Supply Licence wording should be updated so that it is explicit that Ofgem will not terminate or suspend the Levelisation Policy without appropriate consultation with suppliers.</p>
<p>28AD.39A The licensee must ensure that it participates in and complies with the terms of the Levelisation Reconciliation Mechanism, including: (b) Pays into the Reconciliation Mechanism any Levelisation Charges notified to it by the Reconciliation Operator in a timely and accurate manner</p>	<p>It should be explicit that payment must be submitted to the Reconciliation Mechanism Operator in a timely and accurate manner, as well as data.</p>
<p>28AD.39B The Authority may issue, from time to time, guidance for the purposes of paragraphs 28AD.14A and 28AD.39A (following consultation)</p>	<p>Ofgem must not change supplier obligations without following full and proper due process. Therefore, the Supply Licence wording should be updated to require Ofgem to consult before providing or amending any guidance on the Levelisation Policy.</p>
<p>‘Verified Data’ means data requested by the Authority or Reconciliation Operator for the purposes of levelisation and reconciliation which is accompanied by a statement from a named Statutory Director or authorised company officer confirming that they have taken all reasonable steps to satisfy themselves that the return is a true and accurate reflection of the data held by the licensee at the time the data is submitted used for its customer billing purposes.</p>	<p>The Supply Licence wording must be updated so that it is clear that data could be requested by the Reconciliation Operator, as well as the Authority.</p> <p>Verified Data can only be ‘true and accurate’ for a particular point in time. The definition of Verified Data should be qualified in the licence to make it clearer that data must be true and accurate at <i>‘the time the data is submitted’</i>, this is particularly important for unit rate levelisation, as the data submitted at a point in time for customer billing purposes may change in the future, for example if estimates are replaced by actual reads, up to the point of settlement.</p>

Annex 9

The Customer Accounts and Tariff RFI will be used to identify the proportions of customers on each payment method for the price cap calculation. However, as Ofgem will be counting all customer accounts and not just accounts supplied under the Default Tariff Cap to establish the proportion of customers on each payment method, there is a risk this could be inaccurate if the breakdown of customers by payment type is different in the fixed market. This could occur if competitive pressures do not act as expected and suppliers do not levelise their fixed contract prepayment and direct debit standing charges. Ofgem should therefore also use the Customer Accounts and Tariff RFI to monitor the pricing of standing charges for prepayment and direct debit fixed contracts to ensure that it is as expected (and indeed to ensure that suppliers are not gaining from the reconciliation mechanism).

Due to the potential impact on supplier forecasting Ofgem should notify suppliers of the breakdown of customer accounts by payment type prior to the Default Tariff Cap announcements, and not on the day itself.

We recognise, particularly if there were to be unit rate levelisation, that a new Annex 9 is likely to be required. However, calculations for the Default Tariff Cap are becoming increasingly complex. Ofgem should use the levelisation policy as an opportunity to rationalise existing annexes where the data is no longer relevant. Rates for previous price cap periods are established with published agreed prices, so information such as transitional and seasonal logic that would previously have been required for calculations, can be removed as it is superfluous, and adds complexity for suppliers.

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

We agree that uncapped contract numbers should be included in the reconciliation mechanism to ensure that fixed prepayment and standard credit prices can remain competitive. It will also help ensure that the costs from levelisation are not borne disproportionately by unengaged direct debit customers supplied under the DTC.

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. We support the case put forward by Ofgem that competitive pressures will ensure suppliers reflect the levelised costs in their fixed tariffs. However, Ofgem should monitor fixed contract rates using the Customer Accounts and Tariff RFI to ensure that this is the case.

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

Yes. It is disappointing that the proposals have not been used as an opportunity to incentivise smart prepayment in the longer term. From a cost perspective, smart prepayment meters, once delivered at scale, should have the lowest cost-to-serve. Alternative smart prepayment top-up mechanisms will, for example, enable the withdrawal of the costly legacy prepayment infrastructure in the longer term.

Smart meter technology has allowed suppliers to innovate and offer a superior customer experience. This includes, more convenient ways to pay, real-time monitoring of when customers cease making payments, and greater visibility for customers on their consumption and costs, all of which helps us provide more proactive support to customers facing payment difficulty. Smart meters also support wider net zero ambitions by providing the tools for consumers to understand when and how they are using energy to become more energy efficient. This is why when installing a prepayment meter, we are committed to installing smart prepayment meters wherever possible.

While we recognise that there is a wider DTC OPEX cost review that is ongoing, Ofgem should in the interim use levelisation to support the smart meter roll-out and encourage customers paying by legacy prepayment meters to upgrade to smart prepayment.

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

We agree that if there is a levelisation of payment methods, there must also be a reconciliation mechanism to ensure that suppliers do not lose or gain from levelisation based on the breakdown of their customers by payment type. We support the approach for non-volumetric reconciliation and will engage with the RECCo as required to ensure that there is a workable solution in place from April next year.

We do not agree with the proposals for unit rate levelisation. However, if unit rates were to be levelized, there must also be a reconciliation mechanism. As set out in our response to question 3, this should be based on actual consumption. It would not be feasible to introduce a unit rate reconciliation mechanism by April 2024, and, as the consultation acknowledges, many issues still need to be discussed and consulted upon regards levelisation itself before we will reach a point when it is feasible to design the reconciliation mechanism. A start date after October 2024 is therefore more realistic.

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

Yes, we agree for Option 2, as suppliers would not have accounted for levelisation when pricing these contracts, including them in the levelisation proposal could result in losses that suppliers are unable to recoup. However, we note that for Option 3, or any volumetric option, this would create another source of complexity as billing periods will potentially cover both old and new contracts.

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?

We welcome Ofgem's proposal that data submitted to the reconciliation mechanism can be verified by a named company director or other authorised person and will not require independent auditing - this is a proportionate response, which will also reduce supplier cost.

EDF
January 2024