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Sabreena Juneja, Head of Price Cap Policy
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By email only

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Dear Sabreena,

OVO response to Ofgem's Statutory Consultation on Changing standing charges for prepayment meters and debt-related costs across payment methods

Thank you for the opportunity to respond to this Statutory Consultation. We are broadly supportive of the proposals and approach set out. Given the clear overlap with the reviews of debt-related costs, both through the Operating Cost Review and the Additional Debt Costs Review, we urge Ofgem to expedite the delivery of Phase 2. This would allow the bad debt allowance for Standard Credit customers to be set at a level that enables suppliers to recover the costs associated with that cohort of customers. Levelisation will mitigate the impact of increased cost-reflectivity on customer bills, whilst the reconciliation mechanism will make suppliers whole against a more cost-reflective underlying price cap, thereby addressing the current allocation of costs that discriminates against suppliers with higher proportions of customers who pay by Standard Credit.

Levelisation of debt-related costs across Direct Debit and Standard Credit customers must be delivered in tandem with addressing the distortion caused by the current, and historical, allocation of debt-related costs in the price cap. Under the current price cap mechanism, some of the bad debt costs associated with Standard Credit customers are subsidised by Direct Debit customers. As a result, the allowance for Standard Credit customers is lower than a reasonable expectation of the bad debt costs incurred by that cohort.

The price cap methodology therefore clearly excessively rewards suppliers with higher proportions of Direct Debit customers, therefore creating an incentive to limit the payment options available to customers. As Ofgem noted in the August Policy Consultation, a large proportion of consumers opt to pay via Standard Credit as payment on receipt of bill provides them with control over how much they pay and when. Allowing perverse supplier incentives to continue could therefore result in negative outcomes for a significant number of customers who either cannot, or do not wish to, pay by Direct Debit or PPM.

As noted above, the current methodology delivers over-recovery on the Direct Debit customer

base, and under-recovery against the Standard Credit customer cohort. Rising debt levels resulting from the ongoing energy and cost of living crises have significantly increased the materiality of this systematic issue; OVO has discussed the materiality of this with Ofgem on a number of occasions, and we have provided our underlying analysis to demonstrate the resulting distortion.

Ofgem have recognised that the problem has existed since the inception of the price cap, acknowledging that *'suppliers with more Standard Credit customers than average could under-recover those costs'* and *'suppliers with fewer standard customers could over-recover costs, increasing their profits'*.¹

Without addressing this distortive impact Ofgem has, and continues to, severely impede the ability of suppliers with an above average proportion of Standard Credit customers to recover their efficiently incurred costs, hence reducing the investability of the sector as a whole.

Due to the severity of the impacts described above, we are concerned that Ofgem has not set a hard date for delivery of Phase 2. While we recognise that there is further work to be done to design the appropriate systems and processes to address the historic and ongoing impact of the allocation of bad debt costs, the impact is increasing and must be addressed in a timely manner in order to:

- Fully address the lack of cost-reflectivity in the allocation of bad debt costs; whilst
- Mitigating the impact on consumer bills that will arise from rectifying this manifest distortion.

We strongly urge Ofgem to commit to a delivery date of October 2024 for Phase 2.

Additionally, we note Ofgem are not proposing to make an adjustment to existing price cap allowances to cover the administrative costs associated with levelisation, as the expectation is that administration costs will broadly align to the bad debt savings suppliers will experience as a result of the scheme, with variances covered by existing uncertainty allowances. We do not agree with this approach. As a matter of principle, we do not believe that relying on the uncertainty allowance to cover a potential shortfall is appropriate as it means such allowances are not available for their true purpose - this has been an ongoing trend in recent policy decisions, resulting in the uncertainty allowance effectively being used up many times over by each element of the price cap parking a portion of real costs into the uncertainty allowance. We therefore consider it appropriate that the costs of administering levelisation should be included within the scope of the operating cost review.

Our detailed responses to the Statutory Consultation questions are provided in the below Appendix. We would be happy to discuss our response further, and should you have any questions in the meantime please contact policy@OVOenergy.com.

Kind regards,

Nicola Roberts,
Senior Regulation Manager, OVO

¹ Ofgem Default Tariff Cap: Decision - Appendix 8 - Payment Method Uplift - 6 November 2018

APPENDIX

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

No response.

Q2: Do you agree with our levelisation policy aims?

We agree with the policy aims set out in the consultation. However, we would add an additional aim *to ensure that suppliers are able to recover their reasonably incurred costs from customers of all payment types.*

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

We broadly support the proposed approach. However, as set out in our covering letter, we believe that it must be delivered in tandem with addressing the underlying mis-allocation of debt related costs under the price cap. There is a significant distortion under the current cap methodology that must be addressed to ensure that all suppliers recover reasonably incurred costs.

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

We have reviewed the model changes for Annex 9 and would note the following:

- The filter in C6 in tab 1a levelised DTC does not work
- Cell C6 in tab 'Nil Levelisation Allowance' is not synced with the cell C6 in tab '1a levelised DTC' C6.
- '3b Customer account details' should be populated prior to publication to allow suppliers to predict the levelised cap levels.

We have also reviewed the regional price cap levelisation model and note that compared to all other tabs, the calculations within the 'GB average' tab are inconsistent. In this tab, the Standard Credit headline price increased by £2 at the end of Step 2, even though the Standard Credit headline price should remain the same. Additionally, the bad debt figures are not clear in tab 'Regional Cap Levels', row 559 - 670. It would be helpful to understand whether these values are expected to change in future cap periods.

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

Yes, we agree that uncapped contract numbers should be included in the levelisation reconciliation. As the market stabilises, post-energy crisis, and we see a return to FTCs and customer switching, there must be protection for customers who remain on capped tariffs, and Ofgem should be mindful of the potential for distortive impacts and ongoing cost-recovery for suppliers.

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?

As a matter of principle we agree that Ofgem should avoid introducing unnecessary SLCs. In this instance we would expect Ofgem to monitor whether suppliers are reflecting levelised costs within uncapped tariffs as part of assessing compliance with the existing SLC 27A.

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

We believe there may be merit in further consideration of the regional differences in bad debt and whether this could be mitigated through regional levelisation. However, we agree that this should not delay implementation of the current proposals.

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

Given the need to have Phase 1 delivered for 1 April 2024 to ensure there is no gap in support for PPM customers, we support phased implementation. However, as set out in our covering letter, we are concerned that there is no hard delivery date for Phase 2. We believe Ofgem should commit to a delivery date of October 2024 for Phase 2.

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 that FTCs agreed prior to the decision date should be excluded. Should there be any changes from Ofgem's "minded-to" position set out in the consultation and the final decision that could impact Phase 1 levelisation costs then, in order to ensure that suppliers can include updated forecasts of levelisation costs into uncapped tariff pricing, there may be benefit in allowing limited time between decision date and the date from which FTCs are included.

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?

Yes, we agree that the controls achieved through other measures are sufficient and proportionate.