Prepayment meters

Consultation on new powers under the Energy Act 2004 and update on recent developments

February 2005 32/05

Summary

This document seeks views on how Ofgem should use the new power, introduced by the Energy Act 2004, to extend the range of payments which can be collected through a prepayment meter. Ofgem's initial view is that it would be in consumers' interests to allow the recovery of an energy debt from a previous property; that it is unclear whether it is in consumers' interests to allow the collection of debts relating to gas from an electricity meter and vice versa; and that there may be grounds for considering that it would not be in consumers' interests to allow the collection of energy services charges through the meter. Ofgem would welcome the views of consumer groups and the industry on use of the new power. Subject to views, Ofgem will then proceed with work on draft regulations.

As context for this consultation, the document also provides an update on various aspects of the arrangements for prepayment metering. Although the majority of households in fuel poverty do not use prepayment meters, Ofgem remains concerned about the potential effects of prepayment charges on customers with low incomes. Ofgem's strategy for addressing this issue has been to reduce barriers to prepayment meter customers switching suppliers; to introduce metering competition to enable suppliers to choose the most cost-effective way of providing these services; and to provide for price controls of the charges levied by the monopoly network companies until competition has developed. Over the past year, Ofgem has been in discussion with the companies to identify whether there are further barriers to the introduction of more cost effective metering technology which Ofgem should be looking to address. Based on these discussions Ofgem is optimistic that the market is continuing to develop and does not consider that further intervention would be helpful at this stage.

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1. Introduction

1.1. In July 2004 the Energy Act 2004 ('the Act') was passed. Prior to the Act, a gas or electricity prepayment meter (PPM) installed at premises could not be used to recover any sum other than sums relating to the supply of gas or electricity respectively to those premises or the provision of the meter. The Act gives the Authority the power, following consultation and the approval of the Secretary of State, to make regulations to allow suppliers to recover other sums through a PPM. Ofgem is seeking the views of interested parties on how its new power should best be exercised.

1.2. As context for this consultation and in line with its commitment in the Social Action Plan Review 2004, this document also provides an update on other developments relating to PPMs, including the discussions Ofgem has held with companies over the past year on the scope for reducing the costs of PPMs.

1.3. This document is divided into 4 sections. Chapter 2 provides background on the steps Ofgem has taken in relation to metering and the licence obligations. Chapter 3 sets out the options on which Ofgem is consulting following the changes to the Energy Act 2004. Chapter 4 provides an update on other developments relating to prepayment meters including current technologies, metering competition, the distribution price control and other issues raised in our discussions with suppliers earlier this year.

Views sought

1.4. Ofgem is seeking views on the issues outlined in this document. In particular, Ofgem would welcome views on the new powers under the Energy Act and the options outlined in Chapter 3. Ofgem would also welcome wider feedback from consumer groups on consumer issues relating to PPMs. Responses should be submitted electronically to graham.knowles@ofgem.gov.uk and will be published on the Ofgem website. Any confidential material should be marked as such and will not be published. Where possible, confidential material should be confined to an appendix. Responses should be submitted by 1 April 2004.

2. Background

Ofgem's approach

2.1. On average, customers who use PPMs for both fuels pay £63 per year more than customers who pay by the cheapest payment method of direct debit and £31 more than customers who pay by standard credit[1]. While links with fuel poverty are weak (of those in fuel poverty under 20% use an electricity PPM and fewer than 15% use a gas PPM), there is some correlation between customers who pay through a PPM and customers on low-incomes. Additionally, around 14% of electricity PPM customers and 35% of gas PPM customers are currently repaying a debt through their meter. For these reasons, and in the light of its statutory duties, Ofgem continues to monitor closely the arrangements for prepayment metering.

2.2. During the passage of the Energy Bill (now the Act) through Parliament, proposals to mandate uniform prices for PPM and credit meter customers were rejected. Given that the vast majority of those in fuel poverty do not use PPMs, any move to cross-subsidise PPMs would actually disadvantage many more people in fuel poverty than it would benefit. Moreover, Ofgem's research shows that most PPM customers are very satisfied with their chosen method of payment[2].

2.3. The National Audit Office, in its report on the Social Action Plan[3] recommended that Ofgem should encourage suppliers to offer prepayment meters as cost effectively as possible. It also recommended that Ofgem should press ahead with its efforts to introduce competition into the metering market and to explore the scope for more innovative and cheaper forms of prepayment. This is the approach that Ofgem is adopting.

2.4. Ofgem has introduced competition into the provision of metering to provide a wider range of options to suppliers on how they source metering services.

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[1] Social Action Plan and Household Energy Efficiency – Report by the Comptroller and Auditor General, 2004
[2] Social Action Plan Annual Review 2004, March 2004
[3] Social Action Plan and Household Energy Efficiency – Report by the Comptroller and Auditor General, 2004

While competition is still in its infancy, and in the short-term there has been an inevitable uncertainty, progress has already been made. One supplier has already contracted with alternative providers of metering services, and a new prepayment infrastructure service has emerged. Ofgem is optimistic, having spoken to suppliers, that the prepayment market is viewed as an attractive segment. A number of suppliers report to Ofgem that they are actively seeking to replace or update their current prepayment metering stock. Ofgem will, therefore, continue to work with the grain of competition and will monitor the market to see how it matures.

2.5. In its Domestic Competitive Market Review[4] Ofgem's switching data showed 39% of electricity and 32% of gas PPM customers having switched against an average of 51% and 47% respectively. At the time of the report, PPM customers could make savings of up to £39 in electricity and £85 in gas. These savings being broadly in line with maximum savings available to customers using other payment types. While the number of offers in the electricity market varied by area, with customers in some areas having the choice of up to 8 better offers, all gas PPM customers that had not switched had between 4 and 6 better offers depending on the level of their usage. Updated data will be published by Ofgem later this year, but it is important to note that during recent price rises some suppliers deferred or limited rises for PPM customers.

Obligations on companies

2.6. There are some special obligations on companies with regard to PPMs. All gas and electricity suppliers must operate under a code of practice for PPM customers (SLC 36). Among other things, the code must set out the supplier's policy with regard to debt recovery and the provision and maintenance of charging facilities.

2.7. Former Public Electricity Suppliers (PESs) have an obligation under their licences (SLC 53, 53A and 53B) to make available, on a non-discriminatory basis to other suppliers, facilities for obtaining credit for PPMs. These facilities, known as prepayment meter infrastructure provision (PPMIP), include the provision of payment devices (tokens, keys, or smartcards), use of a network of payment outlets, and the transfer of payments and customer data. Suppliers are not obliged to take these services from the former PES, and could, if they chose, find another source for one or more of the services provided. For example, in order to support the introduction of a new type of meter, British Gas will be working with a PPMIP which will be operated by Actaris Metering, and which will be available to all suppliers.

2.8. There is no comparable licence obligation concerning a PPMIP in gas. The PPMIP facilities for gas meters are provided by Siemens Metering Limited.

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[4] Domestic Competitive Market Review April 2004

3. The Energy Act 2004

3.1. Section 181 of the Energy Act 2004 amends paragraph 6(A) to Schedule 2(B) to the Gas Act 1986, and paragraph 12 of Schedule 7 to the Electricity Act 1989, concerning PPMs. It gives Ofgem the power, after consultation and with the approval of the Secretary of State, to extend the range of payments which can be collected through a PPM. The new powers can only be used after consultation with energywatch, authorised suppliers, and such other persons as the Authority considers appropriate. Section 181 of the Energy Act 2004 is reproduced in appendix 1.

3.2. The new provisions make it possible to vary the existing rules on PPMs, following the making of regulations approved by the Secretary of State. Under the existing rules gas and electricity suppliers may only recover sums arising from the provision of the individual fuel to premises currently occupied by the customer, or from provision of the meter. The rules prevent customers having sums arising from the purchase of other goods and services, or debts at a previous address, being recovered from a gas or electricity PPM. The new provision continues the existing prohibition, unless recovery of additional sums is permitted in regulations made by Ofgem.

3.3. In discussions leading up to the introduction of the provision in the Energy Act 2004 a number of potential variations were suggested:

- to allow debt from existing premises to be transferred to a PPM in new premises when the occupant moves house
- to allow the use of one PPM to recover debts for two fuels, so the customer could have one PPM and one credit meter for the two fuels, and
- to allow the use of a PPM to recover the costs of energy efficiency or energy services packages.

3.4. Ofgem's initial view on each of these options is set out below. In any regulations made by Ofgem, suppliers could only make changes to the charges they collect with the customer's agreement.

Options

3.5. The first option identified above is to allow debts accrued at previous premises to be transferred to a PPM in new premises when the occupant moves house. At present, those in debt wishing to move must make some other arrangement to settle any existing debt. Even if the customer wishes to continue to use a PPM to pay off the existing debt, and the supplier is willing to provide this, the existing rules place a prohibition on this. The current arrangements could be viewed as unduly restrictive. It could be argued that it is in customers' interests to allow them the choice as to whether to settle the previous debt, agree an alternative arrangement for repayment, or to have it recovered through a PPM in their new property. Transferring the debt from one address to another would not increase the level of that debt. Customers would be protected as the debt could only be moved with their agreement. However, Ofgem would welcome views on the desirability of such a change and the extent to which it would be in customers' interests.

3.6. The second option is the use of a single PPM to collect debts for both gas and electricity. There are some clear benefits to such an option, but also some clear disadvantages. The benefit is that the customer would only need one PPM, along with a credit meter for the second fuel. In so far as prepayment tariffs are higher than tariffs for other payment methods this would allow the customer to save money. The possibility of self-disconnection would also then be limited to one fuel. On the other hand the rate of self-disconnection on that fuel might increase if more costs were loaded on to one PPM. There are also potential competition implications if this were to limit a customer's ability to switch supplier for a single fuel where the customer is not in debt for that fuel. Ofgem would need industry to produce clear and workable processes for handling change of supplier in such circumstances before it could agree to such a change. Ofgem would welcome views on the merits of this option and views on any other factors which it should take into account. Building on this option, in the longer term it is possible that a dual fuel PPM could be developed. However, as no such meter has been proposed for use, this is not an option which Ofgem views it as appropriate to consider at this stage.

3.7. The third option is to allow the use of a PPM to recover the costs of energy efficiency or energy services packages. Ofgem currently has mixed views on this. There are clearly attractions in giving PPM customers the option of paying for energy packages through their meters, with obvious advantages for reducing energy costs. On the other hand, allowing the recovery of additional charges could increase the chances of self-disconnection. This was a concern prior to the prohibition in current legislation, when many households purchased appliances in this way through gas and electricity showrooms. Another concern is the fact that customers on qualifying benefits are eligible for free measures under Government schemes such as Warm Front. Ofgem would welcome views on this.

3.8. Taking into account the considerations outlined above, Ofgem would welcome views more generally on the potential for using the new powers to extend the range of payments which can be collected through a PPM, and whether there are any other options beyond those identified above which Ofgem should be considering.

4. Other Developments

Introduction

4.1. Ofgem wishes to ensure that PPM systems are operated as cost effectively as possible, and that there are no barriers to innovation. Ofgem has sought to address this issue by introducing metering competition and by introducing separate metering price controls for monopoly network companies. These developments are outlined below, together with technology issues. Ofgem met with all major supply companies in 2004 to discuss barriers to innovation in the PPM market. An overview of these discussions and an outline of some of the issues raised follows at the end of this chapter.

Technology issues

Prepayment meter technology

4.2. There are approximately 5.9 million PPMs in use in Great Britain, representing around 13% of installed domestic meters. Virtually all of the 2.1 million gas PPM customers (about 10% of all domestic gas customers) use Quantum meters. These meters use smartcard technology.

4.3. The electricity PPM market is more complex than gas. Of the 3.8 million electricity PPM customers (15% of domestic electricity customers) around 1.5 million use token meters, 1.5 million use key meters and 0.8 million use smartcard meters. Use of these different technologies is spread across the 14 electricity former PES distribution regions. Token meters are used in 9 distribution regions, and, of these 6 use them exclusively. Key meters are used in 6 regions, of which 5 use them exclusively, while smartcards are in use in 2 regions, but both of these regions also use token meters.

4.4. In gas, similar technology to the electricity key meter could also potentially be available. With metering competition suppliers could source an alternative to the Quantum PPM, but so far no supplier has chosen to do so. There have been concerns that the structure of Transco's price control, together with its national coverage as infrastructure provider, reduces the incentive for innovation.

Token meters

4.5. Many suppliers expressed a certain amount of dissatisfaction with token meters which are the oldest technology in use. Token meters are the most basic type of PPM and have a number of limitations including a greater susceptibility to fraud and misdirected payments than for other meter types; high maintenance costs deriving from the need for site visits; inflexibility in the recovery of debts; and general account balancing issues. Suppliers cannot set tariffs and receive meter readings remotely through the transfer of information from the payment device as with other technologies and so must visit the meter to perform these functions. In addition, token meters may not be able to be adapted should Britain opt to join the Euro. Ofgem does not consider it appropriate for it to dictate the type of PPM technology. However, suppliers should have an incentive in a competitive supply market to use prepayment meter technology which is both efficient in terms of end-to-end costs and that serves customers' needs. From our discussions we are confident that suppliers are actively considering options for the replacement of token meters.

4.6. British Gas has already made public its intention to move customers onto more modern Actaris key meters when their existing token meters need replacement. The Actaris meter is the most up to date version of the electricity key meter, incorporating technology known as Talexus. Other suppliers are considering their options with regards to their token meter stocks. While some draw attention to the risk of investing in new meters at the current time, others are more actively looking at options for upgrading their meters. In our discussions with them, most suppliers indicated they tended to favour key meters, with many looking at upgrading their systems to use Talexus software, given its additional functionality. Given British Gas's plans, the use of Talexus would also minimise the risk of the meter being removed if the customer switched suppliers.

Payment outlets

4.7. There are currently three networks providing facilities for PPM customers to buy credit which are the Post Office, Paypoint and Payzone. Paypoint and Payzone provide extensive coverage in urban areas and longer opening hours while the Post Office provides a wider network in some rural areas. There is active competition among service providers. Suppliers have experienced difficulties providing an adequate service to some rural customers when switching away from the Post Office. Ofgem considers that it is a commercial decision for individual suppliers to choose which service provider they use, although they should give consideration to the opening hours of charging outlets, and should ensure there is an outlet within a reasonable distance of PPM customers' homes. Where suppliers are unable to do this they should consider alternatives, including switching the customer onto a credit meter. Ofgem will take the necessary steps to make sure these guidelines are adhered to. The need to ensure the technology can be supported is an important consideration in the replacement of meters.

Regulatory issues

Metering competition

4.8. Ofgem has facilitated competition in metering through the Review of Gas Metering Arrangements (RGMA) and the Review of Electricity Metering Arrangements (REMA). These projects provided standard business procedures and data flows to ensure that the change of supplier process would not be affected by the new metering providers entering the market. Competition will allow suppliers to source meters and metering services from providers other than the host distribution business or Transco where this is more cost effective.

Metering price controls

4.9. For PPMs in gas, Transco, under its price control, makes an annual charge of around £30, but the true costs in relation to the provision of a PPM are claimed to be higher. Suppliers have therefore experienced difficulties in obtaining a competitively-priced prepayment service to use as an alternative to Quantum. Transco is currently considering the transfer of its metering assets away from its regulated business, which may have implications for its PPM charges. Ofgem will consider this issue in greater depth in a separate paper.

4.10. In electricity, Distribution Network Operators (DNOs) currently provide prepayment metering on a non-discriminatory basis to all suppliers. Ofgem's aim in setting the revised price control was to make the charges for provision and maintenance clearer to encourage suppliers to take into account end-to-end costs when deciding which meter to install. This is expected to bring down the costs of PPM in the longer term and to lead suppliers to seek to replace types of meters which have high operational costs. This is explained in more detail in appendix 2.

Discussion with suppliers on barriers to innovation

4.11. In its Social Action Plan Annual Review 2003, Ofgem undertook to investigate the scope for reducing the costs of PPMs, saying it wished to "[look] at the various elements of provision, operation and maintenance, and infrastructure".[5] As a first step, Ofgem sent a questionnaire to suppliers, DNOs and Transco in autumn 2003, seeking information on the potential for the development of prepayment technology and the barriers to introducing this. The results of this questionnaire were briefly outlined in Ofgem's Social Action Plan Annual Review 2004, in which Ofgem stated that it would be taking the issues raised in the questionnaire forward in discussion with companies.[6]

4.12. Ofgem met with the 6 major supply companies during May and June 2004 to discuss their future plans for prepayment metering and to identify barriers to the introduction of new and improved systems. In addition to the points already discussed above suppliers raised the following issues:

External funding

4.13. Some suppliers noted problems in obtaining appropriate finance from external sources which would allow them to invest in more innovative metering. Some suppliers were unwilling to own meters themselves, as this meant tying up significant capital over a relatively long timescale. They would therefore rather lease the meters from an asset owner. However, suppliers said that investors may be reluctant to fund the purchase of meters given the current technological and market uncertainties. As the market became more stable with an established leading technology it was expected that investment would become more attractive.

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[5] P.31 Social Action Plan Annual Review, March 2003

[6] P.P.9-10 Social Action Plan Annual Review, March 2004

Removal of obligations under SLC 53

4.14. One option suppliers suggested was that Ofgem could amend SLC53 to remove the requirement on former PES suppliers to provide a PPMIP service. This would allow suppliers to pursue the most cost effective service to support their own PPM customers on a nationwide basis without the need to offer a service to competitors.

4.15. However, in Ofgem's view, removing this obligation at present could lead to suppliers competing nationally having difficulty in providing services to their PPM customers in the short term. It might also act as a barrier to new market entrants in providing services to PPM customers. Ofgem does not intend to pursue this option at present, but may look again at the issue as part of Ofgem's forthcoming supply licence review.

28 day rule

4.16. Some suppliers said they were reluctant to invest heavily in innovative solutions in a climate where customers can switch supplier giving only 28 days notice and where, as a result, the possibility of their metering assets being stranded was high.

4.17. One option suggested by suppliers was that Ofgem could look at amending the "28 day rule" to allow suppliers to block the transfer of customers for a sufficient period to enable them to recover the investment of costs of new metering. This could be addressed in various ways, including by bringing metering within the definition of "goods and services" in the relevant legislation. Although this would allow suppliers a greater certainty of seeing a return on their metering investment, it may prove confusing and consequently unpopular with customers. Ofgem is also of the view that the issue of stranding may be addressed by meter operators offering commercial terms which mitigate this risk.

4.18. The 28 day rule has also been important in terms of facilitating switching and promoting a competitive supply market. Ofgem is already conducting a trial on amending the 28 day rule to promote energy services and it would be sensible to analyse the results of that trial before considering any changes in this area, potentially as part of Ofgem's forthcoming supply licence review.

Additional tariffs

4.19. Finally an issue was raised concerning the number of tariffs that can be accessed by suppliers. In gas, the Quantum meter has only 10 available tariffs to be shared among the whole industry. Electricity key meters, by comparison, have 256 available tariffs. However, with distribution charges differing across 14 separate regions, there is still a restriction on the number of available tariffs. Industry working groups are looking at this issue but in the meantime suppliers could probably find ways to work around the current technical limitations if, for example, they wanted to offer a discount to customers who cost less to serve through using correct payment devices and avoiding unnecessary site visits.

Conclusion

4.20. Ofgem's conclusion from these discussions is that suppliers are well placed to introduce more innovative and cost effective metering. Moreover, suppliers would appear to be actively considering how to bring down the costs of prepayment metering. At this stage Ofgem sees no reason to depart from its strategy of relying on competition as the most effective way of protecting the interests of PPM customers. However, we will continue to keep the position under review as part of our wider monitoring of the domestic market.

Appendix 1 Energy Act 2004

181 Prepayment meters

(1) In Schedule 2B to the Gas Act 1986 (c. 44) (which sets out the gas code), for paragraph 6A substitute-

"6A (1) A pre-payment meter installed by an authorised supplier through which a consumer takes his supply of gas shall not be used to recover a sum unless-

(a) the sum is owed to an authorised supplier in respect of the supply of gas to the premises on which the meter is installed or in respect of the provision of the meter; or

(b) the recovery of the sum in that manner is permitted by both-

(i) regulations made by the Authority; and

(ii) an agreement falling within sub-paragraph (2) below between the consumer and the person to whom the sum is owed.

(2) An agreement falls within this sub-paragraph if-

(a) the person to whom the sum is owed is a person who is authorised by regulations made by the Authority to enter into agreements falling within this sub-paragraph;

(b) the agreement permits that person to use the meter in question to recover such sums as may be specified in or determined under the agreement; and

(c) the agreement complies with the requirements specified for the purposes of this sub-paragraph by regulations made by the Authority.

(3) The sums that regulations under this paragraph may permit the recovery of through a pre-payment meter include-

(a) sums owed to a person other than an authorised supplier;

(b) sums owed in respect of premises other than the premises on which the meter is installed;

(c) sums owed in respect of matters other than the supply of gas.

(4) Before making regulations under this paragraph the Authority must consult-

(a) the Council;

(b) all authorised suppliers;

(c) such other persons as the Authority considers appropriate.

(5) The approval of the Secretary of State is required for the making of regulations under this paragraph."

(2) In paragraph 12 of Schedule 7 to the 1989 Act (use of pre-payment meters), for sub-paragraph (2) substitute-

(2) A pre-payment meter installed by an authorised supplier through which a customer of such a supplier takes his supply of electricity shall not be used to recover a sum unless-

(a) the sum is owed to an authorised supplier in respect of the supply of electricity to the premises on which the meter is installed or in respect of the provision of the meter; or

(b) the recovery of the sum in that manner is permitted by both-

(i) regulations; and

(ii) an agreement falling within sub-paragraph (3) below between the customer and the person to whom the sum is owed.

(3) An agreement falls within this sub-paragraph if-

(a) the person to whom the sum is owed is a person who is authorised by regulations to enter into agreements falling within this sub-paragraph;

(b) the agreement permits that person to use the meter in question to recover such sums as may be specified in or determined under the agreement; and

(c) the agreement complies with the requirements specified for the purposes of this sub-paragraph by regulations.

(4) The sums that regulations under this paragraph may permit the recovery of through a pre-payment meter include-

(a) sums owed to a person other than an authorised supplier;

(b) sums owed in respect of premises other than the premises on which the meter is installed;

(c) sums owed in respect of matters other than the supply of electricity.

(5) Before making regulations under this paragraph the Authority must consult-

(a) the Council;

(b) all authorised suppliers;

(c) such other persons as the Authority considers appropriate."[7]

[7] Energy Act 2004, Part 3, Chapter 4. © Crown Copyright 2004

Appendix 2 Distribution price control

Impact of DNO price control on PPM customers

2.1 This section explains how changes made in the recent electricity DNO price control may affect charges for PPM meters.

2.2 Ofgem wants to make the charge that suppliers pay for the provision and maintenance of PPMs much clearer. This should encourage suppliers to take into account the total cost, including maintenance and infrastructure costs, when deciding which type of PPM to install.

2.3 The price control covers two different functions that affect PPMs. These functions are the provision of the meter asset (MAP) and the installation and maintenance of meters (MOp).

MAP

2.4 The maximum amount that DNOs charge suppliers for MAP varies for different meter types. The reason for this variation is the charge for MAP reflects the purchase costs of a meter and the expected life of that meter. The strongest explanation for the difference in the MAP charges between PPM meter types is the expected life of each technology with Smartcard PPMs having a significantly shorter life expectancy.

2.5 The MAP charge has been calculated on the basis of the purchase price of a new meter. This builds into the price cap the fall in meter purchase prices that have been occurring. This has resulted in a price fall for MAP in nine of the fourteen DNO regions.

2.6 However, making the MAP charge cost reflective has made the MAP price cap higher in those five regions where the MAP charges were not cost reflective.

MOp

2.7 The price control limits the amount of revenue that a DNO can make from their MOp activities. This limit will vary depending on how much MOp work the DNO does. Currently some DNOs charge suppliers for PPM MOp work on a pence per day basis. Ofgem does not consider this enables suppliers to accurately determine what the true cost of PPM MOp is or to provide any incentive on suppliers to reduce callouts. The new price control incentivises DNOs to charge suppliers on a “transaction basis,” ie a charge for each time work is carried out on a meter.

PPM Cross Subsidy

2.8 Currently there is a cross subsidy in some regions in relation to MAP charges for PPM. This cross subsidy is particularly evident in Scotland where the MAP charge for PPM is set at the same level as the MAP charge for domestic credit meters, even though the purchase cost of a domestic credit meter is less than 20 per cent of that for a PPM.

2.9 Ofgem is of the view that making the MAP charge for meters cost reflective in the new price control is in the best interests of consumers. As previously noted in this document token PPMs offer less functionality than other PPMs currently in use. It should be noted that token PPM technology is in use in Scotland.

2.10 It is Ofgem’s view that the cross subsidy, whilst not the only reason, is a strong factor behind the continued use of token meters in Scotland. The cross subsidy means that the DNO is making a loss on the PPM MAP provision. Providing a more expensive meter, even where it would result in a lower overall cost to the PPM consumer, would mean that the DNO increases the size of loss it is making on PPM MAP. This discourages the DNO from changing to a PPM technology that provides a better service to the consumer.

2.11 Ofgem is of the view that a rise in PPM MAP does not necessarily equate with a higher PPM charge in the longer term. This is because of the interaction between MAP, MOp and PPMIP.

2.12 Ofgem’s view is that by making the price control cost reflective and on a “transactional basis” then DNOs and suppliers can be expected to take into account all the costs associated with a PPM, not just those relating to the MAP charge. This may result in suppliers selecting meter technologies that have a slightly higher MAP charge but which allow them to reduce their MOp and PPMIP charges.

Conclusion

2.13 It is Ofgem's view that in the longer term the price of PPM to the consumer will fall as a result of these changes. This is largely as a result of more efficient selection of metering assets by suppliers. It is Ofgem's view that one of the likely consequences of this efficiency is a reduction in the use of token PPMs. While token PPMs have the lowest MAP cost they appear to have higher MOp costs. Efficient selection of meters is also likely to see a decline in the use of smartcard PPMs because of the higher MAP cost.

2.14 The other benefit of these changes is it will put the supplier in a position to evaluate new technologies against those that are currently in use.

Appendix 3 Prepayment meter costs

3.1 For suppliers to make savings, it is important to understand the current additional costs associated with providing and maintaining a PPM. As well as paying for the provision and maintenance of the meter, suppliers incur additional "supply side" costs, such as paying for PPMIP services, meter reads, dealing with misdirected payments, and making visits to the meter, for example to calibrate a debt or change of tariff.

3.2 Suppliers also get financial benefits from customers using PPMs. These include the benefit of receiving payment in advance rather than 3 months in arrears, and security against the need to recover future unpaid bills.

Cost of meters

3.3 The table below sets out the costs of meter provision for different types of PPM compared with credit meters. Meters are certified to remain accurate for a specified number of years. However, due to the amount of wear and tear associated with inserting payment devices into the meter, in practice some PPMs have a shorter life than the certified life. A realistic measure of the average annual cost of providing each type of meter is therefore to divide the meter cost by its expected lifespan. Costs may vary by supplier and the figures below are only an indicative average.

Meter	Average price	Expected life (years)	Cost per year (provision)
Electricity credit	£10	21	£0.49
Token	£59	10	£6.07
Key	£61	9	£6.56
Smartcard	£64	7	£8.96
Gas credit	£33	20	£1.65
Quantum	£142	10	£14.20

3.4 The average annual costs of meter operation for an electricity credit meter is around £2 per year which compares with a cost of about £6.50 for a PPM. While Ofgem has no data to disaggregate the costs for each PPM technology, it is highly likely that the costs for token meters are much higher than for key and smartcard meters.

Additional supplier costs

3.5 In addition to Meter Service Provision costs outlined above, suppliers have additional costs associated with PPM customers. These include site visits, either when called out by a customer to attend the meter in order to provide credit, or to recalibrate the meter for debt or a change of tariff. The average cost for such a visit is £18.

3.6 Suppliers incur further costs for the provision of PPMIP services, which cost on average £15 per year. Siemens provides equivalent services for the gas market, which are around £20 per year on average. Suppliers could unbundle some elements of these costs if they wished to and some suppliers have looked at the possibility of doing this.

3.7 Suppliers also incur costs from misdirected payments and fraud. Estimates suggest that the combined cost of fraud and misdirected payments relating to prepayment meters runs to several million pounds annually.

3.8 While suppliers incur additional supply side costs, these are in part offset by benefits from receiving payment in advance rather than arrears, and from the removal of potential costs associated with recovering outstanding charges.

Summary

3.9 What the figures show are that the greater part of the cost of providing a PPM service are associated with the operation of the meter, including suppliers' own costs in dealing with customer service issues such as call-out costs. There could be scope for suppliers to reduce these costs through the use of new technology metering. Suppliers could also reduce costs using the current technology through educating customers and providing incentives to reduce operational costs for example, in reducing incidences of misdirected payments. In a competitive supply market suppliers should have the incentive to seek ways of reducing these costs and on the basis of its discussions with suppliers Ofgem is confident that suppliers are considering these issues.