

Protecting Energy Consumers with Prepayment Meters

8 April 2020

Introduction

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering almost all (90%) of both the UK's power generation and energy supply for over 27 million UK homes as well as businesses. The energy industry invests over £13.1bn annually, delivers around £85.6bn in economic activity through its supply chain and interaction with other sectors, and supports over 764,000 jobs in every corner of the country.

This is a high-level response to Ofgem's policy consultation on protecting energy consumers with prepayment meters (PPM). We would be happy to discuss any of the points made in further detail with Ofgem or any other interested party if this is considered to be beneficial.

Protection for PPM Customers

Energy UK agrees with Ofgem's proposals in principle to use the default tariff cap (DTC) to cover relevant customers in place of the PPM cap, with suitable adjustments to account for costs-to-serve. We note that the current position were no action to be taken would see those customers on default PPM tariffs come under the DTC, but at the direct debt level. We agree with Ofgem's view in the consultation (paragraph 2.14) that applying this level to PPM customers, which is about £50 lower than the existing PPM cap level, would be inappropriate.

It will be important to ensure that the adjustments reflect the resources required for serving PPM customers and that final proposals are developed in a transparent manner and implemented with proper regard to the systems changes required of suppliers.

PPM Payment Uplift and Opex

Ofgem's priority should be to ensure that the PPM uplift value is set at an appropriate level. Suppliers have previously raised concerns that the payment method uplift methodology does not produce an accurate reflection of costs. It will be important that Ofgem appropriately accounts for the greater ongoing costs of serving PPM customers in its proposed adjustments. Whilst Ofgem is reluctant to undertake further data gathering, it should ensure that it provides appropriate transparency of the underlying data it is using and allow sufficient time for suppliers to scrutinise effectively and provide detailed and evidenced submissions.

Energy UK believes that Ofgem needs to provide greater transparency regarding any analysis Ofgem is relying upon for its stated expectations. While Ofgem does not show its workings, analysis based upon public domain data implies an assumption that additional PPM costs are recovered equally from

all credit customers, not just those subject to the DTC. If so, this would seem a weak assumption given that there is no reason to assume that additional PPM costs are part of the marginal cost of supplying customers on competitive credit fixed term contracts.

We understand that relaxing this assumption so that no additional PPM costs are recovered from credit FTCs suggests a residual shortfall of about:

- £13 if recovered solely from PPM, or
- £4 if recovered equally across all DTC payment uplifts, or
- £5.50 if for policy reasons Ofgem decided these costs should be borne wholly by DTC credit customers rather than PPM.

In addition, while cross-subsidisation is not a new principle for the DTC, the significant costs differences between PPM and other meters may lead to greater distortive impacts on the market than those created by the existing cross-subsidisation between payment methods, undermining suppliers' ability to fund efficiently incurred costs from serving their PPM customers. We believe that Ofgem should ensure that this issue is accounted for within its disclosure arrangements to ensure that stakeholders can fully scrutinise the underlying data and the analysis Ofgem has undertaken.

Impact on the Smart Meter Rollout

Energy UK agrees in principle that the change in net costs from the opex baseline will not be the same as for credit, and so a PPM-specific SMNCC may be appropriate.

However, Energy UK is not able to comment in detail on Ofgem's proposals for the non-pass-through SMNCC element as it has provided insufficient detail of its analysis to support the expectations that it has outlined.

Given the inherent linkages with the wider review of SMNCC methodology being undertaken by Ofgem in parallel to this update for PPM customers, we would expect Ofgem to ensure the detailed proposals and underlying data at the next consultation stage will be able to be scrutinised across both workstreams at the same time and together. This is particularly important as the intended May statutory consultation will be the first, and only, opportunity for stakeholders to see and comment on any detailed analysis ahead of the potential October implementation.

In doing so, Ofgem should update its previous disclosure process which, as highlighted previously by Energy UK and our members, could have been improved to allow far greater scrutiny of Ofgem's evidence base. Given the importance of the default tariff cap for both customer protection and supplier financeability, we believe that Ofgem should endeavor to be as transparent as possible.

Timing of the Transition

Energy UK believes that it will be particularly important that a seamless transition occurs between the expiry of the PPM cap and the incorporation of default PPM customers being protected by the default tariff cap. We believe that the preferable approach would be to introduce changes to the DTC with effect from 1 October 2020 and to end the PPM cap for PPM customers on default tariffs early, as allowed for by CMA's revised Order (Ofgem's third option in the consultation). We believe that this approach would avoid unintended consequences or bad customer experiences of having two concurrent caps and a mid-period change for PPM customers.

Implementation

While we do not have any specific transitional issues to raise at this time, we would note that implementation issues depend upon the transition timing ultimately chosen by Ofgem and that it should remain open to resolving any issues that are raised once this has been decided.

Energy UK notes that Ofgem is reviewing its work programme in light of the COVID-19 pandemic and related developments.¹ Given the expiry of the PPM cap at the end of 2020 at the latest, we believe that there is strong case to prioritise this stream of work to ensure that PPM customers can remain protected.

Ofgem should, however, be conscious of resource constraints that the pandemic is causing for suppliers and ensure that its consultation and disclosure processes allow for the maximum amount of time possible for scrutiny in these circumstances. We note that achieving this in the current circumstances may necessitate the use of Ofgem's contingency option from October, to allow full and robust scrutiny of its long-term solution and assessment of a PPM uplift value that appropriately accounts for the efficiently incurred costs of serving PPM customers.

If you would like to discuss the above or any other related matters, please contact me directly on 020 7747 2931 or at steve.kirkwood@energy-uk.org.uk.

¹ <https://www.ofgem.gov.uk/publications-and-updates/ofgem-s-work-programme>