FAIR BY DESIGN
Ending the extra costs of being poor

PROTECTING ENERGY CONSUMERS WITH PREPAYMENT METERS: MAY 2020 CONSULTATION

1. INTRODUCTION

1.1. We welcome the invitation to respond to Ofgem's consultation on protecting energy consumers with prepayment meters.

1.2. Please note that we consent to public disclosure of this response.

1.3. For more information about this response please contact Carl Packman: c.packman@barrowcadbury.org.uk

2. ABOUT FAIR BY DESIGN

2.1. Fair by Design is a movement dedicated to reshaping essential services, like energy, credit and insurance, so they don't cost more if you're poor. People in poverty pay more for a range of products including energy, through standard variable tariffs; credit, through pay day loans; and insurance, through post codes considered higher risk. This is known as the poverty premium.

2.2. We collaborate with industry, government, and regulators to design out the poverty premium.

2.3. Our Venture Fund provides capital to help grow new and scalable ventures that are innovating to make markets fairer.

2.4. Fair by Design was conceived by the Joseph Rowntree Foundation and Big Society Capital. The Barrow Cadbury Trust manages the Campaign, and Ascension Ventures manage the Venture Fund. Fair By Design welcomes the opportunity to respond to this updated guidance for credit firms.

3. OUR RESPONSE

THE CASE FOR AN EXTENSION OF THE CAP

From a fairness perspective:

There is a vast literature describing the link between people on pre-payment meters and their exposure to the poverty premium, and other forms of vulnerable circumstances.

Christians Against Poverty (CAP) has found that one in three (31%) of those with a prepayment meter had it installed because of debt[1]. CAP has also found that 50% of PPM customers had self-rationed, and more than a quarter (26%) regularly did so.

Half of CAP's PPM customers (52%) show signs of self-disconnection (i.e. going without energy as they are not able to top up). 1 in 5 (19%) of prepayment meter (PPM) users have gone without basic energy dependent activities for more than two months in a row as a result of self-disconnection.

Pre-payment meter customers are very likely to be renters, using the PPM because it is the landlord's choice as opposed to their own. Citizens' Advice found that nearly half of social housing tenants (43%) and nearly a quarter (23%) of private renters were on PPMs[2].

More positively, it is clear that the price cap on PPM's has gone some way to reducing the energy poverty premium experienced by customers. The Personal Finance Research Centre at the University of Bristol (in as yet unpublished research, commissioned by Fair By Design) has found that the gap between the best PPM tariff and the best online only one had almost halved, dropping from £227 in 2016 to £131 in 2019.

For this reason, there is a compelling case, from a fairness perspective, for extending the cap on the cost of energy for PPM customers.

From a competition perspective:

The status-quo economic theory supposes that where there is more competition in a market, prices will fall to a reasonable rate for consumers[3]. But evidence shows that this isn't the case for PPM customers.

A study by the Cambridge Energy Policy Research group found that "the range of offers [for PPM customers] that are widely available and significantly below the cap is much less than first appears"[4]. The group's paper goers on to conclude:

"With the exception of one fixed tariff offered by one Large supplier, all Large and Medium suppliers are pricing at the cap. So too are several Small suppliers … Although there

[1] https://capuk.org/fileserver/downloads/external_affairs/A_dark_place-Feb2020-Low_Res-DP.pdf
[2] https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/PPM%20self-disconnection%20short%20report.pdf
[3] Note, for example, the line from this study guide: "Consumers are now free to shop around for the best deal, with many observers claiming that the increased competition has helped bring down prices and improve the range of services available for consumers." (https://www.rewardinglearning.org.uk/common/includes/microsite_doc_link.aspx?docid=12114-2)
[4] https://www.eprg.group.cam.ac.uk/wp-content/uploads/2018/10/S.-Littlechild_16-Oct-2018.pdf

appeared to be 15 Small suppliers offering 21 tariffs promising savings in the range £80 to £165 over the tariff cap, only one such tariff, saving £112, seems to be actually widely available. The availability of another tariff, possibly saving £92, has not been firmly established. Unfortunately, both suppliers have poor reputations for customer service".

The paper implies, therefore, that there are deals advertised on Ofgem-accredited Price Comparison Websites (PCWs) suggesting savings over the tariff cap, which are not actually available for consumers when they try to obtain them (at the time of the author's writing the paper). Then also, even where there are suppliers offering a saving for switching, poor customer service may mean this isn't ultimately a positive choice for consumers seeking better energy supply.

The same paper concludes: "It has been suggested … that suppliers will compete more aggressively for SVT customers than for PPM customers."

We also wish to echo the points raised by the Competition and Markets Authority (CMA) in their 2015 energy market investigation, on the reasons for why PPM customers are much less likely to switch than the average customer.

In their review of the available evidence on "the extent to which customer disengagement applies to customers on prepayment meters", they find that PPM customers express less direct market engagement than direct debit customers "particularly in terms of whether they have ever considered switching or are likely to consider switching in the next three years, and their awareness of their ability to switch."

The factors that the CMA use to explain this include:

"low levels of income; low levels of education; living in social rented housing; and having a disability. In addition, we have identified that prepayment customers face higher barriers to accessing and assessing information and additional actual and perceived barriers to switching. While the need to top up prepayment cards regularly is likely to increase awareness of domestic retail energy markets among prepayment customers, low levels of engagement may have in part been influenced by the lower gains from switching available to prepayment customers"[5].

National Energy Action found, in addition to the factors the CMA found, that PPM customers are often likely to: "have a poor credit history; be severely indebted or; be stranded on PPM due to the preferences of their landlords"[6].

The CMA, and the NEA, concludes that the best way to remedy this is to "enforce a price cap for all prepayment metered customers which should be active until the smart meter rollout

[5] https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf (p.34)
[6] https://www.nea.org.uk/wp-content/uploads/2020/03/NEA-Response-to-Policy-Consultation-on-PPM-Cap_final2.pdf

had been substantively completed for this customer set". Fair By Design also agrees with this conclusion.

From a customer-focused perspective:

For a long time, there has been significant emphasis placed on customers switching provider as a primary method of saving money on bills. As the authors of the Cambridge Energy Policy Research Group put it:

"Some customers may well be content to shop around and switch suppliers frequently, and gain the resulting benefits in terms of lower prices. But other customers – perhaps the majority – may prefer not to do so. As one member of a recent Parliamentary Committee lamented: "customers shouldn't have to keep switching".

This point becomes even more important when you consider the following, from the same author:

"It took me considerable time to check the accuracy of the tariff savings claimed on PCWs, and to find that many seem to be inaccurate and that two of the cheapest tariffs (by some margin) were offered by two suppliers with the worst customer service records."

If this is complicated for an academic whose principal task is to assess the accuracy of tariff savings, what would this be like for a time-poor consumer for whom saving money on their bills is just one of multiple activities that requires their attention?

There is an important body of work that looks very specifically at the "scarcity mindset", which relates closely to the amount of time and attention people have to give to particular activities.

The most important example of this literature is *Scarcity: The True Cost of Not Having Enough*, by Sendhil Mullainathan and Eldar Shafir. In it, the authors demonstrate that the more a person is low on resources (such as time, money, food, or sleep), the lesser their ability becomes to "solve problems, retain information, and engage in logical reasoning".

This is very important when considering market engagement by low income households, those experiencing or at risk of fuel poverty, and those in vulnerable circumstances.

Research on the poverty premium by the Personal Finance Research Centre (PFRC) at the University of Bristol found that limited resources can encourage low-income households to disproportionately avoid behaviours which might upset tight financial control, such as switching providers.

The Competition and Markets Authority has also shown the range of relevant factors that describe consumer vulnerability in essential services, including: "'time poverty'; confidence

in using the internet; and level of educational attainment". The CMA points out that these are all "likely to affect consumers' ability to engage in certain markets"[7].

For this reason there should be less emphasis on switching services as the primary method of consumers saving money.

The authors of the previously mentioned Cambridge paper suggest that this emphasis on switching suppliers, as the primary money-saving remedy for consumers, primarily leads consumers to conform only to "norms on engagement and switching", rather than the much more desired outcome of enabling "customers to obtain the kinds of lifestyle and relationship with suppliers that they actually prefer".

We at Fair By Design see the latter as the most desired aim of consumers. To that end, we see extending price caps as the best method of protections and money saving for consumers, especially those on low incomes and/or facing vulnerable circumstances.

HOW THE UPLIFT SHOULD BE PAID FOR?

Fair By Design recognises and appreciates that supplying customers using a PPM will cost more than for those using a direct debit. There is a potential delivery cost-saving to be made for a firm with customers not using credit.

With that being said, the demographic information we have access to would suggest that those on PPMs are likely to be experiencing some form of financial hardship and/or experiencing vulnerable circumstances.

Even with a price cap in place, we are concerned that for many people experiencing financial hardship and/or vulnerable circumstances, achieving the ideal outcome of an adequately heated home is already a difficult one which can often result in self-rationing behaviour or self-disconnection).

Already we know that energy spend as a proportion of total household income is higher for lower income households than for higher. Ofgem data on this shows that the lowest 10% of households by income spend 8.4% of their income on energy, compared with 2.6% of the highest 10% of households by income, and 4% of all households[8].

So despite the fact that there are costs to supply PPM customers to take into consideration, there is a case for ensuring costs are low for PPM customers if they are to be able to afford what is, by definition, an essential service. Extending the cap is one part of this solution. We feel other means of lowering prices for customers even further, should also be considered.

[7] https://fairbydesign.com/wp-content/uploads/2019/08/CMA-Consumer-vulnerability-challenges-and-potential-solutions.pdf (p.7)
[8] https://www.ofgem.gov.uk/data-portal/energy-spend-percentage-total-household-expenditure-uk#:~:text=In%202016%2C%20UK%20households%20were,well%20above%205.5%25%20in%202004.

One way of doing this would be to cross-subsidise costs from other bill payers to reduce energy costs for PPM customers.

For this reason, we endorse Ofgem's plan to spread any additional supplier costs of serving PPM customers to all default tariff customers. As reported in the consultation document, "there is a risk that efficient incremental PPM costs could exceed the PPM uplift by up to £17 (£7.95 electricity and £8.97 gas) per dual fuel PPM customer". Instead of Ofgem taking a cost-reflective approach, we welcome their contingency plans to increase bills for default tariff customers by between £0 and £4.08 (£1.91 electricity and £2.17 gas).

It's a reality in essential services markets that to achieve good outcomes for consumers, reasonable trade-offs must be made. In order to achieve the outcome where PPM customers pay a reasonable price for their energy and enjoy adequate heat in their homes, it is vital we find these alternative methods of covering the costs to suppliers for serving PPM customers.

Additionally, if the price cap is to be effective we need to address some of the other issues that contribute to some people's difficulties in paying their bills: for example, easy access to appropriate schemes that reduce bills at times when energy is more expensive (e.g. through the Warm Home Discount[9]), as well as efforts to bring homes up to the government's target on energy efficiency with a particular focus on those at risk of fuel poverty, in social housing or rented accommodation, and those using PPMs).

THE IMPACT OF THE SMART METER ROLLOUT ON SUPPLIERS' OPERATING COSTS

Ofgem is considering modifying the PPM cap level to include an allowance for the impact of the smart meter rollout on suppliers' operating costs. The justification for this is as follows:

"The gross cost of purchasing and installing smart meters is similar for prepayment customers and credit customers. However, smart meters are cheaper than traditional prepayment meters. So, replacing traditional prepayment meters with smart meters reduces suppliers' operating costs, eroding the additional costs of serving PPM customers. For that reason, the smart metering allowance reduces the cap level".

We doubt whether this is a good way of recouping costs to suppliers' operating costs since many PPM customers are yet to benefit from the smart meter rollout. We therefore offer two alternative scenarios:

1) transferring the cost of the smart meter rollout to those customers who have already benefitted from the rollout. This would mean that households that have not

[9] https://fairbydesign.com/news/whd-campaign/

yet benefitted from the rollout (including the cost savings of having a smart meter) are not penalised for the delay[10]

2) focus the smart meter rollout specifically on those households that stand to benefit the most from their installation, namely those at risk of fuel poverty, in social housing or rented accommodation, and those who will end up paying more in their bills for it (e.g. PPM customers).

We at Fair By Design feel that the latter should only be considered with the condition that there is an ambitious but strict deadline for when the focused rollout of smart meters is set, to ensure that those paying for the rollout through their bills see the benefits. This must be earlier than the revised full smart meter rollout deadline of 2024.

THE USES OF SMART METER DATA

While discussing the benefits of smart meters is not strictly in scope for this consultation, we wanted to communicate what we feel some of the consumer benefits are.

The most pressing benefit pertains to a persistent issue among PPM customers during the current pandemic: the ability to top up meters and access to emergency credit.

We at Fair by Design have seen two main issues relating to this:

- **the identification of those who needed emergency credit**. Although customers with prepayment meters, who may not be able to add credit, can speak to their supplier about options to keep them supplied, we are worried this places the onus primarily on the consumer.
- **The variation of support offered to customers by firms to obtain emergency credit for PPMs**. One major supplier was offering at-risk customers top-up cards or pre-loaded credit keys on a case-by-case basis, while another urged customers to pay online (with risks to those customers unable to or not confident enough to make payments online).

It is our understanding that with smart meters installed, accessing emergency credit would be much simpler for the supplier, for the customer, and would reduce the risk of some customers losing access to energy altogether. This presents a very strong case for a more focused smart meter rollout in the future.

Other benefits of the smart meter rollout will include the potential for suppliers to be more proactive in helping customers lower bills, reduce exposure to vulnerable circumstances, and access the most appropriate tariffs.

[10] https://www.bbc.co.uk/news/business-49721436#:~:text=The%20government%20has%20pushed%20back,by%20four%20years%20until%202024.&text=%22We've%20seen%20some%20energy,to%20meet%20the%20existing%20timeline.%22

For example, smart meter data will allow suppliers to identify better available tariffs for customers, automatically switch them to better deals where appropriate, reduce the risk of self-disconnection, and quickly identify self-rationing behaviour.

PPM STANDARD CHARGES

We at Fair By Design are concerned about the way in which standing charges work for those using a PPM. At the moment if you have a prepayment meter and pay for your energy by topping up your meter with credit, you're obliged to pay a standing charge. Prepayment meter standing charges still need to be paid even if there is no credit on the prepayment meter.

As above, we recognise and appreciate that the cost of supplying PPM customers needs to be efficient for suppliers. But in order to achieve good outcomes for consumers, reasonable trade-offs must be made.

A standing charge for someone who is struggling to afford credit for their PPM could push them into a situation where they are unable to adequately heat their home. In reality a household that is self-rationing to the point of not heating their home at all, would still be obliged to pay a standing charge.

For these reasons Ofgem should commit to moving away from the cost-reflective principle when it comes to PPMs and recoup the cost of supplying a PPM from other sources. Such a move would considerably reduce the risk of self-rationing by those people struggling to provide energy for their homes.