12 October 2020

Anna Rossington
Deputy Director, Retail Price Regulation
Ofgem
10 South Colonnade
Canary Wharf
London E14 4PU

Email: alisonrussell@utilita.co.uk

Dear Anna,

Re: Reviewing the potential impact of COVID-19 on the Default Tariff Cap: September 2020 Policy Consultation

Thank you for the opportunity to comment on the above Policy Consultation (PC). Ofgem's approach of seeking initial views from stakeholders in advance of proposals is welcome, as is its acceptance that Covid has had an enormous impact on the industry. Unfortunately, Ofgem is proposing to ignore impacts on prepay specialists such as Utilita, by systematically underestimating and misjudging the impact of Covid.

We note that the next step from this document will be a Statutory Consultation in mid-November. It is disappointing that yet again Ofgem has failed to provide clear and accessible proposals in advance of moving to a Statutory Consultation. This is poor regulatory practice, showing Ofgem's lack of commitment to high quality consultation, and its reluctance to implement transparent processes around the price caps.

The PC gives a number of indications of policy areas and possible approaches, which is welcome, but fails to set out clear proposals. While this would not be a problem for a working paper, it is concerning as the main consultation prior to a Statutory Consultation. The document does not provide enough information on the proposals for stakeholders to be able to properly evaluate them. No information is given on the scale of proposed adjustments and supporting analysis is lacking, so respondents have no way to assess whether or not the potential adjustment will reflect the costs faced.

As Ofgem is aware, Utilita is a smart, prepay specialist. Our portfolio is mostly prepay and we have a unique level of expertise in managing and supplying prepay customers. Throughout 2020, we have striven to respond effectively to their needs, while safely managing the impact of Covid on our employees and business.

BEIS and Ofgem have repeatedly placed significant demands on suppliers, especially prepay suppliers, in terms of the support to be given to customers. Press announcements have been made without adequate warning, leading to high volumes of calls being driven to contact centres, and unmanageable levels of demands for assistance by customers. In addition, suppliers have been compelled to make numerous voluntary commitments about customers changing mode, discretionary credits being given and extra time to pay.

We agree that generally prepay customers are required to pay in advance and do so, but to suggest there is no bad debt or significant impact on cashflow is a fallacy.

Prepay customers often have debt. This is self-evident. They may have debt due to needing support – by discretionary credit or emergency/friendly credit - which they have not been able to repay. The customer may have come to us with debt on their meter, which we are required to accept under the debt assignment protocol. In this case we must manage the debt. They may have run up a debt as a credit customer and been put into prepay. Again, the debt must be managed – but on a lower cap than when the customer acquired the debt. Simply moving the customer to prepay does not resolve the debt issue which the supplier must still manage.

In addition, debt management with prepay customers is far from simple given the high potential for vulnerability in the portfolio and the consequential licence requirements. While it is true that payment holidays, giving credit etc. are theoretically in the supplier's control, regulatory, Government and even Citizens' Advice pressures to support customers must be acknowledged and valued properly.

The second fallacy in Ofgem's policy thinking is that customer contact is less with smart prepay customers. This is not necessarily the case. While smart prepay customers will contact their supplier less than traditional prepay customers, prepay customers – even smart ones – contact their supplier much more than credit or DD customers. This was the case pre-Covid and has continued during Covid.

During the summer, prepay contact usually reduces, but we consider that this year the reduction has been less. We have delivered additional efficiencies over the summer using email, web, chat, bots etc., but all resources have been stretched to maintain service levels. Debt or vulnerability conversations with prepay customers are frequently longer than for credit customers (due to immediate requirements for meter interactions) and this adds resource pressure. As we move into autumn, we are already seeing call volumes rise, if anything rather earlier than we would usually expect.

Finally, we dispute the position on Warm Home Discount. While the core group process is consistent and will reconcile, albeit with substantial volumes, there has been a significant impact on the broader group. Many more customers are on eligible benefits and keen to secure the payment.

Almost uniquely Utilita has been oversubscribed for its broader group every year since participating. Our process is robust and our eligible customer numbers high. This year has been extreme even for us with approaching three times (at 283% oversubscribed) the number of applications to spaces available. This has meant not only managing these enormous volumes of applications but the level of disappointed customers, both in correspondence and in calls to the contact centre.

We therefore fundamentally disagree with Ofgem's assertion that no adjustment is required for the prepay element of the DTC.

We have supplied as a confidential appendix, summary data in respect of credits made. We may also seek to submit additional confidential data following this submission.

We note that Ofgem does not consider that Contracts for Difference (CfD) costs have been affected by the reduction in national demand resulting from Covid-19. In para 6.43, it is implied that CfD costs have only increased because of falling wholesale prices, but national demand has clearly had a significant impact. Ofgem could calculate the increase in costs resulting from the reduction in national demand and allow for recovery of this variance in a future cap period.

Moving to the general policy proposals, which are set out in respect of credit customers, we are generally supportive of the approach to use a float and true-up, but this needs to be extended to the prepay element of the DTC, not just credit and direct debit. We support Ofgem’s view that if a prepay adjustment is required, this should be managed via the DTC.

We are primarily concerned with the increased operating costs associated with prepayment customers resulting from the country’s response to COVID-19. This is emphasised by the pressure from BEIS and Ofgem to enter into a ‘voluntary’ arrangement for the support of prepay customers. The operational impact has included increased telephone, email and web contact, management of demands for credit and additional levels of contact to support customers in managing financial difficulty.

While we are broadly in accord with the policy approach that the main focus of the adjustment should be on debt and financial assistance, operational impacts have not been minimal and cannot be overlooked. The operational administration costs faced by suppliers in managing debt and support have been escalated due to Covid and the allowances should also reflect this.

We agree with the approach of keeping this adjustment separate rather than integrating within other DTC elements. Equally, the use of the float and true-up mechanism should be confined to this adjustment. Using a separate ‘line’ in the calculations will support this and aid transparency. Subject to robust and transparent estimation processes, we would support a marginally conservative approach to setting a float. While we would not want to create a risk of significant claw-back, the approach must not be so conservative as to leave suppliers in difficulty or the exercise will not achieve the required outcome.

The excessive conservatism of the approach to setting the prepay cap and the DTC, is what has created an industry which lacks financial resilience and hence the need for this proposal. The lack of headroom in the cap reinforces the point that the approach to setting a float should be only marginally conservative.

While we understand the logic and attraction of using an ex-post approach, the timing is such that suppliers cannot afford to carry the costs for that long under the current cap provisions.

We agree that as a minimum, adjustments will be required for cap periods four, five and six, but we consider further adjustments may be required depending on the future progress of the pandemic and the economy.

We accept that ideally impacts should be ringfenced within payment types, but this approach may not be possible where there are clear impacts cross these boundaries. The policy must reflect the requirement to have regard to the matters set out in 1.4, in particular, enabling effective competition and the financing of licensable activities. The approach in the document fails these tests, neglecting as it does the effect of customers needing to move between payment methods and taking their debt with them. The supplier managing a prepay customer’s debt may not have been the supplier when the debt was acquired at the credit cap rate.

In terms of the proposals set out around debt, based on the very limited information supplied, and the points in this letter on prepay, the proposals may be viable, however the following are essential:

- Bad debt assessment proposals must be fully transparent so that stakeholders can assess them properly
- Appropriate adjustments are needed to manage change of payment method
- Mechanisms must be robust to seasonal impacts
- The policy must not disincentivise suppliers from effectively managing customers who are in debt, including using prepay where appropriate.

As set out above in our comments on the type of mechanism, we are concerned that the approach chosen may result in an overly conservative outcome. This concern is accentuated by the potential effect on the proposals of the benchmark. The proposed approach may appropriately reflect the effect on suppliers, but without being able to assess actual proposals, stakeholders cannot be confident.

We accept that Ofgem must set a single cap in each case, but suppliers' portfolios are very different and will have variable vulnerability. The benchmark must accommodate those suppliers who may have had to give more support to their customers than others.

The coming winter is likely to be very difficult for a lot of customers; Ofgem must not disincentivise suppliers from offering critical help and support. Suppliers need confidence that they will be able to recover their reasonable extra costs of support given to customers in need.

Vulnerability is not easily assessed purely in terms of efficiency; in setting an efficiency benchmark, the needs of vulnerable customers should be taken into account. Ofgem must protect the interests of all consumers and should take a prudent approach, but this should be proportionate and well justified for both consumers and suppliers.

Given the effects of Covid, and the unprecedented demands on suppliers, it may be necessary to make higher allowances for several price cap periods. Using a separate adjustment facilitates this approach and allows for limitation and removal/adjustment in future as the impacts of the pandemic ease.

We hope this submission has been helpful and would welcome an opportunity to discuss in more detail possible ways forward.

Yours sincerely,

By email only

Alison Russell
Director of Policy & Regulatory Affairs