FAIR BY DESIGN
Ending the extra costs of being poor

Response to Ofgem's consultation on changes to prepayment meter standing charges and other debt costs

14th December 2023

About Fair By Design

Fair By Design is dedicated to reshaping essential services such as energy, credit, insurance and payments so that they don't cost more if you're poor – also known as the poverty premium. Fair By Design collaborates with regulators, government and industry to design out the poverty premium. Our Venture Fund provides capital/funding to grow new scalable ventures to innovate the market and design out the poverty premium. Ascension manages the Fair By Design Fund. Fair By Design is managed by the Barrow Cadbury Trust on behalf of a group of foundations.

In the context of the energy market, we believe that households on low incomes/living in poverty should not incur a poverty premium based on the way they pay for their energy.

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

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Summary

In July 2023, the Government brought in temporary measures to end the premium pre-payment meter (PPM) customers paid for their energy, whilst tasking Ofgem with finding a way of ending the PPM premium permanently when the Energy Price Guarantee comes to an end in April 2024. Ofgem has taken the opportunity to look at the premium paid by customers who pay on receipt of bill (known as standard credit (SC)) as well as the premium paid by PPM customers. Building on the call for input in April[1], and a consultation in August[2], this statutory consultation sets out three options:

Option 1 - Do nothing
Option 2 - Levelise PPM & DD standing charges

[1] Ofgem (2023), Levelisation of payment cost differentials: a call for evidence. https://www.ofgem.gov.uk/publications/levelisation-payment-method-cost-differentials-call-evidence
[2] Ofgem (2023), Levelling the cost of standing charges on prepayment meters https://www.ofgem.gov.uk/publications/levelling-cost-standing-charges-prepayment-meters

Option 3 - Levelise PPM and DD Standing Charges and levelise debt-related costs between SC and DD (Ofgem's preferred option)

Option 2 and Option 3 differ slightly from the options proposed in the August consultation.

Of the options presented, **Fair By Design supports Option 3** which not only makes having a pre-payment meter the cheapest method of payment under price cap 11b at the typical rate of consumption, but also significantly reduces the standard credit premium (Option 2 would reduce the standard credit premium to £119, option 3 would reduce the standard credit premium to £62). We still believe a standard credit premium of £62 is too high but recognise that it is significantly better than both of the other options included in the consultation.

Question 1: Do you have any comments or views on our updated case for the introduction of levelisation of payment methods?

We agree with the updated case for change. In particular, we note the strengthened case for change given the increased vulnerability of standard credit (SC) customers relative to direct debit (DD) customers between Wave 3 (Nov/Dec 2022)[3] and Wave 4 (July 2023)[4] of Ofgem's consumer impact research.

Question 2. Do you agree with our levelisation policy aims?

Fair By Design agrees with the initial two aims set out in the updated case namely that customers who have a pre-payment meter (PPM) should not pay a premium, and that all customers that have the ability to build debt should contribute equally to debt-related costs.

We also agree that levelisation should be enduring and responsive to policy changes, that there should be limited or no gap in support for PPM customers following EPG removal, and that the solution should be proportionate.

We do not agree that the standard credit (SC) premium should be reduced but maintained to incentivise efficient payment methods. Whilst we are delighted that Ofgem's preferred option in this consultation would significantly reduce the SC premium we would like to see the SC premium eliminated. The evidence does not support the proposition that a premium incentivises people to switch from SC to Direct Debit (DD). As a precondition, this would require people to be aware of the price differential. Ofgem's own consumer research[5] shows that only **24% of people on standard credit know that it is more expensive than direct debit**. The same research shows that the number one reason for choosing standard

[3] Ofgem (2023), Consumer Impacts of Market Conditions survey - Wave 3: https://www.ofgem.gov.uk/publications/consumer-impacts-market-conditions-survey-wave-3-novdec-2022
[4] Ofgem (2023), Consumer Impacts of Market Conditions survey - Wave 4: https://www.ofgem.gov.uk/publications/consumer-impacts-market-conditions-survey-wave-4-july-2023
[5] Ofgem (2023), Consumer Impacts of Market Conditions survey - Wave 4: https://www.ofgem.gov.uk/publications/consumer-impacts-market-conditions-survey-wave-4-july-2023

credit is to maintain control. Ofgem is therefore a long way from being able to make the case that maintaining a standard credit premium incentivises efficient payment methods.

On the other hand, a clear theme emerging from the focus groups we ran with Poverty Alliance in April 2023 was that the current system is too complicated and not well understood. We believe that simplification (albeit with a safety net for those who cannot afford a basic amount of energy) would help to rebuild trust in the energy market.

It is worth comparing Ofgem's approach to the approach of Ofwat in the water sector (energy and water being among the small number of industries under Regulation 4 of the Consumer Rights (Payment Surcharges) Regulations[6] where suppliers are legally allowed to charge a cost-reflective premium for different payment methods). Our understanding is that Ofwat has always expected companies to average the cost differences between different payment methods between customers rather than seek to reflect different costs at individual customer level. There is one company, United Utilities, that voluntarily offers a discount to direct debit customers of £5 for paying by direct debit[7] which raises the question of whether a SC premium many times that (even if reduced to £62 under Option 3) is necessary to incentivise a switch to direct debit. We believe there are lessons to learn for the energy sector from this positive framing/competition-enabled approach. It offers a potential route to incentivising companies to raise awareness of such a discount, encouraging efficient payment methods, whilst also ensuring these price differentials are small and transparent.

This is particularly important in a world where payment methods will continue to evolve. The current delineation into three payment methods: PPM, SC and DD is already an oversimplification. "Dumb" pre-payment meters are more costly to serve than smart pre-payment meters as discussed in the consultation. Some firms also offer flexible direct debits which are presumably more costly to offer but may result in more customers staying on track with their payments. It is proposed that variable recurring payments using open banking should be rolled out to energy and other utilities shortly. As previously stated, Fair By Design would like to see Ofgem encouraging suppliers to offer a greater range of payment methods, in order for consumers to budget and control payments in a way that suits them. Ensuring current premiums are eliminated and that new premiums do not develop alongside new payment methods is a key contribution Ofgem can make to enable consumers on low-incomes to manage their energy payments.

[6] Legislation.gov.uk. (2013). The Consumer Rights (Payment Surcharges) Regulations 2012. [online] Available at: https://www.legislation.gov.uk/uksi/2012/3110

[7] www.unitedutilities.com. (n.d.). Set up a direct debit | United Utilities. [online] Available at: https://www.unitedutilities.com/my-account/your-bill/set-up-a-direct-debit/

Question 3. Do you agree with our proposed approach to levelisation?

We agree that out of the options put forward, Option 3 best meets the aims set out in Chapter 2 (discussed above) and is the best approach to levelisation. We are very pleased to see that as well as eliminating the PPM premium permanently, this will significantly reduce the SC premium.

We also agree with the proposal to proceed with a first phase levelisation of PPM standing charges against DD in April, followed by a second phase in which Ofgem levelises debt-related costs between SC and DD in October, given that it is not possible to deliver both phases before April 2024.

Question 4. Do you have any views on the proposed amendments to SLC 28AD and model changes under Annex 9?

No.

Question 5. Do you agree with our proposal to include uncapped contract numbers in the levelisation reconciliation?

We agree with Ofgem's proposal to include all domestic consumers in the levelisation reconciliation to avoid market distortion.

Question 6. 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?

No comment.

Question 7. Do you have any views on our other considerations related to levelisation, regional levelisation and treatment of smart PPM?

For pragmatic reasons and to ensure implementation by April 2024, we support the approach set out with Ofgem not to target levelisation, not to remove the regional differences, and not to treat smart PPM as a separate payment method.

In principle, we are keen to see support targeted at those who need it most. However, in practice, Ofgem has no means of identifying or targeting low-income consumers. We welcome Ofgem's public calls for the Government to look seriously at options for long-term price support, including a social tariff for energy, which we feel would be a better way of ensuring that targeted support is available to those who need it most.

Given the need to implement this change as soon as possible, we agree that the issue of levelisation across regions should be postponed for the moment. However, we are concerned about the gap between consumer understanding and reality on this issue which calls into question whether aspects of Ofgem's retail regulation are "transparent" and "accountable". In Ofgem's Wave 3 consumer research[8] less than half (42%) of participants correctly identified that the cost of energy varies depending on what region you live in.

As stated in earlier responses, we believe that when considering whether a price differential is fair, Ofgem should consider whether consumers, and particularly vulnerable consumers, can reasonably be expected to be aware of a price differential and whether they are able to, or likely to, change their behaviour in response to a price signal.

We look forward to seeing this addressed as part of consideration of locational pricing in due course.

We also agree that the treatment of smart PPMs should be considered as part of the operating costs review.

Question 8. What are your views on our updated options including the need for a reconciliation mechanism and phasing of implementation?

We agree that a reconciliation mechanism is needed and would be concerned about the impact on SC and PPM specialists of implementing these levelisation proposals without such a mechanism. However, we have no strong views on the details of the reconciliation mechanism proposals.

Question 9. Do you agree with our proposal to exclude fixed term contracts agreed prior to our decision date from our levelisation proposal?

No comment.

Question 10. 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?

No comment.

[8] Ofgem (2023), Consumer Impacts of Market Conditions survey - Wave 3: https://www.ofgem.gov.uk/publications/consumer-impacts-market-conditions-survey-wave-3-novdec-2022