The Centre for Sustainable Energy (CSE) response to Ofgem's Call for Evidence on Levelising Payment Method Cost Differentials

About CSE

We're a charity supporting people and organisations across the UK to tackle the climate emergency and end the suffering caused by cold homes. We do this by sharing our knowledge, practical experience and policy insights. For over 40 years, we've supported people to take effective action on energy in their homes. We help communities and local councils to understand energy issues, set priorities, and put plans into action. Our research and analysis focus on making the energy system greener, smarter and fairer.

Through our advice line, home visits and one to one support, we support around 15,000 people a year to reduce their bills and make their homes more energy efficient. More people are experiencing financial difficulties and higher energy costs. This means that more people need our advice than ever before. During the last financial year, we helped people achieve financial outcomes of over £7m. Over £300,000 of this has been given to prepayment meter customers in the form of vouchers. This short-term intervention is in part designed to address the unfair premium that prepayment meter customers are currently paying.

Summary of our response

CSE wholeheartedly welcomes the Government's commitment to levelise the cost of energy for prepayment customers when compared to direct debit. As shown by the CMA energy market investigation in 2016 customers on prepayment meters are more likely to; have lower incomes; be disabled; be a single parent; or be more than one of disabled, single parent and carer[1]. Our direct experience of supporting these customers has demonstrated that they are particularly vulnerable, at higher risk of fuel poverty and have not been able to benefit from active participation in the energy market.

We would urge Ofgem to take a more ambitious approach to levelising fuel costs. Following the initial UNC modification 0840 customers on standard credit will face bills that are £200 higher than those on direct debit. Similarly, to prepayment meter customers, those on standard credit also demonstrate a higher level of vulnerability often being older, on lower incomes and having lower levels of financial literacy. Both payment types have higher proportions of fuel poverty according to the LILEE indicator (based on 2022 data)[2].

The current approach to calculating the price cap allocates more costs associated with debt to these payment types (prepay and standard credit). This is counter productive as the system is placing more costs on those households that are least able to afford their energy in the first place. By increasing the burden on the most financially vulnerable households you are also increasing their likelihood of becoming indebted (or further indebted).

A long-standing argument to support these differentials is to provide an incentive for households to switch to direct debit. Households use direct debit for convenience rather than purely for financial

[1] CMA Energy Market Investigation Appendix 9.6
[2] https://www.gov.uk/government/statistics/annual-fuel-poverty-statistics-report-2023

gain, the time saved in dealing with their energy costs has its own non-financial benefit i.e. time saved.

Since 2020, the payment differential between standard credit and direct debit has grown substantially, from £85[3] to more than £200. However, the number of households using standard credit has simultaneously grown in that period[4]. In our experience of working with vulnerable households this trend is driven by people's inability to afford their energy costs and a lack of control over their direct debit payments (which suppliers change without their agreement). The best way to increase the numbers of people on direct debit would be to make sure they are able to afford their energy costs.

To make the energy system fairer, particularly for the most vulnerable customers struggling to pay their bills, all payment methods should be levelised. We would recommend an ambitions approach with **Case 4 being our preference**. Given that there may be concerns for vulnerable and fuel poor customers using direct debit, we would support **Case 2 as our second choice**.

Answers to the Call for Evidence

Question 1: What do you think the objectives of levelisation should be (eg, full levelisation across payment methods, partial levelisation, anything else)?

CSE wholeheartedly welcomes the Government's commitment to levelise the cost of energy for prepayment customers when compared to direct debit. The central objective of this work should be to make the energy market fairer and improve outcomes for vulnerable customers. Rather than just levelise costs for prepayment meter clients, they should be equalised for all tariffs where possible and fair. During the current price cap there are significant differences between payment methods with prepayment customers paying on average ~£40 per annum more than direct debit customers. The figure is higher again for those who pay by standard credit at ~£200.

Both prepayment customers and those that pay by standard credit are more likely to be vulnerable across a number of metrics, including:

- Having a lower income
- Being more likely to be fuel poor
- Being more likely to be a single parent (particularly for prepayment meter customers)
- Being elderly (particularly for standard credit users)

Households that use these methods often do so because they have a specific financial vulnerability. For example, they may have been forcibly moved onto a prepayment meter because they cannot afford their bills. They may have chosen to move onto standard credit because their direct debits became unmanageable. A household may also be using standard credit because they do not have high levels of financial literacy, or they are older and simply do not pay for utilities by direct debit.

Using price signals to penalise these households adds an additional cost to a group of households who are already financially vulnerable. The current price cap methodology allocates more debt costs to the groups who are most likely to be in, and fall into, debt. This isn't a fair way of protecting the

[3] Default Tariff Cap Level Model April 2020
[4] https://www.gov.uk/government/collections/fuel-poverty-statistics

most vulnerable in society. It's particularly unfair for those customers on standard credit who use this payment method because they are not confident using direct debit.

Furthermore, for many years there have been little or no good switching offers for their segment (both prepay and standard credit) of the market. They've been failed by competition and regulation. Ofgem has a statutory duty to consider the needs of vulnerable households. It is essential that it uses its powers to protect these households from unfairness in the market.

A long-standing argument to support these differentials is to provide an incentive for households to switch to direct debit. Households use direct debit for convenience rather than purely for financial gain, the time saved in dealing with their energy costs has its own non-financial benefit i.e. time saved.

Since 2020, the payment differential between standard credit and direct debit has grown substantially, from £85 to more than £200. However, the number of households using standard credit has simultaneously grown in that period. In our experience of working with vulnerable households this trend is driven by people's inability to afford their energy costs and a lack of control over their direct debit payments (which suppliers change without their agreement). The best way to increase the numbers of people on direct debit would be to make sure they are able to afford their energy costs.

Question 2: Should we only focus on PPM levelisation or should we also consider SC?

No.

As stated above. To make the energy market fairer for the most vulnerable customers we need to see a levelisation across all tariff types. The tariff differential between direct debit and standard credit of £200 is too large and there is a risk of significantly disadvantaging indebted customers and those who do not use direct debit as a payment method (in our experience often the most elderly and those with low financial literacy).

Question 3: If SC is included in levelisation, should some degree of price difference remain, whereby SC is higher than DD to maintain an incentive for customers to go on DD?

No.

Whilst there may remain a small cost differential due to the need for billing and processing of payments, the driver for the higher cost of standard credit should not be the incentive to move to direct debit. Direct debit is a well established payment method which people favour for convenience as well as cost. The majority of people we support through our advice work who use standard credit do so because they either; do not use or trust direct debit; or cannot afford the proposed direct debit payments.

As discussed above, standard credit has grown in market size despite it becoming more and more expensive in comparison to direct debit. The best way to increase direct debit numbers is to ensure that financially vulnerable households can afford their energy costs. Under the current regime energy becomes more expensive if you are having difficulties with regular payments and then move to standard credit. It is worth noting that this increase is not a marginal one i.e. £200 per year.

Question 4: After considering the different levelisation options presented (charge type, individual elements of the price cap, extent to which levelisation should occur), are there any further levelisation options that you think should be considered?

No. The analysis has covered all the reasonable options.

Question 5: Can you provide any evidence on why one levelisation option should be preferred over another?

To make the energy system fairer, particularly for the most vulnerable customers struggling to pay their bills, all payment methods should be levelised. We would recommend Ofgem takes an ambitions approach with **Case 4 being our preference**. Given that there may be concerns for vulnerable and fuel poor customers using direct debit, we would support **Case 2 as our second choice**.

Question 6: Can you provide any evidence of levelisation effects that should be avoided that have not been shown within our analysis?

No

Question 7: What are your views on targeting levelisation to particular groups of customers within payment methods (eg customers under the price cap or in vulnerable situations)? Do you have evidence to support your views?

To promote fairness across the energy market we feel that a universal approach should be taken (as it is for the price cap).

Previous market interventions and policies, such as Warm Homes Discount, have shown that there will inevitably be winners and losers from a targeted route. The losers often include people who would be eligible if they were claiming passport benefits, like pension credit. Given older people would form an important element of any group of standard credit customers that Ofgem sought to protect, there is a high risk that many households would miss out from this protection if pension credit was chosen as a proxy. This is a further argument for a universal approach.

Question 9: Do you agree with our characterisation of the effects on competition? Can you explain why or why not?

NA

Question 10: Are there any additional impacts on competition or other areas that we should consider? Can you provide evidence of these?

NA

Question 11: Do you agree with our assessment on market competition and incentives? Can you explain why or why not?

No.

The assessment fails to account for the none financial motivators for people's choice of payment method. Many people use direct debit because it's convenient rather than it being the cheapest payment method available. The market should not adversely penalise households who choose to use the payment method that is most convenient for them i.e. those customers who choose to use standard credit.

The infrastructure that underpins the energy market is also changing. Legacy prepayment meters are being replaced by smart prepay which is more cost efficient than direct debit. Reducing the costs of prepay will therefore further incentivise smart prepayment which will improve market efficiency.

As stated above non direct debit households have been poorly served by market competition. The CMA's Energy Market Investigation concluded that there was minimal competition for legacy prepayment meter customers and that competition would require the smart rollout as a pre-requisite. The levelisation of prepayment meter costs alongside the smart meter roll out will therefore benefit all customers.

The consultation notes the previous issues with market competition i.e. *"if competition is weaker in PPM and SC markets than in DD as previously observed, then levelisation could have the effect of 'anchoring' PPM and SC prices to DD, thereby bringing the benefits of active DD competition to SC and PPM customers."*

Anchoring would be beneficial to those 'sticky customers' for whom switching has delivered few benefits over the last twenty years. It's therefore a positive rather than a negative. We would also prefer levelisation across fixed deals to ensure universality as per our response to question 7 above.

Question 12: Are there any other impacts on your organisation or the market that we have not considered?

NA

Question 13: If costs are not reconciled, what would the impact of payment method levelisation be on your organisation, where relevant?

NA

Question 14: Do you consider that the costs of levelisation should be reconciled between suppliers? What are your views on the reconciliation mechanisms presented?

NA

Question 15: Are there any other reconciliation mechanisms that you think we should consider that we have not discussed?

NA

Question 16: Is there anything else Ofgem should consider with regards to levelising costs across payment methods?

NA