Citizens Advice Scotland's response to 'Ofgem's policy consultation on protecting energy consumers with prepayment meters

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Executive Summary

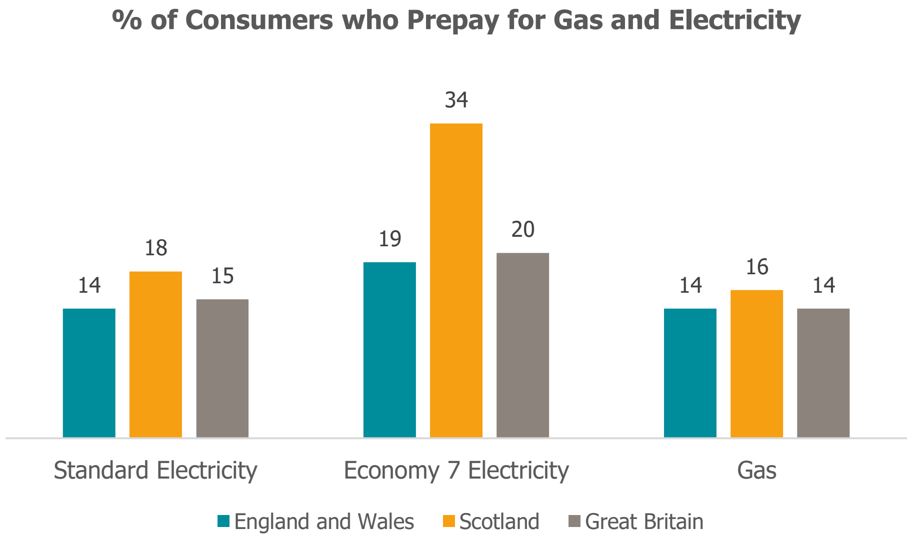
Citizens Advice Scotland (CAS) welcomes the opportunity to respond to Ofgem's consultation on protecting energy consumers with prepayment meters. Scottish consumers are significantly more likely to pay for their energy in advance through a prepayment meter than a typical GB consumer[1]. With 1-in-10 GB consumers self-disconnecting at least once from their prepayment energy supply in 2017[2] and the incidence of fuel poverty in Scotland more than twice that found in either England or Wales[3], the ability of the market to provide prepayment energy consumers with affordable supplies of gas and electricity remains essential to the physical, financial and mental health of hundreds of thousands of Scottish households. Where competition is unable to deliver positive consumer outcomes, we therefore support appropriate market interventions such as the Prepayment Charge Restriction (PCR) and the Default Tariff Cap (DTC).

CAS does not believe that there has been sufficient improvement in the conditions for competition in the prepayment energy market for price protections to be lifted at the current time. However, we agree that the non-standard credit DTC to which prepayment consumers would default were Ofgem not to act would set a price cap significantly lower than an efficient supplier's cost to serve such consumers. This would be likely to harm competition and lead to significant adverse consumer outcomes. As a result, we support Ofgem's proposal to create a prepayment meter specific price cap within the DTC, and we agree with both the methodology and implantation dates proposed to achieve this. However, we also propose an alternative approach to the non-pass through Smart Meter Net Cost Change (SMNCC) that could support the smart meter rollout by creating a small but direct financial incentive for hard to reach consumers to accept or request a smart meter without a change of tariff or payment method being required before savings could be realised.

[1]BEIS Quarterly Energy Prices: March 2020
[2]https://www.ofgem.gov.uk/system/files/docs/2020/01/consumer_vulnerability_strategy_2025.pdf
[3]https://researchbriefings.files.parliament.uk/documents/CBP-8730/CBP-8730.pdf

Our Response

1. In its 2016 Energy Market Investigation (EMI)[4], the Competition and Markets Authority (CMA) found that prepayment energy consumers display a higher proportion of 1 or more of a range of characteristics that are considered to be risk factors for vulnerability[5] than the GB average. These characteristics include low household income, low levels of education, and having a disability. Scottish consumers are considerably more likely to pay for their energy via a prepayment meter than the GB average[6], and with several of these risk factors also key drivers of fuel poverty in Scotland[7], CAS welcomes Ofgem's proposal to extend price protections for the majority of prepayment energy customers beyond the end of the PCR on 31 December 2020.



Source: BEIS Quarterly Energy Prices: March 2020[8]

2. The PCR was originally introduced to help mitigate against a number of barriers to genuine and effective competition that were found to exist in the traditional prepayment energy market by the 2016 EMI. At the time, the CMA noted that many of these barriers were likely to continue to exist until the GB smart meter rollout had been substantially completed, with suppliers under an obligation to take all reasonable steps to offer a smart meter to all consumers by 31 December 2020[9]. By the end of 2020, it was therefore anticipated that the widespread use of fully interoperable smart meters would have removed many of the technical barriers to competition by making it easier for consumers to switch tariff, supplier and payment method. This was also anticipated to provide suppliers with greater incentives to compete more effectively for new prepayment customers. However, delays to the smart meter rollout since the publication of the EMI,

[4]https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf
[5]https://www.ofgem.gov.uk/system/files/docs/2020/01/consumer_vulnerability_strategy_2025.pdf
[6]BEIS Quarterly Energy Prices: March 2020
[7]Scottish House Condition Survey 2018: Key Findings
[8]BEIS Quarterly Energy Prices: March 2020
[9]file:///C:/Users/alast/Desktop/ModificationsSmartEnergyCode26March14.pdf

which have been particularly acute for SMETS2 smart prepayment meters on the northern wide area network (WAN)[10], would render the removal of the PCR on 31 December 2020 premature unless significant positive change within the traditional prepayment energy market could be evidenced in the time since the PCR was first introduced in April 2017.

3. Though price dispersion within the prepayment energy market has actually increased since the introduction of the PCR[11], net switching rates among prepayment energy consumers away from the established Big Six suppliers and net gains among prepayment specialists have both slowed since the introduction of the PCR[12]. Clustering of tariffs around the level of the PCR price cap has also become commonplace at a time when competition for credit metered energy consumers has often pushed typical standard variable tariff (SVT) prices significantly below the level of the DTC[13]. With the number of tariffs available to traditional prepayment energy consumers still limited by technical constraints and prepayment consumers' engagement in the retail energy market remaining low, CAS therefore believes that there has been insufficient improvement in the conditions for competition in the prepayment energy market for price protections to be lifted at the current time.

4. With the incidence of fuel poverty in Scotland currently more than twice that found in either England or Wales[14], it is essential that appropriate checks are in place to prevent overcharging in a market where conditions for competition remain impaired. However, CAS also recognises that energy suppliers must be able to finance their efficient cost to serve prepayment energy consumers, including the provision of appropriate support for those in vulnerable circumstances. Any price control that is introduced to replace the PCR must therefore be set in such a way that innovation and competition is not further constrained, and sufficient incentives should remain for suppliers to compete on both price and service for new prepayment customers. We therefore agree that it would be inappropriate for the PCR to be allowed to expire without further intervention by Ofgem as the price protection afforded by the non-standard credit DTC to which prepayment consumers would default would set a price cap significantly lower than an efficient supplier's cost to serve such consumers.

5. Nevertheless, changes to the way in which the PCR is calculated[15] which came into effect in October 2019[16] have already brought the PCR methodology broadly into line with that used when setting the DTC. The use of the DTC with an appropriate prepayment meter uplift to extend price protection to prepayment consumers beyond the end of the PCR therefore seems like an appropriate means by which to afford such protection to the majority of prepayment energy consumers. Though the

[10] Oral evidence provided to the BEIS Select Committee Hearing on 30 October 2019 by Richard McCarthy CBE, Chairman of the Data Communications Company. Available at: https://www.parliamentlive.tv/Event/Index/06508acb-2eeb-4cd4-bad0-6f378bb457a0
[11] https://www.ofgem.gov.uk/electricity/retail-market/retail-market-monitoring/understanding-trends-energy-prices#thumbchart-c852534280570049-n95439
[12] https://assets.publishing.service.gov.uk/media/5d405962e5274a4016893bd0/Final_Decision_PPPC.pdf
[13] https://www.ofgem.gov.uk/electricity/retail-market/retail-market-monitoring/understanding-trends-energy-prices#thumbchart-c852534280570049-n95439
[14] https://researchbriefings.files.parliament.uk/documents/CBP-8730/CBP-8730.pdf
[15] https://assets.publishing.service.gov.uk/media/5d405947e5274a40137191d8/Final_Variation_order_PPPC.pdf
[16] https://www.ofgem.gov.uk/gas/retail-market/market-review-and-reform/implementation-cma-remedies/prepayment-meter-price-cap

relatively small number of prepayment consumers on fixed tariffs would not be covered by such price protection, we agree that it is reasonable to assume that such consumers have made an informed decision as to their choice of tariff and do not therefore require the same level of protection as the 98% of prepayment energy consumers who are estimated to be on a default, variable rate prepayment tariff.

6. CAS agrees that the adoption of a tariff differential approach is the best way to achieve a reasonable balance of fairness and affordability across all payment options. Though we recognise that the impact of such an approach on suppliers will differ depending on their proportion of direct debit, standard credit and prepayment customers, we note that a tariff differential already exists in the DTC, where the standard credit uplift is set at less than the efficient incremental cost to serve consumers who do not pay by direct debit. While this approach necessarily means that a small proportion of incremental prepayment meter costs would be shared among credit metered customers who pay by direct debit, we consider that the affordability impacts of this are outweighed by the corresponding effects on prepayment energy pricing.

7. CAS also agrees that an efficient supplier should realise greater benefits when replacing a traditional prepayment meter with a fully interoperable smart meter than would be the case with an equivalent credit meter exchange, and we agree that these benefits should be shared with consumers. An appropriately set adjustment to the non-pass through SMNCC currently used in the DTC would create a prepayment meter specific SMNCC and retain an incentive for suppliers to replace a traditional prepayment meter with a fully interoperable smart meter. However, while this approach would be consistent with the existing DTC methodology, the consumer benefits would be mutualised across all prepayment consumers of that supplier, regardless of their meter type. Consequently, there would be no direct financial incentive for a prepayment consumer to accept a smart meter unless further market engagement were to occur. With market engagement among prepayment consumers traditionally low, this may present a risk that the smart meter rollout among such consumers is further delayed. In turn, this could require price protections to be extended further and may place prepayment energy consumers at a significant disadvantage as the energy transition gathers pace.

8. Smart meters hold the potential to provide multiple benefits to prepayment and vulnerable energy consumers, and CAS has previously supported calls for smart meter installations to be prioritised for prepayment consumers with a history of self-disconnection[17]. However, with smart meter acceptance still voluntary, many hard to reach consumers are likely to require a compelling no-regrets reason to engage effectively with the GB smart meter rollout.

9. Were an alternative approach to the non-pass through SMNCC to be adopted, the cost benefits of smart meter installation could be shared directly between suppliers and consumers with smart meters. This would result in a discounted price cap relative to that applicable to an equivalent traditional meter, and with the majority of prepayment tariffs priced at or just below the existing

[17] https://www.cas.org.uk/system/files/publications/cas_response_to_ofgem_self_disconnection_consultation_final_version_sept_2019.pdf

PCR price cap, this might reasonably be expected to produce a small but direct financial incentive for consumers to accept or request a smart meter without a change of tariff or payment method being required before savings could be realised. Though beyond the scope of this consultation, a similar approach could also be taken to the non-pass through SMNCC for all consumers subject to the DTC in an attempt to drive engagement with the smart meter rollout among a customer group that has traditionally been chronically disengaged from the retail energy market.

10. CAS has also previously suggested that there may be a need to provide additional short-term protection for consumers whose ability to access the benefits of smart meters is currently restricted by the industry's readiness to provide them with suitable metering equipment. In our response to the BEIS consultation on a Smart Meter Policy Framework post 2020[18], we considered that this could be achieved via a modification to the gas and electricity supply licence codes, creating a new obligation on suppliers to provide any consumer who has accepted or requested a smart meter installation, but who cannot – for whatever reason – be provided with suitable metering equipment in a timeous manner, with an energy discount equivalent in value to the projected savings a smart meter would have allowed that consumer to make. We observed that such provision would financially incentivise consumers to adopt smart meters where they might not otherwise choose to do so, and so could also help suppliers to engage the interest of vulnerable and hard to reach consumers in the energy transition. Our alternative approach to non-pass through SMNCC in the DTC could support this.

11. CAS therefore agrees with Ofgem's view that price protection for prepayment energy customers continues to be required. We also generally agree with the approach proposed to achieve this at the end of the PCR. Given the proposed use of the DTC to extend such price protection, we also agree that both suppliers and consumers are likely to find it preferable if the move to a DTC-based price control were to coincide with the scheduled revision of the DTC rates which take effect on 1 October 2020. This would avoid the potential for 2 mandatory price alterations within the space of 3 months during Winter, lessening the administrative burden on suppliers and making it easier for consumers to understand their tariff pricing. While ending price protection for prepayment consumers entering into new fixed tariffs between 1 October 2020 and 31 December 2020, we consider that withdrawal of the PCR on 30 September 2020 would have minimal adverse impacts as, unlike the majority of prepayment energy consumers, such consumers can reasonably be assumed to have made an active choice as to their tariff terms and conditions.

Section 3 – Contact information

The Energy Policy team at Citizens Advice Scotland can be contacted on 0131 550 1000, or by emailing cfuenergy@cas.org.uk

[18] https://www.cas.org.uk/system/files/publications/cas_response_to_the_beis_consultation_on_a_smart_meter_policy_framework_post_2020.pdf