Consultation Response

Levelling the cost of standing charges on prepayment meters

Office of Gas and Electricity Markets (Ofgem)

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About this consultation

Direct Debit (DD) customers generally pay less for energy than prepayment meter (PPM) users. The Government recently brought in temporary measures to better equalise, or level, the costs. These measures are set to expire in March 2024 but Ofgem, the energy market regulator, has been given a mandate to resolve it longer term. The regulator is using this consultation to outline the options and has taken the opportunity to also review payment differentials more broadly. This includes looking into the options for addressing the higher rates generally paid by standard credit (SC) customers as well.

Key points and recommendations

- Age UK welcomes Ofgem’s efforts to better address the differential costs faced by prepay and standard credit customers in the energy market.
- Three options are proposed; Option 1 is to do nothing, option 2 is to better address the cost differential between PPM and Direct Debit customers, and option 3 is to better address both the PPM and standard credit cost differential.
- We agree that the regulator’s option 2 proposals should be implemented before April 2024 but strongly recommend that option 3 also be enacted soon thereafter.
- Age UK has provided four reasons why the regulator’s decision not to pursue option 3 is misplaced and could disproportionately impact older people.
- These reasons highlight how cost differential, market incentive, market innovation, and equalities implications have not been fully accounted for in Ofgem’s decision.
- We set out why the regulator should reevaluate its decision to not enact option 3 and would welcome the opportunity for further dialogue on this issue.

About Age UK

Age UK is a national charity that works with a network of partners, including Age Scotland, Age Cymru, Age NI and local Age UKs across England, to help everyone make the most of later life, whatever their circumstances. In the UK, the Charity helps more than seven million older people each year by providing advice and support. It also researches and campaigns on the issues that matter most to older people. Its work focuses on ensuring that older people: have enough money; enjoy life and feel well; receive high quality health and care; are comfortable, safe and secure at home; and feel valued and able to participate.

Introduction

We welcome the opportunity to respond to this consultation[1]. Customers paying by standard credit or via a PPM are more likely to be financially vulnerable[2]. We recommend Ofgem better address the higher relative costs PPM and standard credit customers face when compared to Direct Debit customers. We therefore support Ofgem immediately implementing their option 2 proposals in time for April 2024 but call on the regulator to also enact their option 3 proposals soon thereafter. Implementation of both option 2 and 3 would better address cost differentials across all three payment types, reducing costs for PPM and standard credit customers.

For context, electricity and gas bills are charged via three main methods of payment. The first is Direct Debit, which generally involves an authorised automatic bank transfer from the customer's account, which can often be based on estimated bills. The second, is via prepayment meter (PPM) which is pay-as-you-go energy, with customers topping up their meter prior to accessing their energy. Finally, there is standard credit which is generally where a customer pays on receipt of a bill for the energy they have already used, either monthly or quarterly.

Around 86% of people aged 60+ pay[3] with Direct Debit, 7% with standard credit, and 6% via a PPM[4]. Our research indicates that older households[5] are less likely to pay by PPM than younger households (6.0% compared to 13.2%) and are marginally more likely to pay by standard credit (6.8% compared to 4.8%)[6]. This echoes the anecdotal evidence we hear from many older people who express a desire to pay by standard credit as it avoids estimated bills and often allows them to pay quarterly by cash or cheque.

While these payment types each have pros and cons[7], one of the key differentials is cost. Generally speaking, the typical Direct Debit (DD) customer will pay much less than those paying via other methods. Ofgem's upcoming DD price cap will be £1,923, the PPM cap will be £1,949, and the standard credit (SC) one will be £2,052[8]. These figures represent the annualised amount the typical dual fuel default tariff customer will typically pay by each of these payment types based on average consumption from 1st of October until the 31st of December 2023. Despite DD being the cheapest it has the lowest proportion of customers in receipt of welfare benefits (31%) when compared to SC (48%) and PPM (62%)[9] – meaning benefit recipients are disproportionately paying a premium to access their energy supply.

Research shows satisfaction with their payment method is also highest amongst DD customers (82% satisfied), much higher than PPM (68%) and SC (66%)[10]. A little over half (55%) of customers are aware that there are variations in cost by payment method and when customers are aware that they are paying more for their payment type satisfaction goes down[11].

Age UK has long argued that PPM users and those paying by SC should not be forced to pay a premium for their fuel[12]. The Government recently brought in temporary measures to better equalise the costs faced by PPM users – measures which are set to expire in March 2024. Ofgem is using this consultation to review the options for addressing this in the longer term. The regulator has taken the welcome decision to also review the higher fees SC customers face too.

We support the regulator's option 2 proposals but strongly recommend Ofgem also enact its option 3 addition, ensuring both PPM and SC customers no longer face as steep a premium because of their payment method. In our below response we provide four reasons why the regulator should not discard option 3.

Response

Ofgem is proposing three options[13]:

- Option 1 is to do nothing and leave things as they are.
- Option 2 is to eliminate the standing charge premium paid by PPM customers by equalising these charges and Additional Support Credit (ASC) bad debt costs between DD and PPM customers.
- Option 3 would be in addition to option 2, adding in broader equalisation of specific debt-related costs which would also reduce the cost differential between SC and DD.

For clarity, we have collated the data from Ofgem's impact assessment into table 1 to show the practical implications of these proposals. The cost differentials are relative to the base scenario (option 1).

Table 1: Typical dual fuel bill (annualised) from October under different scenarios

Scenario	Direct Debit	PPM	Standard credit
Option 1	£1,923	£1,949	£2,052
Option 2	£1,934 (+£11)	£1,895 (-£54)	£2,054 (+£2)
Option 3	£1,934 (+£11)	£1,937 (-£12)	£2,019 (-£33)

Source: Ofgem consultation and impact assessment[14]

Ofgem's preference is for option 2[15]. The reason the regulator is averse to option 3 is because it may reduce the incentive to pay by DD, entailing broader ramifications for the market and consumer prices. Ofgem's argument is that option 3 could put people off shifting to DD payments or incentivise an increasing number of customers to actively shift to SC, which has higher cost implications due to its steeper fixed and debt related costs. The regulator is therefore proposing to just pursue option 2 and not enact option 3.

However, there are four reasons Age UK believes Ofgem should reevaluate this choice. Firstly, option 3 does not fully remove the cost differential between DD and SC. This reduces the risk that large numbers of customers will rapidly switch from DD to SC as they will, in most cases, still be paying a higher price. Ofgem's own research[16] shows the most commonly cited reason for customers to opt for DD is actually convenience (49%), rather than it being cheaper (24%), and cost is by no means the only reason people will continue paying by DD, or indeed stay on a more expensive SC tariff. Ofgem should be mindful of this when it weighs up the risk of large volumes of customers switching to SC if it becomes cheaper.

Secondly, Ofgem has not given sufficient weight to the role of barriers to market engagement. As the regulator rightly states, some customers cannot move from SC to DD for a variety of reasons (e.g. they do not have access to a bank account or they pay their bill by cash or cheque). Based on our experience, it is likely that there is a strong relationship between paying by SC and not having access to the internet or paying for goods and services by cash. Older people rely heavily on cash for their essential spending[17] and face significant barriers to accessing the internet[18] – particularly those aged 75+. Importantly, customers who are not online are less likely to switch supplier[19], and market disengaged households are more likely to be struggling financially[20]. Given our research[21] and experience indicates a higher proportion of older people pay by SC Ofgem must be mindful that its decision not to pursue option 3 is likely to disproportionately impact older customers, particularly those not online or paying for goods and services by cash or cheque. This has clear implications for the regulator's obligations under the Public Sector Equality Duty as it pertains to age[22] and its explicit statutory duty to ensure its policy decisions account for the interests of people of pensionable age[23], given that older people will disproportionately be locked into paying by SC and forced to pay the associated higher price for their fuel.

Thirdly, Ofgem must consider how market innovations, such as smart meters, may change preferred payment choices over the coming years as these innovations start delivering enhanced consumer choice. The fact that greater control is the most cited reason for customers to opt for SC (41%)[24] is no surprise to us. When we speak with older people about payment types, they frequently cite that they pay by SC because it bypasses the need for estimated bills. While innovations like smart meters do present implementation issues for some consumers[25], they also generally provide a far greater level of customer control and consumer choice. In the case of smart meters they reduce the need for estimated bills when paying by DD. Ofgem should be mindful that market innovations like this may reduce the risk of consumers wanting to pay via SC, as they can actually maintain greater control using their existing DD.

Finally, we question how much of the additional costs associated with SC are due to economies of scale. Far fewer households pay by SC (around 6%), than DD (84%), or even PPM (11%)[26]. It is therefore hard to know how much of the higher fixed costs associated with this payment type are baked in, and how much of it is because it is a relatively rare, and therefore expensive, method of payment to deliver. We'd be keen for Ofgem to further investigate this.

With this in mind, we are aware that Ofgem considers option 3 will delay implementation before April 2024. We therefore recommend that the best approach is to implement option 2 immediately and proceed to further investigate option 3 as a viable addition later in 2024, once the full implications of this change are better understood.

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[1] Ofgem, 2023. Levelling the cost of standing charges on prepayment meters. Ofgem. [Online]. Available at: https://www.ofgem.gov.uk/publications/levelling-cost-standing-charges-prepayment-meters. [Accessed 01/09/23].

[2] Ofgem, 2023. Levelling the cost of standing charges on prepayment meters. Ofgem. [Online]. Available at: https://www.ofgem.gov.uk/publications/levelling-cost-standing-charges-prepayment-meters. [Accessed 01/09/23]. Pg18-19.

[3] Many electricity and gas customers pay separately for these two fuels. As a result, these statistics relate to the payment type used to pay for central heating.

[4] Age UK, 2023. Keeping the Lights on. Age UK. [Online]. Available at: https://www.ageuk.org.uk/globalassets/age-uk/documents/reports-and-publications/reports-and-briefings/safe-at-home/age-uk-energy-public-policy-report-march-2023.pdf. [Accessed 01/09/23]. Pg9.

[5] Defined here as households with at least one resident aged 60+.

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