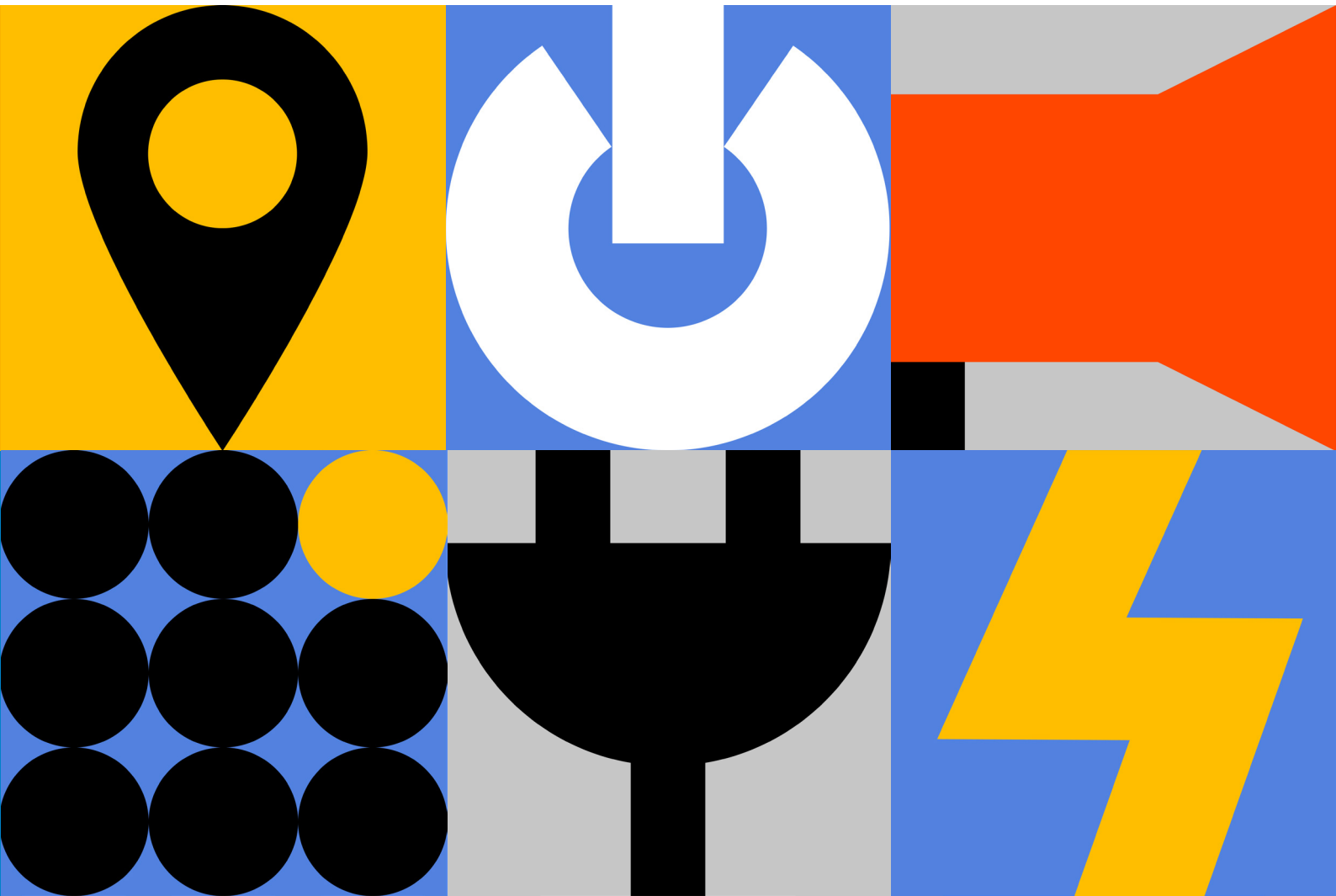
STONEHAVEN

RE-THINKING RETAIL: PROTECTING CONSUMERS



One of the primary questions we received on our Rethinking Retail report was how our proposed model would handle vulnerable consumers. The reason why this is a big topic is not hard to see: in the wake of the energy price crisis, more people than ever have struggled to pay their bills, and the press is full of stories about the forced installation of pre-payment meters. If you can't afford to heat your home, over the winter you are more likely to get sick, more likely to experience the build-up of damp and mould, and for people with pre-existing conditions, the very young and the very old, there is a real risk of death.

We chose not to cover this in the paper because our focus was on how to deliver the kind of competition that could improve outcomes for consumers overall. But there's no denying the importance of a system that seeks to reduce misery, and so this post is intended as an addendum to our paper that sets out how the thrust of our proposals would apply to those who need help the most.

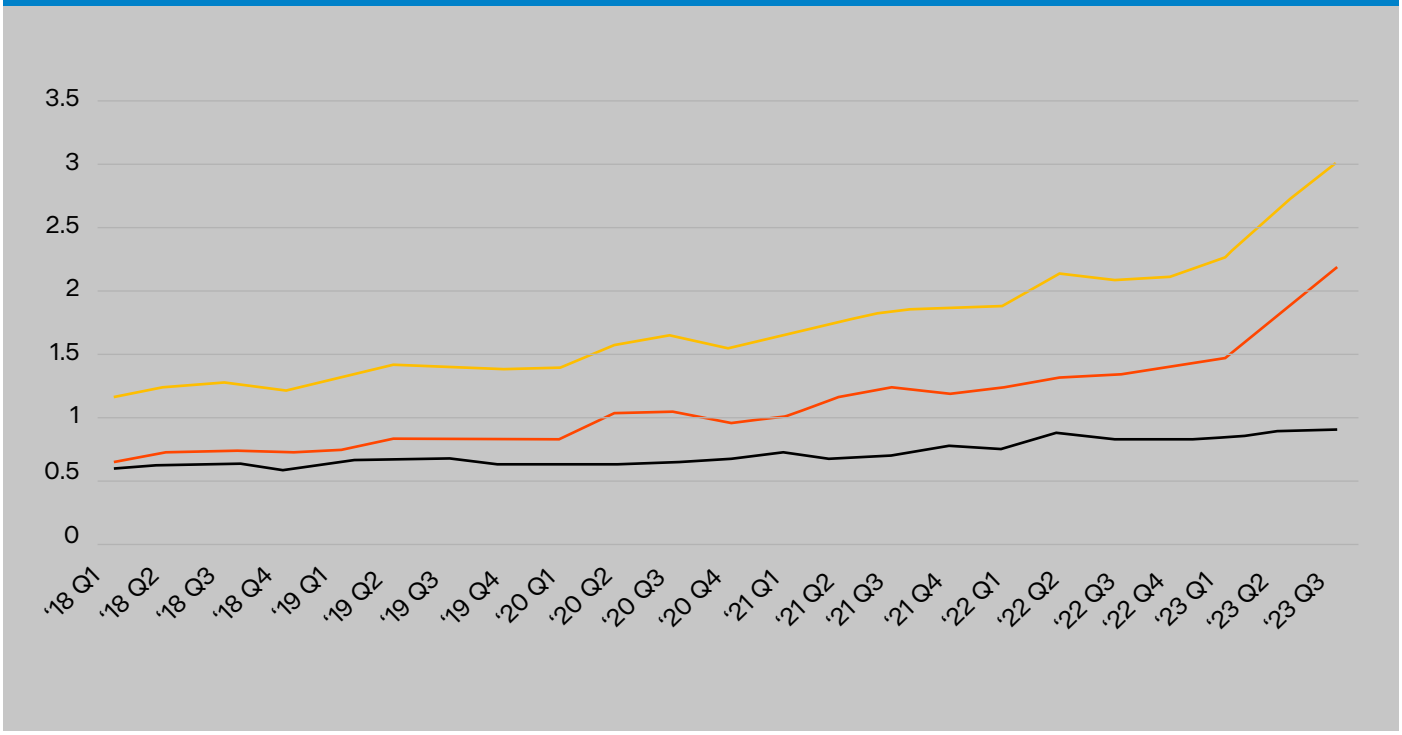
We start from a position of recognising that there is a trade-off between companies engaging in competition & innovation and engaging in consumer protection. Consumers who enter into debt because they are unable to pay – and cannot be switched off, meaning the supplier continues to incur costs to serve that consumer – represent a cost, and in bulk a cost that may be very hard for a new supplier to bear. Total consumer debt and arrears currently stands at £2.9bn. On average, those consumers in debt with no payment plan in place owe over £1,200 to their energy company. Over 980,000 consumers are in this category. A further 805,000 have some kind of debt payment plan of which about half involve a pre-payment meter.

This means that about 6-7% of all UK energy consumers are in debt to energy suppliers, or to put it another way, about 5-6% of the average supplier's customers are a net cost to it rather than a profit. At this scale, this could easily represent the difference between making a profit and between making a loss; Ofgem are in fact considering whether to provide an allowance in the price cap to reflect this. Suppliers are obliged under their licence to continue to serve customers in debt, and new restrictions on the installation of pre-payment meters will limit their ability to recover this debt. They also cannot refuse to take on new consumers they suspect might be likely of entering into debt; they are obliged to offer a tariff to anyone who wants one. This is the Universal Service Obligation.

These obligations are the opposite of incentives to enter this market but are in place for a reason. The impact of not being able to access energy, as set out above, is so substantial that it is vital that people struggling to pay their bills are protected. Energy suppliers' dual role as competitive entities and providers of a service vital for welfare is one of the key reasons the current regime is so cumbersome.

How to resolve this trade-off? Our first insight from Rethinking Retail that applies here is that simply because under the existing regulatory structure a supplier licence covers the entire market does not mean this always needs to be the case. Just as we proposed separate markets for transport and heating, we should consider whether a separate market for vulnerable consumers might not have considerable merit.

Figure 1: Total financial value of domestic customer debt and arrears (existing for >91 days) (Source: Ofgem)



RE-THINKING DEBT

What we care about is that vulnerable consumers can access energy when they need it. It doesn't have to be the case that every single company has to offer them a tariff, merely that at least 1 company does so with imposing punitive costs. But we also have to ensure that if they do get into debt there's a mechanism to encourage that debt to be paid back to avoid unfairly penalising people who do not fall into debt.

There have been plenty of proposals about how to do this, which fall into a number of categories:

Special tariffs (often called 'social tariffs') that sell energy at a discounted rate to vulnerable consumers, with the costs passed back to everyone else. This is tantamount to explicitly extending the welfare system onto energy bills, except paid for via a highly regressive flat tax on everyone else. Raising benefits and pensions in line with inflation so that consumers can decide what to do with their resources offers both greater fairness and more dignity.

A rising block tariff available to everyone. This, similar to the model used in Dubai, sees differential charges for different levels of demand, potentially including a free 'block' of electricity and gas for everyone. This is highly appealing, as it maintains an incentive to minimise demand while ensuring the vulnerable can always access energy. However, it risks unfairly penalising people who have e.g. medical equipment that has a higher than average load that they still need to pay for.

Similar to the above, for consumers who cannot or will not pay, rather than disconnecting them from the system entirely they are instead permitted to access gas or electricity for heating in winter but cannot otherwise access the energy system. The challenge this option faces is that defining what level of energy is necessary for welfare is very context-dependent: should they be given energy in the summer for cooking? Do they also need energy to run a fridge or lighting in the winter? Such a scheme very quickly becomes a question of managing that consumer's life for them, with all the risks and lack of dignity that entails.

There is no perfect solution to this problem; what unites the options above is that they would work for some portion of those in debt but not for others. Attempting to impose a single or even a portfolio of solutions from the centre is therefore likely to be unsuccessful.

Energy companies themselves know a considerable amount about their customers; they know when they pay their bills, they know when they use energy and they know when they might be likely to get into debt. But retailers, as our earlier paper outlined, are vast sprawling enterprises with multiple overlapping regulatory goals, and boards find it hard to focus on the challenges that they already face. Supporting those in debt to get out of it requires dedication.

In our first paper we proposed a division between 'old' electricity demand and 'new' electricity demand, where the new demands of heat pumps and electric vehicles were spun off into new markets, leaving 'old' demand the preserve of existing retailers. The purpose of this was to enable greater levels of innovation and reduce the cost of transitioning much of our energy demand to electricity. Here, we propose to divide 'old' demand again, by creating a new category of licensed retailers who make money primarily by working with consumers to get them out of debt rather than selling energy.

Consumers falling into debt would have the option of immediately transferring that debt and their billing arrangements to one of these licensed entities, along with any data their current supplier holds on their habits and, unique to this category of retailer, relevant income and benefits data from HMRC and DWP. Consumers making the switch would need to explicitly provide access to this data to manage privacy concerns but given that these entities would be carrying out what is in essence a welfare role we believe that this kind of access will be critical for providing a tailored service.

Unlocking this data would give our new entities scope to better understand the income profiles and lifestyles of their customers, helping to identify what kind of support and options would work for the individual concerned. These may be a mix of the kinds of pathways set out above, or something entirely novel.

These entities would be rewarded in line with the number of customers they get out of debt and for how long, funded via the debt levy that Ofgem is looking to implement via the price cap. A new regulatory model would be required to identify what an appropriate level of reward would be. Little information on how much it costs to reduce debt would be available at the start of this framework, but the current costs to suppliers of managing this debt could be taken as an initial ceiling.

CUTTING COSTS

The purpose of taking this route is to find a mechanism that manages the incredible heterogeneity of consumers without requiring the regulator to access information it does not have and could never meaningfully acquire. Because it would be highly novel, we would recommend piloting it in the first instance; we anticipate that this kind of social entity would be of great interest to local authorities who have sought to establish similar social purpose vehicles before but have fallen foul of market conditions.

Regardless of its route to implementation, we take ever-increasing amounts of consumer debt (Figure 1) as a signal that something must be done. We believe the route set out in this note would be optimal, not just for the indebted by also for everyone else; retailers that are not obliged to manage debt burdens will have considerably greater bandwidth to innovate and reduce costs overall. Like our earlier paper, we believe that reducing costs for everyone is the right objective.

