



Pre-payment meters

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Author: Ben Smith

Section Science and Environment Section

There has been widespread criticism of the higher prices that users of prepayment meters pay. There have been 12 Early Day Motions on the subject in the House of Commons over the past year, along with many parliamentary questions and several debates. The government has repeatedly given assurances that it will take action if the situation does not improve. This note looks at recent developments on the issue.

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1 Parliament

On 16 October 2008, the new energy and climate change secretary, Ed Miliband, made clear his intention to push for changes on pre-payment meters in his first statement to the House:

Those are the big issues that we need to address for the future, but today I want to signal a direction of travel on affordability. Last week the energy regulator, Ofgem, highlighted what it believed to be unjustified higher charges for 4 million electricity customers in areas not connected to the gas main. It also believes that, even when account is taken of higher costs facing companies from customers with pre-payment meters, many homes that use them are being overcharged.

Unfair pricing that hits the most vulnerable hardest is completely unacceptable. I made that clear to the representatives of the big six energy companies when I met them yesterday. I also told them that the Government expect rapid action or explanation to remedy any abuses, and I will meet them again in a month to hear what they have done. We, and Ofgem, are determined to see those issues addressed. Ofgem is consulting on its findings until 1 December as part of a due process, but let me say this: if the companies do not act satisfactorily and speedily, we will consult on legislation to prevent unfair pricing differentials.¹

Responding to a PQ in November 2008, energy minister Mike O'Brien said:

If sufficient progress is not made by this winter 2008-09, the Secretary of State is prepared to consult on legislation, with a view to reducing unjustified tariff differentials.²

The Government's approach to the energy supply companies has been described as 'sabre-rattling',³ and there have been calls for stronger action. Some observers have been frustrated with the pace of progress on energy bills for vulnerable consumers: Help the Aged said, "It's time we saw progress rather than baby steps from the industry."⁴

The Business and Enterprise Committee conducted an inquiry into energy prices and fuel poverty in 2008. The report provided some useful basic figures about the prevalence of prepayment meters and their relationship with fuel poverty:

Currently, 47% of standard electricity users pay their bills by direct debit, 39% do so by standard credit (i.e. by cash or cheque), and 14% have prepayment meters (PPM). For gas, the equivalent figures are 51%, 39% and 10%. Customers with PPM tend to have lower incomes, though they are not necessarily fuel poor. (Fuel poverty arises when more than 10% of household income is spent on electricity and heating.) In fact, only 20% of those in fuel poverty are on PPM—the majority use standard credit. PPM users include customers who are in debt to their suppliers, those in rented accommodation, and second home owners.⁵

The committee criticised the functioning of the market:

There has been a widening gap between companies' direct debit tariffs, and those for standard credit and prepayment meters (PPM). Nine years after liberalisation, this suggests a serious failing in the competitiveness of the market.

¹ HC Deb 480 c935-7, 16 October 2008

² HC Deb c1363W, 13 November 2008

³ See for example 'Hands-on approach to providing power', Interview with Ed Miliband, *Financial Times*, 22 December 2008

⁴ 'Consumer groups and charities call for tougher action to reduce power bills', *Guardian*, 20 December 2008

The report called on Ofgem to pursue its market probe thoroughly and, if no satisfactory resolution was found, to pass the matter quickly to the Competition Commission.

2 Ofgem

2.1 Energy supply market probe

The issue of pre-payment meters was investigated by Ofgem at the same time as the regulator was conducting its Energy Supply Markets Probe. An open letter published on 30 May invited people to respond to the PPM issues.⁶ In June 2008 Ofgem released figures to show that nationally prepayment meter customers were losing out on savings worth £250 million by not switching supplier.⁷ The press release also provides a table of average PPM bills for different companies and the difference between those bills and the company's best offer.

Ofgem reported its initial findings to both investigations together at the beginning of October 2008. The summary conclusions of the probe regarding PPMs were as follows:

Pre-Payment Meter (PPM) consumers

1.24. There has been a great deal of public and political interest in whether the higher prices paid by consumers using pre-payment meters can be justified by the additional costs of metering and providing service to these consumers. The price premium charged to PPM customers differs significantly between suppliers, between geographic regions and over the range of energy consumption. PPM price premiums at the lower end of the consumption range appear to us to have a sound cost justification, while those at the upper end of the range do not. We believe that action is necessary to ensure that the premium charged to all PPM customers is placed on a sound cost basis. Moreover, we are concerned that competitive pressure on suppliers in this sector may not be sufficient and, as a result, the additional costs incurred in serving PPM customers may not be efficiently incurred.

1.25. Even once unjustified price differentials are removed, PPMs will remain among the most costly payment methods. PPM customers often choose their payment method for reasons of budget management. However, it is essential, particularly at times of rising prices, that they are aware of the price premium they pay, know the options open to them and are able to switch to a lower cost option as easily as possible.

1.26. PPM customers have recently become the most active in switching their supplier, although this is mainly in response to direct sales activity by the Big 6. This increased engagement of PPM customers is a positive development, and, indeed, we have encouraged this through our "energysmart" campaign. However, PPM customers rarely consider a wide range of alternative suppliers when switching and often switch to more expensive deals. Measures we propose to help consumers make better switching

⁵ Business and Enterprise Committee, [Energy prices, fuel poverty and Ofgem](#), 16 July 2008, HC 293-I 2007-08, para 83

⁶

<http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Open%20letter%20PPM%20Customer%20Switching.pdf> . The call for evidence for the energy market supply probe (which was announced on 21 February 2008) is available here:

<http://www.ofgem.gov.uk/Markets/RetMkts/ensupro/Documents1/Energy%20Supply%20Markets%20Probe%20-%20Call%20for%20Evidence.pdf>.

⁷ ['PREPAYMENT METER CUSTOMERS MISSING OUT ON SAVINGS WORTH £250 MILLION'](#), Ofgem press release 28, 27 June 2008

decisions in response to direct sales activity should be of particular benefit to PPM consumers, a significant minority of whom (around 20 per cent) are also fuel poor.⁸

Ofgem proposed remedies to improve pricing information available to consumers, and to ban price differentials that were not based on costs:

1.40. ACTION 5: addressing concerns over unfair price differentials. Encouraging more consumers to participate actively in the market and improving the quality of switching decisions should intensify competitive rivalry among suppliers. We would expect unfair price differentials to be eroded as a result but in addition:

- We will propose a new licence requirement on suppliers that differences in charges for different payment types must be cost-reflective.
- We are also considering placing a further new condition in the licences of the Big 6 suppliers that would either impose a prohibition on undue price discrimination or introduce a form of relative price control. Any such condition would seek to ensure that price differentials are objectively justified by cost differences. We would need to be sure that such a condition is a proportionate measure and serves to help, rather than hinder, progress towards effective competitive markets. We will conclude on this in the light of responses to the consultation and progress made in securing commitments to the market reforms we seek.

The findings of the probe were published in the form of a consultation paper. The consultation sought responses from suppliers by 1 December 2008, and in the event of failure to reach agreement on implementing Ofgem's proposed remedies, Ofgem was to consider referring the matter to the Competition Commission.

On 16 December Ofgem issued a press notice about unfair pricing, including prepayment meters. The regulator announced that some bills had already come down:

...since the probe began, more than £300 million has been taken off the premiums paid by customers including pre payment meter (PPM) users. And the companies have indicated that further reductions that should reach at least £200 million for more than 4 million households who are off the gas grid and others whom the probe identified as missing out on the best deals.⁹

Although some suppliers have reduced unfair prices, Ofgem viewed the overall rate of delivery as too slow and started a six-week consultation on changes to suppliers' licences on 9 January 2009.¹⁰ With regard to prepayment meters, the regulator stated in the consultation document that:

...several companies have indicated that they will take steps to address the remaining unfair differentials during future pricing adjustments. However, there is a lack of clarity on the timing and the exact nature of any such changes, or whether any of them would be sustained in the absence of specific action. Ofgem has nonetheless indicated that it would expect suppliers to implement changes as soon as possible in 2009.¹¹

⁸ [Energy Supply Probe - Initial Findings Report](#), Ofgem, 6 October 2008

⁹ Ofgem press notice R35, [Ofgem probe has half a billion pounds in its sights for customers](#), 16 December 2008.

¹⁰ [Addressing unfair price differentials](#), Ofgem consultation 1/09, 8 January 2009

¹¹ [Addressing unfair price differentials](#), *ibid.*

In March 2009, Ofgem unveiled its proposed measures to address unfair price differentials and information shortcomings. The regulator intends to finalise the package and for the measures to be in force by autumn 2009. A ban on unfair price discrimination (where the extra charged to prepayment meter users, among others, is more than can be justified by higher costs) was recommended in the regulator's 'market probe' of 2008. The measures also include better information on the tariff that a customer is paying and, specifically for prepayment customers, proof that any offer made on the doorstep is better than the customer's existing deal.¹²

2.2 Recalibration

Prepayment meters that operate by token need to be manually recalibrated to reflect changes in tariff prices, and there was mounting concern about the practice of introducing price increases without immediately recalibrating token meters. This can lead to consumers building up debt without realising it.

Ofgem changed the suppliers' licence conditions in this area from 1 August 2007. The new licence conditions put an obligation on suppliers to recalibrate meters promptly and banned them from 'debt blocking', which is refusing to allow a customer to change supplier until they have paid off their debt. There was no outright ban on raising prices before meters have been recalibrated. E-On, npower and Scottish Power all do this. Best practice guidelines were introduced on the treatment of customers who get into debt because of this practice; suppliers are encouraged to consider writing off debt and to avoid disconnections.

Ofgem also recommended that all token prepayment meters should be replaced by 'key' meters that do not need recalibration. In February 2009 a letter was published giving details of the progress of the replacement programme, and other issues connected with token meters.¹³ The letter said that:

Ofgem is satisfied that suppliers are continuing to meet their commitments and licence obligations in this area, although there remain a number of customers who build up debt where the supplier has not been able to gain access to the meter.

The letter also gives figures on the number of meters accruing debt and the amount of debt written off. There was an increase to 100,000 in the number of token meters in debt in the first half of 2008, due to price rises. In the second half of 2008 the number declined to 62,000.

3 The Business and Enterprise Committee's December 2008 report

On 10 December the Business and Enterprise Committee published another report on energy policy.¹⁴ The committee acknowledged that some energy suppliers had moved voluntarily towards making their tariffs fairer but the committee called on Ofgem to change licenses to include a condition that charges for different payment methods should be cost-reflective, and to ban undue price discrimination.¹⁵

¹² See the Ofgem press release '[Regulator's new rules pack a punch for customers](#)', 23 March 2009

¹³ [Token prepayment meter customer issues](#), Ofgem letter, 2 February 2009

¹⁴ Business and Enterprise Committee, [Energy policy: future challenges](#), 10 December 2008, HC 32 2008-09

¹⁵ [Energy policy: future challenges](#), *ibid.*, para 32

The Business and Energy Committee also repeated in its December 2008 report that most of those in fuel poverty are on standard credit terms, and called for more political attention to be paid to this 'larger and often more vulnerable group'.¹⁶

4 The Financial Inclusion Taskforce

The Financial Inclusion Taskforce has also investigated the energy market. It published its report on 22 December 2008:

The report looks at different payment methods for energy bills and their advantages and disadvantages. It considers the scope for further migration to direct debit payments and makes a number of recommendations to help more people to benefit from direct debit payments and to make bill payments easier and more affordable for vulnerable customers. These include ways to put everyone in the best position to make an informed choice about how they pay for their energy as well as possible changes to payment methods to make direct debit energy payments more manageable and attractive.¹⁷

The findings of the inquiry are summarised as follows:

- A large number of energy customers could save money by moving to pay by direct debit, but choose not to. There are several different reasons why a person might choose another form of payment.
- Some people take a passive approach to managing their energy costs and are unaware of the opportunity to save money. Others are unaware of the protection offered to users of direct debits and are suspicious of promotions and assurances from their suppliers. Others are confused by the apparent complexity and differences between the deals available from each supplier.
- Many people fear that using direct debits will deprive them of the ability to control their payments. Moreover, in practice moving to direct debit payments usually means moving to paying monthly on the basis of estimated usage. Recent press coverage suggests that there is a mistrust of the way in which energy companies estimate customers' consumption, which in turn has exacerbated the fear of loss of control.
- A significant proportion of households currently paying by standard credit could comfortably move to paying by direct debit and benefit from the cost savings by doing so.
- There is also a significant group of people, including many pre-payment meter customers, who are not in a position to move to direct debit payments without compromising their ability to control their finances. For consumers on lower incomes, the ability to control the timing and amount of payments is much more important than for customers on higher incomes.

The main recommendations of the report are:

- **Information** - we believe that many customers would move to direct debit, or at least to a cheaper payment option, if they were better informed about their choices and also about the protection and control that direct debit payments

¹⁶ Business and Energy Committee, [Energy policy: future challenges](#), 10 December 2008, HC 32 2008-09, para 32

¹⁷ ['Financial Inclusion Taskforce reports on access to banking and on direct debit energy payments'](#), Financial Inclusion Taskforce press notice, 22 December 2008

offer. Experience suggests that information from a trusted source (not necessarily energy suppliers) is more likely to be effective.

- **Changes to payment methods** - we believe that the range of payment methods offered for energy could be improved to enable more people to benefit from a reduced tariff by providing them with greater clarity and control over their payments.
- **New payment systems** - in the longer term, it may be possible for energy suppliers to use new and emerging payment technologies to offer less expensive payment¹⁸

5 Statistics

The Department for Business, Enterprise and Regulatory Reform collects figures on pre-payment meter use and prices.

5.1 Regional variation in pre-payment meter use

In September 2008, 37 per cent of standard electricity customers paid by standard credit, 49 per cent paid by direct debit, and 14 per cent paid by pre-payment meter.

The Southern region had the highest proportion of standard electricity customers paying by direct debit, at 57 per cent. Direct debit is the cheapest payment method for domestic fuel. The lowest percentage of direct debit customers was in Northern Ireland, where 32 per cent of customers paid by this method.

Northern Ireland had the highest percentage of pre-payment customers in the UK, at 28 per cent. The Eastern region of England had the lowest percentage of pre-payment customers, at 7 per cent.

At the end of September 2008, 38 per cent of gas customers paid by standard credit, 51 per cent paid by direct debit, and 11 per cent paid by pre-payment meter.

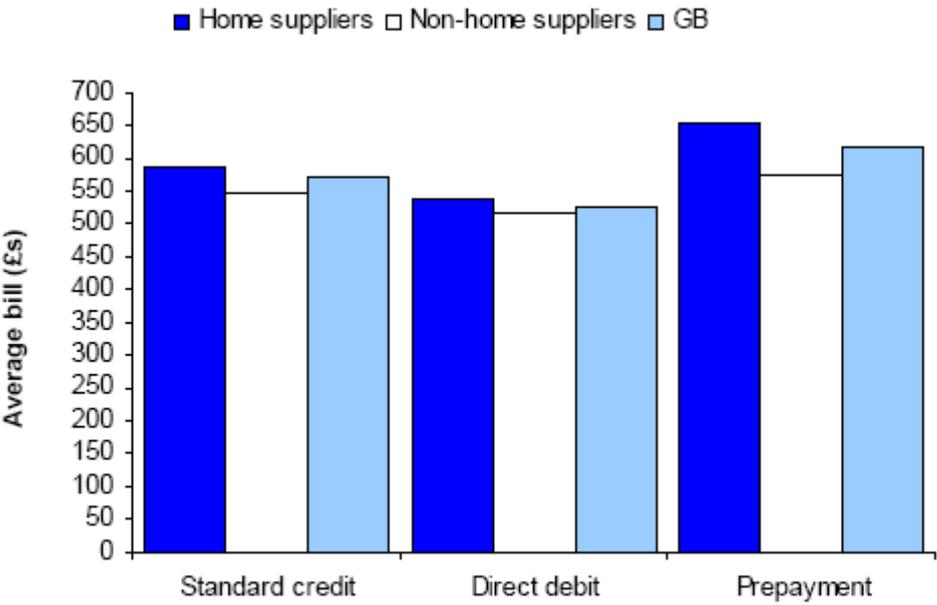
The Southern region of England had the highest proportion of gas customers paying by direct debit, at 62 per cent. Direct debit is the cheapest payment method for domestic fuel.

Wales have the highest percentage of gas pre-payment customers in the UK, at 15 per cent. The Southern region of England had the lowest percentage of gas pre-payment customers, at 7 per cent.¹⁹

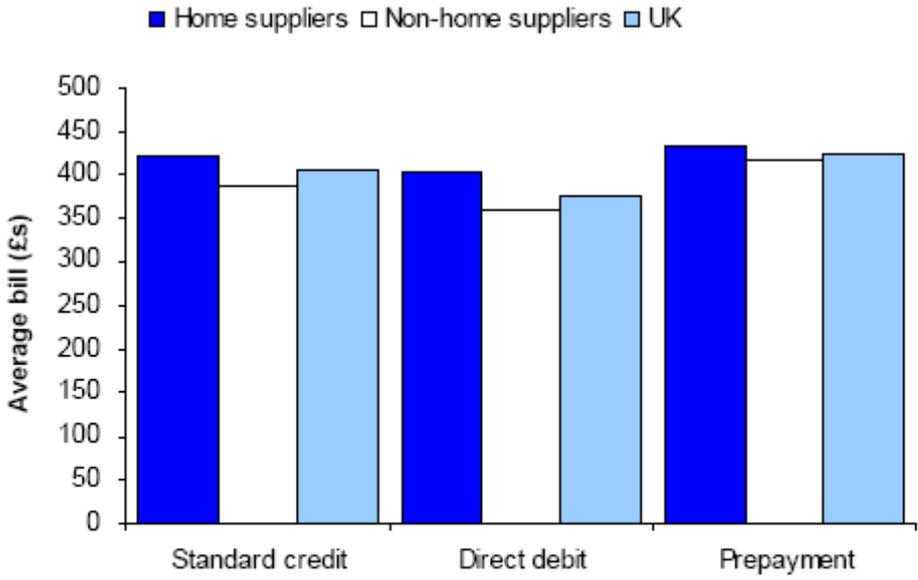
¹⁸ [Report on direct debit energy payments](#), Financial Inclusion Taskforce, December 2008

¹⁹ <http://www.berr.gov.uk/whatwedo/energy/statistics/publications/prices/tables/page18125.html>

5.2 Average GB annual domestic gas bills 2008



5.3 Average annual domestic electricity bills 2008



Source: BERR, [Quarterly Energy Prices, December 2008](#)