



OVO Response to the CMA Second Supplemental Notice of Possible Remedies and Addendum to the Provisional findings

13 January 2016

OVERALL RESPONSE TO FINDINGS AND REMEDIES SPECIFIC TO THE PREPAYMENT SECTOR

1. Prepayment Sector Findings in the Context of Wider Retail Market Findings

- 1.1. In our response to the CMA's proposed remedies consultation in July 2015, we outlined that there are two major problems with the current retail energy market. The first problem arises as a direct result of the ability of incumbent suppliers to use their stock of disengaged customers to segment the retail energy market. The direct means by which suppliers segment the market is by engaging in both loss leading and excess profit taking. The second problem is the current overly proscriptive and complex regulatory framework.
- 1.2. Since our submission to the proposed remedies consultation we became aware of specific issues within the prepayment market that we considered to be restricting competition further in this specific market. Having voiced our concerns to the CMA at the time we are very welcoming and supportive of the CMA's provisional findings that a specific AEC exists in the prepayment market.
- 1.3. Particularly welcoming is the CMA's finding that the existence of technical constraints within the prepayment market;

"Limit the ability of new entrants to innovate by offering tariff structures that meet demand from PPM customers who do not have a smart meter"

- 1.4. Despite welcoming the CMA's findings, we are surprised that the CMA have not proposed any remedies that seek to alleviate these "technical restraints". When we raised the issue of the unavailability of PGTPs to the CMA, our primary concern was that this "technical constraint" acted as an absolute barrier to entry into the prepayment market in many instances.
- 1.5. While it is apparent that the CMA has attempted to solve this problem, such as the "workaround" detailed in Appendix A, we are surprised that the CMA has not sought to direct Ofgem or another industry body to find an equitable means of improving the allocation mechanism for PGTPs. We would therefore welcome further clarity from the CMA on the reasons why an alternative solution to the technical constraints problems was not sought.

2. OVO's Concerns regarding the use of Proscriptive Rules to Improve Market Outcomes

- 2.1. While we were clear that two problems existed in the retail energy market in our prior submissions to the CMA, we neglected to discuss how previous attempts to solve the first problem (unfair pricing) have resulted in a number of regulatory interventions which in turn have contributed significantly to the second problem (proscriptive regulation).
- 2.2. In a previous attempt to curtail the problem of unfair pricing, Ofgem introduced reforms now known as retail market reform (RMR). Unfortunately not only did RMR fail to improve outcomes for the vast majority of customers, as the CMA has found it succeeded in restricting the ability of suppliers to launch innovative and engaging products.
- 2.3. With the benefit of hindsight, the CMA investigation now represents an opportunity to solve the original problem of unfair pricing, having learned from Ofgem's previous approach. While we are confident that the CMA is aware of the failings of RMR and the pitfalls associated with trying to improve market outcomes by imposing strict rules, we are concerned that a number of remedies proposed in this consultation risk making the same mistakes, particularly proposed remedy 20c. We discuss our concerns further in the section below.

RESPONSE TO SPECIFIC REMEDIES

3. Facilitating the Sharing of Data Relating to Prepayment Customers (Remedy 19)

- 3.1. We are not in favour of this remedy being introduced for a number of reasons.
- 3.2. We have grave concerns that the sharing of customer data, even with strict controls on data protection, will result in many customers receiving unwanted marketing information that may further dissuade them further from switching suppliers.
- 3.3. More generally, we consider it unlikely that increasing the frequency of supplier communications to customers, in whatever form, represents a long term solution to improving levels of engagement in the retail energy market. From OVO's experience it is the development of new energy products and engagement tools, such as our online

platform OVO Live, that have the potential to re-engage customers to the extent necessary to improve retail energy market outcomes.

- 3.4. Overall we also do not see how this proposal would benefit customers, certainly not to an extent that would justify the added expense and operational resources involved in implementing this remedy – an expense that will ultimately be borne by customers.

4. Prohibiting the Charging of a Security Deposit in Certain Circumstances (Remedy 20a)

- 4.1. We support the introduction of this proposal. We anticipate that this measure should increase engagement levels in the prepayment market.
- 4.2. We think it is important to highlight that, although we agree that it is important to remove any opportunity costs a customer may face when switching, yet it is also important that suppliers retain sufficient tools to manage customer debt and that the incentive for customers to pay on time is not undermined.

5. Prohibiting the Charging of Customers Upfront for a New Meter (Remedy 20b)

- 5.1. We support the introduction of this proposal. We are also hopeful that this remedy can increase engagement in the prepayment market.
- 5.2. As per our response in paragraph 4.2 above, we agree that it is important to remove any opportunity costs a customer may face when switching, yet it is also important that suppliers retain sufficient tools to manage customer debt and that the incentive for customers to pay on time is not undermined.

6. Require Suppliers to provide Annual Notifications (REMEDY 20c)

- 6.1. We have some concerns around this proposal. As we have outlined in paragraph 2 of this response, we do not think that customers are likely to be engaged by yet further communications regarding their ability to switch either supplier or meter type.
- 6.2. Additionally we have concerns that the CMA failed to consider its own findings with regard to the impact of RMR on engagement levels into its consideration of this remedy. Building on the points we raised in paragraph 3.3 of this response, we do not think that

information based prompts have a proven track record of significantly increasing customer engagement levels.

- 6.3. Based on our experience of the efficacy of information based prompts we have concerns that the likely cost to suppliers of issuing annual notifications, will justify what we believe to be a minimal improvement in the level of customer engagement.

7. Reforms to the Debt Assignment Protocol Specific to Prepayment (Remedy 21)

- 7.1. We support the introduction of this proposal. As we have mentioned earlier, although we agree that it is important to minimise the opportunity cost customers face when switching, it is also important that suppliers retain sufficient tools to manage customer debt and that the incentive for customers to pay on time is not undermined.

8. Transitional Safeguard Tariff for Prepayment Customers (Remedy 22)

- 8.1. We are broadly in favour of this proposal. As the CMA has found there are a number of competitive and social issues that are present in the prepayment market to a greater extent than the standard credit/ direct debit market (DD/SC market). These include the greater likelihood of prepayment customers being vulnerable¹ and the reduced number of competitively priced tariffs due to the technical constraints of the market.
- 8.2. For these reasons we would argue that there is a greater need to protect prepayment customers from unfair pricing practices, particularly overcharging. As such a safeguard tariff that enforces a price cap on tariff prices would appear to have greater benefits to prepayment customers than customers in the DD/SC market.

The importance of ensuring a safeguard tariff does not restrict innovation

- 8.3. As the CMA will be aware, OVO proposed a cost reflective principle as an alternative to the safeguard tariff, precisely because we believed that a well enforced regulatory principle could achieve the same level of protection as the safeguard tariff, without imposing restrictions on supplier's ability to innovate.
- 8.4. Although we have argued that a safeguard tariff has greater benefits for prepayment customers, we are concerned that a strict price cap may restrict suppliers from innovating for the same reasons we outlined in our response to the proposal to

¹ Ofgem (2015) Prepayment Market Review

introduce a safeguard tariff in the DD/SC market. In particular it is not abundantly clear how the methodology for setting the safeguard tariff price would be flexible enough to allow suppliers to offer certain innovative products, such as time of use tariffs or energy tariffs that are bundled with other services such as broadband.

- 8.5. Referring back to our earlier argument in paragraph 2.2, we have highlighted that overly prescriptive interventions have a history of impeding suppliers from offering innovative products. Given that the CMA has found evidence to suggest that the prepayment market already suffers from a lack of competitively priced tariffs, it is crucial that introducing a safeguard tariff does not restrict suppliers from innovating to the benefit of prepayment customers.

Defining which customers are eligible for a safeguard tariff

- 8.6. In our response to the CMA's proposed remedies paper, we outlined our suggestions for determining the method by which a customer is found to be engaged or disengaged. What we neglected to suggest was the length of time a customer would have to be perceived as inactive, before being found to be disengaged.
- 8.7. Our current thinking is that a customer would be considered disengaged, if they fail to respond directly to a supplier prompt within 3 months.
- 8.8. More generally, the CMA has stated that the purpose of a safeguard tariff is to protect disengaged customers from being overcharged. A literal reading of this statement would infer that a customer has to satisfy two separate conditions to qualify for protection under a safeguard tariff - the customer must be disengaged (as per our suggestion in paragraph 8.7), and the customer is also being overcharged.
- 8.9. We think that defining the eligibility criteria for the safeguard tariff on this basis ensures that customers are protected, yet suppliers retain a level of scope to innovate. We have used the following scenarios to indicate what we believe are the benefits of this approach.
- 8.10. In the case where a customer who is found to be disengaged but is not being overcharged, the safeguard tariff should not apply because:
- the customer would receive no benefit from being placed upon the safeguard tariff, and
 - Suppliers would be incentivised to keep their tariff prices lower than the safeguard tariff price in order to be sure of retaining the customer.

In other words, this customer does not need protection merely because he/she is disengaged. The customer is not being over-charged and could be perfectly content with his/her current supplier.

- 8.11. In the case where a customer is found to be suitably engaged but is being overcharged, we think that the safeguard tariff should also not apply because the customer is aware of their current tariff price and thus aware that they could potentially save money by switching.
- 8.12. We would urge the CMA to consider variations to standard tariffs that suppliers may offer ('non-standard tariffs') – for example tariffs that include bundled items, additionality tariffs or time of use tariffs (that have an array of unit rates and standing charges). It is vital that suppliers are not discouraged from offering such non-standard products which we see as vital to enabling suppliers to innovate and differentiate in order to improve engagement in the market.
- 8.13. We would therefore caution the CMA against applying an overly simplistic method for applying the safeguard tariff. We think that a degree of flexibility should be maintained to consider the substantive value of a non-standard tariff or package under the right set of circumstances. Defining the correct set of circumstances is probably a task that Ofgem is best suited to carrying out.
- 8.14. In summary, the clear priority of a safeguard tariff should be to protect customers that are the most vulnerable. As paragraphs 8.6 - 8.9 demonstrate however, the eligibility criteria of the safeguard tariff can be used in a manner that ensures the right and proportionate level of protection, yet would enable customers to retain the ability to choose tariffs that would otherwise exceed the safeguard tariff price cap so long as they are knowingly doing so – i.e., they are overcharged but engaged. In this way we hope that unlike previous market interventions, protection will not be achieved to the detriment of innovation.