

Executive summary

The prepayment (PP) sector is currently in a period of accelerating transition. We have seen market entry, with some new and smaller suppliers specifically targeting this sector, for example Utilita. In recent years we have also seen the introduction of Fixed Term Contracts (FTCs) for PP customers and the development of new and innovative products and services. For example, suppliers such as British Gas and Scottish Power provide customers with the ability to add credit to their PP meter using a home computer¹.

However, the major transition now in train is the roll out of smart metering. This will fundamentally change the customer PP proposition, the underlying cost base and the intensity of competition. In response to this, we expect prices to reduce to somewhere near the level of Direct Debit (DD) tariffs as the industry becomes less reliant on the expensive vending infrastructure in use today, and customers take up the ability to easily purchase energy from their own home via a mobile phone app or computer.

Smart metering will also remove the primary barrier to entry new and smaller suppliers currently face, as they will not need to make investment to utilise today's infrastructure that has very little opportunity to payback before it is made redundant. Smart metering will also reduce the additional costs to acquire and serve PP customers, and resolve the current lack of industry capacity for new tariffs – itself a significant barrier to innovation and competition. This should improve demand and satisfaction with PP products, but it should also improve the effectiveness of competition in the PP sector.

This context is important when assessing the CMA's proposed remedies. Whilst we support those “enabling” measures designed to improve PP customer engagement, we challenge the proportionality of remedies that will become redundant once smart meters are in place.

We therefore support the introduction of remedies designed to promote engagement, such as the removal of the four tariff cap. In particular, we note that this tariff cap will disincentivise the creation of PP specific tariffs at the very time when technology is enabling more innovative and lower cost propositions to be developed for PP customers.

We are strongly opposed to the introduction of “controlling” remedies such as a regulated price cap however. There are a number of flaws in the CMA's analysis which undermine the case for intervention and highlight how disproportionate this would be. We also remain deeply concerned that such price regulation would have unintended consequences, even when applied to a segment of the market such as PP. For example, such price regulation could itself act as a disincentive to enter the PP sector. We also believe this remedy would work against other “enabling” remedies, reducing rather than improving engagement.

We are also opposed to the CMA's proposal to share customer data with third parties. In particular, as currently designed, we believe this proposal is inconsistent with the forthcoming European General Data Protection Regulation (GDPR). We encourage the CMA to engage the Information Commissioners Office (ICO) as soon as possible on the design of this potential remedy. Furthermore, we have concerns that the proposal could actually harm engagement by allowing uncontrolled volumes of unsolicited marketing contact to be made to PP customers.

¹ For more details on the British Gas service, see here: <https://www.britishgas.co.uk/youraccount/discover/home-energy-top-up-service.html>

Finally, we believe that proposals to limit security deposits and up front meter exchange fees for those PP customers switching to a credit meter are unnecessary. Since smart meters can switch between PP and credit modes instantaneously, without requiring a visit to the customer's property, suppliers' will be able to manage debt more easily, removing the need for both security deposits and up front meter exchange costs.

Response to addendum to provisional findings

In this section we set out our response to the addendum to provisional findings. Specifically, we cover:

- the differences between prepayment and direct debit tariffs today;
- the technical constraints to offering more prepayment tariffs;
- the incentives on suppliers to compete for prepayment customers; and
- the regulatory barriers to offering more prepayment tariffs.

The differences between prepayment and direct debit tariffs today

We believe the analysis shown in Figure 1 is flawed. This has the effect of overstating the potential savings available to PP customers switching from the average large supplier SVT to the best available DD FTC.

PP and DD tariff differential analysis

We believe there are at least two problems undermining the validity of the analysis shown in Figure 1. These have the effect of overstating the potential savings available to PP customers switching from the average large supplier SVT to the best available DD FTC.

Our primary concern is with the way the CMA have selected tariffs for comparison. For example, the minimum DD acquisition tariff given in the CMA's analysis for end Q2 2012 to end Q4 2012 was NPower's "Go Fix 11". This tariff was only in market however between 20 February 2012 and 23 April 2012². Given customers would not have been able to choose to take this product in the period the CMA have it as the cheapest product, the comparison presented is not valid. This is also the case where the CMA have used a tariff for comparison that is not available for purchase at the point the comparison is made. We believe this to be the case for the majority of data points used.

Our second concern is with the way that the CMA have selected the cheapest region. In working out which minimum DD acquisition tariff should be used for comparison, we understand that the CMA have chosen the tariff that is the cheapest in one region. The weighted average PP SVT however is an average of all regions. This comparison is therefore not like for like since it ignores regional price differences. It also ignores the fact that the minimum DD acquisition tariff selected is not available to customers in the thirteen other regions. We consider this a material flaw, and note that it is a departure from the previous gains from switching methodology. By way of illustration, in the period Q1 2012 to Q2 2014 the average difference between the cheapest SVT PP region for large suppliers and the average SVT PP region for large suppliers is approximately £50.

We believe that these two errors mean the analysis overstates the gains that PP customers could actually achieve by approximately £120 per annum, or 50%³. The CMA should correct the analysis before any conclusions are drawn from it.

² Source: www.energylinx.co.uk.

³ Estimated from Figure 1.

Finally, we believe that the CMA should also acknowledge that a rational customer may have good reasons for not wanting to take energy on DD terms. Many actively choose a PP meter as a way of budgeting for their energy usage and preventing indebtedness. Others choose a PP meter because it enables them to easily repay a debt at a manageable rate⁴.

British Gas PP to DD tariff differentials

We agree with Ofgem's conclusion that dual fuel PP customers cost approximately £80 per annum more to serve today than a DD customer does, on average across the industry. Within this value though, costs vary from supplier to supplier. Importantly, our DD to PP price differential is just £58 per annum⁵. Whilst it may therefore be accurate to conclude that on average PP customers pay more than the cost to serve difference suggests they should, this is not true for British Gas PP customers.

We also believe that the difference shown in Figure 1 does not in fact show a systematic difference between PP and non-PP terms, but rather reflects other differences in tariff characteristics across the categories that the CMA have chosen for analysis. For example, this will fail to take into account the differences in the costs associated with products used for comparison, for example commodity costs.

We also note that differences in prices due to these other product characteristics will vary over time as market conditions and the relative cost of, and value offered by, different products change. For example, while a shorter hedging strategy may contribute to a comparatively lower commodity cost today, it is more volatile and does not guarantee that commodity costs will always be lower.

Finally, although we acknowledge that PP customers have less choice of FTCs than DD customers, we do not agree that there are no acquisition PP tariffs in market today. For example, British Gas' "Fixed Priced July 2018" has a price differential to DD of £58 per annum, and offers long term price certainty at a discount to today's SVT. [X<]

The technical constraints to offering more prepayment tariffs

The CMA are correct to highlight the barriers to suppliers offering more PP tariffs. In particular, the limited capacity for industry 'tariff codes' provides a real constraint on the development of dual fuel tariffs.

The smart meter roll programme will resolve these issues however, and we therefore see this as only a short term problem. Indeed, although the CMA note that "only very few suppliers ... have focused their strategy in the PPS on installing smart meters with a view to offering cheaper tariffs"⁶, rapid progress is now being made with the development and roll out of smart PP meters. These points are expanded on below.

Technical constraints

We agree that there are some technical constraints that limit non-smart PP innovation. For example, in both gas and electricity the infrastructure between suppliers' systems and customers' meters is provided to the industry by independent third parties – Siemens in gas and Itron in electricity. The number of prepayment tariffs that each supplier can offer is constrained by the number of tariffs that these third party systems can accommodate. This

⁴ We expanded on the reasons why a rational customer may not choose a DD or FTC product in our response to the Provisional Findings and Possible Remedies. See paragraphs 45 and 62-69 in particular.

⁵ Both the £80 and £58 values used in this paragraph are calculated at average consumption.

⁶ CMA, Addendum to Provisional Findings, paragraph 37.

constraint is particularly acute in electricity, where the lack of ‘tariff codes’ within Itron’s system creates a technical barrier to what can be offered to customers.

We have no visibility of how many tariff codes are available across the industry in gas. [§<]

As a supplier operating in a dual fuel market, it is also the lack of electricity tariff codes available which constrains our ability to operate at the technical limits of the gas system as the CMA envisage. In particular, given we already have four dual fuel tariffs, launching a range of additional gas only tariffs would place us in breach of the four tariff cap⁷. The alternative would involve launching a range of gas only tariffs, something which would contradict our strategy of growing our base through compelling dual fuel products. These two factors combine to prevent suppliers from operating at the technical limits of the gas system.

We also note that the lack of available tariff codes also impacts suppliers’ ability to engage with prepayment collective switching events, particularly if they require an exclusive prepayment tariff for entry in to the scheme.

Smart metering as a solution

The smart meter roll out will remove these technical constraints, in particular by replacing these central industry systems and removing the infrastructure constraints on the number of tariffs. When combined with Remedy 3, this will enable suppliers to offer a wide variety of PP tariffs.

As the CMA note however⁸, the roll out of SMETS compliant PP meters is still at an early stage. We note, for example, that a number of the PP meters Utilita has installed in its customers’ properties are not yet SMETS compliant. An industry solution is still needed for certain problems, for example on how to ensure communications networks work within tall buildings. As issues like this are resolved, and implementation costs decrease, this will all be available ‘off the shelf’ to suppliers through the Data Communications Company (DCC).

Notwithstanding these challenges, our early learning in this sector has meant that we are now starting to make strong progress with our smart PP proposition. We have now installed [§<] smart PP meters, and this number is growing rapidly. [§<]

The incentives on suppliers to compete for prepayment customers

We accept that higher costs to acquire and serve act as a barrier to some suppliers competing for PP customers today, however the smart meter roll out will entirely resolve this. We also disagree with the CMA that the Debt Assignment Protocol (DAP) “does not appear to be excessively onerous”⁹, and believe changes are required to improve its operation. These points are expanded on below.

⁷ SLC22B.2

⁸ CMA, Addendum to Provisional Findings, paragraph 36.

⁹ CMA, Addendum to Provisional Findings, paragraph 52.

Higher costs as a barrier to competition

We agree that it is likely that suppliers, and in particular small and mid-tier suppliers, have an incentive to focus acquisition efforts on those customers with a lower cost to acquire or serve. As above, this is exacerbated by the need for suppliers entering the PP sector to invest upfront in separate infrastructure with very short pay back periods, given the smart meter program will make it redundant in the near future.

As the expensive vending infrastructure becomes progressively less prevalent through the smart meter roll out, these cost barriers will be removed. When combined with the removal of tariff code capacity constraints, we believe this will enable far greater competition for PP customers in the future from all suppliers.

Debt Assignment Protocol

We believe that there are a number of issues with the operation of the DAP today. Whilst we accept that there are theoretical financial advantages to acquiring customers through the DAP, there are also a number of process and procedural issues which make it difficult and costly to administer. For example, the DAP remains very manual, time consuming and costly to operate. Despite some improvements to the process in the last year¹⁰, the process remains more difficult than a non-DAP switch from a customer experience point of view, with a number of suppliers yet to adopt the improvements suppliers like British Gas have already made. We therefore propose a number of amendments to the CMA's proposed remedies here, in particular changes to ensure these improvements are adopted by all suppliers.

The regulatory barriers to offering more prepayment tariffs

We agree that the four tariff cap creates a significant disincentive on suppliers to develop specific PP tariffs. To develop such tariffs would use a slot that could otherwise be used to target a larger customer population. There are therefore good reasons why the gas market is not operating at full technical capacity today.

Notwithstanding this, the CMA are correct to observe that gas tariff code capacity was not fully utilised prior to the introduction of the four tariff cap. This is because energy is a dual fuel market, with what we see as very limited demand for single fuel (particularly single gas) tariffs. This is evidenced by the lack of any single fuel tariffs, PP or otherwise, in the market. We believe it would therefore be necessary to increase electricity tariff code capacity to resolve this issue.

Conclusions on addendum to the provisional findings

Whilst we believe that competition in the PP sector is effective today, we acknowledge that there are technical, cost and regulatory features which mean it does not work as well as other parts of the market. Many of these features will be resolved through a combination of the smart meter roll out and some of the proposed remedies, for example the proposal to provide customers with more prompts.

However we believe that the proposed remedies to transfer customer data to third parties and introduce a safeguard tariff risk materially damaging customer engagement and the effectiveness of competition. We therefore oppose their introduction. Specifically we are concerned that, as designed, the proposals could lead to customers receiving a large volume of unsolicited sales contact, damaging trust and confidence in the energy market.

¹⁰ See below, in response to Remedy 21, for more details of these improvements.

Finally, as above, we believe the CMA's analysis of PP and DD price differentials is flawed, and makes a number of erroneous comparisons. The CMA should correct these errors before they reach any conclusions from this analysis.

Our detailed position on the proposed remedies is set out below.

Response to second supplemental notice of possible remedies

In this section we provide our detailed comments regarding each of the proposals set out by the CMA in their second supplemental notice of possible remedies.

Remedy 19 - facilitating sharing of data relating to prepayment meter customers

Whilst we support remedies which increase PP customer engagement, we have concerns about this proposal on the following grounds:

- Potential incompatibility with future data protection regulation; and
- Risk that it will increase PP customer disengagement.

These concerns apply equally here, and for the proposals to share any SVT customer data set out in the Provisional Findings and Possible Remedies notice.

Potential incompatibility with future data protection regulation

We agree with the CMA's interpretation of today's data protection rules, and agree that opt-out consent is currently required for non-electronic contact and that opt-in consent is currently required for electronic contact. It is not clear however from the CMA's proposal how such opt-in consent would be captured.

It is essential that any remedies implemented in this area are agreed beforehand with both the Information Commissioners Office (ICO) and the Department for Culture, Media and Sport (DCMS). We are conscious of previous changes implemented in the industry where suppliers have been asked to share data, only to find that another regulatory body subsequently expressed concerns. For example, as part of their obligation to roll smart meters out to all customers, suppliers were required to send material to customers about smart meters and what they could expect. This activity was subsequently challenged by the ICO who deemed it marketing material, upholding a customer complaint in the process.

As well as noting the requirements of existing UK and EU data protection legislation, we are also mindful of the impact of the new General Data Protection Regulation (GDPR), published by the EU Commission in December 2015. This new regulation, which will need to be transposed in to UK law within the next two years, places far more emphasis on gaining explicit opt-in customer consent for the sharing of data. This is likely to remove the use of any opt-out consent for sharing customer data, and therefore is likely to impact the CMA's proposals here. Any remedies implemented in this area should be assessed against these new European regulations in order to ensure they are future proofed.

Finally, we are opposed to the proposal to store sensitive customer data on a cloud database. We do not consider that this is appropriate, and believe the CMA should – were they to proceed with this remedy – identify more secure alternatives.

Risk that it will increase PP customer disengagement

We also have concerns about the level of marketing that customers whose data is shared will receive. Even if parties were restricted to contacting customers no more than once per annum, this could still lead to 30 unsolicited marketing contacts each year per customer¹¹. This could actually undermine trust and engagement in the market, rather than encourage it. If the CMA proceed with this proposed remedy, we recommend they investigate ways to ensure customers are not inundated with marketing contact, for example by ensuring it is provided centrally by Ofgem.

(a) Would this remedy be effective and proportionate in increasing competition for non-smart prepayment meter customers?

As above, we have concerns that sharing customer data without their explicit opt-in consent risks undermining trust in the industry and the engagement of PP customers. We also believe it may be incompatible with forthcoming GDPR. Were the CMA to proceed with this proposed remedy, they should work with the ICO and DCMS to ensure that it is future proof.

We are also concerned that allowing all suppliers access to this data will result in customers receiving a large amount of unsolicited marketing approaches. The CMA should investigate mechanisms which would protect customers from large amounts of unsolicited marketing approaches, for example by ensuring any contact happens from one central body such as Ofgem.

We also note that this proposed remedy may not help those PP customers with a debt of over £500, as they are unable to use the Debt Assignment Protocol (DAP) to switch supplier.

Finally, this remedy may not be effective if implemented at the same time as the proposed price cap – particularly if that cap is set too low. [3<] Given the majority of PP costs are sunk in to infrastructure and cannot easily be cut, a tariff cap set too low would remove the incentive to compete in the PP market. In such circumstances for example, we would expect suppliers not to make use of any shared customer data even if it was made easily available.

(b) Are there additional legal considerations that are relevant to this remedy (eg under the Data Protection Act 1998 or the Privacy and Electronic Communications (EC Directive) Regulations 2003)?

Yes, as above we note that the new GDPR will impact the type of consent that is required. In particular, we note that the new rules place significantly more emphasis on the need for explicit opt-in consent for any sharing of customer data. These new rules will need to be transposed in to UK legislation within the next two years. Any remedy proposed in this area should therefore be designed so that it complies with these new requirements.

(c) Is Ofgem the right party to have oversight of this process?

We believe Ofgem could have a role in overseeing this process.

¹¹ Assuming one contact from each supplier operating in the PP sector, and one contact from each Price Comparison Website.

(d) What limitations would need to be imposed to ensure that the data was disclosed and used appropriately?

The use of the data by third parties should be subject to an agreement that appropriately limits the disclosure and use of customer data.

As part of this, controls should also be included on the amount of contact customers receive. Left uncontrolled, we are concerned that PP customers may become disengaged by large amounts of proactive sales activity. Even if each PP supplier and Price Comparison Website contacted customers just once a year, that would still mean customers would receive over thirty sales contacts per annum. Without controls, we believe this number may be far larger, damaging customer confidence and trust in the market.

If the CMA proceed with this proposed remedy, we recommend they investigate ways to ensure customers are not inundated with marketing contact, for example by ensuring it is provided centrally by Ofgem.

(e) When should the continued need for this remedy be reviewed?

We believe that, were this remedy to be implemented, it should only apply to non-smart PP customers. We also believe that it should automatically fall away once a significant majority, for example 80%, of PP customers have a smart meter.

(f) What might be a suitable frequency with which to share customer data?

A balance needs to be struck between the costs of refreshing and transmitting customer data and the need to ensure that it remains up to date. We believe that an annual refresh would best achieve this.

(g) Should this remedy apply to prepayment meter customers with smart meters?

No. As the CMA note, “from a technical point of view, smart PPM ... can side-step all aspects of the dumb prepayment infrastructure, including the payment system”¹². We agree that the same barriers and constraints do not exist in the smart PP market, and note that there is also evidence that, as the smart PP technology is developed, it is reducing costs, improving customer experience and enabling more effective competition. Intervention in this part of the sector is therefore unnecessary, and may even undermine these developments.

Restricting the proposed remedy to non-smart PP customers would also have the added advantage of incentivising an early roll out of smart PP meters.

Remedy 20a – prohibit the charging of a security deposit in circumstances when a customer is not in debt and has not incurred any fines, charges or interest for late payment in the last six months

British Gas does not currently ask customers for a security deposit if they wish to exchange a PP meter for a credit meter. Instead we rely on credit vetting to understand whether allowing the customer to purchase energy on credit terms would be appropriate. If a customer does not pass the credit vet, we will refuse to exchange the meter.

This policy is typical in the industry, meaning we do not accept that security deposits are a significant barrier to PP customers taking a credit meter. Ofgem themselves have recently

¹² CMA, Addendum to Provisional Findings, paragraph 35.

found that only five suppliers request security deposits¹³, and that “the number of consumers who are impacted by security deposits for moving to credit is small”¹⁴.

We also expect that this will cease to become an issue following the roll out of smart meters, which allow switching between PP and credit modes remotely, at the press of a button. This will enable suppliers to manage customers’ credit far more closely, potentially removing any future need for security deposits.

(a) Would this remedy be effective and proportionate in removing the barrier to switching that security deposits can pose?

We believe that this remedy may be effective in removing the barriers to switching that security deposits pose. Whilst we acknowledge that some suppliers still use a security deposit to enable customers with a high future risk of falling into arrears to take energy on credit terms, we believe that there are alternatives available. For example, we understand that some suppliers avoid the need for a security deposit through requiring such customers to pay in advance by DD.

We are aware that some may argue that this remedy will only be effective if it is combined with a rule saying that suppliers should not refuse a request to exchange a PP for a credit meter. Whilst we appreciate that allowing customers to use energy through a credit meter resolves a number of the issues the CMA have identified, we strongly believe that this needs to be balanced with the responsibility energy suppliers have to ensure that customers do not incur significant debt. As with other forms of credit provision, this means that, where appropriate, suppliers need to be able to refuse to provide customers with credit terms. This is also an important part of reducing the cost of bad debt to other customers.

(b) Are these the right criteria to apply in determining circumstances in which suppliers can charge a security deposit?

No. A customer satisfying the criteria above may still be at a high risk of becoming indebted were credit to be provided, for example if they have a low credit score. Suppliers should be able to continue credit vetting customers that request credit terms.

(c) What are the potential unintended consequences of being explicit about when customers can be charged a security deposit?

If suppliers are unable to support these customers paying in advance through DD (as we have suggested above), then limiting the circumstances in which a security deposit can be requested may lead to more requests for a meter exchange being refused. There is therefore a risk that this remedy actually increases the barriers to these exchanges.

(d) Is there a preferable alternative way of mitigating detriment arising from the impediments to switching posed by the potential need to pay a security deposit?

As above, we are aware that some suppliers avoid the need for a security deposit through requiring such customers to pay in advance by DD.

(e) Should the CMA implement this remedy itself, or should the CMA make a recommendation to Ofgem to do so?

¹³ NPower, SPower, Economy Energy, First Utility and Utility Warehouse.

¹⁴ Ofgem, Proposals to improve outcomes for prepayment customers (December 2015), paragraph 1.26.

Were the CMA to decide this remedy was necessary, we believe Ofgem should be allowed to implement this so that it can be designed in a way that it is compatible with other regulations in this area.

Remedy 20b – Suppliers are prohibited from charging customers upfront for the cost of a new meter when switching away from prepayment

British Gas does not currently charge customers for the cost of exchanging a PP to a credit meter. Although the fact that some suppliers do levy a charge can exacerbate the issues the CMA have found, our preference is that the market is allowed to resolve this issue. For example, were suppliers obliged to set out the costs of such a meter exchange in their schedule of charges it would allow suppliers that did not levy an upfront charge to differentiate themselves and win customers from those that did. We are therefore opposed to this remedy being implemented.

(a) What length of time is reasonable and appropriate to allow the recovery of the cost of the meter and installation?

As above, we neither levy up front charges nor believe that they should be prohibited. Were the CMA to prohibit charging customers upfront for the costs of installing a PP meter, we believe that suppliers should be able to add the cost on to the first bill. Where the customer was not able to afford this, existing regulations requiring suppliers to provide payment plans¹⁵ would allow the cost to be spread over subsequent months in a way which better suited the customer.

(b) Is this a proportionate remedy given the number of cases in which suppliers charge for removal of a prepayment meter?

No. We believe that, as the statistics in the CMA's report demonstrate, this is not a major barrier to PP to credit meter exchanges. We also note that the smart meter roll out will ultimately resolve this issue by ensuring that the meter installed in every home is capable of switching between PP and credit mode both instantly and at low or no cost.

(c) Is there an equally or more effective alternative way to reduce the costs of prepayment meter removal and replacement?

Suppliers are able to competitively procure metering services today. We believe this is the best mechanism to drive down the costs associated with meter exchanges.

(d) Should the CMA implement this remedy itself, or should the CMA make a recommendation to Ofgem to do so?

As above, were the CMA to implement this remedy, it would be sensible to do it through a recommendation to Ofgem so that it can be designed so that it is consistent with other regulations in this area.

¹⁵ SLC27.6

Remedy 20c – Require suppliers to provide annual notifications to prepayment meter customers setting out their right to switch and highlighting any potential restrictions or charges that may be payable

Prepayment customers already receive annual prompts today in the form of the Annual Statement. This includes a prompt that it may be worth considering changing their supplier¹⁶, and provides information about where the customer may obtain impartial advice and information about how to change energy supplier¹⁷. We also make clear that there may be an exit fee to pay if the customer is currently on an FTC.

Notwithstanding this, we support the use of triggers to improve further customer engagement in the energy market, and believe that this proposal has the potential to complement Remedy 10. This can best be done by removing the level of prescription around the current information remedies, and allowing suppliers to design effective prompts within the boundaries of CMA or Ofgem set principles.

The high level of prescription around the current message means that it is not as engaging as we believe it could be. With a relaxation of these prescriptive rules, this message could be easily amended to also make explicitly clear that the customer has a right to change supplier, and provide basic information about the restrictions that may apply and / or information to the effect that a pre-existing debt may not be a barrier.

It is however important to note that not all PP customers want to switch to a credit meter. Many actively choose a PP meter as a way of budgeting for their energy usage and preventing indebtedness. Others choose a PP meter because it enables them to easily repay a debt at a manageable rate. Some tenants also face restrictions from landlords who insist that their property is supplied through a PP meter. Whilst we support the role of prompts to encourage engagement, it should be acknowledged that success does not equate with all PP customers changing to use a credit meter.

(a) Would this be an effective means of facilitating switches away from prepayment meters?

As above, it is important to note that a large number of PP customers either cannot move away from PP (for example, because of restrictions imposed by landlords) or do not want to move away from PP (for example, because they value the benefit it gives them in either budgeting their energy expenditure or repaying a debt).

Notwithstanding this, we support any remedies which are designed to encourage more customer engagement. Even though similar prompts are already provided annually, we believe there is scope to improve these. Central to this will be removing the level of prescription around the content of such prompts, and allowing suppliers to design effective prompts within the boundaries of CMA or Ofgem set principles. This could be an effective means of facilitating switching across the market.

¹⁶ SLC31A.9(j)

¹⁷ SLC31A.9(k)

(b) What would be the most effective means of communicating this information to customers?

We believe the current Annual Statement would be the most effective and efficient means to communicate this information. We would be opposed to any new mailings going to these customers unless it can be shown that the benefit of a separate mailing outweighed the cost.

(c) What is a suitable frequency with which to contact customers? Would this messaging be more appropriately included alongside other messages or be triggered by particular events (such as outstanding debt being paid off)?

As above we believe that annual prompts would be sufficient, provided suppliers were given sufficient flexibility to design them within CMA or Ofgem set boundaries. Additionally, we potentially see a role for prompts to be provided when a new customer moves in to a property with a PP meter, or when they switch supplier.

(d) Should a prompting remedy such as this be introduced directly by the CMA or should this be an area that Ofgem considers running randomised controlled trials to assess its effectiveness?

As above, we believe that prompts such as these are best designed by suppliers, within the boundary of principles set by either the CMA or Ofgem. It should therefore be suppliers to test the effectiveness of various designs and wording, albeit it under a CMA or Ofgem provided obligation to achieve a particular customer outcome.

Remedy 21 – reform the protocol for assignment of debt on prepayment meters

Following Ofgem's request in 2014 for the industry to improve the practices and procedures associated with the DAP, we and other Energy UK suppliers have worked to develop changes that deliver this. These changes, collectively known as the Point of Acquisition (PoA) model, were implemented by us and nine other suppliers in April 2015. Utilita then also implemented the changes in July 2015.

The PoA model streamlines the DAP so that the acquiring supplier will, at point of sale, seek the customer's consent both for their data to be shared with the losing supplier and for any debt to be transferred. Assuming consent is given, the switch can then proceed automatically, provided the outstanding balance is less than £500. It also set out changes to the content of the objection letter to bring it in to line with Ofgem expectations. Collectively these changes improve the customer experience of using the DAP, and increase the success with which indebted PP customers switch supplier.

We are aware however that issues remain even following implementation of the PoA model. In particular, we note that only 10 suppliers (including British Gas), have signed up to the changes. This means that a number of potential PP debt switches continue to be managed outside of the process. Furthermore, we have concerns that a number of suppliers outside of the PoA process are not complying with the existing requirements of the DAP.

We believe that this remedy has the potential to improve the process, in particular if in doing so it led to an obligation on all suppliers to adopt the PoA. Closer monitoring of suppliers' compliance with the existing rules would also be beneficial.

We would like to clarify that neither the DAP nor the PoA model “disallow” any switches flagged as involving complex debt as the CMA have stated¹⁸. Moreover, following the receipt of a complex debt flag, the acquiring supplier has a choice over whether or not to proceed. We support the retention of this right. Complex debt includes, for example, instances of fraud or debt which is subject to a dispute. We oppose any curtailment of this right, and believe that to do so would increase acquiring supplier costs by obliging them to take on a debt they stood little chance of recovering.

Finally, we also support the future automation of the DAP process, although note that this is complicated by other industry initiatives currently in development. In particular, we believe that it would be important to deliver Project Nexus before introducing any automation in the gas industry. Energy UK are investigating this at the moment, and we will continue to support their efforts.

(a) Would a remedy recommending Ofgem to address the above-mentioned issues be effective in ensuring that adequate changes to the DAP are implemented promptly? Or should the CMA instead use its order-making power to support Ofgem’s ongoing work?

Given the difficulties faced by Ofgem in getting all suppliers to adopt the PoA model, we believe that the CMA should use its order-making power to provide them with support.

(b) What is the most efficient way for Ofgem and the industry to improve the DAP process in relation to the above-mentioned areas identified by Ofgem in order to increase the switching rates of indebted PPM customers?

As above, we believe that the DAP process can be best improved by obligating all suppliers to adopt the PoA model. We also believe that increased monitoring is required by Ofgem to ensure that all suppliers are meeting their obligations under the DAP.

Finally, we see benefits in the future automation of the DAP process, however are mindful of the fact that this needs to be closely coordinated with other industry initiatives, such as Project Nexus.

(c) How would this remedy interact with the other remedies to address the Domestic AEC and/or detriment?

We believe that this remedy would complement the other pro-engagement remedies the CMA are proposing, although note that it would not be worthwhile including customers with more than £500 debt in any data sharing exercise given the scope of the DAP.

We would however be concerned if restrictions were placed on an acquiring supplier’s ability to refuse to take on a site with complex debt. As above, complex debt includes the repayment of balances associated with matters such as fraud and disputed balances, where repayment rates would be significantly lower than the 90% envisioned under the DAP. As above, this would increase acquiring supplier costs through leaving them with a debt they stood little chance of recovering.

¹⁸ CMA, second supplemental notice of remedies, paragraph 44(b).

(d) Are there other impediments to switching for indebted PPM customers – other than those identified by Ofgem – that need to be addressed? If so, what are these and how should Ofgem or the industry address them?

No.

Remedy 22 – A transitional ‘safeguard price cap’ for domestic prepayment customers

British Gas is strongly opposed to the introduction of price regulation in any part of the retail market. We believe a transitional “safeguard price cap” would be fundamentally incompatible with the CMA’s principles of improving the framework for competition and facilitating widespread customer engagement. We also believe it is in direct conflict with the CMA’s other proposed remedies, in particular those aimed at improving levels of customer engagement.

We see many parallels with the proposed “safeguard tariff” for SVT customers, and the concerns raised in our response to the Provisional Findings and Possible Remedies notice apply equally here¹⁹.

In particular, we believe that, given that the smart meter roll out will resolve many – if not all – of the problems the CMA have identified by 2020, any price cap would be a disproportionate solution.

We also believe that setting the price cap at an appropriate level would be difficult. If set too low then the remedy would have a negative effect on customer engagement and switching levels, and damage incentives for innovation and investment by suppliers over the longer term. This could fundamentally undermine the new market entry smart PP is expected to enable through reduced infrastructure costs, reduced acquisition costs and the removal of PP tariff number constraints. It could also undermine the roll out of smart meters, removing any incentive for customers to request the installation of a smart PP. [§<]

Again, we highlight the example of regulated pricing in New South Wales where customers viewed the regulated tariff as a “safe haven” and were reluctant to switch away from it – even where there was headroom. If set too high, the cap would have a limited effect on supplier pricing and could act as a target price for other PP tariffs – potentially raising costs for all PP customers.

We also would like to highlight the significant complexities associated with calculating and operating any cap calculated with reference to the cheapest tariff(s) in market. In particular, it will be important to ensure that such a calculation is not simply done at ‘average’ consumption across the country. To do so would fail to take account of how different standing charge and unit rate configurations impact low or high consuming customers, and how that may make any such cap too high or too low for all but ‘average’ customers. Taking this in to account in each of the fourteen different regions, for each of the various fuel and meter type combinations will be complex²⁰.

Given the risks associated with this exercise, we disagree that setting a price cap could be done with any degree of accuracy in a “short period of time” as the CMA envisage²¹. As

¹⁹ In particular, please see pages 89 to 97.

²⁰ For example, dual fuel versus single fuel supply, or single rate meter versus static time of use or restricted meter.

²¹ CMA, second supplemental notice of remedies, paragraph 54.

above, the risks of setting the cap too low or too high are material, meaning any process to calculate the level of the cap would necessarily be detailed and lengthy, and require constant monitoring and frequent updates. This in itself may present a technical challenge given the inflexibility of the infrastructure in delivering new prices to non-smart PP meters.

We do not consider it would be possible to set the price cap at a level that adequately reflected the different PP cost bases that exist in the market, or how this could be sufficiently flexible to manage variations in those costs, including for new entrants. There is a risk, for example, that a cap could mean suppliers are unable to respond to sudden volatility in the wholesale markets, exposing suppliers to material commodity risk.

We also note that the issues identified in the PP sector by the CMA relate in part to the lack of competition in this sector from small and mid-tier suppliers, despite there being active 17 suppliers in the PP market. We believe that there is a real risk that the introduction of a tariff cap could exacerbate this issue by damaging customer engagement at the very time smart PP stands to provide a solution. For example, if the price cap is set too low the potential gains from switching will also decrease, reducing the incentives for new entry. Similarly, if the price cap provides a 'safe haven' effect, switching levels will fall, again reducing the incentives for new entry.

Furthermore, and as with Remedy 11, we believe that once introduced it will be extremely challenging for the regulator to remove any price cap. As above, any "safe haven" effect created by the cap would likely mean the number of customers subject to it would be large. This limiting effect on engagement, together with the significant risk of political pressure could lead to the price cap becoming a long term feature of the market. This would be a highly regressive and disproportionate step for competition in the energy market.

Finally, we also note that the implementation of Remedy 3, and the potential for suppliers to offer cash incentives to PP customers, could also make a safeguard tariff cap unnecessary.

[&]

(a) If the transitional safeguard price cap for PPM customers were set relative to other prices in the domestic retail energy markets, how should we identify an appropriate level of prices and how can we ensure the level of the cap remains appropriate for the duration of the period it is in effect?

Pricing "based on other retail prices" creates a significant risk of unintended consequences, including gaming by market participants in order to affect competitor price levels, and challenges for supplier risk management. It may also result in a more limited range of products on offer to customers in the competitive part of the market, as suppliers would not be able to offer a tariff based on a different hedging strategy (for example) without that having damaging implications for the regulated tariff. It would also fail to account for the structural differences in supplier cost bases.

Any assessment of the appropriate level of prices should be with reference to other prepayment tariffs in market. We argue that the level of the cap will be difficult to monitor in volatile wholesale markets where companies employing different hedging strategies will see diverging wholesale costs.

(b) Could the imposition of a transitional safeguard price cap for PPM customers result in energy suppliers reducing the quality of service offered to customers on

these tariffs? Is this risk reduced by prepayment customers' ability to choose alternative, unregulated tariffs or changing to a smart prepayment meter?

Yes, this is a clear risk, particularly if price points are set relatively low, creating an unavoidable need for suppliers to cut costs in order to achieve profitability. The risk of reduced service levels would be limited to some extent by customers' ability to switch, but accentuated until the roll out of smart meters is more advanced.

The CMA are correct to note that "from a technical point of view, smart PPM ... can side-step all aspects of the dumb prepayment infrastructure, including the payment system"²². As above, we agree that this will bring a number of service improvements, reduce costs and enable more effective competition in the PP market. Given the materiality of these changes, and the proximity in which they are due to occur, we believe they highlight the disproportionate nature of this proposed remedy.

(c) How should the headroom be calculated to provide the right level of customer protection while not unnecessarily reducing healthy competition?

We believe a regulated tariff will inevitably serve to reduce market competition. As noted above, we see significant complexity in setting the 'right' cap and the potential unintended consequences of a regulated price point (set too high could inflate prices, set too low will further constrain competition). It will also be difficult to assess the optimal amount of "headroom" above that cost base at which to set the regulated price.

As a basic principle, however, headroom on the safeguard cap should allow for a profit margin that is sufficient to ensure a price point that incentivises customers to engage with the market and actively choose a better value tariff. We note that this was the approach taken prior to deregulation in New South Wales, although even then it still led to the 'safe haven' effect described above.

(d) What regulatory information would be required to set the transitional safeguard price cap?

Deep knowledge of existing PP suppliers' and prospective new entrant costs would be required to set the cap effectively. For example, there would need to be a detailed understanding of full hedging requirements (and implications for capital requirements and / or commodity procurement intermediary costs), and balancing costs including liquidity constraints. Assuming the CMA would ensure that the cap reflected regional cost differences, detail on cost bases by region would also be required.

This information would enable the CMA to calculate the profit margin made by the reference tariff. Without this, there is a risk that the safeguard tariff would be set with reference to a loss-making tariff, removing any intended headroom and therefore limiting gains from switching and incentives to compete in the PP sector.

(e) How long should the transitional safeguard price cap be kept in place? Is it appropriate to include a specific sunset provision, or should there be a commitment to review the need for and level of the safeguard price cap after a certain period of time?

As above, we do not accept that there is a need for a safeguard price cap. Were the CMA to introduce one, it would be important to include a sunset clause so that it lapsed after a

²² CMA, Addendum to Provisional Findings, paragraph 35.

specified and reasonable period of time, and at the latest towards the end of the smart meter roll out.

(f) Should the termination date of a transitional safeguard price cap remedy be linked to the roll-out of smart meters? If so then should this be done explicitly, in aggregate or on a customer-by-customer basis?

As above, we are pleased that the CMA have acknowledged the benefit the roll out of smart PP meters will have in addressing the concerns set out in the addendum to the Provisional Findings. Although we do not support the introduction of a price cap, were the CMA to introduce one, we believe that once a customer is on a smart meter they should be no longer subject to it. This would also have the added benefit of incentivising energy suppliers to roll out smart meters to PP customers as quickly as possible.

(g) How frequently – if at all – would the level of the cap need to be reassessed?

The absolute level of the cap should be reviewed at a minimum each quarter to ensure that the cap is not set inappropriately relative to costs, for example commodity, and is not having an unduly chilling effect on switching. It should be noted that even a quarterly review may not be sufficient to allow suppliers to reflect wholesale market volatility in their PP tariffs.

It is also important to consider the frequency of the publication of the price cap. In periods of falling prices it is likely the most competitive tariffs will be decreasing, therefore lowering the level of the price cap – requiring customers on the safeguard tariff to have prices reduced. On the other side, if wholesale prices increase, then suppliers may face periods where they are making losses without the ability to re-price, discouraging market entry and harming competition in the medium to long term. Any design of a safeguard tariff must consider these factors.

In contrast to these needs, we consider that the ability of the non-smart PP system to deliver frequent price changes is limited. In our most recent price change event for example, approximately [3<] of messages were picked up by customers in the first four weeks, with approximately [3<] being picked up after eight weeks.

This indicates the real risk that customers may not pick up new prices before they change again, particularly in periods of wholesale market volatility. This will create differences between the PP meter and the supplier's billing system, leading to customers running out of credit early when prices have fallen (and not been picked up by the meter) and building up debt when prices have risen (and not been picked up by the meter). The CMA should consider the flexibility of this infrastructure when considering whether this produces disadvantages which are disproportionate to the aim.

(h) Which prepayment customers should this remedy apply to?

As we note above, the impact of a tariff cap will restrict competition and therefore it is our view that it should not be implemented at all.

Were the CMA to implement it anyway, the tariff cap should only apply to non-smart PP customers who cannot change suppliers, for example because they have a debt balance of more than £500.

(i) Which energy suppliers should be subject to the transitional safeguard price cap, and why? Should it be restricted to the Six Large Energy Firms, or should all retail energy suppliers be covered?

Any cap should apply to all suppliers, both as part of the principle of a level competitive playing field and in order to avoid customer confusion.

(j) How should the transition from the current arrangements be managed? Should there be a period over which the transitional safeguard price cap is phased in? If so, how long should this period be and how should the transition work?

Our experience is that any mass rollout of PP messages will take a long time and this should be considered in setting any transition. As above, in our most recent price change event for example, approximately [X] of messages were picked up by customers in the first four weeks, with approximately [X] being picked up after eight weeks. The length of any rollout should also be considered in relation to the length of the period that the price cap is in place for.

(k) Would energy suppliers have the ability to circumvent the remedy, for example, by encouraging domestic prepayment customers to switch on to less favourable, unregulated tariffs, and how could such risks be mitigated?

In theory this might be possible, but we believe it would be challenging, brand damaging and potentially in breach of the existing Standards of Conduct all suppliers are obliged to adhere to. It is however important to note that some selected tariffs may be higher priced but still favourable given customer preferences (e.g. less volatile or fixed to manage risk, with an appropriate premium).

(l) Should the CMA set the level of the transitional safeguard price caps itself, or should the CMA make a recommendation to Ofgem to do so?

We do not believe that there should be a price cap.

(m) Are there any potential unintended consequences of setting a transitional safeguard price cap, for example, in terms of their potential impact on the level of other, unregulated tariffs?

As above, if the cap is set too low then the cap is likely to materially impact engagement and damage competition. If it is set too high, it will be ineffective and act as a price target for other tariffs in market, increasing the cost of energy for all PP customers. A regulator-set cap is also likely to create a “safe haven” effect, reducing customer engagement and therefore the scope for the benefits of competition to be extended to a wider part of the market.