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Project Manager
Competition and Markets Authority
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And by email to energymarket@cma.gsi.gov.uk

Dear Sirs

Economy Energy has considered the proposals set out by the CMA and in particular the proposed price cap remedy for consumers using prepayment meters. Nearly all of Economy Energy's customers use prepayment meters and as a result the impact on our business is likely to be very high.

The CMA has stated, based on its current analysis, that any revenue reduction would still result in revenues in excess of efficient prices. In Paragraph 7.164 the CMA goes on to state as follows:

> *"and so all suppliers should be able to supply at a profit in the prepayment segments"*

We do not accept such analysis for the reasons set out below

Similarly at Paragraph 7.190 the CMA acknowledges that the impact of the proposed price cap remedy on suppliers will vary in accordance with the proportion of prepayment customers each supplier has as part of its total customer base: -

> *"the size of this impact relative to each supplier's revenue varies significantly across suppliers as prepayment customers make up a larger proportion of the customer base for some suppliers than others."*

The CMA clearly recognises that this is an issue for suppliers. As almost all of our customers use prepayment meters, this remedy will impact our future business. Accordingly, the proposed price cap level does not mitigate any detriment for our business.

Our analysis of the methodology for setting the price cap suggests that when adjusted for wholesale price movements since June 2015 the level of the cap would be below the cheapest PPM tariffs available from any supplier in the market today.

We believe that a cap set at or near to this level would cause serious distortion to the market and all but remove any element of competition.

The CMA has identified a number of barriers to entry to the prepayment segment of the market. There are a number of reasons, such as the limited number of gas and tariff slots, over 85% of which are held by the Six Large Energy Firms. Similarly there are less incentives for suppliers but in particular new entrants, to compete to acquire all prepayment customers as a result of the higher costs to acquire those customers and low prospect of switching indebted customers. We note that the CMA has accepted that entry and expansion by suppliers other that the Six Large Energy Firms in the prepayment market is slower and that entry is limited to fewer suppliers. We submit that the introduction of this tariff cap will exacerbate the position and make it even more difficult for other suppliers to enter or gain any market share from the Six Large Energy Firms. (see Paragraphs 3.27 and 3.28 of the Report and 37 and 38 of the Summary of Provisional Decision on Remedies notified on 10 March 2016). In particular we believe that a cap at so low a level would produce little to no price variance between suppliers resulting in little to no reason for consumers to want to switch supply. In turn this would ensure that the current monopoly position of the six large suppliers would endure.

New entrants or other existing independent suppliers would have no incentive to want to offer prepayment tariffs significantly different to the cap and given the low level of profitability would probably not seek to do so. Indeed it is likely that had the price cap at the proposed level been in place when Economy Energy entered the market that Economy Energy would have been unable to attract customers away from the six larger suppliers and begin to build any kind of market share.

We identify the following areas where we would like to raise some concerns we have with the conclusions of the CMA investigation.

1. **Customers suffering detriment**

The CMA is proposing a price cap on PPM customers in reaction to the detriment it claims these consumers suffer and their unlikeliness to switch supplier. The CMA have identified that it is in fact credit customers on standard variable tariffs that are least likely to have switched (only 15% in the last 3 years compared to 22% of prepayment customers and only 7% in the last year compared to 11% of prepayment customers). We believe that if the market needs encouragement then it is the standard variable tariff credit customers that need more intervention.

Indeed, we fear there is a great danger that in response to the loss of earnings to the larger suppliers as a result of the PPM price cap the suppliers will simply look to recoup losses through their most loyal and least likely to switch customers – namely those on the standard variable credit tariffs.

Economy Energy identified PPM as a sector not well served by the six large energy companies and one where it could make an impact and benefit customers. It invested significantly in systems specific to these customers and has never installed a PPM for debt reasons. However, the imposition of a price cap at too low a level could mean that the business needs to refocus its efforts onto other customer groups.

2. **Benchmark tariff**

We do not believe that the current choice of benchmark tariff is correct. Both First Utility and Ovo have grown rapidly over the past few years and we believe it is likely that their tariffs are designed with customer acquisition in mind and that acquisition costs will be recovered over the life of a customer. We note both First Utility and OVO say that their tariffs are profitable. We also note Ovo's losses and First Utility's low profit margin along with the implication that as these companies mature their customer base will be less based on new acquisitions and therefore more profitable.

We believe a benchmark tariff based on a range of evergreen tariffs would be more appropriate as a baseline.

3. **Cost to serve differential**

As a company serving predominantly prepayment customers it is difficult for us to assess the level of cost differential between prepayment and direct debit customers. Our analysis suggests that the six larger suppliers have approximately 94% of the prepayment market with Utilita accounting for about 3% and Economy Energy about 1%.

With the larger suppliers having such big customer numbers and therefore the ability to take advantage of economies of scale and Utilita operating Smart meters for the majority of its customers we think it is difficult to truly assess the cost differentials experienced by a typical supplier between its prepay and direct debit payment methods. It would seem that the difference will depend to some extent on the mix of payment methods within any one supplier. However, having analysed the CMA report we have the following observations.

It is clear that the CMA has little confidence in the cost allocations made by the six large energy firms and the mid-tier suppliers or in the research carried out by Ofgem. It has therefore sought to determine the level of costs itself and we believe has arrived at a level that is too low and does not properly reflect all of the extra costs associated with prepayment customers which we believe include, but are not limited to, greater numbers of customer contact and more lengthy and complicated queries, repeated issue of card and keys, more faults with more complicated meters, a higher number of change of tenancy requests and higher customer acquisition costs.

We note that the CMA doesn't think the larger suppliers have been able to evidence that prepayment customers make more frequent contact with their suppliers. We fail to understand how this can be true. The principal reason for a credit or direct debit customer contacting their supplier is to query a bill – if they had lost power or gas they would need to call their DNO. In contrast, while a prepayment customer might not need to query a bill (although issues around payment do occur) they will need to contact their supplier over a number of device (key or card) issues and off-supply problems often caused by self-disconnection.

PPM Debt levels

Economy Energy operates almost exclusively in the prepayment sector of the market. It has never installed a prepayment meter in place of a credit meter in order to recover debt. We do however incur bad debt on meters particularly in cases of change of tenancy where standing charge has been allowed to build up.

Additionally a not insignificant number of customers choose to operate their meters by using the emergency credit almost all the time – thus effectively putting themselves in a post-pay position. This often leads to self-disconnection and the need for a wind on (essentially sending an engineer (at our cost) to add credit to a meter that the customer later has to repay) and causes the customer to have to contact the supplier more often.

We also charge customers for lost payment devices (cards & keys), for engineer appointments that are for non-faulty meters and for revenue protection cases where gas or electricity has been stolen by bypassing the meter. These debts are added to the meter, but if the tenant then moves out they become very difficult to recover.

Customer acquisition costs

Prepayment customers are more difficult to sign up than credit customers mainly due to the low visibility on price comparison websites and the low levels of internet availability to many of these customers. As a result more sales are done face to face and this incurs significant extra cost as sales need to be verified by a person different to the sales agent and many more levels of safeguard need to be in place to ensure a compliant sale and ensure protection for potentially vulnerable customers.

In order to persuade a customer to join a newer supplier that they might not have heard of the potential savings can be a very important factor. A price cap with leaving only a very small margin between different suppliers prices will we believe discourage customers from moving from their current supplier.

Once the sale has taken place successfully the customer needs to receive new payment devices (gas card and electricity key) in order to operate the meter on their new tariffs. The current cost of sending these devices is approximately £x.xx for an electricity key and £x.xx for a gas card although it is worth noting that costs were considerably higher (almost double) when the company had fewer customers. These are costs not incurred by customers paying by direct debit but do represent a significant cost differential when signing up volumes of new prepayment customers.

Vulnerable customers

We note from the CMA's report that among prepayment customers there are significantly more disabled and single parents leading to a much a higher likelihood of being on the Priority Services Register. This would quite rightly mean a number of services being offered at no additional cost to these customers and as more device issues occur with prepayment meters increasing the cost differential.

Barriers to entry

As is mentioned in the CMA report new suppliers can face barriers to entering the prepayment sector because of the infrastructure required to successfully take payments and set correct tariffs. We note the CMAs recommendation to make gas tariff pages available to more suppliers.

However, we believe a price cap will increase barriers to entry by not allowing new entrants to offer a significant enough price differential to tempt customers away from the six larger suppliers.

Conclusions

In conclusion we believe that while a price cap remedy could produce improved prices for prepayment customers the level it is set at, if too low, could have the effect of reducing the number of suppliers able to operate in that market sector.

We urge the CMA to consider the implications to smaller suppliers of such price controls, particularly their ability to be offer a competitive alternative to the larger suppliers.

We note that the CMA has assessed the proportionality of its proposed remedies in line with its published criteria. A proportionate remedy must be one which is, inter alia, effective in achieving its legitimate aim. We do not think this is achieved here. We note from Paragraph 7.224 that the CMA has acknowledged the risk that the level of price cap may be set too low to allow for the recovery of efficient costs. The CMA has attempted to mitigate this risk by suggesting that £50 is a suitable level of headroom (£25 per fuel). We submit that such an approach will not address some of the unintended consequences the CMA has identified (see Paragraphs 7.168 – 7.170).

As highlighted by the CMA in Paragraph 7.221, a proportionate remedy must be one which is no more onerous than needed to achieve its aim. We note from Paragraph 7.230 the CMA has acknowledged that the price cap remedy may be onerous in that it will specify a cap for prices which does not permit reasonable opportunities to recover efficient costs. The CMA has stated in Paragraph 7.231 that those risks are mitigated by designing a price cap to take competitive prices in the market as a starting point and then updating in line with key components of the customer's bills. In addition, the existence of headroom also mitigates the risk that the level of the cap will be below efficient costs. However, we do not accept that these measures will effectively mitigate the risk for Economy Energy and other smaller competitors who are already at a competitive disadvantage compared to the Six Large Energy Firms. Therefore, the proposed remedy remains too onerous.

A proportionate remedy must not produce disadvantages which are disproportionate to the aim. We note from Paragraph 7.237 onwards that the CMA has looked at various risks including the risks of suppliers exiting the market. We note from Paragraph 7.247 that the CMA expects that while the price cap may initially reduce prices, the new level of prices will still:-

> *"be at such a level that profitable competition is possible beneath the level of the cap. Thus we do not expect that suppliers will have significant incentive to exit the market"*

As we have outlined above, our concern is that if set too low suppliers may have no alternative but to exit this segment of the market. Accordingly, the resulting disadvantages are in fact disproportionate to the aim of this remedy.

We hope that the CMA will be able to reconsider the effects of introducing this remedy into only one section of the market and the effect that may have on the amount of competition in that sector.

Yours faithfully

Lubna Khilji
Chief Executive Officer