Appendix 14.1: Summary of responses to the proposed price cap remedy

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1. This appendix outlines a summary of responses received in relation to the proposed price cap for prepayment (PPM) customers, outlined in our Provisional Decision on Remedies. This provides a summary of parties' views concerning the following elements:

   (a) The scope of the PPM price cap remedy;

   (b) Our approach to sun-setting the remedy;

   (c) The mid-term review of the remedy;

   (d) The general design of the remedy;

   (e) The approach to updating the remedy;

   (f) The mechanism for indexing wholesale costs;

   (g) The mechanism for indexing network costs;

   (h) The mechanism for indexing policy costs;

   (i) The mechanism for indexing other costs;

   (j) Potential unintended consequences resulting from the remedy; and

   (k) Alternative options to the price cap remedy.

2. Parties' views relating to our analysis of the competitive benchmark price, which forms the basis for the price cap, and the cost-to-serve differential for PPM customers are outlined in Section 10 and its associated appendices and in Appendix 9.8 respectively.

3. In this document we generally reference the part of the Section 14 in which we respond to the issues raised by parties. Where a number of parties raised the same or substantially similar views we reference a single response to all of those points. However, in a few cases, we set out our consideration of the issues raised by parties in this Appendix, following our summary of their views.

Parties' views on the scope of the PPM Price Cap Remedy

4. Citizens Advice, Age UK, National Energy Action and Caroline Flint MP[1] outlined their support for the price cap's application to PPM customers, however considered that the scope should be extended. Comhairle Nan Eilean Siar[2] outlined their support for the price cap and uSwitch[3] outlined their support for the price cap as a temporary measure.

   (a) Citizens Advice stated that refocusing the safeguard tariff on households that struggle with affordability but are also disengaged from the market would allow the CMA to make significant inroads into tackling fuel poverty and better matching the characteristics of disengaged consumers. As a result, Citizens Advice suggested that the Cold Weather Payment eligibility group could provide a better basis for targeting the safeguard tariff than simply applying it to PPMs.[4]

   (b) Age UK strongly supported the proposed temporary price cap for customers on PPM meters, however considered that Ofgem should explore the range of customer data available to identify other groups of vulnerable customers who could also benefit from a price cap or other similar mechanisms.[5]

   (c) National Energy Action outlined that costs are likely to be recovered by suppliers from customers on different payment types, and therefore by focussing on vulnerable customer, and not all PPM customers, these costs would be kept to a minimum and the remedy better targeted.

[1] Caroline Flint MP response to the Provisional Decision on Remedies – Page 1.
[2] Comhairle Nan Eilean Siar response to the Provisional Decision on Remedies – Paragraph 3.
[3] uSwitch response to the Provisional Decision on Remedies – Paragraph 3.5.
[4] Citizens Advice response to the Provisional Decision on Remedies – Page 4.
[5] Age UK response to the Provisional Decision on Remedies – Page 2.

National Energy Action considered that suppliers should also provide the tariff on a discretionary basis to other domestic PPM customers who are known to them as suffering from severe financial insecurity or health related issues.[6]

5. SSE, Utilita and MoneySupermarket.com noted that PPM customers are a poor proxy for vulnerable customers.

(a) SSE[7] considered that the proposed remedy would have limited effectiveness in providing additional protections for vulnerable customers because PPM customers are generally a poor proxy for this type of customer, outlining that:

(i) Ofgem data suggested that the majority of vulnerable customers (as defined by Ofgem) use credit and DD payment methods, with only 25% of vulnerable customers paying by PPM;

(ii) Only 23.4% of SSE customers who received a rebate (across the Core and Broader Groups) under the Warm Home Discount (WHD) were PPM customers; and

(iii) The proposed remedy will attach to significant proportions of customers who are not, in the CMA's view, "less able to engage to exploit the benefits of competition."

(b) Utilita also considered that PPM customers are a poor proxy for vulnerable customers, citing Ofgem's report 'Energy: The Debate, Ofgem Roundtable Report – Payment Differentials' (March 2015) which noted that more fuel poor customers pay their energy bills by direct debit or standard credit than by PPM (72.9% of electricity customers and 59.7% of gas customers - a further 18.2% of customers are noted as having no gas).[8]

(c) Moneysupermarket.com noted that the focus on improving the situation of PPM customers risks making the assumption that all those on PPM are in a vulnerable situation. Moneysupermarket.com therefore encouraged the CMA to make sure its focus on PPM is balanced and not at the expense of many of the equally vulnerable customers in the market using, for example, credit meters.[9]

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[6] National Energy Action response to the Provisional Decision on Remedies – Paragraph 1.1 – 1.5.
[7] SSE response to the Provisional Decision on Remedies – Paragraph 4.52.
[8] Utilita response to the Provisional Decision on Remedies – Paragraph 4.11.
[9] Moneysupermarket.com response to the Provisional Decision on Remedies – Page 8.

6. We set out the rationale for our final decision on the scope of the PPM Price Cap in paragraphs 14.2 – 14.25. In Section 11, we set out in detail our reasons for imposing a price cap for prepayment customers specifically and not for other groups, such as vulnerable customers. We have considered the effectiveness of the PPM Price Cap Remedy in paragraphs 14.349 – 14.380.

7. E.ON considered that there was a lack of clarity in defining eligible customers within the PDR.[10] We note that we have clearly stated the scope of the PPM Price Cap Remedy in Section 14. The PPM Price Cap Remedy will apply to domestic prepayment meter customers except those with a SMETS 2 smart meter.

8. Centrica highlighted the risks associated with the number of PPM customers increasing as a result of the remedy and smart meter rollout.[11] Similarly, E.ON questioned whether the CMA intended for the price cap to apply to PPM customers that have switched from a credit meter to a PPM after the introduction of the price cap. E.ON noted that such customers would not have been included within the CMA's analysis on detriment and considered that it is not clear such a remedy should apply to customers who have made an active choice to switch to a PPM. E.ON considered this had the potential to create the incentive for customers to switch from credit to PPMs.[12]

   (a) Centrica outlined proposals around limiting the scope of the price cap to specific elements of the PPM segments, considering that these would be less damaging interventions.[13] These alternative options included:

      (i) Restricting the PPM price cap to only those customers who had a PPM meter at a given point in time – Centrica noted that this would limit the scope of the price cap remedy to the 16% of the market that the CMA is targeting, rather than the much larger proportion of the market that it may capture as a result of the smart roll out (which enables customers to switch to prepay more easily and cheaply) or of other customers switching to a PPM meter in order to obtain access to the regulated price cap;

      (ii) Restricting the PPM price cap to only customers who have a dumb PPM meter – Centrica noted that this would also limit the scope of the price cap remedy to the 16% of the market that the CMA is targeting (with the proportion impacted reducing over time with the roll out of smart meters). Centrica considered that this would also prevent

[10] E.ON response to the Provisional Decision on Remedies – Paragraph 233.
[11] Centrica response to the Provisional Decision on Remedies – Paragraph 144.
[12] E.ON response to the Provisional Decision on Remedies – Paragraph 245.
[13] Centrica response to the Provisional Decision on Remedies – Paragraph 156.

customers with smart meters from becoming disincentivised from engaging in their energy supply, thereby ensuring that the benefits of smart are achieved as quickly as possible; and

(iii) Restricting the PPM price cap to only customers on SVT or 'default' tariffs – Centrica considered that customers on fixed term contracts have, by definition, engaged in the market recently and so do not need 'safeguarding'.

(b) E.ON outlined that, should the CMA continue with this remedy, the eligibility criteria should be refined to a sub-set of the PPM population, for example, to include only those PPM customers which are in debt and have additional barriers to switch or providing protection under the cap for fuel poor PPM customers only. E.ON considered that such an approach would remove the potential unintended consequence that the remedy may incentivise existing non-PPM customers to switch from their credit meter to a classic PPM meter in order to be eligible for the price cap tariff.[14]

9. Our rationale for setting the scope of the PPM Price Cap as we have done is set out in paragraphs 14.2 – 14.25. In addition, we consider customer incentives to switch on to prepayment meters in paragraph 14.447.

10. SSE outlined that PPM customers are a poor proxy for less engaged customers. SSE stated that PPM switching levels are in line with those for customers with credit meters and the CMA's customer survey shows high satisfaction rates among PPM customers.[15]

11. RWE and Scottish Power considered that the CMA had not sufficiently investigated the causes of any disengagement to justify the basis for the proposed price cap.

(a) RWE considered that the CMA did not properly take into account the extent to which disengagement might be caused by the PPM AEC itself. RWE expects engagement by PPM customers to increase significantly once the technical and RMR constraints are removed, allowing suppliers and PCWs to compete more effectively for PPM customers.[16]

(b) Scottish Power recognised that the PPM segment has not yet been characterised by the keener pricing that has been seen for non-standard tariffs in the direct debit segment however outlined their consideration that this was partly a timing issue (e.g. most new entrants focus on the DD/SC

[14] E.ON response to the Provisional Decision on Remedies – Paragraph 232, 233.
[15] SSE response to the Provisional Decision on Remedies – Paragraph 4.5.3.
[16] RWE response to the Provisional Decision on Remedies – Paragraph 46.16.

segment initially, and then invest in developing the additional systems and processes to support the PPS) and partly due to technical factors around tariff codes. Scottish Power outlined that the CMA should seek to build on the recent acceleration in non-Six Large Energy Firm market share and give space to the wide range of pro-competitive remedies the CMA has proposed (coupled with tariff code rationalisation) to achieve the desired outcome for consumers.[17]

12. Our consideration of the causes of customer disengagement, including the specific issues faced by prepayment customers, is set out in detail in Section 9. We discuss the rationale for the remedy, including our assessment of how the PPM AEC and Domestic Weak Customer Response AEC relate to the scope of the price cap, in paragraphs 14.2 – 14.25. The aim of this remedy is to mitigate the detriment suffered by domestic customers on prepayment meters arising from the PPM AEC and the Domestic Weak Customer Response AEC during the transitional period.

13. In addition, we have considered less onerous alternatives to the PPM Price Cap Remedy in paragraph 14.393 – 14.397.

14. RWE highlighted the need to ensure the remedy clearly addresses the AEC and not wider political perspectives.[18] We have described how the PPM Price Cap Remedy mitigates the AEC in paragraphs 14.26 - 14.28.

15. The Six Large Energy Firms outlined varying degrees of objection to the price cap. Some suppliers (EDF Energy and RWE) recognised competition issues in the PPM segments, however all of the Six Large Energy Firms considered that the CMA's quantification of the detriment was overstated. See section 10 for our final assessment of detriment.

    (a) EDF Energy submitted that it had serious reservations about the imposition of a price cap remedy, however recognised that current technical constraints in the PPM market limited tariff availability (pending SMETS2 smart meter rollout) and that certain PPM customers face particular difficulties moving onto a credit meter.[19]

    (b) E.ON said that it was strongly opposed to the introduction of a regulated price cap for PPM customers. E.ON stated that it does not believe an area of the market that has seen the arrival of new competitors with new business models and technological innovation should be encumbered with regulated prices. E.ON considered that the remedy goes against the

[17] Scottish Power response to the Provisional Decision on Remedies – Paragraph 12.3, 12.4, 12.5.
[18] RWE response to the Provisional Decision on Remedies – Paragraph 46.9.
[19] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.54.

aim of introducing smart meters into the segment as the best way of addressing the technical barriers, and that the remedy is not based upon a robust analysis of the PPM segments.[20] We consider recent developments, including smart metering, in paragraphs 14.93 and 14.21.

(c) E.ON considered that this would distort competition in the market, have significant unintended consequences and work against the other proposed remedies thereby reducing their effectiveness and is not proportionate. E.ON noted that a price cap is a seriously regressive step and runs counter to market liberalisation and competitive markets.[21] We consider possible unintended consequences in paragraphs 14.398 – 14.458.

(d) E.ON accepted that there are a number of technical constraints in the PPM segments, however E.ON considered that it is those constraints, and not a lack of competition, which need to be addressed.[22]

(e) RWE told us that it agreed that there are certain supply-side constraints and higher costs to serve for PPM customers that may have had an adverse effect on competition within the PPM segments and/or given rise to a degree of consumer detriment. However, RWE considered that the CMA significantly overstated the scale of any detriment faced by PPM customers and also significantly underestimates the extent to which the PPM AEC (and the Domestic Weak Customer Response AEC insofar as it applies to PPM customers) will be addressed by the CMA's package of other PPM and engagement remedies. On this basis, RWE told us that it believed that the PPM price cap was not necessary.[23] We consider the need for a price cap in paragraphs 14.10 – 14.19 and consider the proportionality of the price cap in paragraphs 14.381 – 14.458.

(f) Centrica stated that it strongly objected to the principle of introducing price regulation for any segment of the retail market, as it was inconsistent with the promotion of competition.[24] Centrica considered the basis upon which the CMA justified the price cap remedy to be unfounded.[25]

(g) Scottish Power submitted that it had serious concerns about a price cap remedy for domestic PPM customers and considered that it would be highly damaging to competition in the PPM segments and unnecessary.[26]

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[20] E.ON response to the Provisional Decision on Remedies – Paragraph 236.
[21] E.ON response to the Provisional Decision on Remedies – Paragraph 20.
[22] E.ON response to the Provisional Decision on Remedies – Paragraph 224.
[23] RWE response to the Provisional Decision on Remedies – Paragraphs 46.1 – 46.4.
[24] Centrica response to the Provisional Decision on Remedies – Paragraph 134.
[25] Centrica response to the Provisional Decision on Remedies – Paragraph 138.
[26] Scottish Power response to the Provisional Decision on Remedies – Paragraph 12.2.

We consider the possible impact on competition in paragraphs 14.405 – 14.416. See also Section 11.

(h) SSE submitted that the alleged AECs had not been established to the required legal standard and that CMA's analysis of detriment was materially overstated and therefore there was no justification for the proposed remedy.[27]

16. RWE considered that the package of remedies including the PPM price cap was likely to be less effective than one without a price cap and the CMA had failed to assess the extent to which these remedies address the PPM detriment. In addition RWE outlined that three years and nine months for the effectiveness of a remedies package meets the "reasonable period of time" standard, negating the requirement for a transitional price cap remedy. Our assessment of effectiveness is set out in paragraphs 14.349 – 14.380.

(a) RWE highlighted that a price cap would directly counteract the other remedies aimed at encouraging customers to engage and suppliers to compete. RWE therefore considered that the package of remedies including the PPM price cap is likely to be less effective than one without a price cap.[28] RWE told us that the proposed remedies package would significantly increase competitive pressure, and that the package of PPM and engagement remedies could significantly reduce any detriment faced by PPM customers within a very short timescale.[29] Our assessment of the interaction between remedies is set out in section 11. Our assessment of effectiveness is set out in paragraphs 14.349 –14.380.

(b) RWE also considered that the competition enhancing remedies can be expected to take effect more quickly than estimated by the CMA and/or implementation of certain of these remedies could be brought forward.[30]

(c) RWE considered that the CMA failed to assess what that impact of the remedy package (excluding the price cap) might be and how much these other remedies will reduce the PPM customer detriment. RWE stated that any residual detriment would be small and, to the extent that any interim remedy was required, there were options much less onerous than the PPM price cap that could address the detriment in the meantime.[31] Our assessment of how the interaction between remedies is set out in Section

[27] SSE response to the Provisional Decision on Remedies – Paragraph 4.4.2.
[28] RWE response to the Provisional Decision on Remedies – Paragraph 46.35.
[29] RWE response to the Provisional Decision on Remedies – Paragraphs 46.23 – 46.28.
[30] RWE response to the Provisional Decision on Remedies – Paragraph 46.41.
[31] RWE response to the Provisional Decision on Remedies – Paragraph 46.29.

11 and we consider proportionality off the PPM Price Cap Remedy in paragraphs 14.382 – 14.458.

17. Utilita, Littlechild et al and Flipper Ltd also outlined that they did not support the price cap remedy.

(a) Utilita stated that it does not support a cap and considers this to be a blunt remedy that will not achieve the desired outcome and believes that this will fundamentally damage competition. Utilita considers that if a cap is to be utilised it must be viable and allow for effective competition. Utilita outlined various key outcomes that it considered the cap must deliver. These were that the cap should: be practical and workable; treat all customers fairly; allow suppliers to manage risk; allow customers to have a range of competitive offers and choice of suppliers; promote healthy long term competition in all elements of the market; and maintain downward pressure on prices. Utilita told us that it believed the provisionally proposed design failed on all of these counts.[32] Utilita considered that the CMA's approach of a highly interventionist action with the potential to inflict long term damage on the market, at the same time as seeking to invigorate and clarify Ofgem's focus on competition was contradictory.[33] Our assessment of proportionality, including the effect on competition, is set out in paragraphs 14.382 – 14.458. In addition, we note that headroom is included in the calculation of the level of the cap which allows for competition beneath the level of the cap.

(b) Littlechild et al considered that the adverse consequences that the CMA associated with a price cap on Standard Variable Tariffs applied equally to these tariffs. That is, a PPM price cap would undermine the competitive process with respect to PPM customers, potentially resulting in a worse outcome for PPM customers through a combination of reducing the incentives of suppliers to compete for PPM customers, and reducing the incentives of PPM customers to engage. Littlechild et al considered that this would hit hard the innovative existing Mid-tier PPM Suppliers and discourage entry from new suppliers.[34] Our assessment of proportionality, including the effect on competition, is set out in paragraphs 14.381 – 14.458.

(c) Flipper Ltd outlined that it did not support the CMA's proposal to put in place a price cap for PPM customers and considered that the proposals to address supply side issues were sufficient to see significant competitive

[32] Utilita response to the Provisional Decision on Remedies – Paragraph 4.1, 4.2 and Table 4.1.
[33] Utilita response to the Provisional Decision on Remedies – Paragraph 4.4.
[34] Littlechild et al response to the Provisional Decision on Remedies – Paragraph 32.

pressure re-emerge for PPM customers. Flipper Ltd considered that prior to the introduction of Ofgem's anti-discrimination licence condition and the RMR, Ofgem's reviews of supply competition showed vigorous competition for PPM customers, high engagement and that the difference between the most competitive PPM and direct debit tariffs were at or below reasonable estimates of the difference in costs to serve. Flipper Ltd considered that if the RMR restrictions and the PPM supply side issues were resolved, there would be even more competitive pressure in these segments.[35]

18. Scottish Power suggested that there should be a transitional exemption from the price cap in respect of customers on existing fixed price fixed term tariffs entered into by the date of the CMA's final report. Scottish Power noted that in these cases, the customer would have engaged with the market and it was appropriate to respect the choice that had been made by both parties.[36] We note that detriment in the prepayment segment exists because competitive prices are not available. Therefore, even where prepayment customers have made an active choice of tariff, this does not mean that they may not be suffering detriment. As a result, we have not excluded these customers from the price cap. Our assessment of how the price cap will interact with existing forward purchases of energy is set out in paragraphs 14.453.

19. Scottish Power, EDF Energy, E.ON and SSE considered that the cap should not apply to customers with smart meters. Flow Energy also highlighted that the inclusion of customers with smart meters within the scope of the cap was not necessary.

    (a) Scottish Power considered that the tariff cap should not apply to customers with SMETS2 smart meters. Scottish Power noted that once customers moved to smart PPMs, suppliers are no longer constrained in their ability to offer a wide range of tariffs and customers should be encouraged to take advantage of this increased flexibility; Scottish Power highlighted the presence of the price cap could discourage this. Scottish Power told us that suppliers will have a strong incentive to ensure that PPM customers on SMETS2 meters, even if they are not subject to the cap, are offered as good, if not better, deals than customers on dumb meters in order to minimise risks around smart meter roll-out progress and potential enforcement action.[37]

[35] Flipper Ltd response to the Provisional Decision on Remedies – Page 2.
[36] Scottish Power response to the Provisional Decision on Remedies – Paragraph 12.34.
[37] Scottish Power response to the Provisional Decision on Remedies – Paragraph 12.36.

(b) EDF Energy also told us that the price cap should not provide customers with an incentive not to make active tariff choices, and as a result considered that the cap should not apply to PPM customers with a SMETS2 meter. EDF Energy proposed that the price cap should be removed at an individual customer level once a SMETS2 meter is fitted.[38] EDF Energy outlined that tying removal of the cap explicitly to individual smart meter installations would also provide a powerful incentive for suppliers to roll-out smart PPMs to customers as quickly as possible for those customers who would benefit from them the most.[39] We note that customers with SMETS 2 smart meters will not be included in the scope of the price cap.

(c) E.ON submitted that it was not proportionate for the cap to extend to Smart Pay as You Go ("PAYG") customers, as the key cause for the detriment identified by the CMA in the PPS was the effect of technical restrictions arising from dumb PPM infrastructure. In support of this, E.ON highlighted that the features giving rise to the PPM AEC will, to a significant extent, be addressed by smart metering, with the cheapest PPM tariff in each region generally relating to a smart offering.[40] E.ON noted that it previously described to the CMA its intention to target its Smart PAYG proposition at PPM customers, as the result of a commercial decision based upon an attractive competitive opportunity in the market, with other suppliers also actively pursuing this opportunity, demonstrating the benefits of competition in this area.[41] We consider the implications of E.ON's plans in paragraph 14.22.

(d) Flow Energy told us that they did not consider that a transitional price cap was the best means of providing protection for customers with smart meters, who were likely to consider that the safeguard tariff offers them protection and means that there was no point in engaging in the market. A more appropriate move may be to cap those customers on long term legacy pre-payment infrastructure only.[42]

20. EDF Energy did not believe that the level of the price cap would be appropriate for smart PPM customers as it included legacy PPM infrastructure costs that smart customers no longer needed or benefited from.[43] In addition, EDF Energy noted that this would prevent smart PPM customers moving to

[38] EDF Energy response to the Provisional Decision on Remedies – Paragraph 0.21.
[39] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.84.
[40] E.ON response to the Provisional Decision on Remedies – Paragraph 234.
[41] E.ON response to the Provisional Decision on Remedies – Paragraph 225.
[42] Flow Energy response to the Provisional Decision on Remedies – Page 3.
[43] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.81.

an alternative smart PPM tariff.[44] We consider the scope of the price cap in relation to smart meters in paragraph 14.89 – 14.94.

Parties' views on the sun-setting of the PPM Price Cap Remedy

21. SSE told us that it was important that the arrangements for the termination of the proposed price cap were robust and appropriately reflected market conditions (in particular SSE noted that customers who already have smart meters installed should not be eligible for the price cap).[45] The PPM Price Cap Remedy will terminate on 31 December 2020. See paragraphs 14.328 – 14.340 for further detail.

22. EDF Energy submitted that the smart meter related sunset clause should operate at an individual customer level (rather than industry level), with an overall end date of 2020 subject to an Ofgem led review. Spark Energy also considered that the CMA should define a fixed end date for the price cap.

    (a) EDF Energy outlined that that the removal of the price cap should be linked to SMETS 2 smart meter installation at an individual customer level rather industry level, so that customers who have a smart meter installed are able to benefit from the opportunities of the new infrastructure straightaway, rather than wait up to three years before they are able to do so.[46] As noted above, customers will cease to be in scope of the price cap once they have a SMETS 2 smart meter installed.

    (b) EDF Energy considered that the overall end date for the PPM price cap should remain as 2020, by which time most PPM customers will have had their smart meters installed and the price cap lifted. EDF Energy noted that this date will then provide a further prompt for any customers remaining on legacy PPM meters and the price cap to engage in the market as well as an incentive to have a smart meter installed if they have not already done so. EDF Energy considered that a review in 2020, as proposed by the CMA, would be appropriate to assess whether the installation of smart meters had fallen behind schedule and whether the deadline needed to be reviewed. EDF Energy considered that this review should be undertaken by Ofgem who were already monitoring the roll-out programme.[47] Arrangements for a mid-term review are described in paragraph 14.328 - 14.340

[44] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.80.
[45] SSE response to the Provisional Decision on Remedies – Paragraph 4.8.5.
[46] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.55.
[47] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.86.

(c) Spark Energy outlined concerns that by linking the duration of the price cap to completion of the mass roll-out of smart meters, residual uncertainty existed about its duration. Spark Energy considered that this uncertainty for suppliers, stakeholders and investors would reduce appetite to compete in the PPM market and a fixed end date was therefore preferable.[48] We consider the impact of the price cap on competition in paragraph 14.405 - 14.413

23. EDF Energy and Scottish Power told us that sun-setting on a customer level may disincentivise customers from obtaining smart meters, however considered that this was not a significant risk. We consider this risk in paragraphs 14.400 - 14.405.

(a) EDF Energy submitted that for customers who value the protection of a regulated tariff, the removal of that tariff may prove to be a disincentive for agreeing to a smart meter installation. However, EDF Energy considered that suppliers will be offering customers who have smart meters installed attractive tariffs and that the removal of a regulated tariff will be another incentive for customers to engage in the market.[49] We consider the impact of the price cap on customer engagement in paragraphs 14.400 - 14.405.

(b) Scottish Power highlighted that suppliers will have a strong incentive to ensure that PPM customers on SMETS2 meters, even if they are not subject to the cap, are offered as good, if not better, deals than customers on dumb meters. Scottish Power noted that if this were not the case, customers may be reluctant to have a smart meter installed, and suppliers would find their smart roll-out progress put at risk. Scottish Power highlighted that given the potential enforcement action if rollout targets are missed, this is not a risk that suppliers would wish to run.[50] We consider the possible impact of the price cap on the smart meter roll out in paragraph 14.451.

24. Scottish Power considered that the price cap end date should be 31 December 2019, rather than 31 December 2020, noting that by that time smart roll-out would be well underway, and competitive conditions could be expected to have improved sufficiently that there would be no ongoing need for any cap.[51] We set out the need for a mid-term review in paragraph 14.328 - 14.340.

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[48] Spark Energy response to the Provisional Decision on Remedies – Section 2.
[49] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.84.
[50] Scottish Power response to the Provisional Decision on Remedies – Paragraph 12.36.
[51] Scottish Power response to the Provisional Decision on Remedies – Paragraph 12.37.

25. Citizens Advice and Which? noted that the CMA should clearly set out the characteristics of a market with effective consumer engagement and that the price cap should not be removed until these are met. MoneySavingExpert.com stated that the price cap should only be removed if it would not result in consumer detriment.

(a) Citizens Advice supported the tariff being tethered to the rollout of smart meters, however, outlined their concerns about writing a specific date into legislation due to questions around the progress of the rollout and outcomes for PPM customers. Citizens Advice considered that it was important that the mid-term review looked, not only at the numbers of smart meters, but also at the competitiveness of PPM tariffs, the propensity of consumers on those tariffs to switch and the ease with which PPM consumers can access the market. Citizens Advice believed that only through assessment of a range of metrics would it be possible to judge whether the prepay market has in fact become more competitive as a result of smart meter rollout. [52] Citizens Advice therefore noted that it would be useful to set out clear criteria on what success is considered to look like and the price cap should not be removed until these criteria are met.[53] In addition to the mid-term review, we note that Ofgem acts as market regulator with an ongoing role in monitoring the state of competition in the energy markets.

(b) Which? told us that it was concerned about the limited detail on the success and testing criteria for this remedy, as well as the uncertainty around the impact of smart meters. Which? noted that price caps have traditionally been put in place to protect consumers in the absence of effective competition and were removed when competition became effective. Which? considered that the CMA should assess the market again at a defined point, or instruct Ofgem to assess the market, to determine whether the final remedies have been effective in addressing the AECs identified and allow an informed decision about the validity of any price cap rather than linking it to an arbitrary date.[54] We set out the need for a mid-term review in paragraph 14.328 - 14.340. In addition, as part of our package of remedies, we are recommending that Ofgem carry out an annual state of the market report (see Section 19).

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[52] Citizens Advice response to the Provisional Decision on Remedies – Page 51.
[53] Citizens Advice response to the Provisional Decision on Remedies – Page 6.
[54] Which? response to the Provisional Decision on Remedies – Section 5.

(c) MoneySavingExpert.com outlined that the price cap should only be removed if it will not result in consumer detriment, if this was not the case it must be extended as long as necessary.[55]

26. We consider the need for a sunset clause to ensure the duration of the price cap is both certain to the industry, and to ensure it is a proportionate remedy. We consider that the proposed approach to terminating the price cap on 31 December 2020 provides certainty to suppliers, customers and other key stakeholders including government, Ofgem, consumer bodies and investors in the energy sector. We note that there is some inherent uncertainty over exactly when the roll-out of smart meters in the domestic retail energy markets will be completed, as such we set out the need for a mid-term review in paragraphs 14.328 - 14.340. This mid-term review will consider the state of the smart meter rollout as this is likely to have a significant impact on competition. In the event that, at the date of the mid-term review, the roll-out of smart meters does not appear likely to be completed by 31 December 2020, we would consider whether to encourage Ofgem to review the situation and take whatever action it considers appropriate (including whether to introduce a similarly structured price cap in the prepayment segments as from the start of 2021). In addition, we are recommending that Ofgem undertake an annual state of the market report as part of our package of remedies designed to address the Governance AECs we have identified.

Parties' views on the mid-term review of the PPM Price Cap Remedy

27. Centrica and RWE did not consider that the mid-term review proposed by the CMA was sufficient. RWE and Spark Energy suggested that an annual review to consider whether the price cap continues to be justified is required.

(a) Centrica outlined that it considered the proposal for the cap to apply until 2020 with one review taking place in 2019 was disproportionate against the background of a competitive market and range of other remedies being implemented.[56] Centrica also noted that linking the duration of the remedy to the completion of the smart meter roll out could be used to justify a continuation of the cap indefinitely given that a single customer could prevent 100% completion by continuing to refuse a smart meter installation.[57] We consider the proportionality of the PPM Price Cap Remedy in paragraphs 14.380 – 14.458. We have considered this issue in the subsection titled "Risk that the price cap becomes permanent".

[55] MoneySavingExpert.com response to the Provisional Decision on Remedies – Page 2.
[56] Centrica response to the Provisional Decision on Remedies – Paragraph 146 – 150.
[57] Centrica response to the Provisional Decision on Remedies – Paragraph 149.

(b) RWE highlighted that the Federutility case clearly stated under Article 3(2) of the EU Energy Directives, the need for a price cap needs to be re-examined "at close intervals". In this regard, RWE did not consider that the mid-term review proposed by the CMA was sufficient. RWE considered that an annual review is required considering more generally whether the price cap continues to be justified.[58]

(c) Spark Energy also considered that the CMA should undertake an annual review of the state of PPM market (including switching levels) and make provision for the price cap to end sooner if the CMA considers that sufficient progress has been made during the fixed term.[59]

28. We have considered the frequency of reviews in the context of the Federutility judgment as described in paragraphs 14.365 – 14.369. We consider that the mid-term review proposed is consistent with the requirements of the Federutility judgment. We consider that smart meters, and our other remedies concerning the Prepayment AEC and domestic customer engagement, are expected to change the competitive dynamic in the prepayment segments, and more broadly across the domestic retail energy markets, affecting the way that customers and suppliers interact. As a result, the PPM Price Cap Remedy would no longer be required once smart meter roll-out has been concluded by the end of 2020. Accordingly, while we have incorporated a sunset provision into the PPM Price Cap Remedy that is linked to the successful completion of the roll-out of smart meters and excluded customers with SMETS 2 smart meters from the cap, we propose to conduct a focused mid-term review in January 2019 of the progress that has been made concerning the roll-out of smart meters.

29. Scottish Power supported the CMA's proposal to conduct a focused mid-term review, and in the event that the roll-out of SMETS2 smart meters was materially ahead of schedule, to consider whether to terminate the price cap early. Scottish Power, however, considered that the CMA should not include provision for the price cap to be extended. Scottish Power considered that the longer the price cap is left in place, the harder it will be to move customers back to a more engaged mind set. Scottish Power outlined that if any provision for extension is included, this should include clear guidance as to the maximum additional duration.[60]

[58] RWE response to the Provisional Decision on Remedies – Paragraph 46.31.
[59] Spark Energy response to the Provisional Decision on Remedies – Section 2.
[60] Scottish Power response to the Provisional Decision on Remedies – Paragraph 12.38, 12.39.

30. We consider the impact of the price cap on customer engagement in paragraph 14.400 - 14.405 and consider the risk that the price cap becomes permanent in paragraphs 14.431 – 14.435.

31. SSE outlined that the CMA should include a sunset clause allowing for review or removal of the cap in the event that changes in Government policy render the cap obsolete before 2020.[61] We note that the CMA's existing remedy review powers allow for this. SSE also noted other conditions which should trigger a review, as outlined at paragraph 61 below.

Parties' views on the general design of the PPM Price Cap Remedy

32. SSE considered that integral elements of the proposed cap mechanism were opaque or entirely absent. In addition, SSE stated that the structure and form of the cap were fundamentally flawed and would produce a wholly disproportionate and unworkable remedy which would result in damaging outcomes in the market.[62] We have described the design in detail in paragraphs 14.58 – 14.246. We consider the form and structure of the price cap in paragraphs 14.40 – 14.57. We consider proportionality of the price cap in paragraphs 14.381 – 14.458.

33. SSE also outlined that the proposed cap is not clearly defined and the mechanics of the proposed price cap raise considerable uncertainty about its operation in practice. SSE considered that several critical elements of the proposed price cap have not been defined appropriately (or defined at all).[63]

34. Scottish Power considered that the base tariff levels forming the benchmark should not be drawn from two relatively small companies' prices on a single day. Scottish Power noted that this approach is highly susceptible to error and gives no assurance that the cap would be at an efficient level and would be unlikely to provide a reliable basis for a price cap that would apply over a number of years.[64] We note that whilst the competitive benchmark has been estimated at a particular point in time (a single day), it does not reflect Ovo and First Utility's prices on that day only. It reflects the tariffs offered by Ovo Energy and First Utility over an extended period of time. This is because it covers the stock of (direct debit) tariffs on which Ovo and First Utility had customers as of the observation date. This includes a large number of tariffs that were no longer available for sale at that time. Therefore, we consider that this approach to benchmarking provides a reliable basis for the price cap.

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[61] SSE supplementary submission on tariff cap – Paragraph 2.1.8.
[62] SSE response to the Provisional Decision on Remedies – Paragraph 4.6, 4.6.1.
[63] SSE response to the Provisional Decision on Remedies – Paragraph 4.4.2 (c).
[64] Scottish Power response to the Provisional Decision on Remedies – Paragraph 12.40.

35. E.ON, SSE and Utilita outlined that the approach to separately calculating single fuel and dual fuel caps was not appropriate, recommending that the dual fuel cap should be calculated as the sum of the single fuel electricity and single fuel gas caps.

(a) E.ON noted that the CMA proposed to set a dual fuel price cap based upon a dual fuel benchmark and single fuel price caps based upon single fuel benchmarks. E.ON noted that this was not consistent with the pricing practices commonly used in the PPS, where typically the dual fuel tariff is priced as the sum of the single fuel tariffs due to the technical constraints of the infrastructure. E.ON therefore recommended that the CMA refined its thinking in this area.[65]

(b) SSE also considered that there was no benefit in going beyond three tariff types (i.e. electricity, gas, and Economy 7) for the purposes of administering a cap.[66]

(c) Utilita considered that the only practical and enforceable method of ensuring compliance at multiple levels of energy usage is to treat gas and electricity price caps separately. Utilita considered operating three single fuel caps on gas, electricity and Economy 7 would be a more robust approach.[67]

36. We have taken these submissions into account and decided to use single fuel price caps rather than a dual fuel cap. See paragraphs 14.60 – 14.77, where we set out our rationale for this approach.

37. SSE suggested that an obvious simplification would be to set a maximum standing charge and unit rate for each tariff type in each region.[68] We note that the price cap implicitly defines a standing charge and unit rate though we have chosen not to specify it as such to avoid introducing further complexity in the form of the licence condition and associated order.

38. Scottish Power and EDF Energy highlighted the risk of distortions in future indexations arising due to errors in the splits between components of the benchmark bill.

[65] E.ON response to the Provisional Decision on Remedies – Paragraph 240.
[66] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.25 and 4.6.26.
[67] Utilita response to the Provisional Decision on Remedies – Paragraph 4.45, 4.47, 4.48 and 4.49.
[68] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.26.

(a) Scottish Power highlighted that an incorrect split between components of the benchmark bill could result in distortions to the cap.[69]

(b) Similarly EDF Energy highlighted that to ensure that the approach adopted is sustainable, it is essential that the process begins with an accurate view of the proportion of the June 2015 benchmark price that represents wholesale costs.[70]

39. Our approach to determining the splits is described in paragraphs 14.137 – 14.145.

40. SSE highlighted that the split of the benchmark bill between the relevant elements is incorrectly assumed to be uniform across different consumption levels. Similarly Utilita highlighted that the weighting of costs changes dependent on consumption levels and the weightings used do not consider the fact that PPM customers, in general, consume less energy.

(a) SSE noted that the component breakdown percentages as applied by the CMA are the same for low, medium and high TDCVs. SSE considered that the correct proportion of the bill accounted for by these different cost types actually vary with the level of consumption.[71] We have adopted different splits at nil and medium TDCV as described in paragraph 14.137 – 14.145.

(b) Utilita considered that the weightings used in the indexation do not consider the constitution of a PPM customer's bill highlighting that, as PPM customers on average use less energy, wholesale costs are a proportionately smaller part of total cost. Utilita noted that if the basis of the weightings of the indexation is flawed, suppliers of prepayment customers will be exposed to greater risk as retail prices will not move in the same way as underlying costs.[72] While we noted the potential differences in the component breakdown percentages for prepayment customers, we considered that these were unlikely to be significant as the constituent elements of energy are consistent, with the exception of the prepayment cost to serve differential. We have made a separate adjustment for this cost to serve differential, adding it to the price cap. In addition, we discuss differences in the component breakdown based on the differing consumptions above.

[69] Scottish Power response to the Provisional Decision on Remedies – Paragraph 12.25.
[70] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.67.
[71] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.27 – 4.6.29.
[72] Utilita response to the Provisional Decision on Remedies – Paragraph 4.66.

41. E.ON highlighted the need for the split of components of the benchmark bills to be revisited annually due to the increasing proportion of the bill relating to policy costs. E.ON highlighted that if this approach were not followed, the price caps were increasingly likely to become less or even un-representative of the costs that suppliers' bear.[73] We note that the proportions of the price cap relating to each component will update naturally over time as each element is indexed with its own index.

42. SSE noted the requirement for clarity around the CMA's approach to verification of dual tariffs, stating that the PDR failed to make clear whether suppliers should confirm the validity of their dual fuel tariffs with respect to the electricity/gas split inherent in the TDCV levels, rather than the actual electricity-to-gas proportion of each customer.[74] We have decided to have only single fuel price caps as described in paragraph 14.60 – 14.14.77.

43. SSE noted the requirement to ensure clarity around the CMA's approach to the price cap below and above the low and high TDCVs respectively. [75] We have defined how compliance will be assessed in paragraph 14.78 – 14.102.

44. SSE noted the requirement to ensure clarity around the CMA's approach to verification of Economy 7 tariffs against the assumed peak/off peak split or to each consumer's actual consumption.[76] We describe how the price cap will apply to economy 7 tariffs in paragraphs 14.95 – 14.102.

45. SSE noted the requirement to ensure clarity around the CMA's approach to Ofgem's revision of TDCVs, noting that the PDR failed to make clear whether the CMA proposes to update the TDCV levels used to define the price cap in line with revisions that Ofgem make to the TDCVs.[77] We consider TDCV updates in paragraph 14.244.

46. RWE considered that the use of TDCVs introduces two potential downside biases to the calculation: (i) that the median understated average volume levels because it disregards very high volume consumers; and (ii) outturn average volumes consumed are systematically higher than those assumed by the TDCV.[78] We describe how the price cap will be defined at nil and medium TDCV in paragraph 14.75.

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[73] E.ON response to the Provisional Decision on Remedies – Paragraph 244.
[74] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.31 (d).
[75] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.31 (b).
[76] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.31 (c).
[77] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.31 (a).
[78] RWE response to the Provisional Decision on Remedies – Paragraphs 46.113.

47. RWE and Scottish Power highlighted the distortions which would arise due to the non-linear structure of the cap and how these could be recognised in tariffs.

(a) RWE outlined that the non-linear structure of the price cap would distort tariff-setting and introduce complexity to the market. RWE considered that, in order to stay below the cap at each consumption level, suppliers will either have to price significantly below the cap for higher consuming customers or adopt multiple unit rates and/or multiple standing charges in order to flex tariffs to accommodate the non-linear tracking of the cap.[79]

(b) Scottish Power also highlighted that due to the non-linear structure of the price cap, suppliers would not have the flexibility to offer a variety of tariffs, nor would they be able to price their tariffs up to the level of the cap. Scottish Power considered that this could represent a significant 'hidden' reduction in the headroom available to suppliers.[80]

48. The price cap will be linear as described in paragraph 14.71.

49. RWE considered that the CMA failed to demonstrate that the proposed approach would appropriately apply to customers with multiple meters.[81] We consider customers with multiple meters in paragraph 14.95 – 14.102.

50. EDF Energy highlighted that the CMA must take account of differences in consumption between single rate meter and Economy 7 meter customers in setting the price cap.[82] We have done so and describe how the price cap will apply to economy 7 meters in paragraph 14.95 – 14.102.

51. SSE and RWE highlighted the inaccuracy associated with regional network costs, particularly in terms of the impact of using the 14 electricity regions to determine the gas price cap.

(a) SSE noted that the CMA has elected to use the 14 electricity areas as its foundation, which necessarily involves some inaccuracy and compromise in the setting of the gas price. SSE outlined that while this may be pragmatic, they do not consider it appropriate for a regulatory body to be making such intrusive commercial judgements around pricing policy.[83] SSE also considered that the network costs published in the Provisional

[79] RWE response to the Provisional Decision on Remedies – Paragraphs 46.134 and 46.135.
[80] Scottish Power response to the Provisional Decision on Remedies – Paragraph 12.32 and Figure 2.
[81] RWE response to the Provisional Decision on Remedies – Paragraphs 46.114.
[82] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.74.
[83] SSE supplementary submission on tariff cap – Paragraph 3.1.5.

Decision on Remedies contained errors and could not be reconciled to published sources.[84]

(b) RWE outlined that the proposed approach for setting regional price caps would create distortions in certain supply areas. RWE noted that if a price control for gas were set based on PES areas, this would create an incentive for suppliers to target customers in particular PES/LDZ area combinations, while avoiding others. RWE considered that this would distort the market as well as likely disadvantaging some PPM customers.[85]

52. Our revised approach to determining network cost allowances is described in paragraph 14.187 – 14.202.

53. Scottish Power[86] and SSE[87] suggested that VAT should be accounted for separately in the price cap. We note that the price cap will be defined exclusive of VAT.

54. E.ON highlighted that the price cap should not be included in any market-wide cheapest tariff messaging, noting that any cheapest tariff messaging should only cover competitive market tariffs open to all (due to potential perverse incentives for credit meter customers transferring to PPM meters).[88] We note that we do not expect the price cap to set the lowest price level in the market as described in paragraphs 14.311 – 14.313 and 14.445.

55. RWE highlighted that significant ongoing monitoring and enforcement by Ofgem will be required, which were materially underestimated by the CMA in the PDR.[89] Centrica also noted that the price cap design adds a huge level of complexity and administrative burden for customers, suppliers and Ofgem.[90] We consider compliance burden in paragraph 14.436 – 14.439.

56. Utilita outlined their disagreement with the CMA's statement in the provisional decision on remedies that sufficient scope for challenge of the price cap remedy exists and highlighted their concerns around the process.[91]

57. RWE considered that the price cap should include a mechanism for ex post recovery of realised costs in excess of those built into the price cap. RWE

[84] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.20.
[85] RWE response to the Provisional Decision on Remedies – Paragraphs 46.137.
[86] Scottish Power response to the Provisional Decision on Remedies – Paragraph 12.28.
[87] SSE response to the Provisional Decision on Remedies – Paragraphs 4.6.30.
[88] E.ON response to the Provisional Decision on Remedies – Paragraph 22.
[89] RWE response to the Provisional Decision on Remedies – Paragraph 46.36.
[90] Centrica response to the Provisional Decision on Remedies – Paragraph 142.
[91] Utilita response to the Provisional Decision on Remedies – Paragraph 4.32.

noted that there is established precedent in price regulation that regulated business should be allowed to “recover” such a shortfall. RWE highlighted that any proposed price cap must include a mechanism of this nature.[92]

58. We have enhanced the design of the price cap as described in 14.58 - 14.246 and thus do not consider such a mechanism is necessary.

59. RWE considered that an amendment to SLC 27.1 is required to allow suppliers faced with the risk of making a loss on customers to be able to choose not to offer PPM terms. RWE also consider that alternatively, or additionally, the CMA should remove the exemption under SLC 27.2 that allows suppliers with less than 50,000 customer to choose not to offer all payment types.[93]

60. We consider that the design refinements we have made (see paragraph 14.58 - 14.246) and the allowance for headroom (see paragraph 14.124 – 14.131) adequately mitigate the risk that the price cap doesn’t allow for recovery of costs.

61. SSE highlighted the lack of a mechanism to trigger a reassessment of costs implicit within the price cap, due to the risk of these diverging from the rest of the market. EDF Energy and Centrica also highlighted the requirement for a derogation process to be included in the cap.

   (a) SSE noted that the proposed design lacks a mechanism to trigger a reassessment of certain costs where it is clear that costs to firms are turning out to be significantly different to those used in the cap calculation. SSE consider there would be strong grounds for Ofgem to be given the role of annually reviewing the inputs to the price cap in order to ensure that changes to government schemes, or other unexpected changes in the cost base, could be properly built into the price cap calculation.[94] SSE also highlighted the requirement for the identification of specific conditions which would cause the price cap mechanism to be reopened for review to prevent damage to the market (e.g. where outcomes for PPM customers decline as a result of the cap).[95] We note that any party can request that the CMA initiate a remedy review process.

   (b) EDF Energy considered that the price cap should include derogations to reflect active choices by customers. EDF Energy outlined that where a customer wishes to actively choose a tariff that is above the cap (e.g. a

[92] RWE response to the Provisional Decision on Remedies – Paragraph 46.115.
[93] RWE response to the Provisional Decision on Remedies – Paragraph 46.49.
[94] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.18 (a).
[95] SSE response to the Provisional Decision on Remedies – Paragraph 4.8.5 (h).

long-term fixed-rate tariff), in a transparent and informed way, then suppliers should not be prevented from making that tariff available. EDF Energy outlined that it considers the lack of such a process to be a disproportionate approach, which unnecessarily restricts innovation and tariff availability for customers and does not take into account how costs may evolve in the industry over the next few years.[96] We note that long term fixed tariffs are not present in the prepayment segments. We consider the possible impact of the price cap on innovation in paragraphs 14.423 – 14.430.

(c) Centrica noted that the CMA does not consider that a derogation procedure is needed to dis-apply the price cap temporarily, due to the potential for suppliers to appeal the Final Report. Centrica outlined that ability for suppliers to appeal the Final Report provides no safeguards that the measure is or remains necessary until 2020. Centrica outline that this proposal fails to meet the EU law Third Package requirements and does not properly reflect the need for a temporal limitation, as required by EU law.[97] We have considered the need for review against EU law as described in paragraphs 14.365 – 14.369.

62. Centrica noted the risk of inaccuracy between prices under the cap against prices in the market and that in order to help assess the validity of the CMA's indexing approach, it should run the benchmarking analysis on other dates to provide actual prices against which to compare the derived price that the index produces.[98] We have done so and the results are shown in the sub-section titled "Updated price cap for April 2016 to September 2016".

Parties' views on the inclusion and value of headroom

63. Several suppliers submitted that the level of headroom was not sufficient.

(a) EDF Energy submitted that the basis for the allowed headroom was unclear and appeared arbitrary.[99] EDF Energy noted that the level appeared to have been set on the basis of bringing the benchmark level up to the price charged to some PPM customers in some areas, rather than on an assessment of what level of headroom would allow competition between suppliers to continue, and incentives for customers to engage to be maintained in future. EDF Energy stated that, in order to ensure the cap did not stifle competition, and that headroom was

[96] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.76 – 8.78.
[97] Centrica response to the Provisional Decision on Remedies – Paragraph 151.
[98] Centrica response to the Provisional Decision on Remedies – Paragraph 219.
[99] EDF Energy response to the Provisional Decision on Remedies – Paragraph 0.19, bullet point two.

sufficient to address the risks of outturn costs differing from forecasts, more rigorous analysis was necessary.[100] We have assessed headroom in terms of EBIT and cross checked against tariffs in the market and the level of detriment, see paragraphs 14.250 – 14.275.

(b) E.ON told us that the level of the headroom was unlikely to address the issues that result from the flawed benchmark.[101] We describe the analysis that we have carried out to come to a view on the competitive benchmark in Section 10.

(c) RWE highlighted that the headroom included within the Price Cap design was explicitly stated to allow for competition on pricing and not to allow for errors in the calculation of a price cap, or indeed for the possibility of cost increases.[102] RWE suggested that even using the full headroom there is still a risk of making a loss in supplying customers in the PPM segments. RWE considered that this risk was compounded by the fact that no allowance was included for errors in calculating the initial level of the price cap and subsequent indexation.[103] RWE told us that the headroom would be insufficient to encourage effective competition and consumer engagement, noting that research commissioned by RWE in 2013 found that increasingly customers were requiring up to [✂] savings or more to make it worthwhile to switch. We consider that the design refinements described in paragraphs 14.58 - 14.246 mitigate the risk that the price cap does not allow for recovery of costs. We consider that the level of headroom is sufficient to take into account the assumptions and judgements adopted within the calculation, as well as having regards to the scope for competition below the cap.

(d) Utilita outlined that the level of headroom should be linked to indexation and the frequency with which the indexation takes place, outlining that the less frequent the indexation, the more chance of cost shocks. Utilita considered that the required level of dual fuel headroom was £70. Utilita also outlined an alternative option using a ratchet mechanism to bring the PP cap down gradually. Utilita considered that this would allow challenger organisations to update their business plans and models and make controlled choices on how best to respond.[104] We note that headroom will update in line with the other indices as it is specified as a percentage, see

[100] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.65.
[101] E.ON response to the Provisional Decision on Remedies – Paragraph 228.
[102] RWE response to the Provisional Decision on Remedies – Paragraph 46.47.
[103] RWE response to the Provisional Decision on Remedies – Paragraph 46.50.
[104] Utilita response to the Provisional Decision on Remedies – Paragraph 4.69.

paragraph 14.129. Our assessment of the suitable level of headroom is described in paragraphs 14.250 – 14.275.

(e) EDF Energy also outlined that the absolute level of headroom will need to vary for different consumption levels.[105] As noted above, headroom is now specified as a percentage.

64. Citizens Advice and Which? outlined concerns around the level of headroom adopted being overly generous to suppliers. Our assessment of the suitable level of headroom is described in paragraphs 14.250 – 14.275.

(a) Whilst it was broadly sympathetic to the idea, Citizens Advice questioned the rationale for including £50 headroom and noted that if it is the case that overly generous inflationary calculations and supplier efficiencies serve to ensure they can deliver the safeguard and operate at a profitable level without headroom, they would favour the allowance being scrapped.[106] As described in paragraph 14.252 we considered the design refinements since PDR justified a lower level of headroom.

(b) Citizens Advice also questioned whether all suppliers would be permitted to charge headroom. Citizens Advice noted that given the constituent parts of the tariff are based on the efficient costs of two suppliers, allowing these suppliers to charge headroom may be seen as a de facto admission that they are permitted to charge above the efficient price.[107] The price cap will apply equally to all suppliers and the level of the price cap includes headroom to allow for competition. We expect that more efficient suppliers will offer prices below the price cap as they compete.

65. Which? expressed concerns that the inclusion of headroom in the proposed cap would legitimise the overcharging of customers that the remedy was intending to protect against.[108] We note that we expect there will always be tariffs below the level of the price cap, see paragraph 14.445. As set out in paragraphs 14.280 – 14.313 the price cap will produce significant savings for prepayment customers.

[105] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.65.
[106] Citizens Advice response to the Provisional Decision on Remedies – Page 50.
[107] Citizens Advice response to the Provisional Decision on Remedies – Page 50.
[108] Which? response to the Provisional Decision on Remedies – Section 5.

Parties' views on the approach to updating the PPM Price Cap Remedy

66. SSE and First Utility outlined the requirement for a clear and precise timetable for updating the cap to be put in place.

   (a) SSE stated that a clear and precise timetable for updating the cap should be put in place to ensure that suppliers are able to set tariffs and notify customers in advance of the changes.[109]

   (b) First Utility outlined that on implementation of a safeguard cap remedy, suppliers will need to know the time frame for making changes to their PPM tariffs and updating of the PPMIP following publication of changes to the price index and to Ofgem typical consumption values.

67. We have specified the timetable for updates, see paragraph 14.347 – 14.348.

68. Centrica outlined that at least a month would be required to validate the index formula and update systems to the new prices, with an additional 30 days' advance notice required (according to regulations) to be given to customers in advance of price rises. As such, Centrica considered that a two month lag should be built into the indexation approach.[110] We have included a two month lag in the design of the price cap.

69. First Utility considered that, given the short time frame for responding to the PDR, Ofgem should hold a consultation for market participants to share their views on a six months or one year indexation period.[111] We do not consider this would be appropriate given the need for a swift remedy. We have set out our approach to implementing this remedy, together with our reasons for adopting this approach, in Section 14 ("Implementation, monitoring and enforcement").

70. RWE considered that indexation should take place on an annual basis. RWE outlined that if the CMA were to move away from this approach, this would introduce substantial further complexity as further adjustments would be required for seasonality and other factors.[112] We have adopted a six monthly update schedule, although have been careful to avoid seasonality as described in paragraphs 14.161 – 14.186.

71. Centrica, SSE and Ovo highlighted the additional volume risk arising as a result of annual indexation to the cap. Centrica suggested a six monthly update period would be more appropriate than annual updates. Ovo

[109] SSE response to the Provisional Decision on Remedies – Paragraphs 4.6.18 (c).
[110] Centrica response to the Provisional Decision on Remedies – Appendix 4, paragraph 9.
[111] First Utility response to the Provisional Decision on Remedies – Paragraph 4.56.
[112] RWE response to the Provisional Decision on Remedies – Paragraph 46.116.

considered that the price cap design should include flexibility to update the wholesale index during the price cap period to cater for unexpected spikes in the wholesale market.

(a) Centrica highlighted that the price cap introduced additional volume risk due to the likelihood that suppliers would seek to purchase 100% of forecast volume when the price cap was set in order to remove the risk of not being able to change prices in response to movements in wholesale costs. Centrica submitted that, due to the uncertainty over actual volumes required, which is driven by customer numbers, consumption and weather, volume risks arise. Centrica told us that this risk was exacerbated by the cap period running from April to April, because demand (and therefore risk) is highest in the winter months which fall towards the end of the cap period, furthest from when the initial commodity cost was set. On this basis Centrica submitted that a six month update period would be more appropriate.[113] Centrica outlined that it would be possible to update the wholesale index twice a year based on a full year forward price, thus avoiding seasonality.[114] We have considered volume risk as part of the refinement of the wholesale cost index, see paragraphs 14.165 – 14.178.

(b) SSE noted that if wholesale prices rose between the annual setting of the price cap, suppliers would face a material disincentive to taking on new PPM customers (since they would need to purchase additional energy at higher prices, making a loss on these customers). SSE considered that this may dampen competition for PPM customers.[115] We were mindful of this point and the need, therefore, to minimise lag as described in paragraphs 14.158 – 14.161.

(c) Ovo outlined concerns that by updating the price cap only once a year, there was a risk that if commodity prices increase markedly, growing suppliers would be exposed to potentially significant losses. Ovo noted that, assuming that a supplier purchased 100% of their wholesale gas and electricity upfront for the entire price cap year (April to March), a supplier would need to accurately forecast both the correct number of customers and the expected future volume of these customers to minimise risk. Ovo told us that accurately forecasting the number of customers was difficult for growing suppliers where customer growth was more unpredictable than for established suppliers with stable customer bases, speculating

[113] Centrica response to the Provisional Decision on Remedies – Paragraph 173, 180, 181.
[114] Centrica response to the Provisional Decision on Remedies – Appendix 4, paragraph 19.
[115] SSE response to the Provisional Decision on Remedies – Paragraph 4.16.17.

that this may become even more difficult in the context of a market with a price cap. Ovo concluded that this would therefore expose growing suppliers to greater energy purchasing risks than more stable suppliers.[116] We have considered these risks as described in the subsection titled "wholesale costs" and have decided to update the price cap every six months.

(d) Ovo considered that the price cap design should include flexibility to update the wholesale index during the price cap period to cater for unexpected spikes in the wholesale market. Ovo suggested that this could be achieved through monitoring of the index on a quarterly basis and if prices increased by more than a certain percentage, the wholesale index would be updated for the following quarter and suppliers could update their PPM tariffs in line with the updated wholesale cost component for new customers.[117] We have considered these risks as described in the subsection titled "wholesale costs" and have decided to update the price cap every six months.

72. Centrica highlighted that the cap would have the impact of all PPM customers changing price on the same date each year. Centrica noted that this would result in messages being sent to every PPM device on the same day every year, which could take a significant period of time to fully process given the PPM infrastructure limitations.[118] We have considered this issue in paragraphs 14.155 and note that the infrastructure is designed to be able to cope with tariff updates affecting many customers.

73. First Utility noted that outside of twice yearly windows for changing PPM tariffs costs are incurred each time when launching a new tariff.[119] We have decided that the price cap will be updated with effect from 1 April and 1 October. We note that there is no charge for updating prices on these dates.

Parties' views on the mechanism for indexing wholesale costs

74. SSE suggested that the CMA should seek expert advice or enlist Ofgem's assistance to ensure that the treatment of wholesale costs reflects market conditions and is consistent with a practicable and commercially viable hedging strategy.[120] We have considered in detail suppliers' representations

[116] Ovo response to the Provisional Decision on Remedies – Paragraph 3.9 – 3.12.
[117] Ovo response to the Provisional Decision on Remedies – Paragraph 3.13.
[118] Centrica response to the Provisional Decision on Remedies – Paragraph 187.
[119] First Utility response to the Provisional Decision on Remedies – Paragraph 4.56.
[120] SSE supplementary submission on tariff cap – Paragraph 5.2.6.

on the treatment of wholesale costs in designing this element of the price cap. This is set out in paragraphs 14.161 – 14.186.

75. EDF Energy, E.ON, SSE, Ovo and Utilita highlighted the incentive for suppliers to purchase energy on the same day. EDF Energy considered that this may expose customers to the risk of bill shock and other parties noted potential liquidity implications in the wholesale market that may arise as a result of this approach. We have decided that the wholesale index will be observed over a period of six months thus mitigating this risk, see 14.161 – 14.186.

(a) EDF Energy noted that the proposed calculation of wholesale energy costs creates a strong incentive for suppliers to purchase all of their energy on the same day that the allowed cost is calculated. EDF Energy considered that such an approach would result in customers being exposed to changes in wholesale prices without any smoothing of costs that would result from an incremental approach to hedging, which gives a high risk of 'bill shock'. In addition, EDF Energy noted that it is not optimal to concentrate trading activity in such a short period of time, as this also introduces exposure to the risk of market manipulation.[121] As noted above, the wholesale index will be observed over six months.

(b) E.ON also highlighted the likelihood that suppliers would seek to match their hedges to the strategy implied within the price cap to reduce their risk, noting that this will have a further impact on liquidity in the market. E.ON consider that the potential offering of a wide range of tariffs into the PPS using smart meters is likely to be significantly reduced.[122] We have considered that suppliers may seek to match the wholesale index as described in paragraph 14.167.

(c) SSE also highlighted that, faced with a binding price and uncertain wholesale energy costs, suppliers should theoretically seek to reduce this risk by buying their energy for PPM customers for the year ahead at the time the cap is amended (although such concentrated hedging activity may induce a short-term price distortion in the wholesale markets).[123] As noted above this risk is mitigated by observing the wholesale index over a six month period.

(d) Ovo outlined that basing the index entirely on forward market prices calculated on one specific date presents a risk for suppliers and may lead

[121] EDF Energy response to the Provisional Decision on Remedies – Paragraph 0.19, bullet point three.
[122] E.ON response to the Provisional Decision on Remedies – Paragraph 230.
[123] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.15.

to detrimental outcomes for both customers and suppliers. Ovo considered that suppliers need greater foresight of what the wholesale energy cost index is likely to be well in advance of the start of each price cap year.[124]

(e) Utilita highlighted that by using forward prices at a point in time, the CMA is exposing PPM customers to price shocks when revising the price cap. Utilita considered that in order to avoid forcing PPM customers to be exposed to the risk of volatile changes when revising the price cap, some consideration should be given to historical forward prices.[125] We have considered volatility when refining the design of the wholesale index, see paragraph 14.165.

76. Centrica, EDF Energy and Ovo highlighted alternative methods for calculating wholesale costs, using the average price for a season over a period of time.

(a) Centrica outlined that an alternative indexation approach would be to price-in the index over a period of time. Centrica considered that a pricing-in period of three or six months would keep a closer link to current wholesale prices, but reduce the liquidity risk (noting that an approach based on pricing on a single day would require over ten times typical daily liquidity). Centrica noted that this has the advantage of allowing suppliers to purchase their requirements for customers over a longer period of time, leaving the index less prone to short-term impacts and more resilient to short term market movements.[126] The wholesale index reflects Centrica's suggestion to some degree as described in the subsection titled "wholesale energy costs".

(b) EDF Energy outlined that a method for calculating wholesale costs has already been established within the industry to calculate the reference price for baseload CfDs, using the average price for a season over a six month period. EDF Energy considered that a mechanism that uses a similar principle to this should be used for the cost matrix.[127] We considered this suggestion, see 14.168.

(c) Ovo suggested calculating the wholesale energy cost index on the basis of a daily average of the forward curve prices, weighted by volume, during the three month period October to January prior to the start of each price cap year. Ovo considered that this would enable suppliers to have an

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[124] Ovo response to the Provisional Decision on Remedies – Paragraph 3.17 – 3.20.
[125] Utilita response to the Provisional Decision on Remedies – Paragraph 4.65.
[126] Centrica response to the Provisional Decision on Remedies – Appendix 4, paragraph 13.
[127] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.68.

early indication of what the price is likely to be based on a three month period rather than a single date, as well as ensuring a greater level of stability, while also offering suppliers a three month window in which to purchase commodity prior to the start of the price cap year.[128] Elements of this proposal are reflected in the design of the wholesale cost index.

77. [✂].[129] We note that the wholesale index will use only future trading days, see paragraph 14.456.

78. Centrica noted that a rateably constructed index would address concerns around market liquidity and price volatility in the wholesale market. Centrica considered that an 18 month rateable (18mR) strategy would protect customers from volatility to a significant extent, but even a shorter period (12mR) could keep prices closer to fixed products in the market while still offering reasonable volatility protection.[130] We considered a rateable approach as described in paragraphs 14.171.

79. RWE highlighted concerns that the proposed approach does not consider price for electricity products beyond peak and off-peak to properly reflect the demand shape of PPM customers; potentially resulting in inaccuracies in the wholesale energy costs included within the price cap.[131] We have considered this point, see 14.183 – 14.184.

80. Utilita outlined concerns that smaller suppliers may not be able to hedge across the 12 month period implied by the cap and may be exposed to greater risks when competing for new customers.[132] We discussed this point with Utilita [✂]. We note that there are also potential considerations in respect of collateral requirements.

81. Spark Energy outlined that the proposed wholesale index did not take into account the cost of wholesale energy to vertically integrated suppliers and those who procure energy from third parties.[133] As described in section 7 we consider that there is sufficient liquidity in the market that third party suppliers are, all else equal, able to achieve the same prices as vertically integrated suppliers.

[128] Ovo response to the Provisional Decision on Remedies – Paragraph 3.21 – 3.23.
[129] Ovo further submissions (26/04/2016, 28/04/2016 and 20/06/2016).
[130] Centrica response to the Provisional Decision on Remedies – Appendix 4, paragraph 10, 11, 12.
[131] RWE response to the Provisional Decision on Remedies – Paragraph 46.118.
[132] Utilita response to the Provisional Decision on Remedies – Paragraph 4.63, 4.64.
[133] Spark Energy response to the Provisional Decision on Remedies – Section 3.

Parties' views on the mechanism for indexing network costs

82. RWE considered that further consultation with the industry was necessary to develop a methodology for network costs benchmarking and ensure this would not create windfall gains or losses.[134]

83. Ofgem, EDF Energy, RWE and Ovo outlined concerns around inaccuracies in the proposed approach to indexing network costs. Ovo considered that the CMA should use the charging statements that network companies publish as the means of computing the network cost component of the price cap.

(a) Ofgem outlined that allowed revenue may not provide an appropriate basis from which to form the network costs index. Ofgem noted that network companies' allowed revenues will also cover charges to electricity generators and gas shippers, and include both domestic and non-domestic customers.[135]

(b) EDF Energy considered that the proposed approach of using allowed revenues for calculating transmission and distribution costs, rather than published prices, would lead to material inaccuracies, as the allocation between customer groups can change substantially from year to year.[136] RWE also outlined that the proposed indexation methodology for network costs is flawed since it focusses only on revenue changes for Transmission and Distribution Network Operators.[137]

(c) RWE also highlighted that it is unclear from the CMA's proposed methodology what version of Allowed Revenues will be used for the assessment of costs, and what is included or excluded,[138] and that, for electricity transmission, the indexation methodology does not reflect the way that tariffs are calculated in the charging methodology.[139]

(d) Ovo considered that calculating networks charges on the basis of the network company's allowed revenues offers suppliers little transparency of what the future price is likely to be. Ovo considered that basing the index on network companies published charging statements will make it easier for suppliers to comply with the price cap as these statements are

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[134] RWE response to the Provisional Decision on Remedies – Paragraph 46.123.
[135] Ofgem response to the Provisional Decision on Remedies – Annex 4.
[136] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.70.
[137] RWE response to the Provisional Decision on Remedies – Paragraph 46.119.
[138] RWE response to the Provisional Decision on Remedies – Paragraph 46.121.
[139] RWE response to the Provisional Decision on Remedies – Paragraph 46.122.

published in advance by the electricity network companies and form the basis upon which suppliers price their existing tariffs.[140]

84. We considered these submissions carefully and concluded that by calculating network costs using network charging statements we can avoid creating windfall gains and losses, see paragraphs 14.187 – 14.201.

85. First Utility highlighted that clarification was required around the indexation of Independent Gas Transporters costs.[141] We consider that there is no need to consider the costs of independent gas transporters separately since they are relatively small in extent and, in any case, operate on a relative price control such that their charges move in line with those of the incumbent network companies.[142]

86. Ovo also suggested that the network costs index should be updated bi-annually. Ovo considered this would reduce the risk to suppliers that changes in the gas network charge and load factors increase the cost of supplying PPM gas customers for the six months between the date that gas network charges change (1st October) and the date that the PPM price cap updates (1st April). Alternatively, Ovo suggested that the network costs index could update only if the cost of supplying domestic gas customers increased by more than a certain percentage.[143] We note that network costs will be updated semi-annually.

Parties' views on the mechanism for indexing policy costs

87. SSE highlighted the uncertainty caused by using Office for Budget Responsibility (OBR) forecasts for policy costs and outlined the requirement for regular review of these elements.

    (a) SSE stated that policy costs are subject to material uncertainties, outlining, for example, that the OBR estimates around the cost of government schemes may not be updated to take account for the cost escalation that can arise when schemes turn out to be more problematic to deliver than originally intended. In addition, SSE noted that HM Government may fail to set the precise requirements of delivering a scheme in advance of requiring suppliers to commence. SSE also noted that other policy changes can be announced unexpectedly and therefore

[140] Ovo response to the Provisional Decision on Remedies – Paragraph 3.26 – 3.28.
[141] First Utility response to the Provisional Decision on Remedies – Paragraph 4.56.
[142] Independent Gas Transporters.
[143] Ovo response to the Provisional Decision on Remedies – Paragraph 3.26, 3.29, 3.30.

outlined that a mechanism for cost adjustment to be reflected is required.[144]

(b) SSE considered that because of this uncertainty Ofgem should be given the role of annually reviewing the inputs to the price cap.[145]

88. We note that future policy costs are uncertain, see paragraphs 14.202 – 14.205. We consider that the OBR forecasts are a reliable source since they are based on data and assumptions from DECC and are then critically appraised and stress tested. We have decided that should the OBR cease to publish forecasts of policy costs then Ofgem would specify an alternative index, see paragraph 14.213.

89. RWE highlighted that the method of policy costs allocation to suppliers varies between the different mechanisms, with different schemes using different definitions of demand to allocate costs (and therefore a different indexation required for each definition).[146] We considered indexing each scheme separately and concluded that this would be unduly complex, see paragraph 14.205.

90. EDF Energy, E.ON, RWE, Scottish Power, SSE and Spark Energy considered the policy indexation methodology to be incomplete. The parties outlined various policy costs (e.g. Balancing Services Use of System ("BSUoS") costs, Hydro Benefit, Capacity Market Supplier Charges, ECO, Warm Homes Discount and other potential policy costs) that they considered were not appropriately reflected in the index. We have considered each cost in paragraphs 14.231 – 14.238.

(a) EDF Energy outlined that BSUoS costs are separate from the allowed revenues of the transmission companies, and have been rising in recent years.[147] We note the BSUoS costs are included within the network cost allowance, see paragraph 14.236.

(b) EDF Energy also outlined that the OBR forecast of the Capacity Market Supplier Charge must also be included because, although this was zero at the time of setting the benchmark price, this will become a significant cost in future. We have considered this cost in paragraphs 14.213.

(c) EDF Energy recommended that either headroom that properly reflects these risks is included or the ability to adjust the level of the price cap

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[144] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.21.
[145] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.22.
[146] RWE response to the Provisional Decision on Remedies – Paragraph 46.128, 46.129.
[147] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.71.

more frequently if there is a change in law. We consider that the headroom allowance recognises the level of risk in the price cap as described in paragraph 14.250 – 14.275.

(d) EDF Energy also submitted that there was a need to reflect changes in demand in the calculation of costs at the customer level.[148] We note that the price cap is defined for all levels of consumption such that the price cap is higher for higher levels of consumption, see paragraphs 14.71.

(e) E.ON noted that the capacity mechanism has procured capacity for the delivery year October 2018 to September 2019 at a cost of around £1bn (in 2012 money), which is to be recovered via suppliers. In addition, E.ON noted that DECC is currently consulting on its intention to run another capacity auction in January 2017 for delivery in October 2017 to September 2018. E.ON consider that the cost of this auction is unknown at this stage, but this, alongside future capacity auction costs, will need to be accounted for when setting the price cap for April 2017. E.ON also highlighted that the capacity delivery years run from October to September, each price cap year will span two different capacity delivery years, which means costs will need to be averaged, potentially leading to periods of over and under recovery of costs for suppliers.[149] We note this issue does not apply to the final design since price cap periods will run for six months starting 1 April and 1 October.

(f) RWE highlighted that the proposed mechanism covers some policy costs, but fails to mention costs associated with BSUoS, Hydro Benefit and the Capacity Mechanism. These costs would need to be included in any indexation arrangement, so the current proposed methodology is incomplete.[150] We have considered these costs in paragraphs 14.231 - 14.238.

(g) SSE highlighted that the costs of the capacity mechanism have been excluded within the current specification. In addition, SSE outlined that the current proposal contains no proper assessment of the impact of the smart meter programme on costs over the period covered by the cap.[151] We have considered these costs in paragraphs 14.231 - 14.238.

(h) Scottish Power highlighted that the DECC cited forecasts used for electricity policy cost indexation does not include costs of ECO and Warm

[148] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.72.
[149] E.ON response to the Provisional Decision on Remedies – Paragraph 243.
[150] RWE response to the Provisional Decision on Remedies – Paragraph 46.124, 46.125.
[151] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.23.

Home Discount, as well as capacity market supplier obligation costs, which are expected to be levied on suppliers with effect from 1 October 2017.[152] We have considered possible changes in the level of these costs in paragraphs 14.202 – 14.225.

(i) Spark Energy also noted concerns that DECC's projections of policy costs going forward may understate the true position. Spark Energy considered that no provision has been made for any potential increases to the costs of the Warm Home Discount and uncertainty existed around ECO costs, particularly for suppliers who are approaching the obligation for the first time, as well as beyond 2018. Spark Energy considered that the CMA's approach to updating policy costs should be based on real policy costs during the lifetime of the price cap to avoid unintended consequences.[153] We consider ECO and WHD costs in paragraph 14.202 – 14.225.

91. EDF Energy highlighted that an allowance for the costs of smart metering and other industry-wide infrastructure projects such as faster switching and half hourly settlement should be included.[154] We have considered these costs in paragraphs 14.231 - 14.238.

92. Ovo noted that the increase in costs incurred by suppliers rolling out smart meters and implementing the data communications company (DCC) is not included in the benchmark bills.[155] Ovo highlighted that the operating revenue of the DCC is regulated and paid for by suppliers on the basis of monthly charges that are set in advance. The methodology is therefore identical to the means by which networks costs are calculated. In line with its proposed approach for network charges, Ovo suggested that the charges suppliers pay to the DCC should also be included in the NCC of the PPM price cap and calculated on the basis of the actual charging statements issued by the DCC.[156] We consider the cost of smart meters in paragraph 14.231 - 14.238.

93. RWE told us that the indexation methodology did not allow for the introduction of other, as yet unknown, policy costs and charging methodology changes and how these would be included in the cost base. RWE submitted that the CMA should set out a complete framework for developing a methodology of assessing these costs as they may be introduced. This is a particularly acute concern when changes are immediately implemented such was the case with the 2015 change in Levy Exemption Certificate rules.[157] We note that where

[152] Scottish Power response to the Provisional Decision on Remedies – Paragraph 12.27.
[153] Spark Energy response to the Provisional Decision on Remedies – Section 3(c).
[154] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.73.
[155] Ovo response to the Provisional Decision on Remedies – Paragraph 3.31.
[156] Ovo response to the Provisional Decision on Remedies – Paragraph 3.34.
[157] RWE response to the Provisional Decision on Remedies – Paragraph 46.126.

the OBR's forecast no longer reflects policy costs then Ofgem would specify a new policy cost index, see paragraph 14.213.

94. RWE highlighted that the rapid growth in policy costs and resulting sensitivity on the accuracy of the indexation calculation (specifically citing the growth in Capacity Market costs and Contracts for Difference).[158] We note the growth in policy costs, see paragraph 14.215.

95. RWE told us that the proposed methodology did not consider indexation of national demand forecasts. RWE noted that the costs of policy obligations are set by forecasting costs and then dividing by the demand base that they need to be recovered from. RWE noted that national demand levels for gas and electricity have been falling over recent years, resulting in increased pricing for individual units of energy even in the absence of increased costs in total.[159] We note that national demand levels may fall or rise[160], resulting in increased or decreased pricing for individual units of energy respectively. We have estimated the impact of this. By construction this effect is not present in the first year of the price cap and the effect rise up to £5 per electricity account at medium TDCV in the final year (and lower than this for gas), which we do not consider material. We consider that inclusion of adjustments for national demand levels would result in additional complexity, disproportionate to the benefits of including this.

Parties' views on the mechanism for indexing other costs

96. RWE and First Utility considered that indirect costs and the PPM uplift should be indexed using RPI, rather than CPI.

   (a) RWE considered that the indexation of indirect costs and PPM uplift should adopt RPI consistent with a number of other energy price controls.[161]

   (b) Similarly First Utility noted that Ofgem uses the RPI index and suggested that this was more appropriate than the CPI index proposed. First Utility consider that using the same index and methodology as Ofgem does for projections will also aid comparability and transparency, and would help towards meeting an April 2017 time frame.[162]

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[158] RWE response to the Provisional Decision on Remedies – Paragraph 46.130.
[159] RWE response to the Provisional Decision on Remedies – Paragraph 46.127.
[160] And these movements are unpredictable as they are heavily affected by weather.
[161] RWE response to the Provisional Decision on Remedies – Paragraph 46.131.
[162] First Utility response to the Provisional Decision on Remedies – Paragraph 4.56.

97. We consider that CPI is a more appropriate measure as it is the official measure of inflation and the measure which is used for inflation targeting by the bank of England.

98. SSE outlined that the current treatment of indirect costs is insufficient, as indirect costs may also be materially affected by government policy initiatives, increasing uncertainty around these costs.[163] We have described our approach to allowing for the costs of policies in the subsection titled “policy costs”.

99. Ovo highlighted concerns that certain line items have not been assigned to cost components or do not have a suitable indexes by which to be updated (or both).[164] The approach we take to splitting the entire benchmark into one of the different cost components ensures that all costs are subject to indexation.

Parties’ views on other unintended consequences

100. All of the Six Large Energy Firms outlined a variety of unintended consequences that might arise as a result of the imposition of a price-cap as set out in the PDR.

101. Several parties considered that a price cap was likely to lead to further disengagement amongst PPM customers, due to the perceived level of protection provided.

(a) Centrica highlighted that customers will be disincentivised from engaging in the market due to the safe haven effect of a regulated tariff.[165]

(b) E.ON outlined that customers were likely to believe that they were now ‘safe’ on a regulated tariff and hence would be less likely to engage if suppliers were able to provide more competitive tariffs. E.ON noted that this undermined the benefits of smart propositions, both financially and also in terms of the beneficial impact on customer engagement that such market-opening propositions could result in.[166]

(c) SSE noted that customers on the regulated tariff may see themselves as being adequately “protected” by the cap and therefore feel they did not need to engage with the market to find a better deal. SSE also noted,

[163] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.24.
[164] Ovo response to the Provisional Decision on Remedies – Paragraph 3.35, 3.36.
[165] Centrica response to the Provisional Decision on Remedies – Paragraph 142.
[166] E.ON response to the Provisional Decision on Remedies – Paragraph 230.

more broadly, that the cap also risked undermining customer trust in competition to deliver the best outcomes in the energy markets.[167]

(d) Cooperative energy told us that such an outcome would defeat the objective of the remedy, and undermine engagement and public perception of the smart meter roll out programme.[168]

(e) Centrica considered that the price cap, at the low level proposed, would reduce the price differential between tariffs for smart and dumb PPM meters because it was unlikely that suppliers would be able to reflect the full cost difference in the dumb PPM price whilst remaining under the cap. This would reduce the incentive for PPM customers to switch to a smart meter by eliminating most or all of the gains to switching.[169]

(f) Centrica considered that customers who have smart PPM meters may not receive the full benefits of smart due to the "safe haven" effect, whereby they feel they do not need to concern themselves with reducing their bills by shopping around or managing their consumption because the regulator is doing it for them. This would severely undermine the benefits case for smart meters in terms of engagement and innovation.[170]

102. We consider the possible impact on consumer engagement in paragraphs 14.400 - 14.405.

103. Flipper Ltd also noted this may reduce the incentive for innovative new entrants to accelerate the rollout of smart PPM meters and find ways to better serve these customers at lower cost. [171] We consider the possible impact on innovation in paragraphs 14.423 – 14.430.

104. Centrica considered that the price cap may introduce an incentive for suppliers to prioritise smart meter rollout to PPM customers and introduce inefficiencies in the overall rollout.[172]

(a) Centrica considered that the price cap would have damaging implications for the pace, costs and benefits of smart meter roll-out. We consider the impact on the smart meter rollout in paragraph 14.451.

(b) Centrica considered that the incentive for suppliers to win or convert customers with dumb credit meters to smart meters will be reduced, as

[167] SSE response to the Provisional Decision on Remedies – Paragraph 4.7.2 (b).
[168] Cooperative energy response to the Provisional Decision on Remedies – Page 4.
[169] Centrica response to the Provisional Decision on Remedies – Paragraph 191.
[170] Centrica response to the Provisional Decision on Remedies – Paragraph 195.
[171] Flipper Ltd response to the Provisional Decision on Remedies – Page 3.
[172] Centrica response to the Provisional Decision on Remedies – Paragraph 194.

once a customer has a smart meter it is very easy for them to switch to PPM.[173] We consider the impact on competition in paragraphs 14.405 - 14.413.

105. Centrica considered that the CMA had failed to take into account that the proportion of customers prepaying may eventually increase significantly as a result of this remedy and also with the roll out of smart meters.[174] We note that we expect there will always be tariffs below the level of the price cap, see paragraph 14.444.

106. SSE highlighted potential distributional impacts of the price cap. Ebico and Utilita also highlighted potential negative impacts on low consuming customers.

(a) SSE highlighted potential distributional impacts of the price cap (e.g. proportionately lower savings, and potentially even increased prices, for lower usage customers; undermining Economy 7 and time-of-use tariffs due to the requirement for smaller differentials between the peak and off peak rates; and potential bill shock for certain customers). SSE therefore stated that the CMA should conduct a full distributional analysis of the proposed remedy before its introduction.[175]

(b) SSE noted that suppliers were likely to be forced to price very close to the cap across the consumption range of their customer base. As such, SSE consider that a likely unintended consequence was that many suppliers may be forced to mirror the level of standing charges and unit rates implied by the cap parameters. SSE considered that this may result in standing charges increasing as a direct result of the cap. SSE outlined that for customers with low usage, such increases in the standing charge would impose a significant percentage increase on their total bill.[176]

(c) SSE also noted that if suppliers held standing charges close to their current level they would be forced to operate well below the cap at the medium consumption level, making the required reduction in revenue considerably more than 8%, which SSE did not consider to be commercially sustainable.[177]

(d) Ebico outlined concerns that the CMA's proposed methodology for calculating the price cap may mean that Ebico would be obliged to

[173] Centrica response to the Provisional Decision on Remedies – Paragraph 192.
[174] Centrica response to the Provisional Decision on Remedies – Paragraph 144.
[175] SSE response to the Provisional Decision on Remedies – Paragraph 4.6.33 and 4.6.34.
[176] SSE supplementary submission on tariff cap – Paragraph 2.1.8.
[177] SSE supplementary submission on tariff cap – Paragraph 4.1.3.

introduce a standing charge on their zero standing charge tariffs, which would result in additional costs to their low-demand prepay customers.[178]

(e) Utilita noted that the cap may result in low user PPM customers paying more for their energy relatively. Utilita stated that given the low consumption and the cap, suppliers would be expected to utilise different charging structures to ensure that their fixed costs are recovered up to the limit of the threshold for that consumption.[179]

107. We have considered distributional effects, see the subsection titled “Analysis of savings across consumption levels”.

108. SSE also outlined that for Economy 7 tariffs a range of different revenues were possible when pricing exactly at the level of the cap, dependent on the particular combination of standing charge, peak rate and off-peak rates that is defined to comply based on the theoretical 38:62 split of consumption. SSE considered that, dependent on suppliers’ actual customer bases’ off-peak split, this remedy would create a clear incentive for suppliers to narrow the differential between day and night rates. SSE highlighted that this would be an unwelcome development for off gas grid customers and other potentially vulnerable groups reliant entirely or in part on the use of electric storage heaters.[180] We have described arrangements for providing flexibility in assessing compliance in the subsection titled “Application of the price cap to economy 7 and restricted meters”.

109. Centrica submitted that the proposed price cap was likely to result in customers experiencing more volatile retail prices. Centrica also noted that as many of these customers are on PPM meters to help manage expenditure and / or debt, this could have a particularly harmful effect – resulting in higher debts and distress for some customers as well as a fall in consumer trust in the market.[181] We have sought to avoid volatility through the design of the wholesale index, see paragraph 14.165.

110. Several parties highlighted the impact of the price cap on tariff offerings to customers in the PPM segments.

(a) SSE highlighted that the price cap would reduce the scope for suppliers to differentiate and compete on contract structure as the price cap is only updated once a year. In addition, SSE noted that this would lead to a

[178] Ebico response to the Provisional Decision on Remedies – Page 1.
[179] Utilita response to the Provisional Decision on Remedies – Paragraph 4.16.
[180] SSE supplementary submission on tariff cap – Paragraph 4.2.3, 4.2.5.
[181] Centrica response to the Provisional Decision on Remedies – Paragraph 172 and 177.

reduction in customer choice and reduced incentives for firms to compete for new PPM customers if wholesale costs rise.[182]

(b) EDF Energy outlined that the price cap would make it difficult to introduce time-of-use tariffs and other tariffs perhaps not yet created which are made possible by the introduction of smart meter infrastructure for PPM, effectively putting on hold innovation in the PPM market until the price cap is removed.[183]

(c) RWE noted that there was a clear risk that the remedy would dull innovation within the PPM segment, to the further detriment of PPM customers.[184] RWE also noted that this would result in a lack of (wholesale) cost variety, damaging the ability of suppliers to compete on wholesale price and thus offer a better PPM tariff to customers.[185]

(d) Centrica noted that the proposed wholesale index would result in the withdrawal of fixed price products (other than a one-year tariff each April 1st).[186]

(e) Centrica outlined that rateably hedged tariffs, fixed price products and innovative propositions would not be offered to PPM customers as the methodology limits the type of products that can be efficiently hedged and prevents sustainable returns.[187]

111. We note that headroom is included in the calculation of the level of the cap which allows for competition beneath the level of the cap. In addition, we have excluded from the price cap scope customers with SMETS 2 prepayment smart meters. We have considered the potential impact of the price cap on innovation in paragraphs 14.423 – 14.430.

112. Centrica considered that the any new products that would have been launched as a result of other remedies (e.g. removal of the 4 tariff limit and freeing up of meter slots) will not be offered due to the cap. Centrica considered that this results in a serious risk that the market will stagnate and converge around the same hedging strategy and price (around the level of the cap).[188]

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[182] SSE response to the Provisional Decision on Remedies – Paragraph 4.7.2 (a).
[183] EDF Energy response to the Provisional Decision on Remedies – Paragraph 8.80.
[184] RWE response to the Provisional Decision on Remedies – Paragraph 46.53.
[185] RWE response to the Provisional Decision on Remedies – Paragraph 46.54.
[186] Centrica response to the Provisional Decision on Remedies – Paragraph 182.
[187] Centrica response to the Provisional Decision on Remedies – Paragraph 142.
[188] Centrica response to the Provisional Decision on Remedies – Paragraph 184.

113. RWE noted[189] that the interaction between wholesale costs and the annual recalculation of the price cap may further dampen competition in the PPM segments, in either a rising or falling wholesale market.

(a) RWE highlighted that in a rising market scenario, the proposed annual recalculation of the price cap would limit incentives for incumbent and new suppliers to acquire customers once the wholesale cost is set.

(b) RWE highlighted that in a falling market, incentives on suppliers may mean retail prices do not fall until the cap is reset, undermining competition in the PPM segments.

114. E.ON highlighted the increased risks that would be associated with offering tariffs into the segment other than those matched to the price cap. E.ON noted that unless “grandfathering” protection is permitted (which E.ON stated brings its own questions around customers’ understanding and perceptions of “fairness”), this may require the price of fixed-price tariffs spanning price cap periods to be reduced in order to remain compliant. This could be done under the unilateral contract variation rules, however may result in the tariff becoming loss making for the supplier.[190]

115. E.ON noted the likelihood that suppliers would seek to mitigate this risk by only offering tariffs which directly matched the price cap. E.ON outlined that this is likely to have knock-on impacts in terms of hedging, with suppliers seeking to match their hedges to the price cap to reduce their risk of being out of the market, which will have a further impact on liquidity in the market. E.ON considered that, as a result, the offering of a wide range of tariffs into the PPS using smart meters is likely to be significantly reduced. [191]

116. Utilita highlighted that the nature of the cap may lead to annual contracts for most PPM customers, which may not be appropriate for many PPM customers. Utilita noted that many fixed term contracts carry termination fees for early exit, and because of the high change of tenancy rate in the PPM market, many PPM customers may prefer variable contracts.[192]

117. SSE noted the potential focal point effect of the price cap reducing price competition. SSE considered that this risk is particularly acute if there is uncertainty that suppliers would be able to operate profitably within the restrictions imposed by the cap.[193]

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[189] RWE response to the Provisional Decision on Remedies – Paragraph 46.55.
[190] E.ON response to the Provisional Decision on Remedies – Paragraph 229.
[191] E.ON response to the Provisional Decision on Remedies – Paragraph 230.
[192] Utilita response to the Provisional Decision on Remedies – Paragraph 4.12, 4.13 and 4.14.
[193] SSE response to the Provisional Decision on Remedies – Paragraph 4.7.2 (c).

118. Littlechild et al also highlighted the potential impacts on smaller suppliers and potential new entrants into the PPM segments, as well as the quality of service to PPM customers.

(a) Littlechild et al noted that a range of different organisations were planning to enter the market to focus on serving PPM customers and considered that the price cap would discourage such suppliers from entering, to the detriment of PPM customers. In addition, Littlechild et al consider that where some existing suppliers have been considering new products for PPM customers, a price cap would again discourage them from doing so.[194]

(b) Littlechild et al noted that with PPM customers now significantly less profitable, and in some cases actually unprofitable, suppliers will inevitably be led to focus their efforts and resources on keeping and attracting non-PPM customers. Littlechild et al consider that it would be very surprising if, in various respects, PPM customers did not suffer as a result.[195]

119. We consider the possible impact of the price cap on competition in paragraphs 14.405 - 14.413.

120. Centrica highlighted that the proposed price cap would have the impact of all PPM customers changing price on 1 April every year, which is likely to create major spikes in customer contact that will be costly to handle. In addition, Centrica noted that this would mean messages being sent to every PPM device on the same day every year, which could take many months to fully process given the PPM infrastructure limitations.[196] We have confirmed that this concern regarding the PPM infrastructure is misplaced, see paragraph 14.156.

121. Several parties noted the additional volume risk arising as a result of the price cap. Centrica considered that suppliers would look to buy up to 100% of their forecast commodity requirements for the cap period, with volume risk therefore existing due to the uncertainty over the amount of energy actually required by suppliers due to potential changes in customer numbers, consumption and weather. Centrica considered that this risk was exacerbated by the cap period running from April to April, because demand (and therefore risk) is highest in the winter months which fall towards the end of the cap period, furthest from when the initial commodity cost was set.[197] We have

[194] Littlechild et al response to the Provisional Decision on Remedies – Paragraph 105.
[195] Littlechild et al response to the Provisional Decision on Remedies – Paragraph 106.
[196] Centrica response to the Provisional Decision on Remedies – Paragraph 185.
[197] Centrica response to the Provisional Decision on Remedies – Paragraph 180.

considered volume risk when designing the wholesale index, see paragraph 14.165.

122. Utilita also highlighted that the annual indexation risks customers having a reduced range of competitive offers to choose from during the year other than when the latest cap has been announced.[198] We have decided that the price cap will be updated every six months.

123. SSE considered that the proposed price cap would create considerable uncertainty in the market and could potentially lead to PPM customers becoming loss-making. SSE noted that this would have a significant impact on investment (including in innovation) and expansion, deter new entry, and could lead to falling customer service standards or suppliers exiting the PPM segment altogether.[199] We consider the possible impact of the price cap on innovation and investment in the subsections titled "Risk of reduced innovation" and "Increased perception of regulatory risk".

124. RWE noted that the price cap exposes suppliers to a significant risk of making a loss within the PPM segments, but without the supplier being able to exit the segment (or even being able to choose not to take on new customers) unless the supplier exits the Domestic market entirely.[200]

125. Centrica considered that, as a result of the cap, suppliers and PCWs will do as much as they can to limit their exposure to PPM segments due to the negative or low returns and high risk of market distortion.[201] Centrica estimated that, at the price cap level proposed, revenues from the supply of PPM customers will become unsustainably low for the majority of the market and loss making for many suppliers. Centrica considered that this will weaken competition and may even see some companies exiting the market entirely.[202]

126. Centrica considered that the proposed cap risked being loss-making for many suppliers such that the proposed remedy risked being incompatible with EU law.[203]

127. Economy Energy considered that if the cap is set too low suppliers may have no alternative but to exit this segment of the market. Economy Energy

[198] Utilita response to the Provisional Decision on Remedies – Paragraph 4.12, 4.13 and 4.14.
[199] SSE response to the Provisional Decision on Remedies – Paragraph 4.7.2 (d).
[200] RWE response to the Provisional Decision on Remedies – Paragraph 46.5.
[201] Centrica response to the Provisional Decision on Remedies – Paragraph 142.
[202] Centrica response to the Provisional Decision on Remedies – Paragraph 162.
[203] Centrica submission – Paragraph 143.

therefore considered that the resulting disadvantages would be disproportionate to the aim of this remedy.[204]

128. We consider the risk of suppliers exiting the market in the subsection titled "risk of suppliers exiting the market".

129. RWE noted concerns that a price cap was likely to deter other suppliers from entering this segment. RWE considered that this effect would be particularly severe if the price cap made it difficult for those smaller suppliers that focus almost exclusively on the PPM segments to operate a commercially viable business.[205]

130. First Utility and Utilita highlighted that the introduction of a price cap could act as a barrier to cost recovery for new entrants into the PPM segments.

(a) First Utility highlighted that the introduction of a price cap on PPMs could act as a barrier to cost recovery given the upfront costs new entrants can face when moving into this market segment.[206] We consider that the design of the price cap mitigates the risk that the price cap does not allow for cost recovery.

(b) Utilita noted that it expects a cap to adversely impact challenger suppliers more than the Six Large Energy Firms; not only do they lack the ability to spread cost over a wider portfolio, but they may well lack resource to address the regulatory consequences of a cap, leading to at best reduced market entry and at worst market exit. Utilita considers that challenger suppliers also have tighter credit cover and hedging requirements – their portfolios are less diversified and unlike larger players, cannot carry the additional risk associated with infrequent indexing. Utilita consider that the outcome is that CMA is applying significant adverse consequences to the segments of the market it needs to be keen to enter and compete for PPM customers.[207]

131. We have considered the impact on smaller suppliers, see paragraphs 14.324.

132. Centrica and RWE considered that the price cap imposed a disproportionate and discriminatory financial burden on certain suppliers (as a result of the relative proportion of PPM customers held by different suppliers).

(a) Centrica considered that the price cap proposal imposed a disproportionate and discriminatory financial burden on certain suppliers

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[204] Economy Energy response to the Provisional Decision on Remedies – Page 5.
[205] RWE response to the Provisional Decision on Remedies – Paragraph 46.52.2.
[206] First Utility response to the Provisional Decision on Remedies – Paragraph 4.55.
[207] Utilita response to the Provisional Decision on Remedies – Paragraph 4.9 and 4.10.

and, as such, was contrary to established case law. This burden arises because some suppliers have a higher proportion of PPM customers than others. Since different suppliers are, for this objective reason, in a different position, the measure will likely give rise to discrimination unless regard is paid to those objective differences in the design of any price cap.[208] We have considered the impact on different suppliers in the subsection titled "impact on suppliers".

(b) RWE outlined that the CMA must consider the requirements of Article 3(2) of the EU Energy Directives in relation to non-discrimination. This means not only considering whether a measure might be discriminatory on its face, but also whether it would be discriminatory in practice. In the current context the CMA must have regard to the fact that suppliers below the 50,000 customer threshold would be able in the face of a price cap that required it to make losses on PPM customers to pull out of the PPM segments, whereas this option would not be available to others. Similarly, RWE considered that the CMA must have regard to the distribution of PPM customers in considering whether the Six Large Energy Firms are subjected to a risk by virtue of the imposition of the PPM Price Cap that other suppliers are not subject to.[209] We have considered this point in paragraph 14.367.

133. Scottish Power considered that the CMA had failed to give proper consideration to the risk of the PPM price cap having a material and long-lasting effect on customer engagement. Scottish Power told us that it expects there to be a significant time lag between the end of the PPM price control and any gradual increase in levels of engagement.[210] RWE also submitted that it expects the negative impact on customer engagement to persist after the price cap is removed.[211]

134. Scottish Power submitted that the CMA dismisses the risk of PPM harm to customer engagement on the basis that there is currently only "limited competition" in the PPM segments, so that "the marginal impact of any disincentivisation resulting from the remedy, relative to the current status quo, may be relatively small". However, Scottish Power noted that the CMA acknowledges "in the counterfactual scenario competition in the PPM segments may intensify such that the marginal impact of a price cap would be

[208] Centrica response to the Provisional Decision on Remedies – Paragraph 154.
[209] RWE response to the Provisional Decision on Remedies – Paragraph 46.48.
[210] Scottish Power response to the Provisional Decision on Remedies – Paragraph 12.11 - 12.13.
[211] RWE response to the Provisional Decision on Remedies – Paragraph 46.52.4.

more significant". Scottish Power considered that the CMA dismisses this risk without providing sufficient justification.[212]

135. We have considered the possible impact on engagement in the subsection titled "Possibility of reduced customer engagement".

136. Centrica told us that the proposed price cap meant that suppliers would have less incentive to manage the repayment of debt through PPM meters and instead they are likely to write off more debt than before and to pursue more costly debt recovery methods, adding costs to the industry.[213]

137. Utilita noted that there was a risk that the cap, by applying only to PPM customers would mean that Six Large Energy Firms have a perverse incentive on payment mode, and may result in customers being moved to credit or direct debit, or not returned to PPM mode on transfer. Utilita therefore consider that there was a risk that those on credit may end up paying more for their energy, and the financially vulnerable may end up in debt as well, due to inability to budget.[214]

138. We note that suppliers will have the option to install SMETS 2 smart meters which are outside the scope of the price cap and that these can operate in prepayment mode.

139. Centrica highlighted the cost to the industry of withdrawing existing products and hedges, estimating that it would incur a loss [✂].[215] We have considered this point in paragraph 14.453.

140. RWE and Ovo noted that a likely consequence of the PPM price cap will be that suppliers seek to recover the revenue losses by increasing the prices of other tariffs. This was also noted by Littlechild et al and Utilita among other parties.

   (a) RWE noted that the there was a risk that the if the price cap were set too low, this would result in credit customers cross subsidising PPM customers through their tariffs, which would be unfair and contrary to the principle of cost reflectivity.[216]

   (b) Ovo outlined that, based on the likely value of the PPM price cap, most if not all suppliers will have to reduce their current PPM tariffs dramatically to fall below the cap. Ovo highlighted concerns that many suppliers would

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[212] Scottish Power response to the Provisional Decision on Remedies – Paragraph 12.12.
[213] Centrica response to the Provisional Decision on Remedies – Paragraph 171.
[214] Utilita response to the Provisional Decision on Remedies – Paragraph 4.18.
[215] Centrica response to the Provisional Decision on Remedies – Paragraph 197 – 199.
[216] RWE response to the Provisional Decision on Remedies – Paragraph 46.104.

attempt to recover the significant revenue lost from such reduction by increasing their SVTs or other tariffs, rather than improve their operational efficiencies and cost bases in order to minimise such revenue losses. Ovo noted that the impact of this potential increase in non-PPM prices will be borne by (among others) the two thirds of fuel poor households who are not PPM customers.[217]

141. Littlechild et al considered that it was implausible that these suppliers would not seek to recover such a reduction in revenues by adjusting their pricing of other products. Littlechild et al outlined that the reduced revenue from PPM customers would thus be offset by higher prices to Standard Credit and Direct Debit customers.[218]

142. Utilita stated that applying a cap to only one segment of the market simply risks rebounding on other areas of the market which are not protected. Utilita note that one potential effect of the cap would be to leave credit customers paying higher rates, incentivising the Six Large Energy Firms to transfer PPM customers to credit payment methods, rather than using PPM meters which will help them to budget and manage their costs. Utilita do not consider that there would be anything to prevent the Six Large Energy Firms cross subsidising between payment types, meaning that in the long run, the Six Large Energy Firms may be only choice of supplier for PPM customers.[219]

143. We have considered possible waterbed effects in paragraph 14.443.

144. Littlechild et al and RWE questioned whether a price cap on PPM tariffs would effectively be a price cap on tariffs for all payment methods.

(a) Littlechild et al highlighted that SLC 27.2A, which outlines that suppliers cannot charge more for one payment method than another unless the price differential can be justified by the cost difference, may result in a price cap on PPM tariffs which effectively acts as a price cap on tariffs for all payment methods.[220]

(b) RWE outlined that under Article 3(7) of the EU Energy Directives the price cap might be regarded as requiring any differences between the pricing of PPM tariffs and non-PPM tariffs to be cost reflective. As a result RWE consider that a PPM price cap could operate as a de facto cap on the pricing of non-PPM tariffs.[221]

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[217] Ovo response to the Provisional Decision on Remedies – Paragraph 3.4.
[218] Littlechild et al response to the Provisional Decision on Remedies – Paragraph 100.
[219] Utilita response to the Provisional Decision on Remedies – Paragraphs 4.3 and 4.8.
[220] Littlechild et al response to the Provisional Decision on Remedies – Paragraph 102.
[221] RWE response to the Provisional Decision on Remedies – Paragraph 46.56.

145. We have considered the interaction with cost reflectivity requirements in paragraph 14.366.

146. Centrica and RWE considered that the price-cap remedy would render the remedies which directly address the AEC ineffective. SSE highlighted that these other remedies will have an immediate positive effect on the market, addressing the concerns identified by the CMA in an effective and comprehensive manner.

(a) Centrica submitted that the CMA has proposed other remedies by which the barriers to competition for customers on PPM meters can be removed. Centrica considered that these remedies, along with the smart meter roll out, provided the opportunity for a step change in engagement for PPM customers in advance of the roll out of smart meters. Centrica considered that the price cap remedy would render these remedies entirely ineffective for PPM customers (and potentially also for some customers not currently prepaying).[222]

(b) RWE considered that the main features having an adverse effect on competition in the PPM segments were the technical limitation on the number of tariff slots and the RMR four tariff rule.[223] RWE told us that it expected engagement by PPM customers to increase significantly once the technical and RMR constraints are removed, allowing suppliers and PCWs to compete more effectively for PPM customers.[224]

147. We consider the effectiveness of the package of remedies as a whole in section 15.

148. SSE outlined that to the extent that technical or regulatory constraints could restrict the number of tariffs that suppliers could offer to PPM customers, these restrictions would be addressed by the other remedies proposed by the CMA. SSE considered that both the improved slot management scheme and rolling back on RMR rules would have an immediate positive effect on the market, addressing the concerns identified by the CMA in an effective and comprehensive manner.[225]

149. E.ON submitted that the proposal to set the price cap on a regional level would reduce the effectiveness of the remedies aimed at addressing the PPM

[222] Centrica response to the Provisional Decision on Remedies – Paragraph 141 and 142.
[223] RWE response to the Provisional Decision on Remedies – Paragraph 46.13.
[224] RWE response to the Provisional Decision on Remedies – Paragraph 46.16.
[225] SSE response to the Provisional Decision on Remedies – Paragraph 4.3.2 and 4.3.3.

infrastructure technical constraints (which it considers to be the key constraint in the PPM segments). [226]

150. We consider the interaction with other remedies in section 11.

151. RWE highlighted that the CMA considered that the detriment the price cap seeks to address will have gone away by 2020. RWE submitted that as any detriment would reduce progressively over the duration of the remedy, it was not proportionate to retain a price cap until this point in time, considering that at some point during April 2017 and December 2020 the detriment would reduce to a sufficient extent that it was lower than the disadvantages of a price cap. As a result, RWE considered that the CMA should also incorporate into the remedy a 'glide path' allowing for the gradual withdrawal of the price cap.[227]

152. We note that the price cap will taper due to SMETS 2 smart meters being out of scope, see paragraph 14.434.

153. The Centre for Competition Policy and Littlechild et al outlined their concerns that a temporary PPM price cap may be extended.

   (a) The Centre for Competition Policy questioned the conclusion that a PPM price cap would be temporary: noting that once introduced there was likely to be considerable consumer and political pressure for the price cap to remain in place, with potential consequences for the feasibility of long-term competitive solutions for PPM consumers.[228]

   (b) Littlechild et al considered that if a PPM price cap were put in place, it would invite further lobbying to extend the duration and coverage of the control, and more generally to intervene in other ways. Littlechild et al noted that, in addition to the likely adverse effects of such measures, the additional regulatory uncertainty would increase the costs and risks faced by suppliers, with corresponding adverse effects on competition, prices and customers.[229]

154. We have considered the risk that the price cap becomes permanent in the subsection titled "Risk that the price cap becomes permanent".

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[226] E.ON response to the Provisional Decision on Remedies – Paragraph 239.
[227] RWE response to the Provisional Decision on Remedies – Paragraph 46.30.
[228] The Centre for Competition Policy response to the Provisional Decision on Remedies – Page 9.
[229] Littlechild et al response to the Provisional Decision on Remedies – Paragraphs 107 and 109.

Parties' views on alternative options to the PPM Price Cap Remedy

155. EDF Energy considered that the extension of SLC 7 (i.e. that deemed prices should not be unduly onerous) to all default prices, if accompanied by auditable guidelines/principles and properly enforced, would be a more effective and practicable solution.[230]

156. RWE suggested requiring suppliers with 50,000 or more customers to make all products available to all payment types would be less onerous.[231]

157. SSE and Ebico outlined that a relative control between payment types would be a preferred approach. Ecotricity does not consider that it would be unreasonable for other suppliers to have to limit the premium to £25 per year for an average customer.

(a) SSE stated that relative control between payment methods would be a much simpler way to achieve CMA's desired outcome. SSE consider that the CMA's formulation is inferior to this option.[232]

(b) Ebico outlined that, instead of an absolute price cap, a cap on the differential in cost between a supplier's cheapest direct debit tariff and their cheapest tariff available to prepay customers should be considered. Ebico outlined that as the additional costs of serving a prepay customer are largely fixed, and do not vary with demand level, this cap on cost differential could apply at all demand levels.[233]

(c) Ecotricity noted that its prepayment customers pay the same as its credit meter customers. On this basis, Ecotricity does not consider that it would be unreasonable for other suppliers to have to limit the premium to £25 per year for an average customer.[234].

158. Alternatively, SSE outlined that either a cost plus cap or a starting value based on market experience across a broad group of suppliers, customers and tariffs (and over a sufficient period of time) would also be preferred approaches.[235]

159. RWE considered that even if some form of price cap were required, the current price cap design was not the least onerous option[236] (for example due

[230] EDF Energy response to the Provisional Decision on Remedies – Paragraph 6.5.
[231] RWE response to the Provisional Decision on Remedies – Paragraph 46.45.
[232] SSE response to the Provisional Decision on Remedies – Paragraph 4.8.2.
[233] Ebico response to the Provisional Decision on Remedies – Page 2.
[234] Ecotricity response to the Provisional Decision on Remedies – Page 2.
[235] SSE response to the Provisional Decision on Remedies – Paragraph 4.8.2.
[236] RWE response to the Provisional Decision on Remedies – Paragraph 46.6, paragraph 46.45.

to the fact that the design does not guarantee that a supplier will recover costs in supplying PPM customers[237]).

160. RWE suggested that improvements to the remedy addressing technical constraints in the PPM infrastructure to further expand choice and competition in the PPM segments would give rise to a more effective remedy negating the requirement for the price cap.[238]

161. Utilita submitted that the CMA had not thoroughly assessed other options to support PPM customers and address the PPM AEC and outlined several alternative options, which it believed were less interventionist. These included[239]:

(a) Prioritising the roll out of smart meters to PPM customers;

(b) Implementing relative pricing for all suppliers;

(c) Non-compete clauses for long term disengaged customers; and

(d) Customer auctions for long term disengaged customers.

162. Secure Meters Ltd also considered that suppliers should prioritise smart meter rollout for PPM customers outlining that PPM customers were likely to benefit more from a smart pay-as-you-go meter than a transitional price cap.[240]

163. Dawn Butler MP and BGL Group outlined their support for the PPM price cap remedy although noted that smart meter rollout should be prioritised for PPM customers.

(a) Dawn Butler MP outlined that the current PPM infrastructure may have insufficient capacity for the price cap to be effective and smart meter rollout to PPM customers should be prioritised to assist successful implementation of the cap.[241]

(b) BGL considered that an acceleration of the smart meter roll-out by the Government would be a more effective measure as it would avoid price controls and the complexities that these have.[242]

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[237] RWE response to the Provisional Decision on Remedies – Paragraph 46.47.
[238] RWE response to the Provisional Decision on Remedies – Paragraph 46.44.
[239] Utilita response to the Provisional Decision on Remedies – Paragraphs 4.76 – 4.97.
[240] Secure Meters Ltd response to the Provisional Decision on Remedies – Page 1 and 2.
[241] Dawn Butler MP response to the Provisional Decision on Remedies – Page 3.
[242] [✂]

164. The Centre for Competition Policy considered that opt out collective switches may be a more appropriate remedy, since the central cause of detriment is consumer disengagement. The Centre for Competition Policy noted that while price caps explicitly limit the extent of the competitive process, the auction mechanism at the heart of collective switches simply represents an alternative form of competition to atomistic markets rather than a restriction on competition.[243]

165. Littlechild et al consider that if it is desired to further protect vulnerable customers, including the fuel poor, a better targeted approach would be to extend the Government's Warm Home Discount scheme and to encourage the various energy trust support schemes for vulnerable customers run by all or most of the Six Large Energy Firms.[244]

166. We have considered whether there are less onerous alternatives in the subsection titled “Is the least onerous if there is a choice between several effective measures” (see paragraph 14.393).

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[243] The Centre for Competition Policy response to the Provisional Decision on Remedies – Pages 7 and 8.
[244] Littlechild et al response to the Provisional Decision on Remedies – Paragraph 110.