

**Centrica response to the CMA's Formal
Consultation on the Energy Market (Prepayment
Charge Restriction) Order 2016**

11 November 2016

Introduction

This document provides Centrica's comments on the CMA's drafts of:

- The Energy Market Investigation (Prepayment Charge Restriction) Order 2016 (the Draft Order), including
 - New SLC28A of the Electricity Supply Licence; and
 - New SLC 28A of the Gas Supply Licence.
- The Draft Explanatory Note for the Order
- The illustrative price cap models which are due to be incorporated by reference into the electricity and gas licence conditions as annexes to SLC 28A

Summary

Following the CMA's initial consultation on the Draft Order, the CMA has made a number of positive changes that take into account our feedback. The most material of these include:

- Extending the notice period that suppliers are given to implement the new prices under the cap
- Providing some reassurance that suppliers will not be held responsible for actions that are outside their control with respect to compliance
- Adjusting the definition of Technical Interoperability to ensure that the standard is realistic
- Improving the accuracy and source data of network costs

However, there are a number of outstanding issues we raised at the initial consultation that the CMA has entirely failed to address, or failed to do so sufficiently.

The Draft Explanatory Note continues to risk creating a disincentive for customers on traditional PPMs to take up smart meters, with a number of adverse unintended consequences. We continue to believe this is a major unintended consequence of the CMA's remedy, with potentially far reaching implications for the smart meter rollout and competition for prepayment customers. We reiterate our request that the CMA either removes paragraph 32 from the Draft Explanatory Note in its entirety, or replaces it with the statement that "*The price cap shall apply solely to the provision of traditional prepayment meters*".

We continue to believe that the CMA currently risks creating a second test for what constitutes a successful smart rollout that is different to the standard that suppliers are being held to under the existing "all reasonable steps" smart rollout obligation. We urge the CMA to clarify that when it conducts the mid-term review and examines progress of smart rollout, that it will use the same standard that suppliers are being held to under their current "all reasonable steps" licence condition.

We believe that the CMA should provide further reassurance in the drafting of the Order and Licence Conditions that suppliers will not be held responsible for actions that are outside their control with respect to compliance.

We continue to believe that the CMA should explicitly confirm that SMETS1 meters that are enrolled in the DCC are fully interoperable, and are therefore classed as exempt smart

meters. It would contradict Government policy for the CMA to suggest that DCC-enrolled SMETS1 meters are not fully interoperable.

We have some other outstanding issues and comments in relation to the policy costs index, and ensuring the accuracy of the inputs and calculations of the models.

We would also like to raise an issue that we did not raise in response to the initial consultation. There are industry-wide technical restraints that place a barrier on implementing price changes for electricity over the weekend or on Mondays. Suppliers require involvement from the Prepayment Meter Infrastructure Providers (PPMIPs) and National Service Providers (NSPs) on the day before and on the day of an electricity price event in order to implement it, for example doing the tariff downloads. However this cannot currently occur on a weekend or a Monday due to restrictions on contractual hours at the PPMIP and NSPs. 1 April 2017 is a Saturday, 1 October 2017 is a Sunday and 1 April 2018 is a Sunday. We ask that the CMA considers providing that the Price Restriction Period comes into effect on the first working day after 1 April or 1 October as appropriate that is not a Monday.

In our response to the initial consultation on the Draft Order we made some recommendations that were aimed at Ofgem rather than the CMA, primarily in relation to the interplay of the price cap with existing requirements on price increase notifications in SLC 23. Those recommendations are not included in this response because we will speak to Ofgem separately.

Outstanding issue 1 – adverse impact on smart rollout

Paragraph 32 of the Draft Explanatory Note states that:

“For the avoidance of doubt, the price cap shall apply solely to the supply of energy to the premises of Relevant Customers where no Excluded Smart Meter has been installed. Any Relevant Customer who is not supplied, for any reason, through an Excluded Smart Meter will remain protected by the Prepayment Charge Restriction until an Excluded Smart Meter has been effectively installed at their premises”.

If this statement in the Explanatory Note has legal force, then the guarantee of protection will create a strong disincentive to customers on traditional PPMs to take up smart meters, thereby -

- undermining the long term remedy to the prepayment AEC that the CMA diagnosed; and
- conflicting with the Government’s policy objective of achieving smart rollout.

The statement in paragraph 32 will also unduly interfere with existing obligations by:

- changing the parameters of suppliers’ obligation to take all reasonable steps to roll out smart meters; and
- undermining Ofgem’s statutory locus as the enforcer of supply licence obligations to offer terms of supply to customers via a range of payment methods.

The CMA only ever intended the PPM price cap to be temporary, pending the successful rollout of smart meters. By creating a disincentive to take-up smart meters, paragraph 32 therefore risks creating a degree of permanence to the price cap that the CMA never intended.

We strongly urge the CMA to either remove paragraph 32 from the Draft Explanatory Note in its entirety, or replace it with the statement that “*The price cap shall apply solely to the provision of traditional prepayment meters*”.

Outstanding issue 2 – need to clarify that the CMA will not create a second benchmark against which smart rollout will be assessed

The CMA has said that at the mid-period review it would consider (a) terminating the price cap early or (b) recommending that Ofgem extends it. The CMA’s choice would depend on whether the rollout is “materially ahead of (or behind) schedule”. The CMA has not defined what “materially ahead of (or behind) schedule” means, nor which schedule it would rely on. Not only does this create significant uncertainty, it could also mean the CMA benchmarks its assessment of smart meter rollout against a different standard to the “all reasonable steps” obligation that Ofgem uses. This could effectively create, without consultation, a separate obligation that holds suppliers to unreasonable standards given the tools at their disposal to install smart meters.

Our position is that the price cap should definitely end in December 2020 because, by that point, all customers should have had the opportunity to have a smart meter installed.

However, if the CMA maintains the link between an assessment of the progress of smart meter rollout and the end of the price cap, then the assessment must be based against the same standard that suppliers are being held to under the “all reasonable steps” obligation.

We urge the CMA to clarify that when it conducts the mid-term review and examines progress of smart rollout, that it will use the same standard that suppliers are being held to under their current “all reasonable steps” licence condition.

Outstanding issue 3 – avoiding an absolute obligation that suppliers do not have control over

In our response to the CMA’s initial consultation we raised concerns that the proposed absolute obligation - “must ensure that” – would be unreasonable because suppliers cannot ensure that customers activate any price change (increase or decrease) from day one of the new Price Restriction Period. This is because a customer has to top up for that change to be effective for them and, suppliers cannot force customers to top up.

We are grateful for the CMA’s clarification in paragraph 48 of the Draft Explanatory Note as to how suppliers’ compliance with the Order will be assessed. The wording “*It may be that for a short period following 1 April or 1 October some customers still consume energy at the rates prevailing prior to 1 April or 1 October as they are yet to top up.*” is helpful in this

regard. We are, however, concerned that the reference to a “short” period suggests there is a limit to the application of this principle and that, if a customer takes some time (i.e. beyond a *short* period) to top up, then suppliers will be in breach of their obligations. This cannot be the case as there is little a supplier can do to control when a customer tops up. We therefore suggest removal of the words “*for a short period*” from the drafting.

The final sentence of paragraph 48 (beginning “However, for the purpose of the assessment of compliance”) is unclear and we recommend that it is deleted and replaced with the following wording added to the end of the previous sentence: “*and, in such circumstances, the supplier shall not be in breach of the Prepayment Charge Restriction if a customer fails to top up.*”

Finally, we do not believe that the CMA’s reassurance goes far enough because the Draft Explanatory Note states that “Nothing in this Explanatory Note is Legally Binding”. We believe that the CMA has attempted to provide reassurance in the licence conditions with the use of the phrase “Charges for Supply Activities **applicable to...**” (emphasis added). We would recommend that this drafting is changed to “Charges for Supply Activities **made available to...**” We also suggest that the CMA’s clarification as to how compliance is assessed (as appears in paragraph 48 of the explanatory note - revised as suggested) should also be included in Licence Conditions.

Outstanding issue 4 – definition of fully interoperable smart meters

In our response to the CMA’s initial consultation we said that SMETS1 smart meters that are enrolled in the DCC are fully interoperable, and that the Order should specify as such.

We do not understand why the CMA has not made the change we suggested, and instead continues to propose that any meters other than SMETS2 meters will need to be designated as fully interoperable separately by the CMA. On this basis SMETS3 meters, which are more advanced than SMETS2 meters, would also need to be designated as fully interoperable separately by the CMA.

The Government is responsible for smart meter rollout. We believe it reflects Government policy that SMETS1 meters that are enrolled in the DCC are fully interoperable. By questioning whether enrolled SMETS1 meters are fully interoperable, the CMA appears to be contesting whether Government will deliver its policy intent.

We urge the CMA to ask Government to confirm that enrolled SMETS1 meters are fully interoperable. Following such confirmation, the CMA should specify in the Order that enrolled SMETS1 meters are exempt smart meters.

Outstanding issue 5 – Maintaining the integrity of the Policy Costs index

In our response to the CMA’s initial consultation we highlighted that the proposed exemption of energy intensive industries from certain policy costs (RO and FIT) from 2017/18 would require a rebasing of the policy cost inputs to the price cap model to ensure that the price

cap appropriately allowed for the additional cost burden that will fall on domestic customers. We estimated the impact would be to add c. £5 to each domestic bill due to the fact that the overall policy cost will be being recovered over c. 5% less volume. Ofgem has recognised that these additional costs to domestic customers should be reflected in its consultation on “Monitoring trends in suppliers’ expected costs”¹.

We reiterate our view that in order to maintain the integrity of the policy cost index, values need to be adjusted to appropriately reflect the increase in these policy costs on a £ per customer (or p/kWh) basis that will result when the energy intensive industry exemption begins.

Outstanding issue 6 – Ensuring the price cap models are based on accurate inputs

We raised a number of issues relating to the accuracy of some of the inputs and calculations in the models. We are pleased to note that most of these have been taken into account in the latest model. However, we have identified a few data inaccuracies that remain in these latest models. We attach a version of the network cost model with annotated comments, and also include a table below setting out these inaccuracies:

Tab	Cells	Description
Gas transmission	H5:H17	The NTS exit capacity charges are pulling through the incorrect rates for the base date. The formula should be pointing to column B (15/16) rather than column C (16/17).
Gas transmission	G5:G17	The load factors now listed are actually for the period Oct15-Sep16. This is fine for the 2016-17 summer period but the base date should be using the values from the Oct14-Sep15 year.
Gas distribution	J5:J17	As above.
Elec transmission	K19:K20	These values for the distribution loss factors should be swapped around (East Anglia should be 1.115 instead of 1.093 and East Midlands should be 1.093 instead of 1.115).
Elec distribution	I21, P21, I27, P27	Fixed charges for 2016/17 for the London and South East regions need to include 2.466p/day relating to the recovering of the rebate provided in 2014/15.
BSUOS	Column J	The applicable BSUoS rate for each Charge Restriction Period is being drawn from the same year in the ‘Half hourly settlement data’ tab i.e. the BSUoS rate for the 2016-17 summer period is based on the BSUoS costs for 2016-17. This is inconsistent with the CMA intent to use the BSUoS costs from the preceding period. We assume this is a simple error and will be corrected as it is not possible to show compliance on an ex-ante basis if one element of the cap is not finalised until after the charge restriction period has ended.

¹ See <https://www.ofgem.gov.uk/publications-and-updates/monitoring-trends-suppliers-expected-costs> paragraphs 3.34 and 3.31, footnotes 14 and 17 respectively

Outstanding issue 7 – technical comments on Explanatory Note and Licence Conditions

We believe that there is a mistake in paragraph 60(a) of the Draft Explanatory Note. Our understanding is that it is incorrect to suggest that the potential for payment of rebates exists for Economy 7 tariffs because Ofgem will direct the consumption split and suppliers will therefore not be making projections. We suggest that paragraph 60(a) of the Draft Explanatory Note is removed.

We also have the following comments on the draft licence conditions.

Reference	Electricity Licence Condition 28A Comment
Definition of “Relevant Maximum Charge”	Should be clarified that is exclusive of VAT, as per the definition of Benchmark Maximum Charge “(in pounds sterling and exclusive of Value Added Tax)”
28A.12 value of PI_j	<p>The policy index values do not take account of the effect of the exemption from RO/FIT costs for Energy Intensive Industry (EEI) which is expected to take effect from April 2017.</p> <p>The impact will be to add c. £5 to each domestic bill due to the fact that the overall policy cost is being recovered over c. 5% less volume.</p> <p>Ofgem has recognised that these additional costs to domestic customers should be reflected in its consultation on “Monitoring trends in suppliers’ expected costs”².</p> <p>In order to maintain the integrity of the index, values need to be adjusted to appropriately reflect the increase in these policy costs on a £ per customer (or p/kWh) basis.</p>
28A.25	The licence condition sets out that for customers with Economy 7 metering arrangements, compliance will be assessed on the same assumed consumption profile applied when deriving the price cap. It would be useful to include a similar clause which sets out the assumed consumption profile used for TNUoS purposes, for both the calculation of the cap and for assessing compliance (i.e. 17.7% for unrestricted and 14.5% for Economy 7)
Annex 4	The Baseline Values of the network cost allowances for benchmark consumption m align with the calculated network costs in the ‘price-cap-network-costs-calculations-spreadsheet-annex-3’ spreadsheet. However the network cost values contained in the ‘price-cap-illustrative-model-spreadsheet.xlsx’ do not align with the values in the licence or in the network cost model. We believe the values in ‘price-cap-illustrative-model-spreadsheet.xlsx’ are incorrect.

² See <https://www.ofgem.gov.uk/publications-and-updates/monitoring-trends-suppliers-expected-costs> paragraphs 3.34 and 3.31, footnotes 14 and 17 respectively

Annex 5	The Baseline Benchmark Maximum Charges for benchmark consumption m do not align with the maximum charges contained in 'price-cap-illustrative-model-spreadsheet.xlsx'. Even when the correct network charges are pasted in from 'price-cap-network-costs-calculations-spreadsheet-annex-3' the maximum charges in 'price-cap-illustrative-model-spreadsheet.xlsx' still do not align with the licence values. We have been unable to identify the cause of the discrepancy.
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Reference	Gas Licence Condition 28A Comment
Definition of "Relevant Maximum Charge"	Should be clarified that is exclusive of VAT, as per the definition of Benchmark Maximum Charge " <i>(in pounds sterling and exclusive of Value Added Tax)</i> "
Annex 4	The Baseline Values of the network cost allowances for benchmark consumption m align with the calculated network costs in the 'price-cap-network-costs-calculations-spreadsheet-annex-3' spreadsheet. However the network cost values contained in the 'price-cap-illustrative-model-spreadsheet.xlsx' do not align with the values in the licence or in the network cost model. We believe the values in 'price-cap-illustrative-model-spreadsheet.xlsx' are incorrect.
Annex 5	The Baseline Benchmark Maximum Charges for benchmark consumption m do not align with the maximum charges contained in 'price-cap-illustrative-model-spreadsheet.xlsx'. Even when the correct network charges are pasted in from 'price-cap-network-costs-calculations-spreadsheet-annex-3' the maximum charges in 'price-cap-illustrative-model-spreadsheet.xlsx' still do not align with the licence values. We have been unable to identify the cause of the discrepancy.