Project Manager
Energy market investigation
Competition and Markets Authority
Victoria House
Southampton Row
London
WC1B 4AD

By email to : david.fowlis@cma.gsi.gov.uk and energymarket@cma.gsi.gov.uk

11 November 2016

Dear Sir/Madam,

Re: DRAFT ORDER – CONSULTATION The Energy Market Investigation (Prepayment Charge Restriction) Order 2016

Thank you for the opportunity to comment on the above, we set out our response below.

Our most significant concerns are in relation to how wholesale prices are used to determine the level of the charge restriction.

The method adopted by the CMA appears to principally use wholesale costs from the season of the previous year to determine the charge restriction for the equivalent season in the following year. This approach would work well if wholesale costs were stable from year to year, however, prices have been in general decline for the past 3 years until a few months ago when they started to rise. In addition, the model assumes suppliers buy 30% peak and 70% base load regardless of season. Fundamentally the method proposed by the CMA is not aligned with supplier hedging strategies and poses a further risk to an already volatile market environment.

By way of example, in the past 2-3 months, we have observed a 40% increase in wholesale costs which has led to some smaller suppliers raising their retail prices, some by as much as 31%. The restriction in its current form would have prevented those suppliers from raising prices in response to genuine material wholesale cost increases which has lead to some commentators suggesting significant stress has been placed on, and the potential failure of, some suppliers in the market. This cannot be the right outcome for a safeguard cap.

This volatility in commodity prices is being further exacerbated by unprecedented (in recent history) imbalance cash-out prices. We believe that what we have observed in recent weeks is a material change in market behaviour. Some commentators are raising concerns for the stability of those smaller suppliers who are not appropriately hedged. For example, electricity imbalance cash-out prices were above £1500 / MWh for a period on 8 November 2016. This places unforecastable cost onto suppliers, especially smaller suppliers, given there is no liquid wholesale market in which they can participate in order to shape power purchases: smaller suppliers cannot “shape” until the day before, by which time it is too late to obtain an attractive price. To mitigate this problem, a suggestion is that the winter calculation uses a higher headroom %: if there was not a material wholesale cost change then it could be clawed back through a lower headroom % in the summer.

The increased margin risk associated with prepayment customers as a result of the charge restriction and the abovementioned wholesale cost volatility make the acquisition of such customers much less attractive and might lead to suppliers not marketing to them at all during the restriction period at best and possibly withdrawing their cheapest prepayment tariffs in the worst case.

We agree that a link should exist between the prepayment charge restriction and the SMETS2 smart meter rollout. We have some concern however that by releasing a supplier from the prepayment charge restriction once a SMETS2 meter has been installed, some suppliers might shortly afterwards increase the customer tariff. Clearly the CMA has anticipated this and accepts this risk because once a SMETS2 meter is in place the customer can more easily switch supplier. Our concern however is related to the impact on the smart meter rollout: some prepayment customers might be alerted to the price rise risk and refuse their SMETS2 meter installation. We ask that the CMA carefully considers how this potential harm to the already challenging smart meter programme could be avoided.

We especially agree with the concern raised by Energy UK in their response: giving suppliers approximately only 22 days after the publication of the updated Benchmark Maximum Charges to manage the logistics required to implement their pricing strategy for the next Charge Restriction Period is insufficient in our view.

Should you have any questions regarding this information please do not hesitate to contact me directly.

Yours sincerely,

[not signed]

Jeremy Guard
Head of Industry Supply Codes