

## ENERGY MARKET INVESTIGATION

### Summary of responses to the consultation on the Draft Energy Market Investigation (Prepayment Charge Restriction) Order 2016, associated draft Licence Conditions and Draft Explanatory Note

#### Introduction

1. On 11 October 2016, the Competition and Markets Authority (CMA), consulted on a draft order relating to the Prepayment Charge Restriction (the Draft Order), including the associated draft Licence Conditions (the Draft Licence Conditions) and a draft explanatory note (the Draft Explanatory Note) for the implementation of the Prepayment Charge Restriction remedy set out in the energy market investigation final report (the Report).<sup>1</sup> The consultation closed on 11 November 2016.
2. In response to its consultation, the CMA received 18 submissions relating to the Draft Order, Draft Licence Conditions and the Draft Explanatory Note. Non-confidential versions of the responses received are available on the CMA's webpages.<sup>2</sup> This paper sets out the main changes which have been made to the Draft Order as a result of those submissions and also gives reasons why certain suggested changes were not made. Minor changes (such as the correction of typographical and spelling errors, minor clarifications to the Draft Explanatory Note, and other consequential changes) are not discussed in this paper. References to specific Articles in this paper refer to the final version of the order published on the same date as this paper (the Order), rather than to any earlier drafts. Capitalised terms in this paper have the same meaning as defined in the Order, unless otherwise specified below.
3. Responses to the consultation can be categorised into three broad categories:
  - (a) Comments in respect of the CMA's decision to introduce the Prepayment Charge Restriction remedy;
  - (b) Comments relating to the drafting and application of the Draft Order, Draft Licence Conditions and Draft Explanatory Note; and

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<sup>1</sup> [Energy Market Investigation: Final Report](#).

<sup>2</sup> [Responses to the draft prepayment charge restriction order](#).

- (c) Comments relating to future activity which have no direct bearing on the drafting of the Order, Explanatory Note or Licence Conditions.

### **Comments in respect of the CMA's decision to introduce the Prepayment Charge Restriction**

4. Prior to publishing its Report, the CMA considered multiple policy options<sup>3</sup> and ultimately decided upon those set out in the Report. A number of comments made in response to the consultation related to matters of policy on which the CMA has already taken its decision.
5. Pursuant to the Enterprise Act 2002 (the Act), the Order must be consistent with the decisions included in the final report unless either there has been a material change in circumstance or the CMA has a special reason for deciding to differ.<sup>4</sup> The CMA considers that there has been no such material change of circumstances nor is there a special reason to depart from the decisions set out in the Report. No argument has been made, or evidence provided, by parties suggesting the existence of such a material change of circumstances or special reason.
6. Several of the policy related suggestions made by respondents to the CMA's consultation included suggestions seeking to enhance the accuracy of the price cap.<sup>5</sup> The CMA considered in the Report the balance to strike between accuracy and practicability.<sup>6</sup> The mechanism of the price cap as set out in the Report represents the CMA's final decision in this respect.
7. Where respondents suggested mechanisms alternative to those identified in the Report, seeking to enhance the accuracy of the price cap, these suggestions were commonly motivated by a concern that the price cap may not track costs with sufficient accuracy. The CMA has a duty<sup>7</sup> to monitor its remedies and to consider if a remedy needs to be varied or revoked. Therefore, to the extent that there might be in the future a material divergence between costs and the level of the Prepayment Charge Restriction, the CMA already has a process for identifying such issues and taking appropriate action. The CMA also notes that Ofgem, as regulator, monitors the market and can inform the CMA of any findings it considers relevant in terms of impact of the price cap on the market.

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<sup>3</sup> For example, options in respect of the structure, form and design of the price cap as described in the [Final Report](#), paragraphs 14.36–14.245.

<sup>4</sup> The Act, [section 138\(3\)](#).

<sup>5</sup> For example, seeking to vary the way in which allowance is provided for wholesale costs.

<sup>6</sup> [Final Report](#), paragraphs 14.37–14.57.

<sup>7</sup> The Act, [section 162](#).

## Comments relating to the drafting and application of the Draft Order, Draft Explanatory Note and Draft Licence Conditions

8. Some respondents suggested amendments to expand on definitions, and other drafting aspects within the Draft Licence Conditions, to make the CMA's policy intent clearer. The CMA has made some changes in response to these suggestions.
9. For instance, the CMA has removed the 'technically interoperable' limb of the definition of 'Fully Interoperable' on the grounds that this appeared to be unnecessary to achieve the aim of this requirement and risked making the definition tighter than intended.
10. One respondent suggested that the wording in paragraph 28A.21<sup>8</sup> of the draft Electricity Licence Condition should be relaxed. It argued that the original wording was too stringent as it suggested that a direction for alternative compliance would only be available if no customers ended up in need of a rebate.<sup>9</sup> The CMA notes that, for any group of customers, there will always be a mix of consumption levels and therefore a small percentage of customers might have higher consumption levels than expected. Consequently the CMA has clarified the wording to reflect its intent, which is that a direction for alternative compliance may be available even where there is a material possibility that a small number of customers may end up in need of a rebate.
11. Paragraph 28A.26(b) of the Electricity Licence Condition previously referred to historic data relating to 'two consecutive Charge Restriction Periods'. The CMA has removed this wording as suggested by a supplier in response to the consultation. As the supplier noted, the requirement that the data relate to historic Charge Restriction Periods was unnecessary and created a difficulty in selecting appropriate data to use for the first two Charge Restriction Periods.
12. Five respondents were uncertain about whether 30 days was a long enough period for submission of the compliance statement. Some of these respondents noted in particular that in the first year reporting could take longer whilst suppliers establish efficient reporting processes. The CMA recognises that this is a reasonable concern and has consequently adjusted the requirement (see Article 5.1 of Order) such that suppliers now have 45 days to submit the compliance statement. In recognition of the possible

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<sup>8</sup> Paragraph 28A.21 concerns the process for obtaining a direction for alternative compliance assessment.

<sup>9</sup> The wording in the draft stated that a direction would only be available where 'it is unlikely that *any* Relevant Customer subject to such Prepayment Tariff will have a consumption level which would cause them to incur Charges for Supply Activities in excess of the Relevant Maximum Charge' (emphasis added).

complications arising from the first round of reporting Article 5.1 provides that the reporting deadline may be extended on a case by case basis by the CMA.

13. One respondent suggested that when the CMA intends to issue a direction so that a type of meter is to be treated as an Excluded Smart Meter, there should be a consultation prior to the final decision to issue such a direction. The CMA considers that this is a reasonable suggestion. The Explanatory Note (paragraph 35) has been amended to make it clear that the CMA would consult, if and when appropriate, prior to issuing a direction on such a matter.
14. Two suppliers responded to the consultation noting that, whilst the policy intent in respect of BSUOS cost allowances was clear, the spreadsheet calculations appeared to be inconsistent with that policy intent resulting in a small discrepancy of the order of 40 pence. Following review of the spreadsheet calculations, these have been updated to reflect the CMA's policy intent<sup>10</sup> such that the allowance for a forthcoming charge restriction period uses data from the previous year. This approach is conceptually similar to the approach used for assessing wholesale cost allowances.
15. Two suppliers suggested practical changes to the network cost calculations to enhance the accuracy of those calculations. The network cost calculations have been updated accordingly.
16. One supplier queried how to handle a situation in which a customer has two meters: one for off peak use only and one for general purpose (the latter for use both on peak and off peak). This point is addressed in the drafting of the Electricity Licence Condition – see the definition of 'Multi-Register Metering Arrangement'. The definition of 'Prepayment Tariff' has been amended to make clear that a Prepayment Tariff can cover charges paid through more than one meter.
17. The more material suggestions made by respondents that have not been accepted are discussed below.
18. One supplier suggested that the definition of Excluded Smart Meter should explicitly cover smart meters which conform to the first smart metering equipment technical specification (SMETS1) and which have been enrolled with the data and communications company (DCC). The CMA has not amended the Draft Order in this way as it believes that the existing definition would already capture these meters - provided that they meet the

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<sup>10</sup> See paragraph 14.200 of the [Final Report](#).

interoperability requirements set out in the definition of Excluded Smart Meter.<sup>11</sup>

19. One supplier suggested that the definition of Relevant Customer should specifically mention the exemption in respect of fixed term contracts entered into on or before 24 June 2016 set out in paragraph 28A.5 of the Electricity Supply Licence and paragraph 28A.3 of the Gas Supply Licence.
20. The CMA considers that such a change to the definition would be inappropriate. The exemption is intended to only apply for the duration of the fixed term contract. Hence it is not the customers themselves who are out of scope of the price cap, but rather their tariff until the end of their term.
21. The Report indicated that there would be a period of two months between the level of the price cap being determined and the price cap taking effect. This period needed to be reduced in order to give sufficient time to GEMA to calculate the level of the price cap. As a result, the Draft Licence Conditions reflected the majority view among suppliers<sup>12</sup> by giving no more than five working days to GEMA.<sup>13</sup> Only two suppliers responded to the consultation suggesting that such a timetable would be challenging for implementing price changes on the first day of the new charge restriction period.<sup>14</sup> We have therefore left this part of the Draft Licence Condition unchanged.
22. One supplier noted that where the first day of a charge restriction period falls on a weekend or a Monday the update process may pose challenges to teams, both within suppliers and within their third party service providers. The supplier suggested an amendment to the definition of Charge Restriction Period to avoid this. The CMA considers that whilst this suggestion would facilitate the price update process, it would introduce new challenges which would outweigh the benefits. For example, such a change would mean that price cap updates would not align with network charging updates or wholesale commodity windows.
23. One supplier noted the increased volume of price changes that would need to be handled at a single point in time. As discussed in the Report the CMA considers that the existing infrastructure already handles a high volume of

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<sup>11</sup> See paragraphs 14.89–14.94 of the [Final Report](#).

<sup>12</sup> Prior to the formal consultation on the draft charge restriction conditions the CMA sought views from suppliers on whether it would in fact be practical to split this two month period such that GEMA have 15 days to calculate the level of the price cap, leaving suppliers with approximately 45 days to implement any resulting price changes. Suppliers responded to say that this would not be practical. Suppliers' views varied in regards to the minimum length of time needed to implement price changes. There appeared to be a majority of opinion amongst suppliers that it would be practical to implement price changes if GEMA were to publish the level of the price cap within a week of the necessary data becoming available.

<sup>13</sup> See paragraph 28A.16 of the [Draft Electricity Licence Condition](#).

<sup>14</sup> The related issue of price increase notifications is discussed in paragraph 26 below.

updates twice a year and the increase associated with the introduction of a price cap is not likely to be so significant as to create practical difficulties (see paragraphs 14.155 to 14.157 of the Report).

24. One supplier queried whether there would be sufficient gas tariff codes to permit smaller suppliers to offer one tariff in each region. The CMA expects that, as a result of one limb of the remedies concerning the Prepayment AEC (see paragraph 20.25(a) of the Report), there will be more tariff codes available but also more flexibility available in the use of tariff codes. In particular, the softening of SLC 22B.7(b) allows a supplier to use one tariff to supply customers in different regions even where there are cost differences between these regions. Since regions can be grouped on the basis of relatively similar network charges, evidence set out in the Report suggests that a supplier could offer a single tariff (using therefore a single tariff code) across multiple regions and still achieve a high degree of cost reflectivity.
25. Three respondents queried why the Draft Order required suppliers to submit a compliance report to the CMA in addition to the reporting to GEMA. Such reporting is required in order for the CMA to fulfil its statutory duty to monitor its remedies. The reporting to the CMA has been made intentionally brief and the pro-forma compliance statement was designed so as to minimise the burden of this reporting obligation.<sup>15</sup>

### **Comments relating to future activity which have no direct bearing on the drafting of the Order, Explanatory Note or Licence Conditions**

26. Some of the comments made in response to the consultation related to the Prepayment Charge Restriction but did not have a direct bearing on the drafting of the Order, Explanatory Note or Licence Conditions.
27. Three of the more material comments falling into this category are discussed below:
  - (a) One supplier suggested that the CMA should monitor the extent to which the price cap accurately tracks costs, noting in particular the possibility of over- or under-recovery in respect of policy costs. The CMA believes this comment is relevant to the CMA's duty to monitor, under section 162 of the Act, whether its orders are still appropriate or need to be amended or revoked. Therefore the CMA decided no changes to the Draft Order or Draft Licence Conditions were required in this respect.

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<sup>15</sup> Separate reporting to GEMA is required in order for GEMA to fulfil its duties in respect of monitoring compliance with the licence requirements.

- (b) Six respondents noted some concern about the potential impact of the prepayment price cap on the rollout of smart meters. Customers with fully interoperable smart meters are out of the scope of the price cap. When a customer has an existing ‘dumb’<sup>16</sup> meter replaced with a fully functional smart meter they will move from being covered by the price cap to not being covered by the price cap. Respondents noted that this effect may incentivise customers to resist smart meter installation which could in turn frustrate the national rollout.

These arguments have already been considered in the Report<sup>17</sup> where the CMA set out its expectation that ‘the net result of the removal of the PPM Price Cap Remedy would be positive’ due to increased competition for prepayment customers. The CMA continues to hold this view and considers that suppliers are well positioned and appropriately incentivised to highlight to customers the potential benefits offered by installation of a fully functional smart meter.<sup>18</sup>

- (c) As noted in paragraph 21, two suppliers noted concern that there may not be sufficient time to update prices between GEMA’s publication of the price cap level and the start of each new charge restriction period. These suppliers noted the existing licence requirement to give customers 30 days’ notice of price increases.<sup>19</sup> They also queried whether it may be possible to reduce the length of this notice period or in some other way have flexibility over its application. The CMA considers that it is for GEMA to decide on whether to make such changes to the licence condition relating to price increase notifications.

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<sup>16</sup> Or a smart meter that is not fully interoperable.

<sup>17</sup> See paragraph 14.434 of the [Final Report](#).

<sup>18</sup> Such as the greater diversity of tariffs available, the greater ease of switching, the ability to monitor usage more accurately and the ability to top up more quickly and easily.

<sup>19</sup> See standard licence condition 23.4 of the gas and electricity supply licences.

## **Appendix 1: respondents to the consultation on the Draft Order, Draft Explanatory Note and Draft Licence Conditions**

1. The CMA received 18 responses to the Draft Order, Draft Explanatory Note and Draft Licence Conditions. These were:
  - (a) Centrica
  - (b) Citizens Advice
  - (c) Economy Energy
  - (d) Ecotricity
  - (e) EDF
  - (f) Energy UK
  - (g) EON
  - (h) First Utility
  - (i) Fuel Poverty Action
  - (j) Our Power
  - (k) OVO
  - (l) Robin Hood Energy
  - (m) RWE
  - (n) Scottish Power
  - (o) Secure Meters
  - (p) SSE
  - (q) Utilita
  - (r) Which?
  
2. Non-confidential version of these responses are published on the [Energy market investigation case page](#).