PPM cap review – draft response

Thank you for the opportunity to state our views on a review of the Energy Market Investigation (Prepayment Charges Restriction) Order 2016 (the Order).

We have only been able to provide limited evidence for what we believe should be included in the review of the Order, given the short timescale for responding to this request over the Christmas period; in addition, January is an extremely busy month for Ofgem and BEIS reporting and we have other significant ongoing consultations and requests for information. If you require further information from us in order to take account of our proposals, please let us know as soon as possible and we will endeavour to provide more detail. Of course, we would provide full and detailed information to the CMA as part of the review itself.

We agree with the CMA that a review of the Order is required. The energy market has moved on since the CMA carried out its initial analysis and the impacts of the introduction of the prepayment (PPM) price cap can (and should) be analysed. There are more domestic suppliers in the market, but there has been a considerable amount of supplier failure in recent months, as a result of the impact of increased wholesale costs set against poor and unsustainable business models that rely on suppliers offering unrealistically cheap prices without having any plans to handle periods of highly volatile market costs. Evidence has also emerged of some suppliers misusing customer funds as working capital or mis-applying funds received for one purpose to another purpose, for example, suppliers not paying for obligations such as Renewable Obligation (RO) and Feed in Tariff (FIT) in order to fund low retail prices. These failures have often resulted in Ofgem implementing its Supplier of Last Resort (SoLR) process.

The costs of administering the SoLR process within companies are not accounted for within any price cap mechanism and must currently come out of the already inadequate level of headroom. The issue is exacerbated when such suppliers use the SoLR process to exit the market, other suppliers must pick up those avoided costs through mutualisation processes.

We accept that there is a need to prioritise what should be contained in the review; suppliers are severely resource constrained given the impacts of both the Order and the default tariff cap that was introduced on 1 January 2019. Therefore, while there are many elements of the methodology for determining the charge restriction that we believe should be revised, we would like to seek the simplest solution that achieves the aim of ensuring the prepayment price cap more accurately reflects suppliers' costs.

To this end, we strongly recommend the following sensible solution that would remove the need to undertake a review at all. We recommend that the CMA revokes the Order and, at the same time, standard licence condition (SLC) 28AD.4 of the supply licence. This would allow for prepayment customers to become subject to the default tariff cap and Ofgem to become the sole administrator of the combined price cap. Some amendments to the calculations in SLC 28AD would also be required to take account of prepayment as a payment method; it would not be appropriate to require use either of the existing payment methods for these customers as the cost base is different. The changes should be timed to coincide with the start of a new Charge Restriction Period, with sufficient time allowed for suppliers to apply the change. There are a number of advantages to this approach:

- The default tariff cap would better reflect suppliers' costs. We worked closely with Ofgem to help them devise their bottom-up methodology for determining costs and, while the default tariff cap is still inadequate to some degree (we raised concerns about certain policy costs, EBIT and headroom), in our opinion it is calculated on a much more realistic cost basis. In particular, it would allow account to be taken of the costs of smart metering and other policy costs, which are not, or not adequately, taken into account in the PPM price cap.

- It would reduce administration costs for suppliers and the regulator;
- It would reduce confusion for consumers, particularly those that move between prepayment and default tariffs. There are significant issues due to SMETS1 and SMETS2 meters being subject to different price caps; customers are unlikely to know which SMETS version they have and therefore may receive inaccurate quotes from a new supplier;
- It would simplify the supply licence conditions, with just one set of calculations instead of two;
- It would allow for prepayment customers to retain price protection for at least as long as the default tariff cap exists, which, depending on the decision of the Secretary of State, could be beyond the end of 2020.

There is a precedent for merging two caps into one: as at 31 December 2018 Ofgem revoked its licence conditions relating to customers eligible for the vulnerable safeguard tariff and included these customers in the default tariff price cap (which was based on the CMA's methodology). This was generally welcomed as a positive move as it reduced the administrative burden for suppliers and made it simpler for consumers to understand.

The alternative approach is a limited scope review; we have provided details below of the elements we believe should be reviewed, together with some brief evidence of our reasoning.

Policy cost allowance element of the indirect cost allowance

Throughout and subsequent to the Energy Market Investigation, we (and many other suppliers) have consistently raised our concerns that the policy cost allowance as calculated by the CMA was wholly inadequate, particularly in relation to the smart meter rollout (smart), Renewables Obligation (RO), Contracts for Difference (CfD) and Feed in Tariff (FiT).

One specific element we would like reviewed is in relation RO, FiT and Energy Market Reform (EMR) cost allowances. Costs for these obligations vary with consumption; the CMA methodology bases domestic customer consumption on Ofgem's Typical Domestic Consumption Value (TDCV) for a single register meter. However, the TDCV for Economy 7 meters is almost 50% higher than for single rate meters. Suppliers therefore incur additional costs for multi-rate meters, using up a significant amount of their headroom allowance; our own calculations estimate this at around £50 per account for Economy 7.

We therefore strongly agree with the CMA proposal to include policy cost allowance and the DCC costs element of the indirect cost allowance as part of its review.

Smart costs

Whether or not the CMA considers that policy costs include smart costs, they should be included with the review of the Order. The CMA based its allowance for smart on the 2014 DECC Smart Meter Impact Assessment; this value was significantly underestimated. This was updated in 2016 and used for the default tariff cap; while still not truly reflective of smart costs, it was an improvement. BEIS is due to produce a further cost benefit analysis in mid-2019.

Delays in the DCC and delivery of technical solutions for difficult installations continues to add to the costs. Negative media reports have meant that many consumers are reluctant to take up a smart meter, and this is further increasing the cost to suppliers of engagement with consumers. We provided evidence to Ofgem to aid it in assessing smart costs for the default tariff cap, and we would be willing to share this with the CMA as part of the review.

DCC and Smart Energy GB costs

These costs are handled on a pass-through basis under the default tariff cap, and we believe this is the most appropriate treatment to consider for the PPM cap.

Smart progress

We agree with the National Audit Office assessment that BEIS' 2020 smart rollout ambitions are unachievable. Early completion of the smart meter rollout was one of the main reasons stated by the CMA for revoking the Order before the end of 2020; the CMA may consider, therefore, that the Order should serve its full term. However, we would ask the CMA to assess the deleterious impact the PPM price cap has had on competition in the PPM market as part of its review; currently PPM prices for large and medium suppliers, who are subject to additional costs such as the Warm Home Discount and Energy Company Obligation, are clustered around the level of the cap. We are now seeing some of the smaller suppliers' prices coming closer to that level since the introduction of the default tariff cap. The cheapest PPM tariff offered in May 2018 was £110 below the cap: as at 17 January 2019, the cheapest tariff is £88 below the cap, a differential of £22. The tables below demonstrate that.

League table for 1 May 2018

Rank	Product	Average Online PPM Dual Fuel Bill	% Discount/ Premium to Standard	Fixed / Capped?	Cancellation Fee per fuel	Market
1	[Nabuh Energy] Nabuh Energy Holly Tariff (12 month fixed)	£978	-	Fixed	-	Short Term
2	[Our Power] Our Fairer Energy	£982	-	-	-	VARIABLE
3	[Bristol Energy] Standard Prepayment (April 2018)	£988	-	-	-	VARIABLE
4	[E] Reward Oct 2017	£993	-	Fixed	-	Short Term
5	[E] Reward Smart Oct 2017	£994	-	Fixed	-	Short Term
6	[EBICO] Ebico Prepay (October 2017)	£1,003	-	-	-	VARIABLE
7	[Robin Hood Energy] Evergreen PAYG (October 2017)	£1,003	-	-	-	VARIABLE
8	[Spark] Swift payg	£1,009	-1%	-	-	VARIABLE
9	[Nabuh Energy] Nabuh Energy Emma Tariff	£1,010	-	Fixed	-	Short Term
10	[Spark] Move In Saver v5 PPM	£1,022	-	-	-	VARIABLE
11	[CO-OP] Co-op Green Prepayment	£1,025	-	-	-	VARIABLE
12	[Nabuh Energy] Nabuh Energy Laura Tariff (12 Months Fixed)	£1,025	-	Fixed	-	Short Term
13	[iSupplyEnergy] iPrepay Variable - October 2017	£1,028	-	-	-	VARIABLE
14	[Green Network Energy] GNE Prepayment v1 (Dec 2017)	£1,029	-	-	-	VARIABLE
15	[Utility Warehouse] Value PPM (October 17)	£1,029	-	-	-	VARIABLE
16	[Extra Energy] Variable Price v2 PPM	£1,030	-	-	-	VARIABLE
17	[EDF] Blue + Fixed Prepay May 2019	£1,031	-5%	Fixed	-	Short Term
18	[Economy Energy] Evergreen (PPM - October 17)	£1,031	-	-	-	VARIABLE
19	[Economy Energy] Smartpay 2017 v1 (October 17)	£1,031	0%	-	-	VARIABLE
20	[Utilita] Smart Energy - March 2018	£1,070	-	-	-	VARIABLE
21	[Ecotricity] Green PPM (April 2018)	£1,072	-	-	-	VARIABLE
22	[Engie] ENGIE PAYG (April 2018)	£1,078	-	-	-	VARIABLE
23	[Green Star] Rate Watch PAYG (April 2018)	£1,082	-	-	-	VARIABLE
24	[Boost (OVO)] PAYG Traditional Fixed (April 2018)	£1,084	-	Fixed	-	Short Term*
25	[Boost (OVO)] Smart PAYG+ Fixed (April 2018)	£1,084	-	Fixed	-	Short Term*
26	[SSE] Standard PAYG	£1,087	-	-	-	VARIABLE
27	[BG] Safeguard PAYG	£1,088	-	-	-	VARIABLE
28	[E.ON] Standard Prepayment (April 2018)	£1,088	-	-	-	VARIABLE
29	[EDF] Standard PPM (April 2018)	£1,088	-	-	-	VARIABLE
30	[nPower] Standard Prepayment (April 2018)	£1,088	-	-	-	VARIABLE
31	[Utilita] Premium Energy - March 2018	£1,088	-	-	-	VARIABLE
32	[First Utility] First Variable Prepayment 3	£1,088	-	-	-	VARIABLE
33	[SP] Standard Prepayment April 2018	£1,088	-	-	-	VARIABLE

League table for 17 January 2019

Rank	Product	Average Online PPM Dual Fuel Bill	% Discount/ Premium to Standard	Fixed / Capped?	Cancellation Fee per fuel	Market
1	[Our Power] Our Fairer Energy (September 2018)	£1,050	-	-	-	VARIABLE
2	[Our Power] Our Fairer Energy Fixed to Nov 2019	£1,050	-	Fixed	-	Short Term*
3	[Nabuh Energy] PAYG Tina Tariff (12 month fixed)	£1,052	-	Fixed	-	Short Term
4	[Nabuh Energy] Paige Tariff (Variable)	£1,058	-	-	-	VARIABLE
5	[EBICO] Ebico Prepay (August 2018)	£1,059	-	-	-	VARIABLE
6	[Robin Hood Energy] Evergreen PAYG (October 2018)	£1,059	-	-	-	VARIABLE
7	[Bulb] Vari - Fair (PPM)	£1,061	-	-	-	VARIABLE
8	[Bristol Energy] Standard Prepayment (October 2018)	£1,062	-	-	-	VARIABLE
9	[E] Easy April 18	£1,085	-	-	-	VARIABLE
10	[iSupplyEnergy] iPrepay Variable - August 2018	£1,085	-	-	-	VARIABLE
11	[E] Easy Smart April 18	£1,086	-	-	-	VARIABLE
12	[TOTO Energy] TOTO Prepay Saver (June 2018)	£1,088	-	-	-	VARIABLE
13	[E] 1 Year Reward (Winter 18)	£1,101	-	Fixed	-	Short Term
14	[E] 1 Year Reward Smart (Winter 18)	£1,102	-	Fixed	-	Short Term
15	[Nabuh Energy] Nabuh Energy Lisa Tariff (12 Month Fixed)	£1,107	-	Fixed	-	Short Term
16	[Nabuh Energy] Nabuh Energy Rachel Tariff (12 month Variable)	£1,108	-	-	-	VARIABLE
17	[Nabuh Energy] PAYG Katy Tariff (12 month fixed)	£1,112	-	Fixed	-	Short Term
18	[EDF] Blue + Fixed Prepay September 2020	£1,116	-2%	Fixed	-	Short Term
19	[Spark] Swift Payg (December 2018)	£1,116	-2%	-	-	VARIABLE
20	[Engie] ENGIE PAYG (October 2018)	£1,125	-	-	-	VARIABLE
21	[CO-OP] Co-op Green Prepayment (October 2018)	£1,129	-	-	-	VARIABLE
22	[Green Star] Rate Watch PAYG (Oct 2018)	£1,129	-	-	-	VARIABLE
23	[Boost (OVO)] PAYG Traditional (September 2018)	£1,131	-	-	-	VARIABLE
24	[Boost (OVO)] Smart PAYG+ (September 2018)	£1,131	-	-	-	VARIABLE
25	[Green Network Energy] GNE Prepayment v1 (Oct 2018)	£1,133	-	-	-	VARIABLE
26	[Utilita] Smart Energy (October 2018)	£1,134	-	-	-	VARIABLE
27	[Ecotricity] Green Electricity PAYG & Green Gas PAYG	£1,135	-	-	-	VARIABLE
28	[SSE] Standard PAYG (October 2018)	£1,135	-	-	-	VARIABLE
29	[BG] Safeguard PAYG (October 2018)	£1,135	-	-	-	VARIABLE
30	[Tonik Energy] PAYG Green	£1,135	-	-	-	VARIABLE
31	[Spark] Move In Saver v8 PPM (December 2018)	£1,136	-	-	-	VARIABLE
32	[E.ON] Standard Prepayment (Oct 2018)	£1,136	-	-	-	VARIABLE
33	[EDF] Standard PPM (October 2018)	£1,136	-	-	-	VARIABLE
34	[nPower] Standard Prepayment (October 2018)	£1,136	-	-	-	VARIABLE
35	[Utilita] Premium Energy (October 2018)	£1,136	-	-	-	VARIABLE
36	[First Utility] First Variable Prepayment 4	£1,136	-	-	-	VARIABLE
37	[SP] Standard Prepayment October 2018	£1,136	-	-	-	VARIABLE
38	[Utility Warehouse] Value PPM (October 18)	£1,136	-	-	-	VARIABLE
39	[Avid Energy] Smart PAYG (December 2018)	£1,136	-	-	-	VARIABLE
40	[Eversmart Energy] Safeguard PAYG	£1,136	-	-	-	VARIABLE
41	[Places for People Energy] Plan Ahead	£1,164	-	-	-	VARIABLE
42	[Avid Energy] Smart PAYG Starter (December 2018)	£1,176	-	-	-	VARIABLE
43	[Avid Energy] Smart PAYG Starter Plus (December 2018)	£1,236	-	-	-	VARIABLE

While it would take time for competition to recover in this part of the energy market, the longer the cap is in place, the more difficult and lengthy the recovery will be.

Exceptional costs

Within the PPM cap, exceptional costs were expected to be taken from the headroom allowance. However, there are a number of costs anticipated that are likely to exceed what we already see as an inadequate allowance for headroom. The following list is an indication of the additional costs we currently anticipate that headroom will need to cover over the next two years:

- RO mutualisation. Currently we expect these costs to be in the region of £7m for the 2017/2018 obligation and £[REDACTED] for the 2018/2019 obligation for E.ON. This could rise should we see more suppliers fail.

- FIT mutualisation. These costs have already been invoiced to suppliers for the 2017/2018 obligation period and are not included within the PPM price cap.
- Last Resort Supply Payments. In 2018 there were eight Supplier of Last Resort (SoLR) events where Ofgem nominated new suppliers to take on the customers of a supplier that had exited the market due to insolvency. An SoLR is likely to incur a number of additional costs, including honouring the credits of the failed supplier's customers. It can make a claim to cover some of these costs, a Last Resort Supply Payment, through gas and electricity network charges, smearing the costs across all suppliers. Ofgem is currently considering allowing network companies to apply for a derogation to allow them to increase network charges at short notice: this could lead to network charges being increased within a Charge Restriction Period and therefore not being included within the cap's calculations.
- Energy Company Obligation (ECO). There have been changes to ECO that will not have been accounted for within the CMA's methodology.

These issues also have an impact for the default tariff cap introduced on 1 January 2019, and we have been raising them with Ofgem. We are also currently drafting a response to Ofgem's recent proposals to remove the allowance for Capacity Market (CM) payments from the default tariff cap, due to the EU's recent ruling that State Aid approval should be removed from the GB CM scheme for technical reasons. We are strongly opposed to this proposal, as it is likely that the scheme will be reinstated in future and back-payments will need to be made: suppliers will need to accrue for the back-payments and therefore the CM allowance should continue in its present form.

In its review, the CMA needs to either allow for additional headroom to cater for these costs, or to allow for a re-opener where additional costs in any Charge Restriction Period exceed the headroom allowance.