Energy UK

The voice of the energy industry

Proposed Review of the Energy Market Investigation (Prepayment Charges Restriction) Order 2016

18 January 2018

Introduction

Energy UK is the trade association for the GB energy industry with a membership of over 100 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership covers over 90% of both UK power generation and the energy supply market for UK homes. We represent the diverse nature of the UK's energy industry – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 27 million homes and every business in Britain. Over 680,000 people in every corner of the country rely on the sector for their jobs, with many of our members providing long-term employment as well as quality apprenticeships and training for those starting their careers. The energy industry invests over £12.5bn annually, delivers around £84bn in economic activity through its supply chain and interaction with other sectors, and pays £6bn in tax to HMT.

This is a high-level industry view; Energy UK's members may hold different views on particular aspects of the consultation. We would be happy to discuss any of the points made in further detail with the Competition & Markets Authority (CMA) or any other interested party if this is considered to be beneficial.

Prioritisation

Energy UK welcomes this opportunity to provide comments on the CMA's proposed mid-term review of the Energy Market Investigation (Prepayment Charges Restriction) Order 2016. Energy UK agrees that this review should represent a priority for the CMA.

Scope

With the imposition of the default tariff cap, competition is taking place within a fundamentally different retail energy market. There has been a shift in regulatory rationale since the PPM cap was established, with more consumers receiving price protection rather than protections being determined by meter type. Energy UK believes that it is, therefore, imperative that the mid-term review includes an examination of how the PPM cap interacts with Ofgem's default tariff cap that took effect on 1 January.

Energy UK is concerned that there is a high potential for consumer detriment resulting from the way in which the two price caps will interact and coexist with each other possibly until the end of 2020. Specifically, we are concerned that the different methodologies to determine the caps' levels could delay the completion of the smart meter rollout by causing customer confusion that welcomes the willingness of customers with prepayment meters to adopt a smart meter. For example, consumers could face added difficulty when seeking an accurate tariff quote as they will need to know whether their meter is SMETS1 or SMETS2 to take into account the different ways in which the caps treat the standing charge and unit rate. In addition, at current and future levels of the caps there may be a price increase if a SMETS2 meter is accepted. Consequently, customers could be deterred from adopting a smart meter, risking their overall engagement with their energy use and slowing down the smart meter rollout to the cohort of consumers who may benefit most. This is a particular concern given the CMA's acknowledgement in its Energy Market Investigation (EMI) final report that the cost to serve traditional PPM customers is higher than to serve smart meter customers. A PPM cap set at a level lower than the direct debit level of the default tariff cap would, therefore, not seem to be reflective of the underlying costs to serve. The presence and consequences of these detriments to consumers and the smart meter rollout are likely to exacerbated by the future divergence of the caps' levels as they are updated on separate underlying methodologies.

In order to address these concerns, the CMA should consider including within its mid-term review an examination of potential solutions to avoid consumer detriment and impact upon the smart meter rollout that could arise from the divergent caps. Energy UK believes that the CMA's review should be broad enough in scope to assess potential solutions for these concerns, including, but not limited to:

1. Utilise, or allow Ofgem to utilise, the more recent benchmarking exercise undertaken by Ofgem in its development of the default tariff cap in order to re-baseline the PPM cap.

In order to make the most efficient use of the CMA's resources, it could consider making use of Ofgem's bottom-up assessment methodology used in its development of the default tariff cap. There would be a number of advantages of this option, not least in aligning the methodologies of both caps to provide consistency across the market to both suppliers and customers. In addition, Ofgem made an assessment of different methodologies that could be used for the default tariff cap and decided that its bottom-up cost assessment is most appropriate. In light of this development, the CMA could additionally consider whether the more recent exercise undertaken by Ofgem would be more appropriate as the basis for the PPM cap than the current competitive reference price method (based on historic tariffs), and whether this is something Ofgem should apply directly.

This option would also address a number of approaches in the CMA's original methodology that Energy UK believes need to be updated, such as the treatment of smart metering costs, updates to the base period data where data becomes available, and the treatment of ECO costs. Energy UK believes that these deficiencies could be remedied by utilisng Ofgem's more recent bottom-up assessment of costs. As an example, the wholesale cost allowance under the default tariff cap includes an explicit and transparent uplift for Unidentified Gas whereas the PPM cap methodology does not make such specific allowances.

Energy UK believes that it would be appropriate for any utilisation of Ofgem's methodology to include an assessment of how to ensure that the cap appropriately takes into account the additional costs to serve traditional and non-interoperable prepayment meters, as previously acknowledged by the CMA.

In addition, Energy UK would urge both the CMA and Ofgem to assess the impact of the mutualisation of costs (such as Renewables Obligation and Feed-in-Tariff) as a result of supplier failures, and their appropriate treatment under both caps, whichever cap methodology is ultimately used.

2. Revoke the Order and allow Ofgem to determine how customers with traditional or non-interoperable smart prepayment meters will be covered by the Domestic Gas and Electricity (Tariff Cap) Act 2018 or pre-existing powers.

As previously noted, the development and implementation of the default tariff cap has changed the market for which the PPM cap was developed and in which it now operates. In its final report from the EMI, the CMA laid out the possible outcomes of this mid-term review that were dependent upon the smart meter rollout. If ahead of schedule, the CMA would consider terminating the Order early and if the rollout was behind schedule then the CMA would consider whether to encourage Ofgem to take action, which could include implementing its own PPM cap.

Energy UK believes that the regulatory assumptions upon which these two possible options are based are no longer reflective of the current market, due to the implementation of the default tariff cap marketwide. As a result, the CMA could consider as part of this mid-term review terminating the Order early in order to allow customers under the PPM cap to be protected by a cost-reflective default tariff cap instead. This would address the concerns we have highlighted regarding the customer detriment from different methodologies and diverging caps. This would enable Ofgem to make an assessment of how the additional costs to serve PPM customers can be appropriately taken into account by the default tariff cap to ensure that suppliers remain able to recover efficiently incurred costs of serving their PPM customers.

If the Order is terminated early, and no standalone replacement PPM cap is implemented by Ofgem to provide an exemption under section 3(2)(a) of the Act, then those currently covered by the cap would be protected by the default tariff cap as the exemption in section 3(1)(a) would cease to apply. This would also be the case if at the end of 2020 the default cap is extended, as per the process outlined within the Act, and the CMA does not implement a further PPM Cap.

Even if the Secretary of State were to lift the tariff cap at the end of 2020, Ofgem would retain powers to implement targeted price caps at certain customer groups under Section 9 of the Act. Ofgem would, therefore, have the power to retain protections for PPM customers passed the 2020 deadline if deemed necessary, which aligns with the option that the CMA outlined in its EMI final report.

Timing

As part of the mid-term review, the CMA should also consider that Ofgem will be undertaking a review of smart meter costs under the cap ahead of the October update and the impact that this may have on divergence. Therefore, Energy UK believes that in order to minimise the impacts of the detriment identified above the review needs to take place in a time-scale that allows for action to be taken in time to affect the scheduled updated cap levels in October 2019. This would require a degree of coordination with Ofgem so that Ofgem could consult on a new cap for customers with prepayment meters. However, we believe that this timeline is achievable due to the work already undertaken by Ofgem to date on assessment of costs and the work currently programmed, such as its review of the Smart Meter Net Cost Change element of the price cap.

If you would like to discuss the above or any other related matters, please contact me directly on or at .