15 March 2019

Energy Prepayment Review
Competition and Markets Authority
Victoria House (6th Floor South East)
37 Southampton Row
London WC1B 4AD

Email:

By email

Dear Sirs,

Review of the Energy Market Investigation (Prepayment Charges Restriction) Order 2016: Statement of issues

Thank you for the opportunity to comment on the Statement of Issues identified for the Review of Energy Market Investigation (Prepayment Charges Restriction) Order 2016 (the 'PPM Cap').

As set out in our previous correspondence with the CMA, Utilita has been pressing for a review of the PPM Cap since its introduction. Utilita has never supported the principle of price caps in the market, but if such caps are to be employed they must be properly calculated and applied and not lead to significant market distortions.

Utilita has identified specific issues with the PPM Cap, has supplied detailed evidence to the CMA and has repeatedly requested that the problems with the PPM Cap be addressed. We have been given assurances by the CMA that all this material has been supplied to the Review Panel, and hence we do not review in detail here. Please consider all points from the previous submissions as part of our response to the Issues Statement. If it would assist, we will be very happy to supply copy documents or supporting evidence from these submissions; and we would welcome the opportunity to present this information to the Panel. A list of our submissions since the PPM Cap was implemented is included for reference at Appendix 1.

In addition to our work on the PPM Cap, we have engaged at all levels throughout the process with the implementation of the Default Tariff Cap (DTC) by Ofgem. We recognise that the detailed analysis and bottom up approach employed to derive the DTC has resulted in a more robust outcome than the PPM Cap. We have assessed the DTC methodology in detail and believe that the resulting DTC implemented fully supports the points we have made.

If the headroom[1] for prepayment meters derived by the CMA is added to the Direct Debit element of the DTC, the result is almost identical to the level we have argued should have been the case for the PPM Cap.

Instead, due to the refusal of the CMA to conduct an earlier review, we now have a position where the PPM Cap is below the Direct Debit Cap. This is completely counter-intuitive and indeed contradicts the CMA's original findings. The position cannot be allowed to continue.

In Ofgem's letter of 18 January 2019[2], they make a number of important points, including that the PPM Cap should be cost reflective and suppliers should remain incentivised to supply these customers. Ofgem goes on to note that a review is especially important as the introduction of the DTC reduces scope for suppliers to recover any potential shortfall in PPM revenues from other customers with other payment methods. This is a clear acknowledgment of the difficulties associated with the PPM Cap. Ofgem also supports the approach of a consistent methodology for calculating the two caps.

A simple solution now presents itself, assuming that the PPM Cap will continue - to incorporate prepay customers within the DTC with a suitable PPM uplift above the Direct Debit level, or to align them to it. This would address the issues identified and allow for quick action to resolve.

We welcome the fact that the CMA has decided to conduct a review of the PPM Cap, and has published a Statement of issues (SOI) for comment. There are a number of points we wish to make in respect of the SOI, and the review process.

1) Timing

The review has been too long in coming and appears unnecessarily attenuated. The approach now under consideration requires minimal discussion which should be centred on two points:

a) Incorporation in or alignment to the DTC; and
b) The most timely way to make the change

Supplier failures continue, PPM choice and switching continue to be reduced. The CMA has an opportunity for quick action to improve the position. Prompt action by the CMA could allow for an interim PPM Cap from July. A precedent has been set for such a course of action with the initial DTC period. CMA should consider this option.

2) Change of circumstances

We agree that there have been several changes of circumstance. CMA has selected only the issues associated with the Smart Meter Rollout and the DTC. These do qualify, but as we have previously identified these are not the only changes of circumstance, which should be considered restated here as well.

[1] Adjusted to ensure there is no double counting of the adjustment made by Ofgem to the balance between Direct Debit and Standard Credit.
[2] Response to CMA's proposed review of Energy Market Investigation Order 2016

a) GEMA’s Charge Restriction on Default Tariffs

On the the DTC, in terms of the areas set out under the SOI on the DTC, we agree that the bullets in para 22 on page 6 correctly identify the key points for consideration.

Moving to the difference in methodology specifically, the CMA must consider carefully the reasons behind the differences implemented by GEMA compared to the methodology used by the CMA, and what that means for the effectiveness and appropriateness of the PPM Cap. Ofgem’s January 2019 letter[2] helpfully sets out in Annex 1 key differences in methodology and purpose.

When considering whether the PPM Cap remains appropriate, the CMA should assess this by reference to its original aims for the PPM Cap, and its statutory duties under Section 168 of the Enterprise Act 2002 (which include Ofgem’s financeability duty).

However, the SOI lacks clarity. The drafting does not reflect the clear acknowledgement contained in original CMA Energy Market Investigation that <u>there are higher costs associated with supplying prepayment customers</u>.

While this may be implicit, and is not, of itself, a change of circumstance, it is crucial that this significant problem is openly acknowledged as a fundamental plank of this whole review.

There is no explicit recognition that the costs of serving prepayment customers are in excess of the allowance in the PPM Cap. The material point is that the existence of the DTC exposes the inadequacies of the PPM Cap and, due to the flawed PPM Cap, forces losses on all efficient suppliers, not just prepayment specialists, as there is now no opportunity to subsidise losses made on prepayment customers through over-charging non-prepayment customers.

The CMA may believe it is addressing these concerns in the scope of the review, but it is not doing so explicitly.

If the CMA takes a restricted approach to change of circumstances, the review risks being fundamentally incomplete. We support incorporation or alignment of the PPM Cap to the DTC, which is clearly under consideration by the CMA. However, if for some reason the CMA were to decide this was not the preferred approach, all the existing problems with the PPM Cap would remain unremedied. This would be disastrous, especially given we are now in a position which contradicts the CMA’s own view of the relative costs of PPM and Direct Debit customers to supply.

A further ‘drill down’ is therefore needed, which allows for consideration of issues with the PPM Cap if DTC alignment is rejected.

b) Roll-out of smart meters

We agree that there are many issues with the Smart Meter Roll Out, including the delays experienced and additional costs.

We consider that the National Audit Office report identified a number of issues and problems with the programme, and by inference acknowledged the cost impact on suppliers and customers of the delays. However, the risks of delays and issues to the programme were identified even then, with the 2020 deadline being viewed as unrealistic by many participants.

The implementation of the PPM Cap has had a significant impact on the programme, and this should not be underestimated. It is important that the impact of the PPM Cap on costs and churn is properly accounted for, and that supplier costs are fully met.

The SOI does not explicitly mention the costs of the smart meter roll out for suppliers that are not accounted for in the PPM Cap under either change of circumstances, but it must be considered under both.

We are of the view that incorporation in or alignment to the DTC would largely address the unaccounted for cost impacts on suppliers of the Smart Meter Roll Out. In terms of churn and switching, plus the impact on competition and innovation, the more robust approach of the DTC plus PPM Uplift would allow the market to begin the road to recovery in these areas, by improving suppliers' ability to compete.

However, as noted above, if this approach is not selected, then this problem with the PPM Cap must be remedied.

Finally, while the Smart Meter Roll Out programme has experienced significant delays, given the detrimental impact the PPM Cap has had on the market and competition, we can see no reason why the duration of the PPM Cap should be extended. If the decision to incorporate within the DTC is made, then that would lead to an extension. While we do not support an extension, this would be a simple consequence, and would be on the basis of the more robust methodology.

To conclude, we continue to believe that a review of the PPM Cap is fully justified and should be completed as soon as possible. The CMA should take the most expeditious approach to implementing necessary changes from the earliest date available, and as a consequence we appreciate this may drive an approach of alignment to the DTC rather than incorporation initially.

We hope this submission has been helpful, and would welcome the opportunity to meet with you and discuss our views in detail.

Yours faithfully,

By email only

Alison Russell
Director of Policy and Regulatory Affairs