

## **ENERGY MARKET INVESTIGATION**

### **EXPLANATORY NOTE – CONSULTATION**

#### **The Energy Market Investigation (Prepayment Charge Restriction) Order 2016**

**As varied by**

#### **The Energy Market Investigation (Prepayment Charge Restriction Order 2016) Variation Order 2019**

*This note is not a part of the Order*

#### **Introduction**

1. The Competition and Markets Authority (CMA) published its findings in a report under section 136 of the Enterprise Act 2002 (EA02) entitled Energy market investigation: Final Report on 24 June 2016 (the Report).
2. The Report set out the CMA's findings that there are features of the markets for the domestic retail supply of gas and electricity in Great Britain which, alone or in combination, give rise to adverse effects on competition (AECs).
3. The CMA decided on a package of remedies to be implemented by it in order to remedy, mitigate or prevent the AECs (and associated detriment) that it found.
4. The Energy Market Investigation (Prepayment Charge Restriction) Order 2016 (the Order) gave effect to one of these remedies, namely the requirement on suppliers to ensure that the annual bills paid by prepayment customers do not exceed a specified cap for a period until the end of 2020 (see paragraph 20.24(k) of the Report).
5. Section 15 of the Electricity Act 1989 (EA89) and section 27 of the Gas Act 1986 (GA86) provide that where the CMA makes an order under section 161 of EA02, such

order may also provide for the modification<sup>1</sup> of the conditions of a particular licence, or the standard conditions of licences of any type (including supply licences for gas and electricity) to such extent as may appear to the CMA to be requisite or expedient for the purpose of giving effect to, or taking account of, any provision made by the order.

6. The Order introduced a new electricity supply licence condition 28A, and a new gas supply licence condition 28A (the Electricity Licence Condition and the Gas Licence Condition, together the Licence Conditions).
7. In 2019, the Order was varied by the CMA following a remedy review process in which stakeholders were consulted at pre-launch, launch and provisional decision stages. The Energy Market Investigation (Prepayment Charge Restriction Order 2016) Variation Order 2019 (the Variation Order) was published on [date] 2019 and its purpose is to vary the Order.
8. The Variation Order amended the electricity supply licence condition 28A and the gas supply licence condition 28A. These amendments are set out in detail in Article 4 and 5 of the Variation Order.
9. This Explanatory Note (which replaces the explanatory note that was published alongside the Order on 7 December 2016) applies to the Order and the Licence Conditions as amended by the Variation Order.
10. Nothing in this Explanatory Note is legally binding.
11. Terms defined in the Order, the Variation Order, the Electricity Supply Licence or the Gas Supply Licence (including in the Licence Conditions) have the same meaning in the Explanatory Note. In the event of a conflict between this Explanatory Note and any provision of the Order or the Licence Conditions, the Order and Licence Conditions shall prevail.

## **Possible consequences for non-compliance**

12. Section 167 of the EA02 places a duty on any person to whom the Order applies to comply with it. Any person who suffers loss or damage due to a breach of this duty may bring an action.
13. The CMA has power under the Order to give directions, including directions to a person in their capacity as an office holder, for the purpose of carrying out, or ensuring compliance with, the Order.
14. Section 167 of the EA02 also provides that the CMA can seek to enforce the Order by civil proceedings for an injunction or for any other appropriate relief or remedy.
15. The obligations set out in Article 3 of the Order are reflected in the Electricity Supply Licence and Gas Supply Licence. To the extent that the obligations set out in the Order have been introduced into the Electricity Supply Licence and Gas Supply Licence, GEMA has a duty to monitor compliance and, where appropriate, to use its powers under sections 25 to 28 EA89 and 28 to 30F GA86, including where

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<sup>1</sup> The term 'modification' includes additions, alterations and omissions.

appropriate by imposing on the licensee a penalty of such amount as is reasonable in all the circumstances of the case. The CMA collaborates with GEMA so as to ensure compliance with the obligations set out in the Order and the Licence Conditions, where appropriate, through enforcement measures.

## Structure of the Order

16. The Order is divided into 3 Parts and has 3 Schedules:
  - Part 1 contains general provisions which include specifying when the Order comes into force, the scope of the Order, and the definitions that are used throughout the Order (and which are also used in this Explanatory Note).
  - Part 2 contains an obligation on suppliers to comply with the Prepayment Charge Restriction.
  - Part 3 contains provisions for monitoring compliance, including provisions allowing the CMA to give directions as to compliance with the Order and to require the supply of information for the purposes of monitoring compliance with the Order and reviewing its operation. Article 3.4 was amended by the Variation Order in order to enable the CMA to release Retail Energy Suppliers from their obligation to comply with Articles 3.1 and 3.2 within the Charge Restriction Period beginning on 1 October 2020 and ending on 31 December 2020 if a new charge restriction applies to Relevant Customers during that period.
  - Schedule 1 contains Condition 28A of the Electricity Supply Licence. Schedule 2 contains Condition 28A of the Gas Supply Licence. Schedule 3 contains a Template Prepayment Charge Restriction Compliance Statement. These conditions have been amended by the Variation Order

## The Order, Part 1 – General and Interpretation

17. Article 1 provides that the Order applies to suppliers, defined as any person authorised to supply gas by virtue of a Gas Supply Licence and any person authorised to supply electricity by virtue of an Electricity Supply Licence (referred to as Retail Energy Suppliers in the Order and licensees in the Licence Conditions). It provides that the Order came into force on 8 December 2016, except Article 3, which came into force on 1 April 2017.
18. Article 1.4 provides that the Order shall continue to be into force until 30 June 2021, or until such time (before this date) as it is varied or revoked under the EA02.
19. Article 2 includes definitions of various terms used in the Order and in a limited number of instances cross-refers to terms defined in the Licence Conditions or defined elsewhere in the Electricity Supply Licence or Gas Supply Licence. To the extent possible, the terms used in the Order have been defined to have the same meaning as in the Electricity Supply Licence and the Gas Supply Licence (as applicable). For the avoidance of doubt, when a word or expression has been

expressly defined in the Order, the definition set out in the Order shall prevail over other definitions.

## The Order, Part 2 – Prepayment Charge Restriction

20. Article 3 (and paragraph 28A.1 of both Licence Conditions, as varied by the Variation Order), contain an obligation on Retail Electricity Suppliers and Retail Gas Suppliers to comply with the Prepayment Charge Restriction until 31 December 2020. However, if Ofgem were to adopt a new charge restriction to protect all or some specific categories of Relevant Customers within the Charge Restriction Period beginning on 1 October 2020 and ending on 31 December 2020, the CMA may release Retail Energy Suppliers from their obligation to comply with Articles 3.1 and 3.2 in relation to those Relevant Customers (as identified in the direction).
21. The Prepayment Charge Restriction is implemented through the calculation of a Relevant Maximum Charge so that the total supply charges for any level of consumption over the Charge Restriction Period, i.e. as a pounds sterling amount, will be lower than the Relevant Maximum Charge at that level of consumption.
22. As a result, suppliers must ensure that the aggregate amount of all Charges for Electricity Supply Activities and Charges for Gas Supply Activities to each Relevant Customer do not exceed the Relevant Maximum Charges (i.e. the level of the Prepayment Charge Restriction which is applicable in a given Charge Restriction Period with respect to Relevant Customers, depending on their location). and (for electricity) whether their tariff uses a Multi-Register Metering Arrangement (e.g. for restricted meters or a time of use arrangement) or uses a Single-Rate Metering Arrangement (i.e. single and multi-tier tariffs which do not vary by time of use). The Relevant Maximum Charges will vary regionally to reflect differences in network costs in each Charge Restriction Region, and will vary per fuel. With respect to the Supply of Electricity, there are two separate Relevant Maximum Charges in each Charge Restriction Region to reflect differences in costs between the two Benchmark Metering Arrangements:
  - Single-Rate Metering Arrangements (calculated on the basis of Prepayment Tariffs where a customer is charged on the basis of a single unit rate); and
  - Economy 7 Metering Arrangements (calculated on the basis of Prepayment Tariffs where a customer uses a meter for the purpose of an Economy 7 tariff).<sup>2</sup>
23. We discuss below the scope of the Order (see paragraphs 24 to 32), how the Relevant Maximum Charge is calculated (see paragraphs 33 to 38 and Annex 1) and how compliance with the Prepayment Charge Restriction must be assessed (see paragraphs 40 to 43).

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<sup>2</sup> I.e. where, in each period of 24 hours, the peak electricity consumption for a customer is recorded during 17 'day/normal' hours and the off-peak electricity consumption level is recorded during seven 'night/low' hours.

## **Scope of the Prepayment Charge Restriction**

24. In each applicable Charge Restriction Period, the Prepayment Charge Restriction will apply to (a) all single fuel gas and electricity tariffs made available to new domestic prepayment customers (i.e. through pre- contractual offer or invitation to treat, and whether made available directly or indirectly by a supplier<sup>3</sup>), and (b) to all the single fuel gas and electricity tariffs that are in place through existing contracts with Relevant Customers. Suppliers will also have to ensure that each single fuel component made available or applied within a dual fuel component during the period of application of the Prepayment Charge Restriction complies with the Relevant Maximum Charge for each fuel.
25. There are two exceptions to suppliers needing to comply with the Prepayment Charge Restriction:
  - Fixed Term Supply Contracts entered into prior to the publication on 24 June 2016 of the Final Report (until expiry of the original term of the contract, regardless of any subsequent renewal or extension of the original term) (see paragraphs 27 below); and
  - Customers with Excluded Smart Meters, e.g. those meeting the SMETS 2 technical specification or otherwise being fully interoperable (see paragraphs 29 to 32 below).
26. All other tariffs made available to, or in place with, prepayment customers are within the scope of the Prepayment Charge Restriction and must be set in order to comply with it. In principle, Prepayment Tariffs must comply with the Prepayment Charge Restriction at all levels of consumption. As discussed below, we recognise that tariffs with low standing charges may theoretically breach the cap at certain (high) levels of consumption, but in practice will not breach the Prepayment Charge Restriction (because all Relevant Customers on such tariffs in practice have low levels of consumption). With respect to such tariffs, suppliers will need to seek a direction from GEMA to allow compliance of such Prepayment Tariffs to be assessed on an ex post basis (see paragraphs 67 to 71).
27. As regards Fixed Term Supply Contracts entered into by a customer before 24 June 2016, the agreed price will not be constrained by the Order until the expiry of the original term of the contract. Once the original term of a Fixed Term Supply Contract between a supplier and a customer expires, the Prepayment Charge Restriction will apply as from the commencement of any contract extension period, roll-over period or renewal contract (as applicable).
28. The Prepayment Charge Restriction will not apply in respect of any Relevant Customer with an Excluded Smart Meter.
29. For the avoidance of doubt, the Prepayment Charge Restriction shall apply solely to the supply of energy to the premises of Relevant Customers where no Excluded Smart Meter has been installed. Any Relevant Customer who is not supplied, for any reason, through an Excluded Smart Meter will remain protected by the Prepayment

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<sup>3</sup> E.g. through a third-party intermediary or white label partnerships.

Charge Restriction until an Excluded Smart Meter has been effectively installed at their premises.

30. Excluded Smart Meters are defined to include SMETS 2 smart meters (i.e. versions of the SME Technical Specification other than the first version). As explained in the Report, SMETS 2 are designed such that applicable smart meters can communicate with any supplier via the data and communications company (the DCC). As a result, the implementation of SMETS 2 smart meters will eliminate the technical constraints on suppliers' ability to offer prepayment customers a wider range of tariffs, including tariffs that are equivalent to those on offer to customers on direct debit. It will also make it possible to switch customers with a SMETS 2 smart meter remotely (at little or no cost) to a credit tariff. There will be a gradual process of customers falling outside the scope of the Prepayment Charge Restriction as the smart meter roll-out progresses.
31. In addition to SMETS 2 smart meters, the definition of Excluded Smart Meters also includes any other type of smart meters identified by the CMA (by way of a direction) as being fully interoperable, in terms of providing functional interoperability and commercial interoperability. This definition relies on the two forms of interoperability that the UK Government is aspiring to achieve.<sup>4</sup> SMETS1 meters that are not enrolled in the DCC network do not meet this definition. Accordingly, as the starting position, the Prepayment Charge Restriction will apply to all prepayment customers on SMETS 1 smart meters. At any point when the CMA considers that a particular category of SMETS 1 smart meter satisfies this definition, such as those enrolled into the DCC network, it will issue a direction identifying any such category of meter, and Relevant Customers on these meters will be excluded from the Prepayment Charge Restriction.<sup>5</sup> Suppliers are at liberty to submit evidence to the CMA in support of a claim that a particular category of smart metering system satisfies the definition of Excluded Smart Meter. The CMA will consider any such evidence received, consult if and when appropriate and issue one of the following:
- A direction that the smart metering system in question is an Excluded Smart Meter, accompanied by guidance on how customers should be notified;
  - A statement that the smart metering system in question is not an Excluded Smart Meter or the CMA has been provided with insufficient evidence to be able to determine that the smart metering system in question is an Excluded Smart Meter; or
  - A request for further evidence in order to be able to reach a conclusion.
32. For the avoidance of doubt, where a supplier installs a smart meter at a prepayment customer's premises that belongs to a category of smart meters that falls within the

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<sup>4</sup> See page 17 of DECC's Consultation on the second version of the Smart Metering Equipment Technical Specifications, dated 13 August 2012: [Smart Metering Implementation Programme](#).

<sup>5</sup> The CMA expects that once a SMETS 1 smart meter has been enrolled with the DCC it will meet the definition of Excluded Smart Meter. At the time of this explanatory note, however, the process and conditions for enrolment of SMETS 1 smart meters have not been finalised by the DCC. Therefore, we have not drafted the definition of Excluded Smart Meter to specifically include SMETS 1 meters enrolled with the DCC since this would either be unnecessary (if the enrolment with the DCC necessarily implies that the interoperability criteria are met) or inappropriate (if enrolment with the DCC does not guarantee that the interoperability criteria are met).

meaning of Excluded Smart Meter (i.e. a SMETS 2 smart meter or a category of smart meters which has already been identified by the CMA, through a direction, as an Excluded Smart Meter), there is no need for the supplier to obtain a new direction under the terms of Article 6.2. However, suppliers may instead choose to liaise with the CMA to clarify whether one or more smart meters it is planning to install belong to a category of smart meters that falls within the meaning of Excluded Smart Meters.

### ***Calculation of the level of the Prepayment Charge Restriction***

33. The Licence Conditions (paragraphs 28A.6 of the Electricity Licence Condition 28A and paragraph 28A.4 of the Gas Licence Condition), as amended by the Variation Order, include the formula under which the relevant levels of the Prepayment Charge Restriction (defined as the Relevant Maximum Charges) will be calculated. As noted above, the same core approach is followed for each fuel (save that two separate caps are generated as regards electricity supply in each Charge Restriction Region; one based Single-Rate Metering Arrangements and one based on Economy 7 Metering Arrangements). The approach that will be taken to the calculation of each aspect of the Prepayment Charge Restriction is summarised in Annex 1 to this Explanatory Note.
34. The Prepayment Charge Restriction period is split into six monthly Charge Restriction Periods, other than a three-month final period (i.e. eight Charge Restriction Periods in total). Prior to each Charge Restriction Period, GEMA will, where possible, publish details of the Prepayment Charge Restriction within that period. The values of the Prepayment Charge Restriction are based on a pre-defined set of formulae and assumptions, and in principle suppliers can perform their own calculations in advance of GEMA's publication. In the case of any disagreement, all suppliers will be required to comply with the Prepayment Charge Restriction based on the Benchmark Maximum Charges published by GEMA. If GEMA is unable to publish the updated level of the Prepayment Charge Restriction by the dates specified in the licence, we would expect GEMA to publish the values without delay and at the same time indicate any consequential impacts on the timing of implementation of the new level of the Prepayment Charge Restriction and associated reporting requirements.
35. The formula, as amended by the Variation Order, requires GEMA to calculate, as components of the Prepayment Charge Restriction:
  - **wholesale energy costs:** how much a supplier has to pay to procure the gas and electricity to supply households with energy (we base this on forward prices for energy to be delivered over a 12-month period);
  - **network costs:** the regional costs of building, maintaining and operating the pipes and wires that carry energy across the country to your home. This causes the level of the cap to vary by region.
  - **policy costs:** the costs related to government social and environmental schemes to save energy, reduce emissions and encourage take-up of renewable energy
  - **operating costs:** the costs incurred for suppliers to deliver billing and metering services, including smart metering, after the exclusion of Smart Metering Non-Pass-Through Net Cost.

- **pre-payment uplift allowance:** the additional costs incurred through serving pre-payment customers
  - **headroom allowance:** this allows suppliers to manage uncertainty in their costs
  - **EBIT (Earnings Before Interest & Taxes):** a fair rate of return on suppliers' investments
  - **VAT:** 5% tax added to the level of the tariff
36. Using the process set out in the Licence Conditions (and further described in Annex 1 to this Explanatory Note), GEMA will calculate and publish the following 84 Benchmark Maximum Charges prior to each Charge Restriction Period:
- for each of nil consumption (standing charge) and medium TDCV;
  - for each of the 14 Charge Restriction Regions (equivalent to electricity distribution regions);
  - for each of Gas, Electricity (Single-Rate Metering Arrangements) and Electricity (Economy 7 Metering Arrangements).
37. GEMA will publish on its website the 84 Benchmark Maximum Charges no later than the fifth Working Day of February in relation to a Charge Restriction Period starting on 1 April and no later than the fifth Working Day of August in relation to a Charge Restriction Period starting on 1 October. These updated Benchmark Maximum Charges will be published in the format specified in annex 4 to the Licence Conditions.
38. The two consumption levels, i.e. nil and medium TDCV, are used as the basis for calculating the Relevant Maximum Charge for each Relevant Customer for any consumption level. The Relevant Maximum Charge at other consumption levels will be determined assuming a single unit tariff for all levels of consumption (with an assumed consumption split for Economy 7 Metering Arrangements to give an effective single unit tariff). The Relevant Maximum Charge thereby sets a cap on the total bill for each level of consumption. For the avoidance of doubt, it does not set a cap on the unit rate or require suppliers to offer a single unit tariff for all levels of consumption. Suppliers' tariffs must be assessed against the Relevant Maximum Charge, and the Licence Conditions provide for how more complex tariffs, such as those providing for more than a single unit rate for different consumption windows, must be assessed for compliance with the Prepayment Charge Restriction.
39. Using this approach, Relevant Maximum Charges are calculated by using linear interpolation between the Prepayment Charge Restriction at each Benchmark Annual Consumption Level extrapolated across all consumptions in accordance with a formula set out in paragraph 28A.6 of the Electricity Licence Condition and paragraph 28A.4 of the Gas Licence Condition.

### ***Assessment of compliance with the Prepayment Charge Restriction***

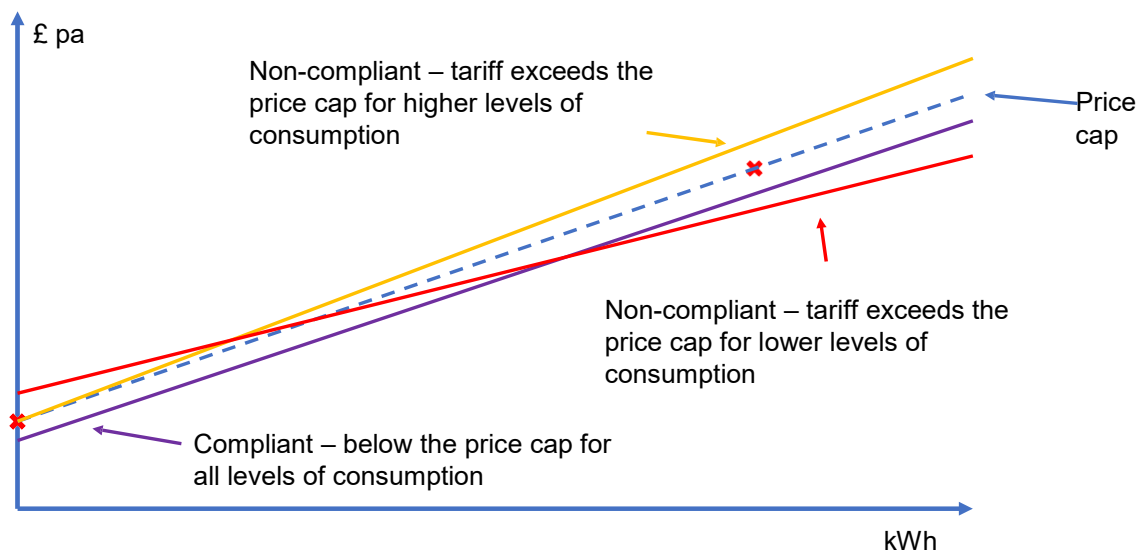
40. Compliance of any individual Prepayment Tariff with the Prepayment Charge Restriction will normally be assessed on an *ex ante* basis by suppliers. A Prepayment Tariff is compliant with the Prepayment Charge Restriction if at any point during a



Charge Restriction Period, at all consumption levels (subject to the possibility of assessing compliance on an alternative basis pursuant to paragraphs 28A.19 and 28A.20 of the Electricity Licence Condition and paragraphs 28A.17 and 28A.18 of the Gas Licence Condition), such tariff is below the level of the prevailing Relevant Maximum Charge for the relevant Charge Restriction Region and (for electricity) Metering Arrangement (see paragraph 28A.2 of the Electricity Licence Condition and of the Gas Licence Condition).

41. Suppliers are responsible for ensuring such *ex ante* compliance of Prepayment Tariffs with the Prepayment Charge Restriction, including following each update of the Prepayment Charge Restriction, unless GEMA has directed that a particular tariff will be assessed on an *ex post* basis (in which case the supplier must adhere to the terms of the direction and relevant paragraphs of the Licence Conditions).
42. For the purpose of this requirement, a Prepayment Tariff is considered to be compliant with the Prepayment Charge Restriction if the aggregate Charges for Supply Activities under the Prepayment Tariff would be lower than the aggregate Charges defined by the Relevant Maximum Charge at all levels of consumption, as illustrated in Figure 2 below. Both the aggregate charges under the tariff and the Relevant Maximum Charges are defined exclusive of Value Added Tax (VAT).

**Figure 2: Prepayment Charge Restriction compliance example**



Source: CMA.

43. When the level of the Relevant Maximum Charges are updated, this may result in the need for available and existing Prepayment Tariffs to be reviewed to remain compliant with the Prepayment Charge Restriction. It may be that until each customer tops up they may still consume energy at the rates prevailing prior to 1 April or 1 October as they are yet to top up, which might be in excess of the new Prepayment

Charge Restriction. In such circumstances the supplier shall not be in breach of the Prepayment Charge Restriction.

44. With respect to Multi-Register Prepayment Tariffs, for the purpose of the assessment of compliance (whether *ex ante* or *ex post*), it should be assumed that all Relevant Customers consume energy in line with the Assumed Consumption Split applicable to Multi-Register Prepayment Tariff.

### **Calculation of Relevant Maximum Charges per fuel and Metering Arrangement**

45. For each Charge Restriction Period, i.e. in every six-month period during the period of the Prepayment Charge Restriction,<sup>6</sup> GEMA will calculate three Relevant Maximum Charges for each region and consumption level: two for electricity and one for gas.
46. With respect to the supply of gas, assessment of compliance will not vary by Metering Arrangement, i.e. all tariffs will need to comply with the same Payment Charge Restriction as illustrated in Figure 2 above.
47. As noted in paragraph 33, there are two different Relevant Maximum Charges, one calculated on the basis of tariffs relying on Single-Rate Metering Arrangements, and the other on the basis of tariffs relying on Economy 7 Metering Arrangements. Prepayment Tariffs will be assessed for compliance by comparison with the most relevant of these two Relevant Maximum Charges. So, for example:
48. Where a customer is charged on the basis of a Single-Register Prepayment Tariff<sup>7</sup> (ie single rate or non-time-of-use multi-tier), compliance of that the applicable tariff will be assessed against the Relevant Maximum Charge for Single-Rate Metering Arrangements. Note that this is the case even if the physical metering equipment used to record the customer's usage is capable of recording consumption on the basis of time of use.
49. For Multi-Register Prepayment Tariffs<sup>8</sup>, compliance will be assessed against the Relevant Maximum Charge for Economy 7 Metering Arrangements. The bill applying over the Charge Restriction Period will be calculated using an Assumed Consumption Split, i.e. the assumed consumption split between each rate (i.e. peak and off peak) supported by the relevant Metering Arrangement.
50. Where a customer has two (or more) single-rate meters for the same fuel, and these meters operate as a single metering system for the purpose of a Multi-Register

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<sup>6</sup> Save for the last Charge Restriction Period which would be three months in duration.

<sup>7</sup> Single-Register Prepayment Tariffs are defined to mean a Prepayment Tariff whereby a customer is charged for electricity supply on the basis of a Single-Register Metering Arrangement (ie any Metering Arrangement that is not a Multi-Register Metering Arrangement (see below)). The definition of Single-Register Metering Arrangement includes a Single-Rate Metering Arrangement which is not a Multi-Register Metering Arrangement (regardless of the metering equipment employed) and a Multi-Tier Metering Arrangement in which the unit rate does not vary according to the time of use.

<sup>8</sup> Multi-Register Prepayment Tariffs are defined to mean a Prepayment Tariff whereby a customer is charged for electricity supply on the basis of a Multi-Register Metering Arrangement (whereby one or more meters is used for the purposes of a prepayment tariff whereby a customer's electricity consumption at certain times or for certain purposes is separately recorded on one or more registers). The definition of Multi-Register Metering Arrangements includes any contractual arrangement whereby the customer is charged on the basis of a time of use tariff (regardless of the metering equipment employed). For the avoidance of doubt, the definition of Multi- Register Metering Arrangements therefore includes any time of use tariff recorded on a single register (and would, therefore, include any smart metering arrangement that applies a time of use tariff).

Prepayment Tariff (e.g. for a time-of-use tariff), then that tariff will be assessed against the Relevant Maximum Charge for Economy 7 Metering Arrangements.

51. One supplier has suggested that Multi-Register Prepayment Tariffs other than Economy 7 Tariffs should be assessed against the Relevant Maximum Charge for Single-Rate Metering Arrangements. This argument was based on data indicating that some customers with Multi-Register Prepayment Tariffs other than Economy 7 Tariffs have consumption profiles more akin to customers with Single-Register Prepayment Tariffs than to customers with Economy 7 meters.
52. We note that, whilst informative, consumption profiles do not give the whole picture. In particular, any customer billed on the basis of multiple registers can expect to benefit from lower rates when consuming electricity off-peak and therefore a Prepayment Charge Restriction which does not reflect this saving is less relevant.
53. Following the approach set out in the Final Report, all Multi-Register Prepayment Tariffs will be assessed against the Relevant Maximum Charge for Economy 7 Metering Arrangements using Assumed Consumption Splits as described in Electricity Supply Licence.
54. For Economy 7 Tariffs, the Electricity Licence Condition assumes that a consumption split of 42:58 between off-peak and peak will remain appropriate for all tariffs and throughout the life of the Prepayment Charge Restriction. GEMA will have the ability to direct an alternative split, should evidence indicate that it would be more appropriate. Where a licensee submits evidence in support of an alternative split for Economy 7 Tariffs, we expect that GEMA will review this evidence and consult prior to directing an alternative split.<sup>9</sup> There are Multi- Register Prepayment Tariffs other than Economy 7 Tariffs including for instance time-of-use tariffs or tariffs where different rates apply to different consumption purposes (but exclude Multi-tier Arrangements). In this case, the Assumed Consumption Split of 42:58 off-peak:peak used for Economy 7 Metering Arrangements may not be appropriate in projecting the mix of consumption at the different charging levels.
55. For instance, if a supplier offers a Prepayment Tariff (e.g. Economy 10) with a greater proportion of the day than Economy 7 being at the lower off-peak rate, this supplier may need to use a different Assumed Consumption Split if a greater proportion of overall consumption is charged at the cheaper off-peak rate over the Charge Restriction Period.
56. Therefore, for the purpose of assessing compliance with the Relevant Maximum Charges, an alternative Assumed Consumption Split may need to be determined by each supplier for each tariff.<sup>10</sup> In assessing compliance, suppliers will be required to use historic data relating to that particular tariff to calculate the relevant Assumed Consumption Split (when available, over at least 24 consecutive months). In the absence of such historic data, for instance for new tariffs, a supplier will need to provide a forecast of the Assumed Consumption Split, as well as evidence supporting

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<sup>9</sup> A single Assumed Consumption Split for Economy 7 will be applied for all regions and for all suppliers. Whilst suppliers may present evidence in relation to their own customer base they may not have data applicable to all customers. In considering whether to direct a revised Assumed Consumption Split Ofgem shall consider data relating to all affected customers.

<sup>10</sup> Note that any Assumed Consumption Split would apply across all regions, and would reflect annual consumption patterns.

such forecast. In addition, the supplier must provide to Ofgem, after the end of the relevant Charge Restriction Period, data on actual consumption to allow an assessment of whether its forecasts were reasonable. Where there is a particularly small number of customers with a given Metering Arrangement it will be for suppliers to identify suitable data and submit this to Ofgem.<sup>11</sup>

57. For the avoidance of doubt, the compliance of a Prepayment Tariff is to be assessed on the basis of the Metering Arrangement on which it relies for charging Relevant Customers. For example, if a customer has its consumption recorded by an Economy 7 meter but is purchasing electricity on the basis of a Single-Rate Metering Arrangement (where the same rates apply to both night and day consumption), then that tariff will be assessed against the Relevant Maximum Charge for Single-rate Metering Arrangements.
58. Where projections have been made by a supplier, and there is a material discrepancy between forecast and actual consumption taking place in the peak period such that Relevant Customers on a given tariff (either individually or taken collectively) have incurred charges materially in excess of the Relevant Maximum Charge, GEMA may direct the supplier to pay a rebate to such Relevant Customers. For the avoidance of doubt where a customer has left supply or changed suppliers during the Charge Restriction Period to which a rebate relates, suppliers should make reasonable endeavours to pay any rebate owed.

#### ***Treatment of white meters***

59. Some suppliers have suggested that tariffs based on white meters should be included within the definition of Economy 7 Tariffs for the purposes of assessing compliance with the Order. We note that white meters are in many cases similar to Economy 7 meters and to a large extent are used in lieu of Economy 7 meters in Scotland.
60. However, we also note that there are different sorts of white meters (including some with three registers) such that it would be difficult to construct a definition of 'white meter arrangements' which includes only those white meters which are used for the purpose of Prepayment Tariffs which are sufficiently similar to Economy 7 Tariffs. Further, we note that the approach to compliance we have set out for Multi-Register Prepayment Tariffs other than Economy 7 Tariffs provides a means of assessing compliance for each metering arrangement type which can cater for each different metering arrangement type.

#### ***Treatment of Multi-tier Arrangements***

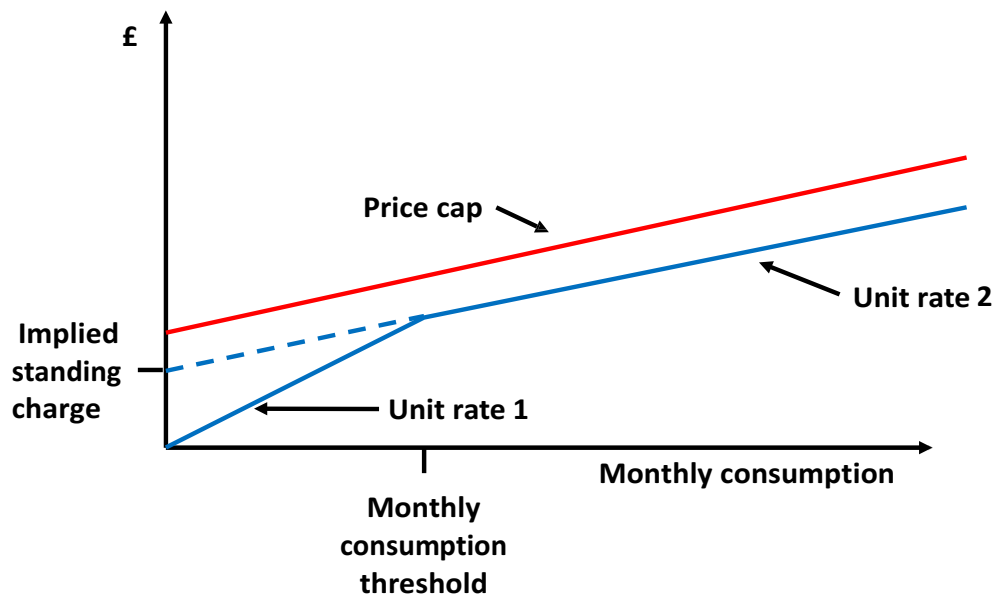
61. Certain suppliers are currently offering tariffs with no standing charge but two or more unit rates. Consumption up to a specified threshold in each month is charged at the first, higher rate, with all consumption above such threshold charged at the second, lower rate. For such a tariff, consumption above the threshold can be modelled as being driven by a standing charge and a single unit rate (where the unit rate is equal to the second rate specified in the tariff). In order to assess compliance of such tariffs

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<sup>11</sup> Such data may, for example, include data from customers with the same Metering Arrangement but a different payment method. However, it will be for suppliers to make the case that any such data is appropriate and relevant.

with the Order this model of the tariff will be used since it provides a simple way to apply the Prepayment Charge Restriction which ensures customers are protected. This approach is illustrated in Figure 3 below.

**Figure 3: Illustration of assessing compliance for Multi-tier Arrangements**



Source: CMA.

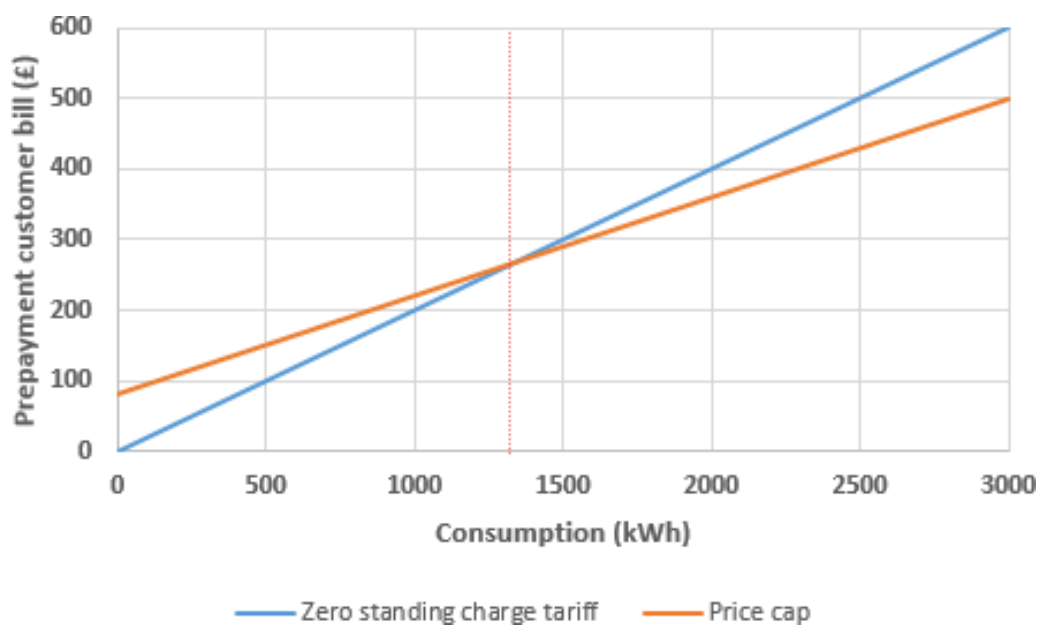
62. In the case of Single-Rate Prepayment Tariffs relying on Multi-tier Arrangements, our understanding is that these do not normally vary by time of day, and in that context appear to be more comparable to a standard tariff, with different unit rates for different levels of consumption. These tariffs are therefore to be assessed against the Relevant Maximum Charge for Single-Rate Metering Arrangements (unless they vary by time of day).

#### **Treatment of Prepayment Tariffs with low standing charges**

63. As explained above, compliance with the Prepayment Charge Restriction will normally be established by assessing each Prepayment Tariff on an ex ante basis. This means that suppliers will assess compliance based on the aggregate amount of charges projected to apply over the Charge Restriction Period. If a Prepayment Tariff is compliant at all consumption levels, no further step (e.g. an ex post assessment) is required.
64. Most Prepayment Tariffs are based on a similar pricing structure, with a (positive) standing charge and unit rate, which broadly reflects the structure of the Relevant Maximum Charges. However, there are a limited number of Prepayment Tariffs which historically have had a different approach, and which might not be compliant with the Prepayment Charge Restriction below or above certain levels of consumption. Such Prepayment Tariffs might however, in practice, be compliant with the Prepayment Charge Restriction for all Relevant Customers because, at actual levels of consumption of each customer on such Prepayment Tariffs, the charges incurred by customers are lower than the Relevant Maximum Charges.

65. An example of such a Prepayment Tariff is a zero standing charge tariff. Generally a consequence of having a zero or low standing charge is that the unit rate is higher. This in turn means that these Prepayment Tariffs are below the Relevant Maximum Charge cap at a low consumption level, but may be above the Relevant Maximum Charge at higher consumption levels.
66. For instance, the zero standing charge tariff illustrated in the chart below is lower than the Relevant Maximum Charge for all consumption levels up to ~1,300 kWh, however the Prepayment Tariff is not compliant with the Relevant Maximum Charge above this level.

**Figure 4: Prepayment Charge Restriction compliance example – zero standing charge tariff**



Source: CMA.

67. In order to allow tariffs targeted at Relevant Customers of a specific consumption profile (e.g. low consumption customers) that may genuinely benefit these customers, suppliers can seek a direction from GEMA that will provide for the supplier to be able to offer and enter into such tariffs, subject to satisfying certain additional requirements. The supplier will still be required to comply with the cap at all levels which are considered likely to occur in practice, i.e. those below 1,300 kWh in Figure 4 above. In addition, the supplier will need to provide satisfactory evidence that:
- it is unlikely that Relevant Customers on this Prepayment Tariff will have an annual level of consumption where the Prepayment Tariff is in excess of Relevant Maximum Charge; and
  - it would not be practical to offer a Multi-tier Arrangement which would be compliant at all levels of consumption in lieu of the proposed tariff.

68. If such a direction is given, the supplier will also be required to assess compliance with the Prepayment Charge Restriction at all actual consumption levels (i.e. at the consumption levels of all Relevant Customers who were on that Prepayment Tariff in the relevant Charge Restriction Period) on an ex post basis. If the ex post compliance assessment were to show that any Relevant Customer on this Prepayment Tariff has incurred charges higher than the Relevant Maximum Benchmark, the supplier must:
- inform Ofgem in writing of such event and relevant Electricity Licence Condition or Gas Licence Condition (or both) without delay; and
  - pay a rebate to such customers equal to the difference between the charges incurred by these customers and the charges that these customers would have paid if the supplier had complied with the Prepayment Charge Restriction.<sup>12</sup>
69. Given the potential for seasonality to result in high consumption during one Charge Restriction Period to be followed by lower consumption during the next period, for the purpose of assessing compliance on an ex post basis, consumption levels should be projected over a 12-month period.
70. Compliance must be assessed every six months based on actual consumption in the Charge Restriction Period that has just ended. The consumption in that Charge Restriction Period would be projected forwards using historic data on seasonal variation in consumption to derive an annualised figure which must then be assessed against the Relevant Maximum Charge.
71. Using the example set out in the chart above, if all Relevant Customers on that Prepayment Tariff had a projected annual consumption level below or equal to ~1,300 kWh, no rebate will be needed. If some Relevant Customers were projected to reach levels of consumption that over a 12-month period, would exceed ~1,300 kWh, a rebate would be due to these customers.

### ***Fully interoperable smart meters***

72. The licence condition refers to Excluded Smart Meters and notes that Smart Metering Systems which are 'fully interoperable' will be defined as Excluded Smart Meters. Such meters will be identified by the CMA (through a direction given under the Order). We expect that Smart Metering Systems which meet the following interoperability criteria will result in the Smart Metering System being fully interoperable:
- 'Commercial Interoperability' means that licensees are capable of operating Metering Equipment installed by another licensee without the need to replace any equipment in the Domestic Premises.
  - 'Functional Interoperability' means that functional requirements are required to be delivered in a consistent, defined way, such that any licensee will be capable of operating any Electricity Meter with a clear understanding of the processing the equipment will undertake and the outputs they, and their customers, will receive.

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<sup>12</sup> In relation to Multi-Register Prepayment Tariffs, assuming consumption in line with the Assumed Consumption Split.

### **Part 3 – Monitoring compliance and reporting**

73. Article 5 of the Order requires suppliers to submit a report to the CMA in the format specified in Schedule 3 to the Order. Compliance statements must be submitted to the CMA no more than 45 days after the end of each Charge Restriction Period. This compliance statement is required to be sent to the CMA in order to ensure that the CMA may fulfil its duties under EA02 in respect of the monitoring of its remedies.
74. Paragraphs 28A.29 to 28A.31 of the Electricity Licence Condition and paragraphs 28A.22 to 28A.24 of the Gas Licence Condition set out the detailed reporting requirements. The format for this reporting is determined by GEMA. Suppliers are required to inform GEMA, in writing or in any other the format specified by GEMA, of any subsequent changes to the information included in the report as soon as it is reasonably practicable.
75. These compliance statements and reports are required to assist the CMA and GEMA in complying with their statutory duties to monitor compliance with the Order and Licence Conditions, respectively.
76. GEMA is also expected to inform the CMA of any breach of the Prepayment Charge Restriction by any supplier. In addition, GEMA is expected to take such enforcement action as it believes is appropriate in the event of non-compliance with the applicable Electricity Licence Condition or Gas Licence Condition (for instance failure to pay a rebate where appropriate). The CMA will also monitor the Order in accordance with its statutory duty.
77. Article 6 provides that the CMA may give directions as to compliance with the Order. Article 7 provides for any person to whom this Order applies to provide information required by the CMA to allow it to monitor and review compliance with and operation of the Order. GEMA has similar powers under the Electricity Supply Licence and Gas Supply Licence, including in the Licence Conditions.
78. SLC 31A of each of the gas and electricity supply licences requires suppliers to provide customers with an annual estimate for the cost of charges for supply of gas or electricity respectively. We expect that suppliers would continue to comply with this condition in the same way as they have done to date. Specifically, suppliers would estimate total annual charges either on the basis of current prices, or – where they have announced an increase or decrease in their charges – the rates that will apply after that change is scheduled to take effect.



## Annex 1 – Calculation of the Prepayment Charge Restriction

1. Prior to each Charge Restriction Period, GEMA will calculate the Relevant Maximum Charges for each Charge Restriction Region<sup>13</sup>, Benchmark Annual Consumption Level (i.e. nil and the medium TDCV<sup>14</sup> and (for electricity) Benchmark Metering Arrangement (i.e. single-rate and Economy 7<sup>15</sup>).
2. The Relevant Maximum Charges will be calculated as the sum of the following cost allowances:
  - Wholesale Cost Allowance,
  - Network Cost Allowance,
  - Policy Cost Allowance, and
  - Operating Cost Allowance (previously referred to as indirect cost allowance),
  - Earnings Before Interest and Tax Allowance,
  - Headroom Allowance, and
  - Prepayment Meter Uplift Allowance.
3. Wholesale, network and policy costs will be calculated as per the relevant gas supply and electricity supply standard licence conditions 28AD that introduced to Ofgem's Default Tariff Cap (DTC). (as amended from time to time by Ofgem). We consider that any future changes to the DTC methodology that are objectively verifiable by Ofgem (for example with reference to out-turn costs) should also be made, for identical reasons, to the PCR.
4. The operating costs will be calculated as per the methodology set out in the relevant gas and electricity licence conditions SLC28AD, as amended from time to time by Ofgem, subject to the exclusion of non-pass through smart meter costs (as defined in SLC28AD for gas and electricity).<sup>16</sup> These costs comprise the cost to suppliers of rolling out smart meters, and are set out at 2a of Annex 5 of Ofgem's Default Tariff Cap Decision. As above, we consider that any future changes to the DTC

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<sup>13</sup> The 14 Charge Restriction Regions are set out in annex 2 to this Explanatory Note.

<sup>14</sup> The medium consumption level is as follows: 3,100 kwh single electricity; 4,200 kwh multi electricity and 12,000 kwh for gas.

<sup>15</sup> As it is further explained in paragraphs 50 to 60, compliance with the Prepayment Charge Restriction for Multi- Register Prepayment Tariffs will be assessed against the Relevant Maximum Charge for Economy 7 Metering Arrangements.

<sup>16</sup> See Ofgem Default Tariff Cap Decision, [Appendix 7 – Smart Metering Costs](#)

methodology that are objectively verifiable by Ofgem (for example with reference to out-turn costs) should also be made, for identical reasons, to the PCR.

5. The Earnings Before Interest and Tax Allowance figure under the Order will be calculated in a similar manner as for the DTC. It is defined as a percentage of the sum of the values for the wholesale costs, network costs, policy costs, operating cost allowance and prepayment uplift. The earnings before interest and tax percentage will remain constant for each Charge Restriction Period. The value for earnings before interest and tax allowance will be determined based on the formula set out in paragraph 28A of the Electricity Licence Condition 28A.11 and paragraph 28A.12 of the Gas Licence Condition 28A, as amended by the Variation Order.<sup>17</sup>
6. Headroom under the Order will be calculated in a similar manner as for the DTC. It is defined as a percentage of the sum of the values for wholesale costs, policy costs, operating cost allowance, prepayment uplift and earnings before interest and tax. The headroom percentage will remain constant for each Charge Restriction Period. The value for headroom will be determined based on the formula set out in paragraph 28A.15 of the Electricity Licence Condition 28A and paragraph 28A.14 of the Gas Licence Condition 28A, as amended by the Variation Order.<sup>18</sup>
7. As regards the pre-payment uplift, rather than using the payment uplift used in the DTC (which do not contemplate prepayment customers, and therefore is excluded<sup>19</sup>), an uplift of £24.4072 for electricity £39.6617 for gas updated with consumer price indices.<sup>20</sup>
8. The components of the calculation are summarised below. Full details of the Ofgem DTC methodology are published at <https://www.ofgem.gov.uk/publications-and-updates/default-tariff-cap-decision-overview>.

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<sup>17</sup> The values and methodology to be used for calculating the EBIT will be the same as the values and methodology used for the DTC under the gas supply and electricity supply standard licence conditions 28AD at the time of the Variation Order. Amendments made by Ofgem to those values and methodology in the relevant licence conditions 28AD after the date of the Variation Order shall not apply to the Order.

<sup>18</sup> The values and methodology to be used for calculating the Headroom will be the same as the values and methodology used for the DTC under the gas supply and electricity supply standard licence conditions 28AD at the time of the Variation Order. Amendments made by Ofgem to those values and methodology in the relevant licence conditions 28AD after the date of the Variation Order shall not apply to the Order.

<sup>19</sup> See Ofgem Default Tariff Cap Decision, [Appendix 8 – Payment Method Uplift](#)

<sup>20</sup> These baseline values for the electricity and gas prepayment uplift will be indexed using CPIH (in line with the Authority methodology). The baseline values have been determined for 2017 (to bring it in line with the baseline values used in the DTC methodology) by indexing the original 2015 baseline values by CPI.