

Energy Market Investigation (Prepayment Charge Restriction) Order 2016: Provisional Decision

8 July 2019

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 response to the Competition & Markets Authority's (CMA) provisional decision following its review the Energy Market Investigation (Prepayment Charges Restriction) Order 2016. We would be happy to discuss any of the points made in further detail with the CMA or any other interested party if this is considered to be beneficial.

Executive Summary

Energy UK is supportive of the CMA's recognition that keeping the cap artificially below the level of efficient costs is not in the interests of PPM customers and we agree with its provisional decision amend the methodology as a result, bringing it further in line with Ofgem's Default Tariff Cap (DTC). In particular, we endorse the CMA's finding that maintaining the cap at an artificially low level may simply lead to suppliers exiting the market or cutting costs, resulting in less competition and lower standards of service.

Energy UK welcomes the CMA's intention for the methodological changes to be in place in time for the October price cap, and we would urge for this intended timeline not to slip. The CMA's indicative level of the cap for historical periods indicates a significant shortfall since 2017, running to many millions of pounds across the industry, inhibiting competition and innovation. Recognition of this historic under-recovery of efficient costs brings into sharp focus the impact that price caps can have on the ability of efficient suppliers to finance their activities to the detriment of their customers.

Energy UK has reservations about some specific policy decisions by the CMA, such as treatment of non-passthrough smart metering costs and headroom. In addition, we do not agree with the CMA's recommendation that Ofgem continue a PPM cap until the substantial completion of the smart meter rollout, which we view as pre-empting the outcome of Ofgem's review. However, varying of the Order to allow for an early termination of the PPM cap if Ofgem does seek to implement relevant protections

following review and consultation (which should include aspects of cap design such as smart allowances and headroom) would be welcome.

Decision Impacts

Energy UK agrees with the CMA's assessment of the impacts that the provisional decision. In particular, we welcome the recognition that keeping the cap set artificially low, below the level of efficient costs, would not be in the interest of consumers as it would risk a detrimental impact upon the outcomes PPM customers that could otherwise have been gained from new investment, innovation and competition, in line with the rest of the market. Ensuring that suppliers can earn a normal rate of return will incentivise greater competition and minimise the risk of efficient suppliers exiting the market segment, improving outcomes for consumers in the long-term.

We note CMA suggested that it had not seen evidence that the co-existence of the PPM cap and default tariff cap has significantly affected the incentives of either suppliers or customers, which may be a product of the lack of material SMETS2 PPM deployment to date. Energy UK nevertheless welcomes the CMA's recognition that two separate caps with different methodologies creates this possibility in theory. Energy UK is pleased, therefore, with the CMA's intention to progress with the Order variation in time for the changes to be in place for the October price cap, which we believe would minimise the customer detriment from divergent caps highlighted in our previous responses to this review.

Extending Protections

Energy UK considers that the CMA's provisional recommendation that Ofgem should provide protection to prepayment customers when the PPM cap expires until the roll-out of smart meters is substantially complete is premature, inconsistent with the Energy Market Investigation (EMI) final report, without adequate consultation or evidence collection, and risks pre-empting reviews Ofgem is required to undertake in any event under the terms of the Domestic Gas and Electricity (Tariff Cap) Act 2018.¹ The CMA should, therefore, limit its decision to encouraging Ofgem to undertake a review in good time ahead of the cap period commencing October 2020, but without pre-determining the outcome or whatever action Ofgem may consider appropriate.

However, we fully support the proposal to vary the order to allow the PPM cap to end on 30 September 2020 in the event that Ofgem plans to introduce separate protection from 1 October 2020. It is the outcome of Ofgem's review, including the scope and duration of any enduring price protection for prepayment customers, that requires further consideration and consultation.

Headroom Rationale

We note that the CMA's original rationale for including a headroom allowance in the PPM cap was to provide additional scope and incentive for suppliers to compete underneath the level of the cap and minimise the distortions to competition arising from the cap, bearing in mind the particular constraints on competition (relating to availability of 'tariff codes') in the traditional prepayment meter market.² This rationale is distinct from Ofgem's rationale in including a headroom allowance in the DTC, which was to cater for uncertainties and unforeseen cost increases.³

We consider that this represents a fundamental change in its rationale for which the CMA gives no explanation. We believe that in order to justify such a change, the CMA would either need to have reconsidered the purpose of the headroom (and consulted accordingly on the reason for changing the purpose) or would need to have reassessed the competitive conditions in the prepayment segment and concluded that a smaller allowance would be sufficient for the original purpose (and consulted accordingly). As far as we can see, the CMA has done neither, and we believe that it should, therefore,

¹ For further discussion see https://www.eprg.group.cam.ac.uk/wp-content/uploads/2019/06/S.-Littlechild_Energy-Prepayment-Review-submission-to-CMA_1Jul19.pdf

² Energy Market Investigation Final Report, CMA, paragraph 256
<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

³ Default Tariff Cap: Decision, Appendix 2, Ofgem, paragraph 3.60
https://www.ofgem.gov.uk/system/files/docs/2018/11/appendix_2_-_cap_level_analysis_and_headroom.pdf

consider retaining the previous value of the headroom allowance. We note that the CMA itself has highlighted headroom as an issue which Ofgem should review in any event.

Treatment of Smart Metering Costs

Energy UK does not fully agree with the CMA's rationale for excluding non-pass-through smart metering costs from the PPM cap. Sufficient provision for the smart meter rollout is vital, to ensure that the smart programme progresses to conclusion and is not inadvertently slowed down, delaying the realisation of its benefits for all customers. The CMA rationale for this decision, specifically that customers with traditional PPMs should not contribute towards all the cost elements in the delivery of smart metering as they do not yet have smart meters themselves, would seem to run counter to the basis on which the Government has established the smart metering programme. The decision is also inconsistent with Ofgem's default cap methodology approach whereby smart metering costs (both pass through and non-pass through) are recovered across the total national residential customer base.

The CMA does not elaborate on why it proposes to exclude non-pass-through SMNCC beyond noting that the PPM cap does not apply to prepayment customers with a fully interoperable smart meter. Given the need to have regard to suppliers' ability to finance their regulatory obligations, the implication of this statement would appear to be that non-pass-through costs should be borne instead by prepayment customers with an interoperable smart meter.

Due to the "All Reasonable Steps" framework, suppliers will be constrained by the allowance embedded within the price cap in terms of the scale of activities that can be undertaken. Energy UK is concerned that the CMA's provisional decision will inevitably constrain investment in the smart roll-out for prepayment customers and further delaying the resulting consumer benefits.

If the CMA's final decision still does not provide fully for the costs of the smart roll-out to prepayment customers within the PPM cap, Ofgem will need to address this risk by ensuring that it will allow recovery of resulting cost shortfalls when it reviews the application of its DTC to fully interoperable smart prepayment meters.

Treatment of SMETS1 & SMETS2 Meters

Energy UK is concerned that there will remain operational difficulties for suppliers arising from the two separate price caps interacting with the enrollment and adoption of SMETS1 meters. We welcome the confirmation in the Explanatory Note that DCC enrolment is necessary but not sufficient condition for SMETS1 (or particular SMETS1 cohorts) to become Excluded Smart Meters for PCR purposes. It will be important to ensure that their adequate, well planned lead times before any change of status takes effect given the interaction with Ofgem's DTC and need to ensure orderly communication of any such changes to across industry and to customers. We would encourage the CMA to engage with the DCC, Ofgem and industry to find the best way forward in terms of customer outcomes, consistency and proportionality.

If you would like to discuss the above or any other related matters, please contact me directly on 020 7747 2931 or at steve.kirkwood@energy-uk.org.uk.