Review of the Energy Market Investigation (Prepayment Charge Restriction) Order 2016 – Provisional decision

We welcome the opportunity to comment on the CMA's provisional decision in respect of the Energy Market Investigation (Prepayment Charge Restriction) Order 2016 (the **"Order"**).

We are broadly supportive of the CMA's decision; however, we raise below some concerns around the exclusion of non-pass-through SMNCC charges from operating costs. We also provide our thoughts on the root causes for a lack of improvement in competition.

The state of competition

1. Suppliers predicted that the introduction of the prepayment (**"PPM"**) price cap would result in stagnation of competition, and this is what has come to pass. The cap does not accurately reflect the cost to serve a prepayment customer and consequently prices have generally bunched around the level of the cap. Given that multiple studies have shown that switching levels decline significantly where savings are insignificant, there has been no incentive for customers to switch.

2. To improve competition, it is necessary to understand the root causes; we urge that more work to be done to understand these and consider appropriate solution. Our own thoughts on this issue are provided below.

3. Firstly, it is necessary to understand why more suppliers do not offer prepayment meters. As the CMA noted in the Energy Market Investigation, many customers with prepayment meters are vulnerable. Ofgem has acknowledged[1] that vulnerable customers are likely to have a higher cost to serve; for example, there are additional costs for providing services such as bills in Braille; services for the hard of hearing and those who do not speak English; regular gas checks. In addition, financially vulnerable customers are more likely to have debt on their account and require considerable ability to pay assistance, even with a prepayment meter: suppliers often need to top up a customer's meter with credit when they have insufficient funds; customers are expected to pay this back, sometimes over a very long period of time. Such high cost to serve customers are less attractive to smaller suppliers, who seek to minimise their costs and offer the lowest prices to grow their portfolios.

4. The additional costs of servicing vulnerable customers are generally shared between a supplier's entire portfolio: thus a supplier with a greater proportion of vulnerable customers has higher overall costs and needs to recover these through higher prices overall, making them less attractive to new customers. This creates an unlevel playing field, whereby suppliers who avoid vulnerable customers are able to offer lower prices than those with a high number of vulnerable customers.

5. We strongly believe that there should be a process whereby the additional costs of supplying vulnerable customers is shared between suppliers on the basis of market share, to ensure

[1] https://www.ofgem.gov.uk/system/files/docs/2018/11/appendix_6_-_operating_costs.pdf, para 2.18

these customers are as attractive as a non-vulnerable customer; this would help improve the disincentive for suppliers to operate in the prepayment market.

Engagement

6. The fact that a customer does not switch to a cheaper supplier is not necessarily an indication that they are disengaged.

7. At E.ON, we regularly hold customer immersion sessions, where we invite a group of customers to share their thoughts with employees at all levels of our organisation, to improve our understanding of customer needs. Recently, we invited 50 customers who had been with us for 20 years or more, to try to help us understand why these customers are loyal. All 50 invitees attended (only the second time this has occurred over all hundreds of similar customer immersion events we have held). A small payment is made to attendees of £40, to cover their expenses. What we heard from these customers was that they had no wish to participate in the competitive market; nevertheless, the fact that they had taken time to come and talk to us was in itself evidence of engagement.

8. Customers must be allowed to make their own informed choices, whether that be to switch or not to switch; engagement should therefore be measured differently, and customer choice must be key.

CMA proposals

9. We strongly agree that the default tariff cap methodology should be used for wholesale, network, policy, operating costs and the payment method uplift; however we do not agree with the CMA's decision to exclude non-pass-through smart meter costs.

10. As the CMA states, non-pass-through smart meter costs relate to the *"roll-out and installation of actual smart meters"*. This includes the costs of promotion of smart to all 'classic' metered customers (including PPM customers), the costs for appointment generation and booking for all 'classic' metered customers (including PPM customers), and the cost of suppliers' internal and external workforce for installing smart meters as replacements for all 'classic' metered customers (including for both SMETS1 and SMETS2 meters). Some of those costs are within the Operational Costs baseline and some are part of the non-pass-through uplift in the SMNCC. With regard to the cost apportionment of smart roll-out related items, these are smeared equally across suppliers' product base regardless of metering type.

11. The roll-out duty in the standard supply licence conditions (**"SLC"**) applies equally to PPM as it does non-PPM customers. The costs of the smart meter rollout are not paid by individuals, but are instead passed on to all consumers through their energy bills, in accordance with SLC 41.8 (electricity) and SLC 35.8 (gas). Also, Ofgem stated in 2015[2]: "*[t]he combined effect of these conditions is that if suppliers want to recover domestic smart meter installation costs, <u>they can only do so across their entire customer base as part of their general tariffs</u>*" [emphasis

[2] https://www.ofgem.gov.uk/sites/default/files/docs/2015/08/installation_cost_restrictions_0.pdf

added]. Ofgem reiterated this point in 2017[3], saying: "*[t]he effect of relevant licence conditions is that any costs associated with a standard installation of a smart meter cannot be recovered from an individual customer, and should instead be borne by a supplier's domestic customers more generally as an increment of the charges for energy supplied to them*".

12. Effort is being expended and costs incurred equally (if not to a greater extent in some ways), to offer and install smart meters for all of our PPM customers. This cost makes up part of our overall smart cost which is passed into all domestic pricing. This should not be treated differently depending on whether the pricing is for a credit metered or PPM metered customer.

13. Similarly, it would be unfair to include these costs for a vulnerable consumer on the default tariff cap whilst excluding them for PPM customers, who may also be vulnerable. Those suppliers with larger numbers of vulnerable customers would thus be disadvantaged, exacerbating the unlevel playing field that already exists for such suppliers.

14. We have no particular concerns about the treatment of EBIT and headroom, other than to re-iterative previous submissions that both of these values are inadequate.

Timing of implementation

15. We are appreciative of the CMA's efforts to adopt this decision in time for the methodology change to be applied for the next charge restriction period (October 2019 to March 2020). Any delay to implementation would have significant negative financial consequences for suppliers, given that Capacity Market charges would not be included if the current methodology was used, as we stated in our letter to the CMA of 17 May 2019. Delivering the change quickly is, in our opinion, a priority.

Protection for prepayment customers beyond the end of 2020

16. We recognise that, as part of the Energy Market Investigation final report, the CMA specifically named the roll-out of smart meters as a key measure of progress to be considered as part of a mid-term review of the Order.

17. Delays in progress of the smart meter rollout are undeniable, albeit generally caused by issues outside of the control of energy suppliers.

18. We do not believe the smart meter rollout will have a great deal of significance in terms of improving competition in the PPM market; we would point to the root causes we have drawn out earlier in this response. Nevertheless, given the requirements set out in the Explanatory Note to the Order, we accept there is likely to be a requirement for protection for PPM customers beyond the end of 2020.

[3]https://www.ofgem.gov.uk/ofgem-publications/119593