

Energy Prepayment Review  
Competition and Markets Authority  
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28 June 2019

### **Why so hasty?**

## **A response to the CMA’s Provisional Decision of 9 June 2019 in its Review of the Energy Market Investigation (Prepayment Charge Restriction) Order 2016**

From Stephen Littlechild\*

### **Summary of response**

The CMA’s Provisional Decision is summarised in the following paragraph:

“6.3 The CMA has provisionally concluded that:

(a) in the short run, it should vary the Order to address the divergence between actual costs incurred by efficient suppliers and the costs included in the PCR. The CMA proposes to adopt the methodology currently used by Ofgem in its DTC, adjusted to take account of the specific costs inherent to the supply of energy to prepayment customers; and

(b) in the long run, the CMA proposes: (i) to recommend that GEMA should provide protection to prepayment customers when the PCR expires; and (ii) to vary the Order to ensure that if Ofgem plans to introduce separate protection for prepayment customers as from 1 October 2020, the PCR would end on 30 September 2020 in order for Ofgem to commence protection at the end of a charge restriction period rather than in the middle of such a period, as would be the case if the original expiry date were to remain.”

Conclusion (a) appears to be appropriate: it addresses an imperfection in the CMA’s original methodology for setting the Prepayment Charge Restriction (PCR) - which is henceforth referred to as the Prepayment Meter (PPM) tariff cap. At present, the PPM tariff cap significantly underestimates the costs incurred by efficient suppliers. The Provisional Decision explains that “where the PCR was set too low, this would present the risk that suppliers reduce service levels to prepayment customers, competition is materially reduced, and suppliers may be forced to exit the market”. (para 5)

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Whether the proposed modification is precisely the best one is not a topic on which the present response is able to comment. Consequently, it has nothing further to say on conclusion (a), and what follows is not intended to preclude a suitable increase in the level of the PPM tariff cap.

Conclusion (b), on the contrary, is not appropriate.

The Provisional Decision makes it clear that “protection to PPM customers” means protection by way of another tariff cap. But the Tariff Cap Act (sections 1(1) and 3(1)) already provides that PPM customers will be protected by the DTC - henceforth referred to as the default tariff cap - after the PPM tariff cap expires. And the Act gives Ofgem a statutory obligation to carry out a review into whether conditions are in place for effective competition in this market, and then to recommend whether or not the default tariff cap should be extended after December 2020.

Hence, the substance of the Provisional Decision conclusion (b) is to propose that Ofgem continue to impose a tariff cap on PPM customers regardless of Ofgem’s forthcoming review. It thereby pre-empts Ofgem’s judgement on this matter.

The main part of the Provisional Decision has clearly explained that the PPM tariff cap was not set in an appropriate way. It has also indicated the serious adverse consequences that a wrongly set tariff cap could have – indeed, in many respects already has had. Why then so hasty to commit to extending this tariff cap?

It is argued in this Response that Provisional Decision conclusion (b) has four serious limitations: it is against the advice of the EMI Final Report, it is without adequate consultation on this issue, it is without adequate collection and assessment of relevant evidence, and it is without recognition that Ofgem will be a better position over the course of the next year to make a judgement as to whether a PPM tariff cap should continue.

Briefly to explain these four limitations:

*First*, Provisional Decision conclusion (b) is inconsistent with what the CMA recommended in its Energy Market Investigation (EMI) Final Report. The latter says “14.338 In the event that, at the date of the mid-term review, the roll-out of smart meters does not appear likely to be completed by 31 December 2020, we would consider whether to encourage Ofgem to review the situation and take whatever action it considers appropriate (including whether to introduce a similarly structured price cap in the prepayment segments as from the start of 2021).” [Note: GEMA and Ofgem are often used interchangeably in CMA publications and in this submission.]

Unfortunately, as explained below, there is an unacknowledged internal inconsistency running throughout the CMA Explanatory Note, the CMA’s present consultation and the Provisional Decision itself. Although the Provisional Decision is claimed to be consistent with the Explanatory Note, it is *not* consistent with what the EMI Final Report recommended. In fact, the EMI Final Report rejected the Provisional Decision proposal as less satisfactory

than its own recommendation. It said “14.338 ... We believe that this approach [review by Ofgem followed by whatever action Ofgem considers appropriate] is more proportionate than extending the PPM Price Cap Remedy for a further specified period.”

*Second*, the CMA has not adequately consulted on this particular issue. The 31 January 2019 Decision to launch a review of the Order presented what is herein called the correct version of the EMI Final Report recommendation. The 19 February 2019 Issues Statement presented what is herein called the incorrect version. The CMA did not acknowledge, let alone explain or invite comment on, its decision to use the different version. In consequence, the responses to the consultation have not addressed this issue, and nor has the CMA. The Provisional Decision cites both versions, apparently without realising the difference, and without indicating or justifying the significant difference between its Provisional Decision and what the EMI Final Report actually recommended.

*Third*, the Provisional Decision has not carried out the collection, analysis and assessment of relevant evidence necessary to make an informed and balanced judgement as to the effects of the present restriction, whether further protection should be provided, and if so in what form. It has not taken account of the imperfect judgements in the EMI Final Report. In assessing the conditions of competition it conflates the impact of the PPM tariff cap with underlying changes in the market. It has not assessed the actual impact or significance of smart meters for competition. It has not addressed evidence that competition is greater than previously assumed. It has not acknowledged or rebutted the considered rejection of its present proposal by the EMI Final Report. It has given no consideration to potential distortions associated with continuing the proposed tariff cap.

*Fourth*, over the course of the next year Ofgem will be in a better position than the CMA presently is to assess the situation, to consult on options, and to take whatever action seems appropriate. In particular, Ofgem will have access to better and more up-to-date information than the CMA presently has. For the CMA to pre-empt such better-informed assessment is premature.

The remainder of the present response documents in more detail the four reasons just given why the Provisional Decision (b) “to recommend that GEMA should provide protection to prepayment customers when the PCR expires” – in the form of a continued tariff cap - is not appropriate. Instead, the CMA Decision should revert to the approach originally set out in the EMI Final Report, and actually cited in the Provisional Decision, namely, that in the event that the smart meter rollout were delayed, the CMA should encourage Ofgem to review the situation and take whatever action it considers appropriate.

### **1. Inconsistency with the EMI Final Report recommendation**

On 24 June 2016 the CMA Final Report set out its proposal, and explained its thinking, on what to do in the event of the smart meter roll-out not being complete by 2020.

“14.338 In the event that, at the date of the mid-term review, the roll-out of smart meters does not appear likely to be completed by 31 December 2020, we would

consider whether to encourage Ofgem to review the situation and take whatever action it considers appropriate (including whether to introduce a similarly structured price cap in the prepayment segments as from the start of 2021). We believe that this approach is more proportionate than extending the PPM Price Cap Remedy for a further specified period. While this creates some uncertainty about the possibility of a price cap being in place beyond 2020, this uncertainty is narrowed to the issue of the extent of roll-out.”

On 11 October 2016 the CMA published its Draft EMI (Prepayment Charge Restriction) Order, together with a Draft Explanatory Note that indicated, inter alia, its thoughts on the envisaged mid-term review of the Order. The Draft Explanatory Note said

“16. .... Pursuant to the Report, the Prepayment Charge Restriction will be subject to a mid-term review commencing in January 2019 of the progress that has been made concerning the roll-out of smart meters (including SMETS 2 smart meters). In the event that such roll-out were materially ahead of (or behind) schedule, the CMA will consider whether to revoke the Order early (or recommend that GEMA consider introducing further measure [sic] to protect prepayment customers until the roll-out is substantially completed) in light of such a change of circumstances.”

It also said

“78. In the event that the roll-out of smart meters does not appear likely to be completed by 31 December 2020, the CMA will consider whether to encourage GEMA to review the situation and take whatever action it considers appropriate (including whether to introduce a similarly structured Prepayment Charge Restriction in the prepayment segments as from the start of 2021).”

These two proposals are not the same: they are mutually inconsistent. Para 78 replicates what the EMI Final Report says: it envisages that the CMA will encourage Ofgem to review the situation and take whatever action it considers appropriate. Para 16 is quite different: it envisages that the CMA will advise Ofgem to continue a PPM tariff cap, with no reference to an Ofgem review or Ofgem’s judgement as to what is appropriate.

There were 18 responses to the CMA consultation. Suppliers, especially, were focused mainly on the methodology for calculating the level of the cap. No response picked up on the inconsistency with respect to proposed action in the event that the smart meter rollout target was not met. (Such a possible event was of course at that time over three years into the future.)

On 7 December 2016 the CMA issued its final Order together with the final Explanatory Note. The same two different proposals, with exactly the same wordings (including the grammatical error), were reproduced in paras 16 and 75, respectively. (Henceforth, references will be to para 75 in the final Explanatory Note rather than to para 78 in the Draft Note.)

Which version is correct? The body of the Explanatory Note appears to be more considered and authoritative, and para 75 is consistent with the EMI Final Report. The first 16 paragraphs of the Explanatory Note, including para 16, appear to be a general introduction,

and para 16 is inconsistent with the EMI Final Report. Maybe para 16 is what the drafter of the October 2016 Explanatory Note wished the Final Report had said. Or maybe the drafter of the general introduction thought that para 16 was an adequate non-technical summary of para 75. But it was not. It seems reasonable to suppose that para 16 is simply in error. Accordingly, it seems reasonable to refer to para 75 as the correct version, correctly reflecting the recommendation in the EMI Final Report, and to para 16 as the incorrect version.

The present Provisional Decision says that “6.3 ... (b) in the long run, the CMA proposes: (i) to recommend that GEMA should provide protection to prepayment customers when the PCR expires;...”. This is essentially a variant of para 16 in the December 2016 Explanatory Note. It is therefore a variant of the incorrect version, inconsistent with the wording and intent of the EMI Final Report.

It is also clear that “provide protection to prepayment customers” in the Provisional Decision means protection by way of a further PPM tariff cap, contrary to the view of the EMI Final Report that this would be a matter for Ofgem to consider. For example, in para 3.30, “we propose to address this [ineffectiveness of the Order beyond December 2020] by making a recommendation to GEMA to provide for ongoing protection following the expiry of the PCR with its own price cap until the roll-out of smart meters is substantially complete”. And in para 5.4, “the justification set out in the EMI Final Report for protecting prepayment customers by way of a charge restriction remains valid until the substantial completion of the roll-out of smart meters”. And in para 5.7 “ In line with our assessment set out above, we propose to recommend that GEMA provides protection for prepayment customers beyond the expiry of the PCR and until the roll-out of smart meters is substantially complete. One way to achieve this would be to prepare the DTC for all prepayment customers on standard variable and default tariffs, subject to adjustments to reflect the prepayment segments (as per the PCR following the proposed amendments).” Para 5.8 recommends two additional areas in which Ofgem carry out further analysis, namely whether the headroom in the default tariff cap is adequate, and whether the PPM uplift and installation allowances will remain adequate as the smart meter roll-out continues. Para 5.9 recommends that Ofgem have regard to “*the original aims of the PCR [PPM tariff cap] when setting the level of any replacement charge restriction*”. Para 6.3 makes provision for “Ofgem to commence protection at the end of a charge restriction period rather than in the middle of such a period”. Moreover, there is no consideration in the Provisional Decision of ways to “provide protection to prepayment customers” other than via a continued tariff cap.

## **2. Inadequate consultation in the present consultation process**

### **2.1 Whether to review the Order**

On 21 December 2018 the CMA invited comments on whether to launch a review of the Order. In explaining the review’s focus on the progress made in the roll-out of smart meters, the document presented an account that used the wording of the correct (para 75) version, consistent with the EMI Final Report, concerning the possible consequences of a delay in smart meter roll-out.



“9. ... Information on the progress in rolling out smart meters was envisaged to allow the CMA to determine whether the prepayment price cap would need to be revoked early (where smart meter rollout was likely to complete earlier than expected), or whether to encourage Ofgem to review the situation and decide whether to take further measures to protect prepayment customers for a longer period of time (where smart meter rollout was taking longer than envisaged when the Order was created).”

It sought views on three issues: briefly, whether to prioritise the Order for review, whether the scope should consist of the assessment of smart meter rollout and of certain specified CMA cost calculations, and whether additional cost calculations or “broader elements of the Order should also be subject to review”. There was no further reference to what might be done depending on the state of the smart meter roll-out.

Not surprisingly, then, responses to the consultation did not raise or comment on this latter issue.

On 31 January 2019 the CMA published its Decision to launch a review of the Order. This Decision again made no reference to what might be done depending on the state of the smart meter roll-out.

## 2.2 Statement of Issues

On 19 February 2019 the CMA published its Statement of Issues. Its para 13 now cited the incorrect (para 16) version in the Explanatory Note (complete with grammatical error) instead of the correct (para 75) version.

“13. The explanatory note to the Order explains that:  
*‘the Prepayment Charge Restriction (ie the price cap) will apply from 1 April 2017 until 31 December 2020. Pursuant to the Report, the Prepayment Charge Restriction will be subject to a mid-term review commencing in January 2019 of the progress that has been made concerning the roll-out of smart meters (including SMETS 2 smart meters). In the event that such roll-out were materially ahead of (or behind) schedule, the CMA will consider whether to revoke the Order early (or recommend that GEMA consider introducing further measure to protect prepayment customers until the roll-out is substantially completed) in light of such a change of circumstances.’”*

In explaining potential outcomes of the review, the Issues Statement built on this incorrect version, saying

“24. Should the CMA conclude that, by reason of any change of circumstances, the Order is no longer appropriate and needs to be varied or revoked, the CMA would need to consider the following matters, on which it will seek views and evidence from interested parties: • how to ensure continued protection for prepayment meter customers until the rollout of smart meters has concluded; and specifically • whether it would be more appropriate to vary the CMA’s Order or to revoke it and, linked to this matter, whether to recommend: an extension of GEMA’s charge restriction to

cover prepayment meter customers, or that GEMA introduce a new charge restriction covering prepayment meter customers.”

The Issues Statement did not point out that its description of the CMA’s potential action in the event of a delayed smart meter roll-out (para 13 above) was now different from its description in its invitation to comment on the launch of the Review, and different from what the EMI Final Report had said. Consequently the Issues Statement did not explain that there was now a proposed change of policy, whereby the CMA itself would be recommending changes to the tariff caps rather than considering whether to encourage Ofgem to review the situation and take what action Ofgem considered appropriate.

Because this change of policy was not noted, the Issues Statement did not give any reasons for that change, or seek to justify it – not least as the opposite policy to what the EMI Final Report had recommended. It is not clear whether the CMA did not realise that it was proposing a significant difference in policy, or whether it did so realise and decided that it was better to have two options, or that the policy associated with the incorrect (para 16) version better suited its present thinking than the policy associated with the correct (para 75) version.

Again, none of the eight respondents to the Issues Statement – seven industry suppliers plus the industry organisation Energy UK – picked up on the CMA’s proposed change in policy. They focused on the proposed changes in method of calculating the PPM tariff cap, and on the merits of combining the default and PPM tariff caps. They did not explicitly address the question – and were not invited to address the question - whether the CMA should encourage Ofgem to review the situation and take whatever action it considered appropriate, as the EMI Final Report envisaged, or alternatively whether the CMA itself should make recommendations as to the action that should be taken, with no reference to Ofgem.

### **2.3 Provisional Decision**

On 7 June 2019 the CMA issued its Provisional Decision. Its Chapter 5 on Protection for prepayment customers beyond the end of 2020 contains at para 5.2 an accurate reproduction of the correct version of the EMI Final Report recommendation.

“5.2 The Explanatory Note to the Order said that the EMI Final Report proposed for the mid-term review to have the following potential outcomes based on the extent of the roll-out of smart meters: ... (c) If the roll-out of smart meters did not appear likely to be completed by 31 December 2020, the CMA would consider whether to encourage GEMA to review the situation and take whatever action it considered appropriate.”

The next three paragraphs then note the CMA’s provisional finding that smart meters are not being rolled out as fast as expected; its provisional conclusion that conditions of competition for PPM customers have not changed materially, so the justification for a charge restriction remains valid until the substantial completion of the roll out of smart meters; and the CMA’s view that PPM customers should continue to be protected “until the completion of the roll-out of smart meters to the large majority of PPM customers”. The Provisional Decision then says

“5.6 In line with the approach set out in the Explanatory Note, the CMA proposes to recommend that GEMA should take action to protect prepayment customers beyond the expiry of the PCR, starting as from 1 October 2020 (for the reasons set out above at paragraph 4.23) until the substantial completion of the roll-out of smart meters.”

There follow three paragraphs where the CMA expands upon the scope of its recommendation. One paragraph refers to preparing to apply the Default Tariff Cap to PPM customers, the other paragraphs recommend undertaking additional analysis on the headroom for PPM customers, and on allowances for PPM payment method uplift and installation. The provisional recommendation is then as follows.

“5.9 The CMA’s provisional recommendation to GEMA is therefore the following: The CMA recommends that GEMA should provide protection for prepayment meter energy customers after the expiry of the CMA’s prepayment meter charge restriction until the roll-out of smart meters is substantially complete in line with its objectives and duties. Within this context, the CMA also recommends that GEMA give consideration to any future changes of circumstance in light of the original aims of the PCR when setting the level of any replacement charge restriction.”

This approach is confirmed in para 6.3(b) cited above, viz

“6.3 The CMA has provisionally concluded that: ... (b) in the long run, the CMA proposes: (i) to recommend that GEMA should provide protection to prepayment customers when the PCR expires; ...”

The claim in para 5.6 is misleading. There is no one single “the” approach in the Explanatory Note, there are two mutually inconsistent approaches. Para 5.6 of the CMA’s Provisional Decision *is* in line with what is herein called the incorrect version. It is *not* in line with the correct version set out in the body (para 75) of the Explanatory Note. It is *not* in line with the correct interpretation cited explicitly just four paragraphs earlier in para 5.2 of the Provisional Decision. And most importantly, it is *not* in line with the recommendation in the EMI Final Report.

## **2.4 Further discussion of the consultation process**

This is not to say that the CMA today is necessarily bound by the view that the CMA took in its EMI Final Report. However, a consequence of the CMA’s failure to recognise the distinction between the correct and incorrect versions of what the EMI Final Report recommended is that consultation respondents were not invited to comment on whether a different policy was appropriate. Indeed, they have now been advised that the proposed policy is “in line with the approach set out in the Explanatory Note”, and by implication with the policy recommended by the EMI Final Report, when clearly the latter is not the case. In consequence, the CMA has neither invited nor received views on whether it should change the policy recommended by the EMI Final Report, nor has it addressed this issue in its Provisional Decision.



It was noted above that the eight industry suppliers and industry trade organisation responding to the February 2019 Issues Statement did not identify and argue against the proposed change in policy (compared to the policy set out in the December 2018 invitation to comment on whether to launch a review). Could it be argued that this indicates that this change in policy is not a matter of great importance to them, and/or that they might even welcome it because a continued tariff cap, provided it is set at an acceptable level, would reduce the extent of competition in the market and thereby provide them with a less risky commercial environment and a quieter life? And hence that any ambiguity in the consultation process and the Provisional Decision is not of significance, so that not only the non-respondents to the consultation, but also the respondents too, tacitly accepted the suggestion that, in view of the delayed smart meter roll-out, the PPM tariff cap (or an equivalent) should simply be continued.

Against this are three counter-arguments. First, the CMA has not sought to make any such claims. Second, at least one respondent supplier argued strongly against a continuation of the tariff cap, and by implication against the approach in the Issues Statement. E.On argued that

“83. The CMA may consider that the delays to the smart meter rollout warrant an extension of the PPM cap beyond the end of 2020. We believe this is not an appropriate response. ... 85. We believe that, because of the unintended consequences of the PPM cap and also the default tariff cap, both caps should end at the earliest possible opportunity, i.e. the end of 2020.”<sup>1</sup>

Third, if suppliers are assumed to accept the continuation of the PPM tariff cap because this reduces competition, it surely requires some explanation why it is nonetheless still in the interests of customers to continue the cap.

### **3. Insufficient collection, analysis and assessment of relevant evidence**

#### **3.1 Issues that need consideration, but are not addressed**

As explained, the EMI Final Report noted the possibility that the smart meter roll-out might not be complete by December 2020. Its considered view was that the appropriate response would not be simply to extend the PPM tariff cap. It would be better – “more proportionate” - for Ofgem to review the situation and take whatever action it considered appropriate.

What kind of issues should Ofgem – or the CMA or BEIS or any responsible authority wishing to pronounce on this situation - consider in such a review? It would need to consider at least three main questions.

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<sup>1</sup> E.On Response to CMA Statement of Issues, published 7 June 2019, available at [https://assets.publishing.service.gov.uk/media/5cf68320ed915d0972b598d7/E.ON\\_Issues\\_Statement\\_Response.pdf](https://assets.publishing.service.gov.uk/media/5cf68320ed915d0972b598d7/E.ON_Issues_Statement_Response.pdf)

- First, in retrospect and with the benefit of hindsight, how accurate were the assumptions made at the time? How valid were the concerns identified by the EMI Final Report – were they broadly reasonable or somewhat overstated or understated?
- Second, again in retrospect and with the benefit of hindsight, how well identified and quantified were the potential beneficial and adverse impacts of the tariff cap? And what effects has it actually had?
- Third, looking forward and with the benefit of three more years of experience since the EMI Final Report, in what respects have conditions changed since then? Does this indicate a greater or lesser need for protection of PPM customers? If there is need for continued protection, would an extension of the PPM tariff cap, or some equivalent, be the best way to do this, or would there be, on balance, an advantage in some other approach?

Has the Review actually addressed these questions? Has it sought evidence and views on the issues involved? Has it sought to appraise this evidence and test these views? Has it thereby come to a considered judgement as to whether there is a need for continued protection for PPM customers and if so whether a continuation of the PPM tariff cap is the best way to do this? The answer to all these questions seems to be No.

The Review has “explored four potential changes of circumstance” (para 3), namely whether conditions of competition have changed in the PPM segments, the speed and scale of smart meter roll-out, the introduction of the default tariff cap, and changes to the costs of supplying PPM customers relative to the costs allowed in the PPM tariff cap. Having concluded (prematurely and wrongly, it is argued here) that conditions of competition have not changed, it has focused on the other three questions, which are indeed important. But the Review has done next-to-nothing in the way of asking and answering the also-important questions posed above, seeking and testing relevant evidence, and assessing alternative policies with respect to the continuation of the tariff cap.

Take for example one of the questions above. In what respects have conditions changed since the EMI Final Report? This is an important input into deciding what effect the tariff cap has had and whether the tariff cap should be continued. What is the Review’s response to this? The Statement of Issues says “23. The CMA highlights that this review will not be examining the extent to which the features identified in the original investigation are continuing with the same intensity as at the time of that investigation.” In other words, the Review is not going to look at whether the conditions that originally justified the cap still obtain. But that is absolutely central to the question whether the PPM tariff cap remains appropriate. How then can the Provisional Decision judge whether the PPM tariff cap should be continued after 2020?

### **3.2 How reliable have EMI Final Report judgements turned out to be?**

Should it simply be assumed that the EMI Final Report got it right, and that its assumptions and judgements need not be questioned or revisited? Consider three examples.

The Provisional Decision recommends a change in the method of calculating the PPM tariff cap precisely because several of the detailed assumptions in the EMI Final Report have not proved correct.

“6.1 (b) The roll-out of smart meters has not progressed in line with the initial projections on which the EMI Final Report was premised.... (e) Some of the costs that an efficient supplier is expected to bear in supplying prepayment customers have increased to a level materially higher than that reflected in the PCR methodology. There are two categories of cost where, due to changes since its design and introduction, the PCR is underestimating costs incurred which, together, amount to a change of circumstance. 6.2 As a result of the changes of circumstance relating to policy and pass-through smart metering costs, our provisional conclusion is that the PCR is no longer meeting all of its aims, due to underestimating the costs incurred by efficient suppliers.”

What about the big picture? Here is the response of the EMI Final Report to a concern raised by the former energy regulators.

“14.432 ... Professor Littlechild et al noted that the PPM Price Cap Remedy might increase the likelihood of price caps being applied elsewhere in the energy markets which could in turn harm regulatory certainty.

14.433 ... We consider that since these circumstances apply to PPM customers but not energy customers more generally there is a clear distinction between where a price cap is justified (namely PPM customers) and the rest of the market where it is not. We therefore do not consider there to be a significant risk that the PPM Price Cap Remedy increases the likelihood of price caps being applied elsewhere in the energy sector.”

Hmm, we know how that turned out. It had precisely the impact that was not considered plausible. The PPM price cap remedy applied to only about 15% of customer accounts, but it inspired the Government to apply another price cap to variable and default tariffs, so that price caps now apply to about 60% of all customer accounts.

Here is another judgement by the EMI Final Report.

“14.435 We note that one possible outcome of the mid-term review is that the CMA may decide to recommend that Ofgem take whatever action it considers appropriate (such as introducing a new price cap) from the start of 2021. However, we would only expect to recommend a further price cap in the event that the roll-out of smart meters was materially behind schedule at the time of the mid-term review. In light of the above we do not consider that there is a significant risk of the PPM Price Cap Remedy becoming a permanent feature of the market.”

This last judgement remains to be tested. But existing legislation now means that a price cap remedy remains a feature of the market for some five years unless there is an active decision to remove it. There seems no enthusiasm for removing it, and the Ofgem Chair and CEO have each indicated their expectation that some form of price cap will need to continue for certain vulnerable customers. Moreover, the Provisional Decision is in effect to extend the

PPM price cap indefinitely, since there is no confident prospect at present of the smart meter roll-out ever being complete. So there does indeed seem a significant risk of the PPM price cap becoming a permanent feature of the market.

These are just a few examples that suggest that it would be prudent to re-examine the validity of previous assumptions underlying any policy choice, not least the PPM tariff cap, rather than simply to extend that policy regardless.

### **3.3 A misunderstanding in assessing competition**

Where the Provisional Decision does attempt some analysis, it misunderstands the issue. For example, para 2.8 assesses “whether competition in the prepayment segments of the energy markets has improved sufficiently for the PCR [PPM tariff cap] to no longer be necessary...”. It finds “no material improvement”, instancing in para 2.10 a reduction in customer switching in the PPM segments and lower price dispersion. It concludes “2.11 Based on the above, our provisional finding is that the conditions of competition in the prepayment segments have not improved significantly since the introduction of the PCR and that levels of overall engagement among prepayment customers are still low ...”

But the reductions in switching and in price dispersion were predicted and plausible adverse consequences of the PPM tariff cap. The relevant question is not whether these particular indicators of competition have actually increased or decreased but what would have happened to them in the absence of the PPM tariff cap. Has there been an improvement in the underlying conditions of competition? The term “conditions of competition” has come to mean this, for example as reflected in Ofgem’s recent consultation on the conditions for effective competition.<sup>2</sup> The Provisional Decision shows no understanding of this distinction, and conflates the impact of the PPM tariff cap with changes in underlying market conditions.

### **3.4 How important is the smart roll-out to competition?**

Admittedly there are not as many smart meters installed as the CMA projected but nonetheless there were about five times as many smart meters in mid 2018 than there were in early 2016. About one third of PPM customers now have smart meters, a higher proportion than the one quarter or so in the non-PPM market. The EMI Final Report was concerned about new suppliers’ access to smart meters and meter pages, but there is no lack of availability of smart meters in the PPM sector: this is how the new suppliers compete (using

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<sup>2</sup> Thus, “... we identify three broad conditions for effective competition... Condition 2: the competitive process is expected to work well in the absence of the cap.” “We also recognise the difficulty of assessing the effectiveness of competition while the price cap is in place as it affects both competitive dynamics and customer outcomes. We will take a pragmatic approach to this and will make every effort to account for the effect that the default tariff cap may have on the indicators that we monitor, and in particular, whether this impact is likely to be temporary or more long-lived.” Executive Summary, Developing a framework for assessing whether conditions are in place for effective competition in domestic supply contracts, Ofgem Discussion Paper, 29 May 2019, available at [https://www.ofgem.gov.uk/system/files/docs/2019/05/cfec\\_discussion\\_paper\\_280519\\_finalversion.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/05/cfec_discussion_paper_280519_finalversion.pdf)

Secure smart meters). The issue of limited meter pages (to the extent that it was a real problem in the first place) has now been addressed (c.f. consultation response from E.On referenced in fn 1 above).

More importantly, perhaps, is there any evidence that a “complete” roll-out of smart meters (and associated 24 hour switching) would be feasible or cost-efficient or conducive to any greater competition than the present level of roll-out? The second sentence of Ofgem’s recent Open Letter on the smart meter roll-out says that “Smart metering brings immediate benefits to consumers, helping them to take control of their energy usage, and is a key enabler for the transition to a more flexible energy market and the move to a low carbon economy.”<sup>3</sup> But there is no suggestion that it increases competition or is critical to protect PPM customers.

With more smart meters there will be advantage in terms of quicker and more accurate bills, fewer estimated bills, and hence reduced complaints and better customer service. Against this, the ever-increasing cost of installing smart meters (and securing 24 hour switching at an estimated £0.5 billion) will mean higher customer bills. There may be advantages in terms of the variety of tariffs that can be offered, though experience in other markets with smart meters (such as Texas, Italy and Victoria) does not suggest that more than a negligible proportion of customers and suppliers will be interested in such tariffs. Some suppliers are now using smart meters to offer new PPM services (e.g. Utilita’s new Power Up feature whereby PPM customers can apply for a top-up when they have run out of credit and need to get back on supply). These seem likely to characterise future competition in the PPM sector.

But is there any evidence that customers are more likely to switch, or engage in the market, or strengthen their “weak customer response”, if more smart meters are installed? And if about 15% of customers prefer to use smart meters, a proportion that has been relatively stable in recent years, is it of any relevance to competition for PPM customers what the smart meter roll-out is for non-PPM customers? Is smart metering basically a red herring when it comes to the case for continuing the PPM tariff cap?

### **3.5 Evidence of greater competition than the EMI Final Report assumed**

Although the PPM tariff cap has had an adverse effect on competition, there seems no reason to think that the underlying conditions of competition in the PPM market – that is, what competition would be like in the absence of the cap – are worse than they were at the time of the EMI Final Report. In some respects the underlying conditions have improved, and indeed are better than in the non-PPM market.

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<sup>3</sup> Ofgem, Smart Meter Rollout: Open letter on Energy Suppliers’ Progress, Future Plans and Regulatory Obligations, 19 June 2019, available at <https://www.ofgem.gov.uk/publications-and-updates/smart-meter-rollout-energy-suppliers-progress-and-future-plans-open-letter-june-2019>



My earlier submission to this Review gave numerous examples of increases in competition since the EMI Final Report was finalised in early 2016, but before the default tariff cap took effect.<sup>4</sup> In the energy supply market generally these included

- Increased number of domestic suppliers from 38 in June 2016 to 64 in June 2018 (later rising to over 70 before falling again)
- Increased annual switching rate from 15% in early 2016 to 18% in early 2018 (and now around or over 20%, a record high)
- Increased proportion of switches going to non-Big Six suppliers, from 50% in early 2016 to 62% in mid-2018
- Increased share of market with non-Big Six suppliers, from 13% in early 2016 to 24% by early 2018 (and now 27%)
- An unprecedented number of supplier failures - over 15 from 2017 to 2019 – including several of substantial size (in the range 90,000 to 290,000 customers each).

In PPM market segments, the PPM tariff cap has had a very adverse effect on competition. But how was competition developing before then, and how does it compare with non-PPM segments?

- The rate at which the Big Six suppliers were losing PPM customers to smaller suppliers more doubled, from 50,000 gas and electricity customers in June quarter 2015 to over 100,000 such customers in December quarter 2016.
- The share of non-PPM customers with non-Big Six suppliers increased from 7.5% in mid-2014 to 14.5% in mid-2016 to 24.4% in October 2018. In contrast, the share of PPM customers with non-Big Six suppliers increased faster, from 7% in 2014 to 17.2% in 2016 to some 30 - 34% in 2018.
- In the non-PPM market, no entrant supplier has yet reached the size of even the smallest Big Six supplier. In contrast, Utilita and Ovo have overtaken five of the Big Six suppliers to become the second and third largest PPM suppliers in the market.

My previous submission concluded as follows. “The PPM tariff cap was predicated on the assumptions that weak customer response is a more significant problem among PPM customers than in the retail market as a whole, and that metering constraints restricted PPM competition. Both these assumptions are now clearly incorrect.”

The evidence shows that PPM customers were more active than non-PPM customers, small PPM suppliers are relatively more successful against the Large suppliers, and smart metering has been a means of competing successfully in the PPM market rather than a restriction on competition.

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<sup>4</sup> Stephen Littlechild, “Providing for a transition back to a competitive retail energy market: A response to the CMA’s Invitation to Comment on its proposed review of the Prepayment Charges Restriction Order 2016”, 17 January 2019, available at [https://assets.publishing.service.gov.uk/media/5c6adf46ed915d4a315f64ee/Cambridge\\_EPRG\\_S\\_Littlechild\\_response\\_to\\_ITC\\_.pdf](https://assets.publishing.service.gov.uk/media/5c6adf46ed915d4a315f64ee/Cambridge_EPRG_S_Littlechild_response_to_ITC_.pdf)

My earlier submission also provided extensive arguments against the EMI Final Report analysis of the domestic energy market. The submission by E.On (fn 1 above) gives more and recent evidence on these and other issues. Not least it explains the various distortions and restrictions to competition introduced by the PPM tariff cap. Another very recent example is the substantial increase (about £100) in most Standard Variable Tariffs as a result of the increase in the default tariff cap. Some critics noted that wholesale costs had not increased that much, or had fallen since the level of the cap was determined, but other suppliers explained that it was too risky to do other than hedge their wholesale costs on the same basis as the cap was set. In other words, the cap had led to higher prices than would otherwise have been the case.

Whether or not these arguments and conclusions are accepted, any review of the PPM market and any recommendation regarding a future PPM tariff cap has to consider these claims and associated evidence and form a considered opinion about them. The Provisional Decision has not done so.

#### **4. Ofgem review and action versus CMA opinion**

Suppose the choice were between the two versions of what the EMI Final Report recommended. Leaving aside which is correct in terms of what the EMI Final Report actually said, what are the comparative merits of the two options?

The first option is that the present CMA Review recommends now that Ofgem provides protection to PPM customers when the PPM tariff cap expires in December 2020, essentially by extending the PPM tariff cap (in some form) until the smart meter roll-out is substantially complete. The case for this is perhaps based on speed: the ability to give earlier reassurance to PPM customers that they will be protected by an extended tariff cap for a further period. There is also the reassurance that, if Ofgem decides to extend the duration of the tariff cap (in some form), this will have the support of the CMA.

The case against this first option is that (in the view of this submission) the CMA has not adequately reviewed the situation and consequently does not fully understand how the PPM market is working and how the PPM tariff cap is impacting on it, and what if any role the extent of smart meter roll-out plays in this. Nor has it fully considered the implications of the various policy options available after December 2020. Consequently, there is no assurance that extending the PPM tariff cap will be the best option. Indeed, it was the view of the EMI Final Report that recommending such extension at this juncture was *not* the best option. Furthermore, given the imperfect consultation process on this particular aspect of the Order review, it seems possible that any such recommendation would be challenged, thereby calling into question the speed and reassurances noted above. And of course it is not certain that Ofgem would take the same view as the CMA, which would raise interesting questions in the event of an appeal to the CMA against Ofgem.

The second option is that the CMA should encourage Ofgem to review the situation and take whatever action it considers appropriate – which action might or might not involve extending the PPM tariff cap after December 2020. The argument for this is that Ofgem will have the ability, the time and the incentive, over the course of the next year, to put itself in a significantly better position than the CMA presently is to assess the situation, to consult on options, and to take whatever action seems appropriate. In particular, Ofgem will have access to better and more up-to-date information than the CMA presently has. Consequently, the resulting decision will be better informed, more likely to be a better decision, and less likely to be the subject of legal challenge.

What are the arguments against this option? That the CMA is passing up an opportunity to be seen to be influencing policy by recommending what specifically Ofgem should do? But this means rejecting the considered earlier view of the CMA itself, and implies a lack of faith in Ofgem's ability to decide on a sensible policy.

It is difficult to see other arguments against encouraging Ofgem to review the situation and take whatever action it considers appropriate.

## **5. Conclusions**

Provisional Decision 6.3 (a) varies the Order to increase certain cost allowances in order to remedy defects in the specification of the PPM tariff cap. These defects seem real, the threats to quality of service, competition, and the viability of suppliers are concerning. Nothing in the present response is intended to prevent the recalibration of the PPM tariff cap to address these issues.

Provisional Decision 6.3 (b) recommends that GEMA/Ofgem should provide protection to prepayment customers when the PCR expires, by extending the PPM tariff cap (in whatever form) after December 2020. This submission has argued that deciding now to extend the PPM tariff cap is premature and inappropriate. It is unduly hasty, given the risks that the Provisional Decision itself highlights in setting price caps.

The Provisional Decision runs contrary to the explicit recommendation of the EMI Final Report, which raises questions about the CMA's consistency. There has not been adequate consultation on the new proposal. There has not been sufficient collection and assessment of relevant information on which to base such a decision. And there is no need to take such a decision. The alternative course of action actually recommended by the EMI Final Report - that the CMA should encourage Ofgem to review the situation and take whatever action it considers appropriate – is eminently feasible. It would allow the collection and more informed assessment of more recent evidence, and is self-evidently more sensible.