Utilita Energy Limited

Government electricity rebate consultation response

14 July 2014

utilita
pre-pay the smart way

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Impact Assessment

From the outset Utilita has been of the opinion that the GER would be an incredibly inefficient and expensive way to deliver a relatively minor benefit to UK energy customers. Expensive due to the huge admin costs involved in changing licences, new processes and contacting energy households. This is far greater than the value being delivered. Inefficient because there are better ways the government could use this money to benefit consumers.

However, what is also now apparent is that as a prepay supplier we face exponentially adverse costs compared to other suppliers. Unless the government is willing to reimburse the administrative costs of delivering this scheme, Utilita's competitive position in the market will be adversely impacted. As prepayment delivery costs are much higher than credit customer delivery costs, this should be taken into consideration and the government should reimburse the marginal cost of prepayment rebate administration or offer some form of compensation. Utilita will be put at further competitive disadvantage due to the cash flow impact if funds for the rebate are not available in advance and immediately at point of need, without any payment terms or delays. If this is not the case then there is a material risk of Utilita not being able to continue trading due to cash flow insolvency as a result of the GER.

Utilita has fought hard to deliver lower prices to pre-pay customers over the last four years and the GER presents a significant risk to the sustainability of our business model for the next two years and is therefore unacceptable.

Bill Bullen

Managing Director

Government Electricity Rebate (GER) Consultation Response

As an independent, domestic energy supplier with a portfolio predominantly consisting of prepayment customers (99%), the rebate presents a significant risk to Utilita's business growth, sustainability and working capital, whilst putting us at a competitive disadvantage within the market (as costs to administer the rebate are significantly higher for prepayment premises). Analysis of the differential impact on suppliers of different sizes and market segments, including Utilita, are contained in section B of this consultation response. The analysis indicates the effect of administering the rebate will reduce the profits of a small, prepayment supplier by 17%, whereas the profit of a large credit supplier will only be reduced by 3% (see figure 9.3).

It is stated by the CMA that the government intends to encourage competition and growth of new and existing small suppliers. Analysis summarised in figure 9.2 demonstrates that passing costs onto suppliers puts small suppliers at a competitive disadvantage. Moreover, the differential costs of delivering the rebate to prepayment customers will have the effect of discouraging growth in this sector, and therefore competition. Minor system changes for credit customer suppliers will be significantly less costly than sending vouchers, additional letters, setting up systems etc. and therefore will have an adverse effect on any supplier where the proportion of prepayment customers is higher than the national average. The likely effect of this in the long term will be higher prices for prepayment customers, who are statistically more likely to be in or at risk of fuel poverty. DECC's analysis (Impact Assessment No. DECC0167) results in a positive NPV because of the increased utility experienced by customers in lower income deciles. It does not account for, however, the differential administration cost of the rebate by income decile in terms of increased prices for prepayment customers. It is Utilita's position that this omission overstates the NPV of the GER. Furthermore, on NPV grounds alone, a higher NPV could be obtained through other redistributive activity and therefore on financial grounds the GER cannot be justified (figure 10.1).

This activity is outside the normal remit and operating conditions of energy suppliers and as an unplanned activity has not been built into our cost model for 2014 or 2015. This poses a particular challenge for suppliers without large amounts of liquidity or balance sheets to absorb this expense, which in turn distorts the market, favouring large suppliers and discouraging competition.

At the time of rebate delivery cash reserves are low and falling (see figure 8.3) due to seasonal trends and the Renewable Obligation. As such, further risk or strain on cash flow would have particularly damaging effects, including the risk of cash flow insolvency, which is calculated to have a risk weighted cost to Utilita of c.£640,000.

The impact on Utilita will not only be the cost to administer the rebate, including, but not limited to, Paypoint vouchers, staff development/implementation costs, communication, text messages, increased call volumes, fees, postage (see figure 8.1), but will also effect revenue: Where Utilita acquires a new prepayment supply that has received the rebate, Utilita will pay for the energy cost on the wholesale market but will not have received the cash for the rebate, which will have been received by the previous supplier. The current delivery proposal provides no mechanism for reconciliation for this and consequently Utilita is estimated to incur c.£119,000 in additional cost that can only be avoided by not actively competing to attract new customers. The net impact being expansion and competition in the prepayment sector is discouraged.

Utilita strives to be the most competitive prepayment energy supplier in the country but this large unforeseen cost inhibits our ability to implement our SMART (SMETS) meter programme and in turn contradicts government policy on SMART meter roll out.

As the analysis in the following pages demonstrates, unless rebate costs are reimbursed or some form of compensation made available for prepayment administration costs, Utilita will be put at a significant competitive disadvantage, which will have an adverse impact on the prepayment market as a whole. In addition, unless cash is made available in advance and at point of need, small prepayment suppliers without ready access to short term financing will run the risk of cash flow insolvency.

DECC Question Response	
1 Do you agree with the proposal for a single qualifying date? **Yes.**	**13** Do you agree with the way in which we are proposing to refund suppliers for the rebate provided to prepayment customers? **Must be paid in advance or at point of need with no delay- reasons detailed in response.**
2 Do you agree that suppliers should be under a responsibility to take all reasonable steps to ensure that the eligible customers they supply on the Qualifying Date receive the rebate? **Yes.**	**14** Would a shorter voucher expiry period (e.g. 3 months) be preferable in order to increase uptake? **No, if after 6 months this has not been redeemed then the funds will be returned to government, we have no evidence to support or estimate a redemption rate.**
3 Do you agree that the direction should state that it will only reimburse suppliers for one payment per eligible premises? **Further discussion required with Paypoint.**	**15** Do you agree with our proposals for reimbursing suppliers? **Must be paid in advance or at point of need with no delay- reasons detailed in response**
4 Under what circumstances do you believe it will not be reasonably practical to provide the rebate? **All circumstances.**	**16** Do you agree with our proposals for having specified exceptions within the direction? **Yes, broadly agree.**
5Do you have suggestions for how Government and suppliers can cost-effectively encourage prepayment meters customers to redeem the rebate? **Advertise - This should be communicated clearly by Government.**	**17** Do you agree with the specified exceptions we are proposing to include within the direction? Should there be others? Please provide evidence to support the inclusion of additional exceptions if possible. **Agreed, no.**
6 Do you agree that as a minimum all customers should be informed of the credit via their bills, statements or receipts for crediting their prepayment meter keys, cards or tokens? **How a customer is informed depends on the type of account/meter they have, for credit customers this should just simply be a line on the bill, SMETS IHD, Legacy-Voucher, NSS- Text. Any communication over and above this should be sent by government.**	**18** Do you agree that suppliers should be under an obligation to return any refunds provided by Government in excess of the number of rebates that have been provided to customers? **Yes.**
7 Do you agree with the broad proposals for seeking assurance for the rebate? **Please clarify 'assurance'.**	**19** Do you agree that the direction should require suppliers to pay the full £12 to their customers? **No.**
8 Do you agree that suppliers should be under an obligation to provide information to the Secretary of State and Ofgem for the purpose of the direction? **Yes.**	**20** Do you agree with the way in which we are planning to treat the costs of suppliers? **No.**
9 Do you agree that suppliers should endeavour to credit all their customers' accounts (or send vouchers and SAMs) with the rebate within 6 weeks of the qualifying date? **Yes, prefer shorter.**	**21** Do you have any further evidence about the costs involved in delivering the rebate which you can provide? **Attached.**
10 Do you agree that suppliers should be required to report on the total number of customer accounts by payment method, the number of customer accounts successfully credited (or been sent vouchers and SAMs), the number of exceptions and the timescale for dealing with the exceptions? **Yes.**	**22** Are there any other concerns to your organisation of implementing the Government Electricity Rebate that have not been addressed in this consultation? **Attached.**
11 Do you agree with the way in which we are proposing to reimburse suppliers for the rebate provided to direct debit customers? **Must be paid in advance or at point of need with no delay - reasons detailed in response.**	**23** To assist with the analysis of this consultation please specify whether you are responding on behalf of a domestic electricity supplier or, if you are an organisation or individual with an interest in the Government Electricity Rebate. **Domestic supplier.**
12Do you agree with the way in which we are proposing to reimburse suppliers for the rebate provided to standard credit customers? **Must be paid in advance or at point of need with no delay - reasons detailed in response.**	**24** Name of your organisation? (if applicable) **Utilita Energy Limited** 25 Your name, or named contact for your organisation: **Kate Hallett** **26**Email address: **katehallett@utilita.co.uk** **27**Contact telephone number: **01962 891155**

Cost summary

Cost	Cost type	Function of	Customer type	PV fixed cost (2 years)	Cost per unit	PV total cost (2 years)
Total						**1,290,948**
Voucher issue and fulfilment	Semi variable	Number of key meter customers	Prepayment	4,424	1.18	73,023
Key issue	Variable	Key meter customers vending on incorrect key	Prepayment	3,932	5.50	83,867
Increased average meter balance on new supplies[1]	Variable	Net increase in prepayment customers	Prepayment	-	6.08	119,436
Customer notification	Semi variable	Number of smart meter customers	Prepayment	3,932	0.58	172,523
Smart meter credit	Variable	Number of Smart meter customers	Prepayment	-	0.05	14,534
System developer staff time	Semi variable	Number of customers	Prepayment	5,000	0.005	6,817
System developer staff time	Semi variable	Number of customers	Credit	5,000	0.005	5,010
Managerial staff time	Fixed	N/A	All	37,751	-	37,751
Cash flow finance cost[2]	Variable	Number of rebates issued	Prepayment	-	0.05	19,546
Staff time - exception management	Variable	Number of exceptions	Prepayment	-	8.88	9,818
Staff time- exception management	Variable	Number of exceptions	Credit	-	8.88	349
Call volume change	Variable	Number of customers (1 in 3 assumed to enquire)	All	-	0.29	105,369
Cash flow insolvency	N/A	Risk weighted NPV of future cash flows	N/A			642,906

Commentary

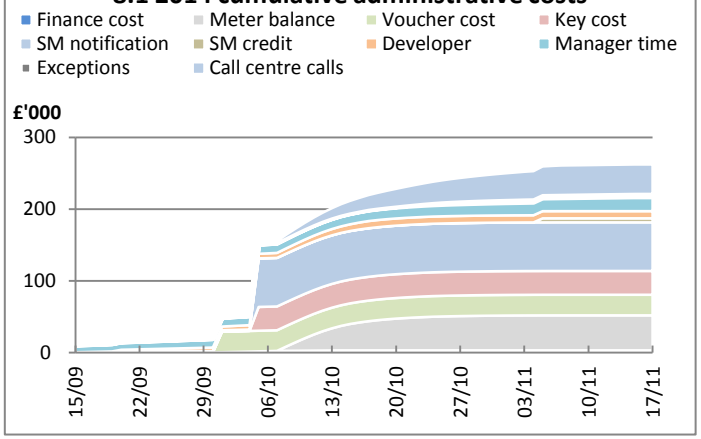
[1] As the rebate will increase the average customer's meter credit balance, any supplier expanding in the prepayment sector takes on an increased liability as no mechanism exits to claim rebate funds from the losing supplier.

[2] Cash flow impact for credit customers is expected to be minimal as in the case of direct debit customers there will be favourable cash impact as cash is received from DECC before the customer's direct debit is adjusted to account for the rebate, and in the case of cash customers the receipt of cash from DECC is likely to be within the payment terms of a customer's invoice.

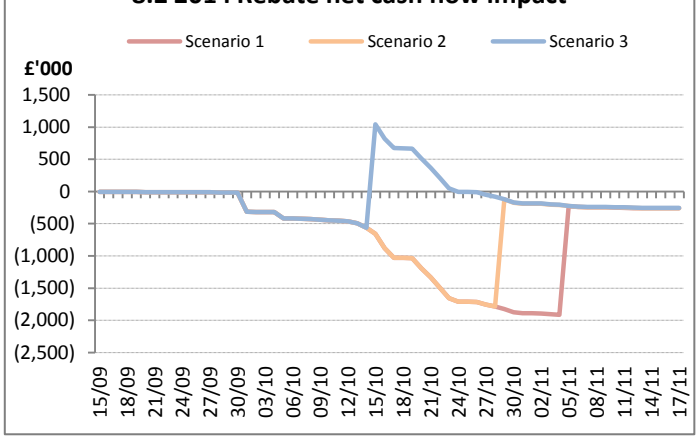
Cost and cash flow impact

2014 rebate only. Excluding risk weighted insolvency cost

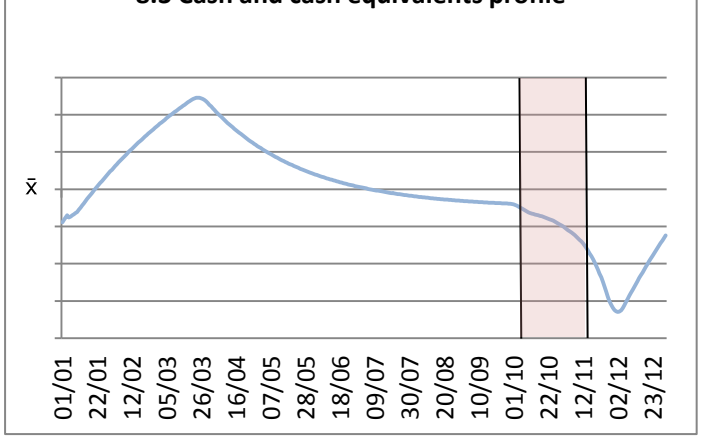
8.1 2014 cumulative administrative costs



8.2 2014 Rebate net cash flow impact



8.3 Cash and cash equivalents profile



Commentary

Cumulative cost of administering the 2014 by category over time. Cost of the rebate itself is excluded.

Commentary

The three scenarios reflect different cash flow impacts of different payment terms.

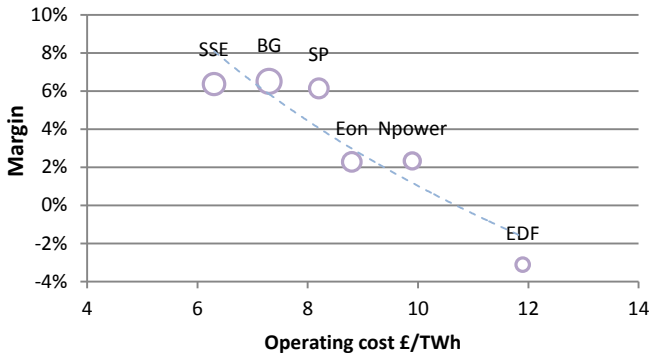
Scenario 1: DECC evidence validation 14 days, payment 14 days.
Scenario 2: DECC evidence validation 7 days, payment 14 days.
Scenario 3: DECC evidence validation 7 days, payment 0 days.

Commentary

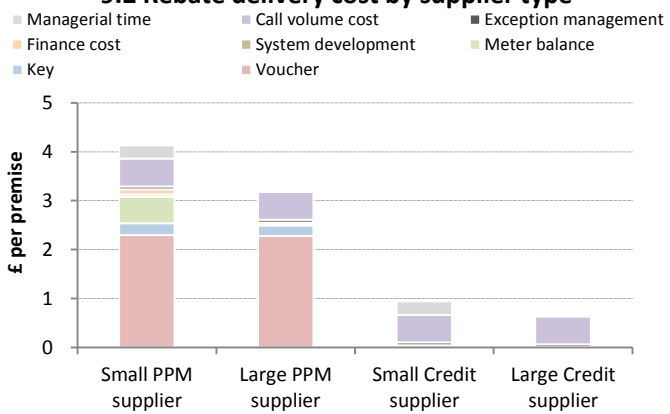
Cash and cash equivalents in the prepayment sector is highly seasonal. Cash steadily decreases throughout the summer and reaches a minimum in the early part of winter due to wholesale trading requirements and other factors such as Renewable Obligation . The time at which the rebate will have an effect on cash flow (indicated in the shaded red area) coincides with the period where cash is already decreasing rapidly, making financing arrangements more difficult and costly to secure.

Notes

9.1 Operating cost vs margin domestic supply[1]



9.2 Rebate delivery cost by supplier type



9.3 GER impact by supplier type

Supplier type	Total cost Δ %	Profit Δ %
Small PPM	0.34%	**-17%**
Large PPM	0.26%	**-13%**
Small credit	0.08%	**-4%**
Large credit	0.05%	**-3%**

Commentary

The graph shows the correlation between operating costs and profit margin for domestic supply in the UK energy market. The size of the data point indicates the relative total operating profit by supplier.

Assuming the relationship is causal, profit margin can be described as a function of operating costs:
Y = -0.153ln(x) + 0.3632
Where
Y = profit margin
X = operating costs per TWh

Commentary

For the purposes of this comparison, a 'small supplier' will have supply of 100,000 premises and a 'large supplier' will have supply of 5,000,000 premises at 8th October 2014. The small supplier is assumed to reach 175,000 premises by October 2015 and the large supplier is assumed to have no material net change in premises supplied.

Costs per premises are higher for the small supplier due to the fixed cost element of delivering the rebate. Costs of delivery to prepayment premises are significantly higher and are reflected in the average costs per premises for a prepayment specialist supplier.

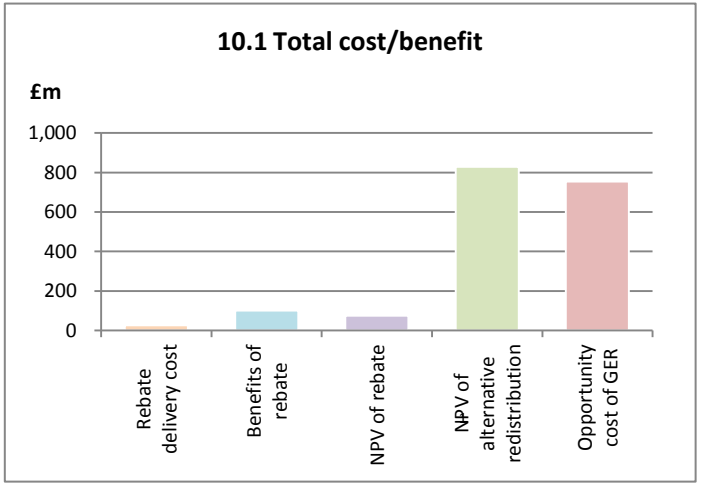
Commentary

The table shows the impact of the rebate in the costs and profits of four supplier types. Although total cost percentage change for all suppliers is relatively low, the low profit margin in the domestic electricity supply business (typically around 2%[2]) results in a much larger impact on profit over the two year period being considered. Moreover, the impact varies considerably by supplier size and market segment, resulting in a competitive advantage or disadvantage (favouring large suppliers and suppliers specialising in credit customers at the expense of smaller suppliers and suppliers specialising in prepayment customers.

Notes

[1] Source data adapted from OFGEM (2013). *The revenues, costs and profits of the large energy companies in 2012.* https://www.ofgem.gov.uk/ofgem-publications/84640/css2012summarydocument.pdf

[2] Ibid.



Commentary

Utilita estimates total supplier delivery costs to be c.£27m. DECC estimates the benefits, largely resulting from increased utility from redistribution, to be £100.5m[1].DECC analysis states that no government costs will be incurred as it can be incorporated into 'business as usual' operations. Using the same methodology, targeting households in the lowest two income deciles (e.g. adjusting benefits through the Department of Work and Pensions) would have greater benefits and negligible administration costs, significantly improving NPV. Under the alternative scheme it is assumed that the value of the transfer equates to £301.1m (as per the DECC Impact Analysis) and is split equally between the lowest two income decile households (weighted at 2.8 and 2.4 times the median decile). The distributional benefit in the second year is discounted at 3.5%, as per the DECC analysis. As a result, using DECC methodology, the GER has an opportunity cost of over £750m, in than an alternative government scheme could generate £750m more utility than the GER.

Notes

[1] Department of Energy and Climate Change (2014). *Government Electricity Rebate Impact Assessment* . IA No: DECC0167.