utilita
life with power

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Dear Anna,

Re: Protecting energy consumers with prepayment meters

Thank you for the opportunity to comment on the above consultation and the short extension to acknowledge the current industry challenges.

The most important point we want to make is that a safeguard tariff should be just that; a tariff which protects those customers who need it from the excesses of differential pricing. A safeguard tariff should not seek to determine the costs of a theoretical 'efficient' supplier and set prices at that level. The approach of seeking to determine a single theoretical supplier – as is acknowledged in the consultation document – fails to recognise or adequately allow for different supplier models.

The appropriate, and most effective long-term approach is to apply the Pay on Receipt of Bill (PORB) tariff to all customers, regardless of payment method. This approach, of applying a single cap for all customers, regardless of payment method, would protect the most vulnerable while providing incentives for suppliers to compete for customers with a range of offers.

The current price-capping regime, even with the reviewed PPM price cap, is likely to cause further supplier failures. We believe that rather than continuing to ignore the effect on the industry of price capping, it is time for Ofgem to act to remedy the harm it has caused by urgently establishing a single safeguard tariff at the PORB level, and so enable a competitive energy retail market to endure.

Moving to the specifics of the consultation document, there are several areas which cause us serious concern. We do not agree that Ofgem's approach to the treatment of suppliers is equitable, neither does it ensure that suppliers can finance their regulated activities.

Ofgem takes the approach that suppliers who meet the average 'distribution' of customer types, or who can cross subsidise, will be able to meet their efficiently incurred costs. This approach disregards suppliers who seek to innovate and to serve particular market sectors - such as prepay – well. Instead, it prioritises those suppliers who focus on direct debit customers or credit customers, while perpetuating a cross subsidy. Moving to a single safeguard tariff would resolve this challenge.

This case is clearly demonstrated in the consultation document. Ofgem considers that the PPM uplift may not be cost reflective and specifically that it is not enough to cover efficient costs. *'In maintaining the current PPM uplift, we should spread the proportion of PPM costs that exceed the PPM uplift onto other payment methods. In practice, the methodology we used to calculate the operating cost allowance already does this. All customers (regardless of payment method) pay a portion of efficient PPM costs. We propose to maintain that approach.'*

This is unacceptable in a competitive market. As we argue above, specialist suppliers are penalised or rewarded arbitrarily, and only certain types of innovation are supported. The intention to prevent excessive price differentials can be met through either fully cost reflective caps or, more effectively, by applying one cap that suffices for all payment methods. In this case, the PORB cap.

Ofgem further notes that *'Provisionally, we expect the different impacts on suppliers [of an inaccurate PPM uplift] with more or fewer PPM customers than average to be acceptable.'* However, Ofgem does not bring forward evidence for how this statement has been tested, the effect on customers, the competitive market or individual suppliers such as Utilita. We ask that Ofgem provides us with its detailed analysis on how the assessment of acceptable impacts, for example on Utilita, has been carried out. We would be happy to meet with Ofgem to better understand the analysis.

Moving to the assessment of PPM customers, Ofgem states that *'Most PPM customers are also default tariff customers, and so may not be engaged in the market'*. Ofgem has failed to substantiate this point. We have repeatedly raised with Ofgem the fact that where a supplier has only a very small number of tariffs and does not lock customers into fixed term contracts, being on a variable tariff does not mean that the customer has not made a choice or is on a poor value default tariff.

Where a customer has moved to a new supplier and selected a variable tariff, the customer has made a very clear choice. They can keep their options open and move supplier easily. The amount of switching in the prepay market shows that such customers are often highly engaged – with some choosing service or preferring a smart meter, others being price-driven.

We believe that poorly or unsubstantiated statements of this sort, are not robust and show a fundamental misunderstanding of the effect of price capping. First, being on a variable tariff does not imply disengagement, and Ofgem should substantiate any assertion that it does. Secondly, the level and prescription of the PPM cap (that it applies to all PPM customers, even to those not on 'default' tariffs), means suppliers incur considerable risk, without the prospect of improved profitability, in offering fixed term tariffs to PPM customers beyond the contemporaneous price cap period. This may again restrict the types of offers that suppliers may be able to make available to prepay customers under the current cap.

Ofgem also sets out in para 4.19 that it is actively promulgating an ongoing cross-subsidy and preventing efficient suppliers of prepay customers from recovering their efficient costs.

'4.19. A fully cost reflective approach would set the PPM uplift at the level of efficient incremental cost of serving PPM customers. This approach would set tariffs in line with efficient costs, but preliminary analysis suggests that it would substantially increase tariffs for PPM customers and reduce tariffs for other customers to a lesser extent.'

This approach by Ofgem directly contributes to the difficulties faced by suppliers in the current market. As an economic regulator, Ofgem should be ensuring a level playing field for market players, addressing market distortions and creating the arrangements for a flourishing competitive market. We are very concerned that the current approach does not meet this challenge in several areas; by creating market distortions and forcing losses on suppliers, Ofgem reduces customer utility and even endangers the existence of a competitive retail market.

Finally, we are extremely concerned with Ofgem's unequal approach to the prepay cap. Throughout the document, Ofgem has taken the approach of supporting a cross subsidy, and not allowing prepay suppliers to recover the efficient costs of supply. However, in paragraph 5.19 copied below, Ofgem takes a different approach, which is equally a matter for concern.

'5.19. We propose to introduce a non-pass-through SMNCC allowance specifically for PPM customers. Our preliminary consideration and analysis suggest that replacing PPMs with smart meters has greater benefits (or lower net costs) for suppliers than replacing credit meters. We should consider the particular impact on the smart meter rollout on PPM customers.'

This appears to suggest that while prepay suppliers will not be allowed to recover their efficient costs under the cap unless they can cross subsidise, Ofgem has identified one area in which prepay benefits may be higher (or costs lower) and it therefore proposes to make provision for an adjustment in this case. This is not an acceptable approach - Ofgem cannot only review those allowances it believes may be reduced.

Ofgem should adopt a consistent approach to adjustments; if it wishes to reduce this allowance, it must also accurately account for all PPM related costs, including the PPM uplift. Applying a focused adjustment in only one direction or to only one aspect of the cap will increase further the distortions set out above.

We are a member of E-UK and support the points raised in the E-UK submission in respect of this consultation document, which we have not restated here.

In summary, the PORB cap should be applied to all customers. Price capping at the current levels is not sustainable, but if price capping in the current form is to continue, it should not arbitrarily create winners and losers by allowing inaccurate payment method uplifts. The PPM payment method uplift should be made properly cost-reflective.

We hope these comments have been helpful and would welcome the opportunity to discuss the points raised in more detail.

Yours sincerely,

By email

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