



## CMA ENERGY MARKET INVESTIGATION

### SCOTTISHPOWER'S RESPONSE TO THE ADDENDUM TO PROVISIONAL FINDINGS

#### INTRODUCTION AND EXECUTIVE SUMMARY

- (a) ScottishPower welcomes the opportunity to respond to the Competition and Markets Authority (CMA)'s Addendum to Provisional Findings (APF) published on 16 December 2015 in the CMA's investigation into the supply and acquisition of energy in Great Britain (GB) (Market Investigation). We have responded separately to the Second Supplemental Notice of Possible Remedies (SSRN) published on the same date.
- (b) We consider that the CMA's decision to focus attention on the prepayment segment (PPS) has been a valuable exercise which has brought a number of issues to the fore; while we think that the provisional adverse effects on competition (AECs) identified by the CMA need some refinement, we agree that there are some issues and impediments to competition that should be addressed. In general, however, we think that the APF may be more pessimistic than the most recent evidence suggests and that a more precise description of the problems may suggest a different approach to the remedies that would more effectively facilitate stronger competition.
- (c) First, we think that the market is addressing the lower participation of firms other than the Six Large Energy Firms (SLEFs) in the PPS much more quickly than the APF suggests. While at the start of 2014, only 13% of ScottishPower's losses (technically, de-registrations) to non-SLEF suppliers were PPM, with 87% being direct debit (DD), by Q4 of 2015, the proportions were almost equal. This reflects the normal self-correction in a market where entry starts with the simplest product and, as this saturates, activity moves to more complex ones.
- (d) Second, we think there is little evidence that PPM customers have a lower propensity to search and switch than DD customers. Despite much lower gains from switching than for DD, the rates of engagement in the market are similar. The Ofgem/Mori tracking survey in 2014 showed hardly any difference in switching rates between DD and PPM customers. It may be that the regular trips to the newsagent to top up the card or key remind the customer of their energy bill and this counteracts the lower gains from switching in stimulating engagement. Further, it is unclear to us that there is a problem in the market accessing PPM customers.
- (e) Third, we think that the cost to serve difference between PPM and DD is somewhat greater than £80. We would estimate around [CONFIDENTIAL].
- (f) Nevertheless, we agree that the PPS does not yet show the keener pricing that we see in the DD segment. In formulating remedies, it is therefore critical to understand why this is happening. We see two linked issues:
  - (i) A transitional issue around the lack of focus on this segment by the SLEFs (who have tended to see the PPS through the lens of debt management) and by other suppliers (who have tended to work with the technically easier DD segment first). This issue is rapidly being eroded by the normal discovery process of markets; and
  - (ii) The tariff code restrictions, which are greatly exacerbated by certain elements of the RMR "simpler choices" rules. In particular, the requirement that the difference in charge between

payment types must be the same in all regions means that if a supplier has 14 regional DD prices, it must also use 14 tariff codes for the same tariff on PPM. But if this was relaxed (and the 4 tariff rule removed), we believe that as few as three codes would be needed per tariff to gain an adequate degree of regional cost reflectivity in the PPS. Further flexibility could be provided by relaxing the rules on standing charges or cashbacks. In short, the code problem is much more open to resolution than the CMA suggests, and it would be disproportionate to propose remedies based on the assumption that this hurdle cannot be overcome.

- (g) In summary, therefore, we believe that the technical limitations can be largely overcome through regulatory change to allow smarter use of codes (and auctioning of any code stockpiles) and that recent developments are already creating the competitive incentive to engage more aggressively in the PPS.
- (h) Finally, we agree that very few customers are transferring from PPM to credit meters. It is unclear to us what the reason for this is. While the CMA's concerns about charges and security deposits may be relevant in some cases, the figures do not suggest that these are large scale issues. We suspect that a continued need for budgeting assistance or unfounded fears about the complexity of the process could be more important. Any remedies here should we suggest be based on further research to understand the issue more fully.

## 1. NATURE OF COMPETITION IN PREPAYMENT SEGMENTS

- 1.1 The APF concludes that the significant difference in entry by non-SLEFs and the absence of acquisition tariffs priced in line with those in the DD segment imply that the nature of competition in the PPS is different from that in the DD segment.
- 1.2 Whilst we agree that there is a clear difference in terms of the range of tariffs available – a consequence of the tariff code restrictions which will disappear when smart prepayment meters have been rolled out – we believe that lower involvement of non-SLEFs in the segment can be understood in terms of natural market evolution. The systems and infrastructure required to serve DD and SC customers are a subset of those required for the PPS. Although some companies may choose to focus on PPS from the outset, it is natural for most new entrants to focus on the DD/SC segment initially, and then invest in developing the additional systems and processes to support the PPS.<sup>1</sup> A similar pattern is observed in many sectors, where entrants start off with a relatively straightforward product or service and then branch out to more complex ones.
- 1.3 As noted in the APF (para 16), there is evidence that this is indeed happening. Following the rapid growth in market share of new entrants in the last 3 years, focused predominantly on DD and SC, switching rates of prepayment customers to non-SLEF suppliers have grown rapidly in the course of 2015. This is illustrated in Figure 1 which shows ScottishPower's losses (technically, de-registrations) of DD and prepayment customers to non-SLEF suppliers over the last nine quarters. At the start of the period losses to non-SLEF suppliers were circa 10% prepayment and 90% DD. By Q4 2015 the split was approaching equal amounts of prepayment and DD.

**Figure 1: ScottishPower losses of electricity customers to non-SLEF suppliers: comparison of direct debit (DD) and prepayment (PP)**

[CONFIDENTIAL]

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<sup>1</sup> Including the need to provide cards/keys to new customers and when they are lost, reconciliation of any differences between the cash balances on the meter and those on the central accounting system, priority repairs where customers are off supply due to a fault in the PPM, dealing with misdirected payments when the wrong key is used to charge the meter and so forth.

1.4 The split of ScottishPower losses between non-SLEF suppliers is shown in Figure 2. Utilita has achieved rapid growth as an electricity supplier focused solely on the PPS<sup>2</sup> and the new Pay as you Go proposition from Ovo appears to have been successful in driving sales.

**Figure 2: ScottishPower losses of electricity customers to non-SLEF suppliers: breakdown by supplier**

[CONFIDENTIAL]

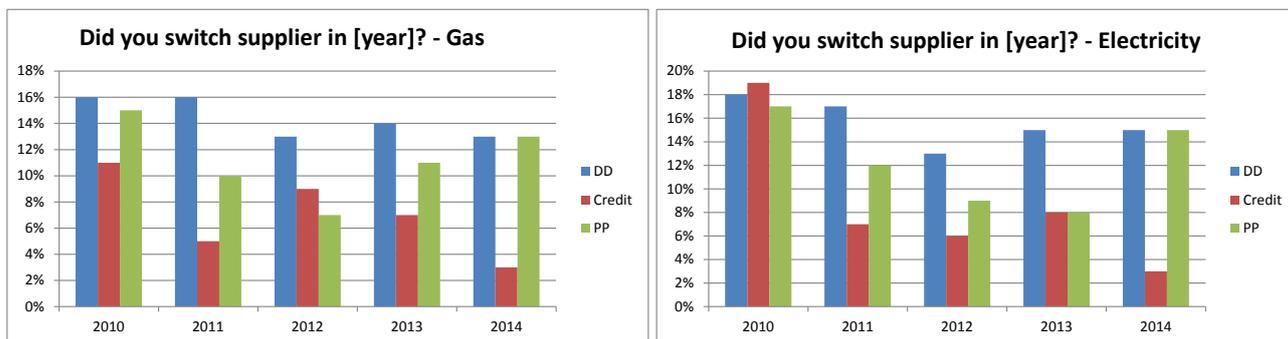
1.5 In summary, we think that difference in competitive dynamics between DD/SC and prepayment is less pronounced and less enduring than presented in the APF. With the benefit of access to more recent data, it is clear that non-SLEF suppliers are starting to engage seriously in the PPS. This supports our position in section 7 below, that the costs of acquiring customers in the PPS are not a material disincentive to non-SLEF suppliers competing in this segment.

**2. PREPAYMENT CUSTOMERS ARE RELATIVELY HIGHLY ENGAGED**

2.1 Another positive feature of the PPS which has not been highlighted in the APF is the relatively high level of customer engagement which again bodes well for future development of competition.

2.2 Despite lower gains from switching for prepayment customers, levels of switching are comparable with those for DD and significantly higher than those for SC customers (see Figure 3 below), demonstrating a healthy level of customer engagement:

**Figure 3: Switching rates for prepayment customers**



Source: "Customer Engagement with the Energy Market" - Ipsos MORI Tracking Surveys commissioned by Ofgem

**3. COST TO SERVE DIFFERENCES**

3.1 The CMA says its current working assumption (based on information provided by Ofgem) is that customers in the PPS are £80 per customer more expensive to serve than those in the DD segment and it goes on to say that it regards this as an 'upper bound'.

3.2 In fact, Ofgem's May 2014 open letter calculates average PPM-DD price and cost differences as shown in the table below (reading off their chart). These were based on an average over the SLEFs excluding ScottishPower data (because at the time ScottishPower was under investigation for compliance with SLC27.2A<sup>3</sup>). The estimated cost difference is £86 not £80, and this is an average not an upper bound.

<sup>2</sup> In October 2015, they were quoted as having 260-265k electricity customers (up 35k quarter on quarter) and 240-245k gas customers (up 30k quarter on quarter)

<sup>3</sup> Ofgem found that ScottishPower had inadequate controls in place to ensure that its tariffs were compliant with SLC27.2A but did not find that any of the tariffs were non-compliant.

**Table 1: Prepayment versus DD price and cost differentials (average)**

	Gas	Elec	Total
PPM-DD price difference	£40	£32	£72
PPM-DD cost difference	£54	£32	£86

Source: Ofgem

The CMA refers (para 9) to Ofgem’s review of payment differentials, and states: “Ofgem found that since SLC 27.2A was introduced in 2009, costs differentials between PPM and DD have decreased from about £140 to £80 a year for dual fuel”. However, it appears that the CMA has misunderstood the statement in the Ofgem March 2015 roundtable report which actually states that “Since SLC 27.2A was introduced in 2009, payment differentials between PPM and DD have gone down significantly – from about £140 to £80 per annum for dual fuel” (emphasis added). It is clear that Ofgem was talking about price differences, not cost differences.

3.3 In ScottishPower’s case, our SVT tariff is £63 more expensive for prepayment than for DD. This price difference is significantly less than the cost difference. Our estimate of the cost difference, based on the indirect cost information we have submitted to the CMA, is [CONFIDENTIAL] per dual fuel customer, as shown in Table 2. This is significantly more than the £80 assumed by the CMA.

**Table 2: ScottishPower cost differences between prepayment and DD**

	Electricity			Gas			DF
	DD	PPM	Delta	DD	PPM	Delta	Delta
CTS	[CONFIDENTIAL]						
Bad debt							
metering costs							
Sales and marketing							
Central overheads							
Other							
Total							

Source: ScottishPower indirect cost data submitted to CMA

3.4 If the estimated cost difference were to form part of the process for setting a safeguard tariff cap, it is essential that it is based on robust analysis. We welcome the CMA’s commitment to investigate the appropriate number and not simply rely on Ofgem’s estimate.

**4. COMPARISON OF PPS TARIFFS AND BENCHMARK ACQUISITION TARIFF**

4.1 The CMA’s analysis (Figure 1) focuses on the difference between the weighted average PPM SVT and the minimum DD acquisition tariff offered by SLEFs. Allowing for an £80 cost to serve difference, the CMA concludes that if competitively priced tariffs were offered in the PPS, PPM customers would be able to make substantial gains from switching, of the order of £150 to £200.

4.2 We believe that this overstates the potential gains from switching in a hypothetical more competitive PPS market for two reasons:

- (a) as noted above, we believe the £80 cost difference is an underestimate and a more realistic value is [CONFIDENTIAL] hence the £150 to £200 figure may be overstated by [CONFIDENTIAL];
- (b) when suppliers set the prices of DD ‘acquisition tariffs’ they assume that a certain proportion of customers acquired on these tariffs will default on maturity to the SVT (albeit often on a temporary basis, ie intermittent engagement) and this provides suppliers with the

opportunity to recover acquisition costs; given that PPM acquisition costs are currently somewhat higher and (at least for ScottishPower) PPM SVTs are somewhat less profitable than those for DD, this effect is likely to be somewhat smaller.

**5. SWITCHING TO A CREDIT METER**

5.1 The CMA says (para 22) that it does not know how many PPM customers could benefit from a low cost switch to a credit meter and therefore a competitive DD segment acquisition tariff, but notes that only 3% chose to do so in 2014. This is in fact higher than ScottishPower’s experience, where less than 1% have switched to a credit meter in the last 4 years (see Table 3).

**Table 3: Proportion of ScottishPower prepayment customers switching to a credit meter**

	<b>Total prepayment services</b>	<b>Number switching to credit meter</b>	<b>Percentage switching to credit meter</b>
2011	[CONFIDENTIAL]	[CONFIDENTIAL]	0.7%
2012	[CONFIDENTIAL]	[CONFIDENTIAL]	0.7%
2013	[CONFIDENTIAL]	[CONFIDENTIAL]	0.7%
2014	[CONFIDENTIAL]	[CONFIDENTIAL]	0.1%
Average			0.6%

5.2 We do not have any direct evidence as to the number of prepayment customers who could benefit, but would note that around [CONFIDENTIAL] of ScottishPower’s prepayment customers have paid off their debt (or never had one) and would therefore be able to switch at no cost if they wished. (In some cases they may be asked to pay a security deposit but since April 2015 we have not charged for such a meter exchange.)

5.3 The number of customers asked to pay a security deposit (as a result of having a poor credit score) is in any event relatively small, averaging 866 per year in the period 2012 to 2014 (see Table 4).

**Table 4: Number of security deposits requested from ScottishPower PPM customers wishing to switch from prepayment to credit**

<b>Year</b>	<b>Security deposits requested</b>	<b>Customers unable to or refusing to pay security deposit</b>
2012	1,282	406
2013	754	142
2014	563	529

5.4 We recently analysed the out-turns for customers who had switched to a credit meter having paid a security deposit (as a result of having a poor credit score<sup>4</sup>). As shown in the table below, a significant proportion ended up paying by monthly DD and relatively few had returned to prepayment. Although these customers may not be representative of the prepayment base as a whole, their experience suggests that where prepayment customers do switch to credit meters, a significant proportion are likely to be realising substantial savings in their bills.

<sup>4</sup> Based on the normal methodologies for predicting default risk used by consumer credit agencies.

**Table 5: Out-turn for customers moving from prepayment to credit meters**

Payment method	Proportion of customers on payment method*
Monthly DD	58%
Quarterly Cash	27%
Prepayment	7%
Other	8%

\* Based on meter exchanges where a security deposit was paid between August 2013 and September 2015

5.5 This raises the question, if prepayment customers are relatively engaged in the market, and if there are significant savings to be made from moving to a credit meter, why don't more do so? We think the barriers identified in the APF (charging of security deposits, charging for meter exchange and lack of information) may well be factors. However, it is unclear how significant these are in practice, especially given the relatively small number of security deposits requested by ScottishPower (Table 4 above) and the fact that ScottishPower (and several other suppliers) do not charge for meter exchanges. Accordingly we are not convinced that the CMA has fully diagnosed the problem, and would recommend that further analysis and research is carried out before any remedies in this area are finalised.

5.6 For example, we suspect that a significant proportion of prepayment customers may choose to remain on a PPM after they have repaid their debt because they continue to experience short term budgeting challenges, and the PPM provides a convenient discipline to ensure that they do not run up new debts. Paying by DD is likely to be impracticable for many such customers because the frequency of monthly DD payments is out of step with state benefit and pension payments. As shown in the table below, most state benefits and pensions are paid on a four-weekly cycle (or in some cases weekly or two-weekly). Other than Universal Credit, none are paid on a monthly basis.

**Table 6: Frequency of benefit payments**

Benefit	How often it's paid
Attendance Allowance	Usually every 4 weeks
Basic State Pension	Usually every 4 weeks
Carer's Allowance	Weekly in advance, or every 4 or 13 weeks
Child Benefit	Usually every 4 weeks - or weekly
Disability Living Allowance	Usually every 4 weeks
Employment and Support Allowance	Usually every 2 weeks
Jobseeker's Allowance	Usually every 2 weeks
Pension Credit	Usually every 4 weeks
Personal Independence Payment	Usually every 4 weeks
Tax credits, eg Working Tax Credits	Every 4 weeks or weekly
Universal Credit	Every month

Source: <https://www.gov.uk/how-to-have-your-benefits-paid>

5.7 A better arrangement for such customers, from the point of view of budgeting, would be for the DD payment to be taken out of their bank account on the day after benefit is paid in. However, if there are 13 benefit payments annually and 12 direct debits, it is inevitable that the two will get out of synch for part of the year, such that there will be a succession of months where the DD payment is taken just before the benefit is paid in rather than just after. At this point in the cycle it is likely that the DD will be refused because there are insufficient funds in the bank account and the customer will be reverted onto SC. If the customer continues to find quarterly bills difficult to manage, they would ultimately revert back onto prepayment. If suppliers were to offer an option of 4-weekly DD payment, timed for the day after benefits are typically paid, this could remove a practical barrier for a significant proportion of prepayment customers to take advantage of cheaper DD tariffs.

## 6. TECHNICAL CONSTRAINTS

- 6.1 We agree with the CMA's finding that the technical constraints around tariff codes make it impossible for suppliers to reproduce for prepayment customers the current structure and type of acquisition tariffs available in the DD segment (but see para 6.4 below).
- 6.2 The CMA suggests that this is not the sole explanation, stating that the dumb prepayment infrastructure is not currently being operated at its technical limits. We consider that the technical factors (together with RMR constraints) are sufficient to explain the lack of aggressively priced fixed price PPM offers. We would note that in ScottishPower's case we are effectively operating at the technical limits when launching dual fuel offers and these constraints are therefore the main reason why we do not offer more tariffs for prepayment customers. As at 11 November 2015, ScottishPower had [CONFIDENTIAL] unused gas tariff codes. With 14 different regions and a licence obligation to maintain uniform price differentials between payment methods, this would allow us to launch only [CONFIDENTIAL] before one of our other tariffs expires. As we have previously explained, we are limited by RMR tariff simplification rules to four core tariffs, some of which are competitively priced 'acquisition tariffs' that are typically refreshed on a monthly basis. As each refresh requires an additional set of 14 codes, we could not therefore replicate our full set of DD/SC offers for prepayment customers with the current availability of tariff codes.
- 6.3 The CMA also suggests that suppliers could have brought forward the installation of smart meters to offer more tariff options to prepayment customers, as a way of mitigating the technical constraints. However, PPMs are the most complex aspect of smart metering, with the potential for severe adverse customer impacts if systems do not function as intended, and wide scale deployment of smart PPM solutions has had to await development of the appropriate solutions. While we are supportive of suppliers having smart prepay targets as part of the roll-out obligations, we do not believe that the lack of large scale smart PPM deployment to date is evidence of lack of focus on the PPS.
- 6.4 More importantly, we think that the CMA has been too quick to dismiss the possibility of introducing more tariff options for PPMs. As explained in our response to the SSRN (section 23), we believe that sufficient tariff codes could be made available for every supplier to offer a competitively priced acquisition tariff (as well as the SVT) if suppliers are required to rationalise their use of tariff codes and surplus codes are then reallocated as required, probably by auction. The key to rationalising the uses of tariff codes is to move from 14 different regional prices per tariff to 3 different regional prices, which in most cases can be achieved with only minor price adjustments. This would require the RMR tariff simplification rules to be relaxed – as has already been proposed by the CMA under Remedy 3.

## 7. COST OF ACQUIRING CUSTOMERS

- 7.1 The APF concludes that one of the features which gives rise to a PPS-specific AEC is the "actual and perceived higher costs to engage with and acquire, PPM customers compared with other customers".<sup>5</sup>
- 7.2 We agree that the cost of acquiring PPM customers is higher than for other customers, but we believe this is a consequence of the channels used to acquire PPM customers, not the difficulty of identifying such customers. In ScottishPower's case, a higher proportion of customers are acquired via the relatively expensive telesales channel, and fewer via the cheaper PCW channel. This is illustrated in Table 7 below. Although the precise mix is likely to vary between different suppliers, we would expect the trends to be broadly similar.

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<sup>5</sup> APF para 85 (b) (i)

**Table 7: Average acquisition costs for customers on different payment methods**

Sales channel	Cost per sale	DD	SC	PPM
Price Comparison Website	[CONFIDENTIAL]	[CONFIDENTIAL]	[CONFIDENTIAL]	[CONFIDENTIAL]
Builders	[CONFIDENTIAL]	[CONFIDENTIAL]	[CONFIDENTIAL]	[CONFIDENTIAL]
Telesales (Internal/External)	[CONFIDENTIAL]	[CONFIDENTIAL]	[CONFIDENTIAL]	[CONFIDENTIAL]
Telesales (External) <sup>6</sup>	[CONFIDENTIAL]	[CONFIDENTIAL]	[CONFIDENTIAL]	[CONFIDENTIAL]
Face to face	[CONFIDENTIAL]	[CONFIDENTIAL]	[CONFIDENTIAL]	[CONFIDENTIAL]
Total	[CONFIDENTIAL]	[CONFIDENTIAL]	[CONFIDENTIAL]	[CONFIDENTIAL]

- 7.3 We think it is wrong to characterise this cost difference as a feature which gives rise to an AEC. It is a natural consequence of the demographics of PPM customers and the sales channels which are most effective in engaging them. In a competitive market, higher acquisition costs would be expected to lead to slightly higher tariffs, such that suppliers are able to recover the acquisition costs; and indeed this is a feature of many competitive markets. The acquisition cost differences in the PPS are nowhere near high enough to reduce suppliers’ incentives (or ability) to compete to acquire PPM customers.
- 7.4 The relatively high churn rates for PPM customers and the recent rapid growth of new entrant market shares noted above provide further evidence that the difficulty of engaging with and acquiring prospective targets is unlikely to be the cause of the AEC identified.

**8. DEBT ASSIGNMENT PROTOCOL**

- 8.1 As the CMA notes, under the standard DAP process, if there is a debt objection, the customers’ current supplier will write to the customer informing them of this. This letter advises the customer to contact their preferred supplier to restart their switch via the DAP and to transfer any debt.
- 8.2 However, a new Point of Acquisition (**POA**) approach was launched by ten of the largest suppliers<sup>7</sup> on 30 April 2015, working with Ofgem. Under this new approach, the gaining supplier obtains (on behalf of the losing supplier) the necessary consent to share data and seeks the customer’s consent to transfer any debt at the point the customer agrees to switch supplier. This enables the switch to proceed automatically via the DAP if a debt objection occurs and the outstanding balance is £500 or less for the fuel being switched. We understand the full details of the POA approach will be provided in a submission from EnergyUK.
- 8.3 As we have noted in our response to the SSRN, we believe any remedies to improve the DAP process should build on this voluntary initiative, for example by making it mandatory.

<sup>6</sup> We have two different telesales approaches, internal (where leads are generated internally potentially from a customer calling us) and external (where we purchase data to source potential customer leads.) The bulk of prepayment sales are via the external route which is more expensive.

<sup>7</sup> British Gas, Ecotricity, EDF Energy, E.ON, First Utility, npower, Spark Energy, Scottish Power, SSE and Utility Warehouse



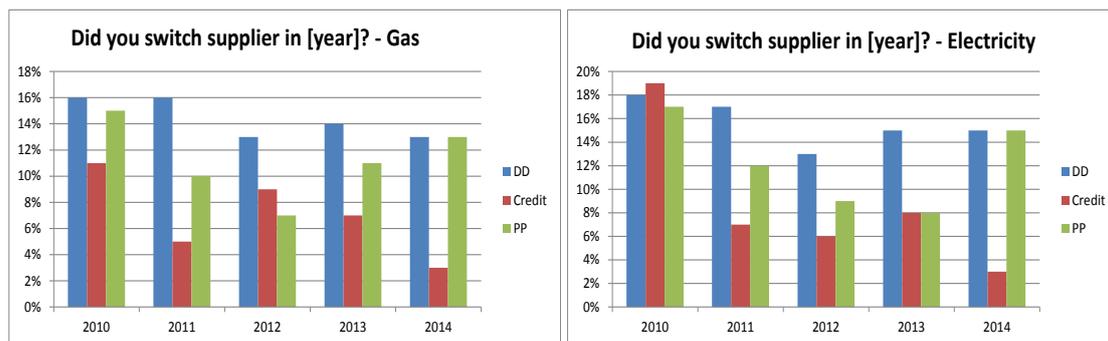
**CMA ENERGY MARKET INVESTIGATION**

**SCOTTISHPOWER’S RESPONSE TO THE SECOND SUPPLEMENTAL REMEDIES NOTICE**

**INTRODUCTION AND EXECUTIVE SUMMARY**

- (a) ScottishPower welcomes the opportunity to respond to the Competition and Markets Authority (CMA)’s Second Supplemental Notice of Possible Remedies (SSRN) published on 16 December 2015 in the CMA’s investigation into the supply and acquisition of energy in Great Britain (GB) (Market Investigation). We have responded separately to the Addendum to Provisional Findings (APF) published on the same date.
- (b) We have consistently advocated competitive solutions to the issues identified by the CMA and emphasised their advantages over regulatory options that may bring unintended consequences. We believe that, on a proper analysis of the issues (see our response to the APF) a remedy that promotes competition is both feasible and appropriate and that a remedy aimed at controlling prepayment meter (PPM) tariff pricing could well stifle competition.
- (c) We do not believe that the issue is one of customer engagement. Current levels of engagement in the prepayment segment (PPS) are in fact relatively healthy. Survey evidence from Ofgem Custom Engagement Survey (September 2015) suggests that switching rates are as high as for direct debit (DD) customers and significantly higher than for standard credit (SC).

**Figure 1: Switching rates for prepayment customers**



Source: “Customer Engagement with the Energy Market” - Ipsos MORI Tracking Surveys commissioned by Ofgem

- (d) We do however recognise that the PPS has not yet been characterised by the keener pricing that has been seen for non-standard tariffs in the DD segment. We see this as being due to a timing issue, as a result of the most active competition originating in the DD segment, and technical factors around tariff codes. As set out in the following paragraphs, both can be overcome.
- (e) Until more recently the suppliers other than the Six Large Energy Firms (SLEFs) have not generally focused their offerings on the PPS. This can be understood in terms of natural market evolution. The systems and infrastructure required to serve DD and SC customers are a subset of those required for

the PPS.<sup>1</sup> Although some companies may choose to focus on PPS from the outset, it is natural for most new entrants to focus on the DD/SC segment initially, and then invest in developing the additional systems and processes to support the PPS. This phenomenon is common in other markets, as intense competition in one segment causes firms to focus elsewhere.

- (f) We now see much more intense competition in the PPS and the CMA should be mindful of recent developments in this segment such as Utilita’s growth as an electricity supplier primarily focused on the PPS<sup>2</sup> and the new Smart Pay as you Go proposition from Ovo, which has been supported by above the line advertising. We have in fact seen switching rates to non-SLEF suppliers growing rapidly in the course of 2015 as evidenced in the chart below. While at the start of 2014, only 13% of ScottishPower’s losses (technically, de-registrations) to non-SLEF suppliers were PPM, with 87% being DD, by Q4 of 2015, the proportions were almost equal.

**Figure 2: ScottishPower electricity deregistrations to non-SLEF suppliers**

[CONFIDENTIAL]

- (g) In addition to competition from the non-SLEF suppliers, we expect the launch of new smart propositions (including PPM) by all suppliers; these may benefit from lower operational costs which may increase competitive pressure on the tariffs offered using dumb meters.
- (h) Turning to the technical limitations, we agree that these (combined with the RMR “simpler choices” rules) have been a significant factor. However, we believe that the CMA has been too quick to dismiss the practicability of adequately working around the technical limitations once the RMR rules have been removed. Indeed, we believe that we have identified a workable solution which would allow more competitive acquisition tariffs to emerge. Combined with the evidence that switching activity in the PPS is growing rapidly, this suggests that a competitive solution is within reach.
- (i) Our proposed competitive solution, which we describe below as a new “Remedy 22A”, would be to take advantage of the removal of the RMR tariff simplification rules to enable a much smarter use of the available tariff codes. Under the current rules, we must have the same price differential between payment methods in all regions. So if we have 14 different regional DD prices on a tariff, we must have 14 different PPM prices and therefore tariff 14 codes. However, absent the RMR rules, we think that adequate cost reflectivity can be obtained for the PPS by using as few as three codes per tariff to cover regional variation rather than the 14 that are required now. This would enable the codes to be used much more efficiently so that more competitive ‘acquisition’ tariffs could be launched.
- (j) Our proposed alternative remedy would therefore involve the CMA determining a maximum number of tariff codes that suppliers can hold and requiring suppliers to release any tariff codes above that limit to enable a fair distribution of codes across suppliers. To this end, we would suggest a programme of gas tariff code auctions. Suppliers would be able to choose how to rationalise their use of codes, but we estimate that this approach would provide sufficient gas code “space” for each supplier to offer its standard tariff plus one competitive acquisition tariff, refreshed at least every two months. There would be more than adequate electricity code space available for a similar product.
- (k) We are concerned that the alternative, regulatory, approach to remedies suggested by the CMA could have unintended consequences. We consider that the impact of the PPM Safeguard Tariff Cap (STC) on switching rates is likely to be severe. We previously submitted results of modelling by Oxera which suggested that under reasonable assumptions, Remedy 11 would roughly halve

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<sup>1</sup> For PPM customers complexities include billing (where the meter and central systems can get out of step), cash allocation (where payments can be misdirected by use of the wrong key), service provision (where new and replacement keys need to be got to consumers and prompt response is needed if a meter fault leaves a customer off supply) and monitoring customer welfare (for example if a customer fails to vend for a period).

<sup>2</sup> In October 2015, they were quoted as having 260-265k electricity customers (up 35k quarter on quarter) and 240-245k gas customers (up 30k quarter on quarter).

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switching rates, and we would expect a significantly greater impact when focusing on the PPS only as the cap might well erode the available savings by more.

- (l) We maintain our view that with an STC, there is a real risk that the reduced gains from switching, combined with ‘endorsement bias’ effects, will cause a deep reduction in the current levels of engagement, and that the resulting behavioural change will persist long after the STC has been lifted, negating the competition benefits that smart PPMs and other remedies would otherwise bring.
- (m) Turning to the other remedies, we believe that Remedy 19 is not clearly directed at the problem. There is no reason on the evidence to suspect a lack of engagement by PPM customers or that non-SLEF suppliers face a significant barrier in competing with the SLEFs. Indeed switching rates for PPM customers are similar to DD and PPMs now account for nearly half our losses to non-SLEFs. Remedy 19 would be likely to attract considerable criticism on data protection and privacy grounds.
- (n) As regards Remedy 20, we recognise that there is a significantly lower number of customers switching between PPMs and credit meters. However we are unsure as to whether the CMA has correctly identified the reasons for this. We consider that the reasons are likely to be diverse but include real and perceived barriers e.g. customers liking or needing the payment management, a view that removing the PPM would be complex or expensive and low awareness of the ability to change. We recommend that some customer research is done before any final decisions are made on this remedy.
- (o) On Remedy 21 (reform of the DAP) we believe that Ofgem’s “Point of Acquisition” (**POA**) model is going well. We suggest that the focus should be making it mandatory.

## 19. REMEDY 19 – CUSTOMER DATA SHARING

### *“Facilitating sharing of data relating to prepayment meter customers”*

- 19.1 The CMA is proposing to require suppliers to disclose to Ofgem details of their PPM customers (either all PPM customers or only those with non-smart meters). These details would include name, billing address, consumption address, telephone number, annual energy consumption and MPAN. Suppliers would contact customers to advise them of the proposed disclosure and give them an opportunity to opt out. The details of those who did not opt out would be passed to Ofgem to put them on a secure cloud database where they could be accessed by other suppliers for marketing purposes.
- 19.2 The SSRN categorises Remedy 19 as an ‘enabling measure’ designed to address the adverse effects on competition (**AECs**) identified at source. We assume that the AEC in question is the “actual and perceived higher costs to engage with and acquire, PPM customers compared with other customers” (APF para 85 (b) (i)). As explained in our response to the APF (section 3), we agree that the cost of acquiring PPM customers is higher than for other customers, but this is a consequence of the channels used to acquire PPM customers,<sup>3</sup> not the difficulty of identifying such customers, and it is wrong to characterise as this as a feature of the market giving rise to an AEC. The relatively high levels of engagement in the PPS and rapid recent growth in non-SLEF market share (including one supplier focusing on the PPS) also suggest that this is not a barrier. We would therefore seriously question whether the proposed remedy is necessary or justified by the CMA’s provisional findings.
- 19.3 At a more practical level, we have concerns about the appropriateness of the remedy from a privacy and data protection perspective. The CMA says it understands that under data protection legislation, opt-out consent would be sufficient for suppliers to communicate with other suppliers’ customers via non-electronic means (e.g. by letter), but that opt-in consent would be required for electronic communications (e.g. email, SMS). We continue to hold the view that such sharing of customer information could raise privacy concerns and may be difficult to implement in a way that is compatible with data protection law. PPMs are generally fitted as a means to manage debt, sometimes under warrant, and there will often be a perceived stigma attached which means that customers are particularly sensitive about this information being disclosed. In view of this, we think most PPM customers would reasonably expect their consent to disclosure to be obtained on an opt-in basis.
- 19.4 We also think that the CMA needs to give careful thought to the use of shared customer data for telemarketing. Whilst unsolicited telemarketing is likely to be more effective than unsolicited mailshots, it is also far more likely to cause distress. If consumers do have concerns over privacy, such concerns are most likely to be triggered by unwanted sales calls, and we would expect this also to be an area of focus for the media and consumer groups. If the CMA decides to implement the remedy (which we do not think it should), we would suggest that the following principles should apply:
- (a) when consent for data sharing is obtained from the customer, the declared purpose should not include telemarketing, so that the consent cannot be seen as over-riding Telephone Preference Service (**TPS**) registrations;
  - (b) the customer’s telephone number should not be included in the data transferred: where the number is listed in directories, it can readily be obtained if the customer’s address is known, and where the number is not listed, this is a strong indication that the customer wishes to keep it private.

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<sup>3</sup> In ScottishPower’s case, a higher proportion of customers are acquired via the relatively expensive telesales channel, and fewer via the cheaper PCW channel, and we see no reason why the relative costs should be different for other suppliers.

The effect of the above is that suppliers could still carry out telemarketing where the customer's number is available from directories (or other public sources) and where the customer has not registered with the TPS – which we think strikes an appropriate balance.

- 19.5 Finally, as noted below (para 19.7), there are a number of measures which we believe are likely to be more effective and more appropriate ways of increasing engagement and competition for PPM customers. These would be a better and less intrusive means of increasing customer engagement than unsolicited mailshots.

*(a) Would this remedy be effective and proportionate in increasing competition for non-smart prepayment meter customers?*

- 19.6 Although the remedy may reduce marketing costs for some suppliers, particularly those who target PPS exclusively, we believe it will be of limited effectiveness overall in increasing competition. As noted in our response to the APF, recent market evidence suggests that non-SLEF suppliers are starting to make inroads into the PPS without the aid of data sharing, and we believe the incremental impact is likely to be small. Telemarketing campaigns are generally more effective than direct mail, but as explained above, we believe there are strong privacy reasons for limiting the use of telemarketing to customers whose telephone numbers are already available and have not opted out via the TPS.

- 19.7 We believe that there are a number of alternative remedies which would enhance competition in the PPS and which would be less intrusive than the proposed remedy. These include:

- (a) measures to reduce the compliance burden associated with face to face selling, which has previously proved to be one of the most effective means of engaging customers with PPMs; Ofgem's recent proposal to remove the prescriptive elements of SLC25<sup>4</sup> could be a positive step in this direction;
- (b) relaxing RMR tariff simplification rules so that suppliers can offer a wider range of tariffs to PPM customers (this is discussed further under remedy 20 below);
- (c) relaxing RMR tariff simplification rules so that suppliers can offer cash-back incentives to encourage switching – as we have previously noted, ScottishPower found this to be an effective way of stimulating switching prior to introduction of RMR rules;
- (d) prioritising the rollout of smart PPMs once the technology is properly developed, so as to enable the full range of tariff options to be offered to PPM customers; and
- (e) measures covering the ground mentioned in the CMA's proposed Remedies 20 and 21.

- 19.8 Accordingly, we do not consider it would be proportionate to introduce a remedy of this nature.

*(b) Are there additional legal considerations that are relevant to this remedy (eg under the Data Protection Act 1998 or the Privacy and Electronic Communications (EC Directive) Regulations 2003)?*

- 19.9 The CMA is proposing that the database will be operated on an opt-out basis (in reliance on section 11 of the Data Protection Act 1998 (DPA)), such that only those customers who actively advise their energy supplier that they do not wish their personal data to be shared will not have their data passed to Ofgem. The CMA would need to explain in the PDR why it believes that it would be fair and lawful to operate the database on an opt-out basis, having regard to the first and second data protection principles of the DPA. Specifically, the CMA would need to show that processing of the

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<sup>4</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/the\\_future\\_of\\_retail\\_market\\_regulation.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/the_future_of_retail_market_regulation.pdf).

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data for the purposes of the database would be fair and lawful (having regard to the legitimate interests of the data subjects) and for purposes which are compatible with the purposes for which it was originally collected.

- 19.10 PPM customers will be aware that their personal data is held by their current energy suppliers in connection with their energy account. Most customers would also have an expectation that they will receive some marketing materials from their current energy provider in relation to new tariffs and other energy related products and services offered by their energy supplier. However, as the Information Commissioner's Office noted in respect of proposed Remedy 10(d):

“[i]t seems unlikely that customers, particularly those who have failed to engage with the market, would expect to receive contact from third parties in relation to their tariff. Indeed, many customers may be confused by such a message and [be] concerned that details of their tariff have been shared with another organisation”.<sup>5</sup>

As a result, it is not obvious that such use would in fact be compatible with the first and second data protection principles.

- 19.11 As the purpose to which Ofgem intends to put the personal data is new and not for a purpose that the PPS customers were told about at the time of its collection, and given the potential stigma associated with PPMs, we consider it would, at the very least, be best practice for the scheme to be operated on an opt-in basis. Opt-in consent would also provide an opportunity to seek consent for electronic marketing.
- 19.12 Finally, even if the CMA is able to justify the operation of the database on an opt-out basis and decides to proceed on that basis (which, again we do not think it should) it will still need to be particularly careful that use of personal data is minimised so as to ensure compliance with the first and second data protection principles. As noted below, we think that the list of data items suggested by the CMA is too long. We think it would be sufficient to require the name, billing address, consumption address and which fuel(s) are supplied by PPM. We do not think it is necessary to provide telephone number, annual energy consumption or MPAN.

### *(c) Is Ofgem the right party to have oversight of this process?*

- 19.13 There are potentially two different roles to be considered:
- (a) Setting policies for the use, protection and retention of the data, including:
    - (i) defining the types of entity who are permitted to receive the data, the purposes for which they may use it and the protections they must apply;
    - (ii) entering into contractual agreements with such parties requiring them to adhere to the relevant policies;
    - (iii) monitoring their compliance with the relevant agreements and imposing sanctions where rules have been breached;
    - (iv) fulfilling its responsibilities as data controller in connection with subject access requests and requests for erasure and correction of data.
  - (b) Maintaining the database of PPM customers, including receiving updated details from suppliers and providing relevant data to relevant third parties for marketing purposes.

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<sup>5</sup> Information Commissioner's Office (ICO) in its response to the CMA Energy Market Investigation's Notice of Possible Remedies, commenting on Remedy 10(d).

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19.14 We agree that Ofgem would be an appropriate party to have oversight of the process (as data controller) as defined in item (a) above. The day to day processing of the data (item (b) above) could be contracted out by Ofgem to a commercial entity.

***(d) What limitations would need to be imposed to ensure that the data was disclosed and used appropriately?***

19.15 We think the following restrictions would be needed to ensure that the data is disclosed and used appropriately:

- (a) The range of personal data that suppliers are required to provide should be limited to the minimum necessary to support direct mail campaigns, ie name, supply address, billing address and which fuel(s) are supplied by PPM, and that such data minimisation would be required from a data protection compliance perspective. As explained above, telephone numbers should not be provided.
- (b) Ofgem as data controller should be required to define appropriate policies for use, protection and retention of data, put in place appropriate contractual agreements with parties to which it provides the data including (but not limited to) any party to which it sub-contracts the function of maintaining the database as described above, and police their compliance with its rules.
- (c) Mechanisms should be put in place to ensure that data is regularly refreshed (as required by the fourth data protection principle), so that, for example:
  - (i) customers are able to withdraw their consent at any time and be confident that within a reasonable period their data will have been removed from relevant lists;
  - (ii) where there is a change of tenancy, details of the previous customer are promptly removed from relevant lists.
- (d) Controls should be put in place to minimise the risk of a consumer backlash caused by unwanted telemarketing. As a minimum, these should ensure that opt-out consent (which, again, we do not think should be used) is not used as a pretext to make unsolicited calls to customers who have registered with the TPS.

***(e) When should the continued need for this remedy be reviewed?***

19.16 The CMA suggests that smart meters are expected to change the way that customers and suppliers interact and that Remedy 19, if implemented would need to be reviewed after 5 years or upon substantial completion of the smart meter roll-out.<sup>6</sup> Presumably, the purpose of such review would be to assess whether or not Remedy 19 is redundant in light of the smart meter roll-out, given that the smart meter roll-out should address any adverse effect on competition that currently affects PPS customers, to the extent that such adverse effect exists.

19.17 We agree that if this remedy is adopted, it should be viewed as a time-limited transitional measure. We would suggest that relevant obligations on suppliers should lapse automatically after 4 years, or after smart meter rollout is substantially (say 80%) complete, whichever is the earlier.

***(f) What might be a suitable frequency with which to share customer data?***

19.18 It is important that data is refreshed frequently, to ensure that, for example, where customers withdraw consent, this takes effect reasonably quickly. Where customers register with the TPS, this

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<sup>6</sup> SSRN, para 26.

must take effect within 28 days<sup>7</sup>, and we think a similar timescale would be appropriate here. Assuming suppliers provide updated information to Ofgem in batches, we think this should be done at least monthly. Likewise, Ofgem should refresh the data provided to third parties on at least a monthly frequency.

*(g) Should this remedy apply to prepayment meter customers with smart meters?*

19.19 Whilst the remedy is in force, we believe it should apply in respect of all PPM customers, whether they have a traditional meter or smart meter. However, even if there is a need for the remedy today (which we do not accept), there will no longer be a need when the majority of PPM customers have smart meters, hence the sunset clause proposed in para 19.17 above.

**20. REMEDY 20 – REMOVING BARRIERS FOR SWITCHING TO CREDIT METER**

***“Removing the barriers that prepayment meter customers without a debt face when attempting to switch to a credit meter”***

20.1 As noted in our response to the APF, we believe it is important to understand why so few PPM customers choose to switch to credit meters (in ScottishPower’s case less than 1% per annum) despite the fact that the majority have paid off their debts. We are not convinced that the CMA has fully diagnosed the problem, and would recommend that further analysis and research be carried out before any remedies in this area are finalised. (For example, one possible impediment to customers switching to DD is the fact that DD payments are typically taken at monthly intervals whereas pensions and benefits payments are often paid at four weekly intervals. This means that the payments will inevitably get out of synch at some point in the year, making it much harder than it would otherwise be to budget.)

20.2 We welcome the CMA’s recognition that it would not be appropriate to require suppliers to allow customers to switch to credit meters when they are still in debt. The effectiveness of a PPM – sometimes fitted after an extended warrant process – as a means to prevent further debt accruing and to recover existing debt, depends critically on the customer not being able to revert to a credit meter without addressing the debt first. It would be absurd if, the day after a PPM was fitted under warrant, the customer could call us up and demand that we reverse the process. Ensuring that we can ultimately collect the money we are owed by those customers who fail to pay protects the customers who do pay – including those in fuel poverty. Similar issues arise where a PPM is fitted as a consequence of theft of energy by the customer.

***Remedy 20a – prohibit the charging of a security deposit in circumstances when a customer is not in debt and has not incurred any fines, charges or interest for late payment in the last six months***

20.3 We assume that the prohibition on requesting a security deposit would be accompanied by an obligation to meet customers’ requests to switch to a credit meter (where the customer satisfies the relevant conditions, i.e. not in debt, not high credit risk etc). Otherwise, suppliers could circumvent the prohibition by rejecting requests for meter exchange in circumstances where they would previously have requested a security deposit.

20.4 Where a customer wishes to switch from a PPM to a credit meter and is not in debt, ScottishPower’s current policy is to carry out a credit check. Customers who achieve a poor credit score are then requested to provide a security deposit (of £150) before they are switched to a credit meter. Exceptions to this policy can be made on a case by case basis.

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<sup>7</sup> See PECR 21(3).

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- 20.5 Our purpose in making the credit check and (where appropriate) requesting a security deposit is to distinguish between:
- (a) customers who are now in a more secure financial position, and are able to manage with a credit meter; and
  - (b) customers who have been able to pay off their debts only with the help of a PPM, and who would be likely to fall into debt again without that discipline.
- 20.6 We assume that customers fall into the first category if they have a good credit rating or if they have a poor rating and are willing to pay a security deposit. Our analysis of the out-turns for customers who have paid a security deposit suggests that this is an effective way of identifying customers who are a good credit risk despite their poor credit score. As shown in the table below, a significant proportion end up paying by monthly DD and relatively few return to PPM:

**Table 1: Out-turn for customers moving from PPM to credit meters**

Payment method	Proportion of customers on Payment method*
Monthly DD	58%
Quarterly Cash	27%
PPM	7%
Other	8%

\* Based on meter exchanges where a security deposit was paid between August 2013 and September 2015

- 20.7 Whilst we believe that our current policy strikes broadly the right balance, we recognise that there are likely to be some customers who cannot afford the £150 lump sum security deposit but would nevertheless be capable of managing their finances with a credit meter, and would be sympathetic to a remedy which made it easier for such customers to switch to a credit meter.
- 20.8 However, it has to be recognised that not all customers will be capable of managing their finances, and were it to become known that no security deposit could be requested, we would expect significant numbers of such customers to move to credit meters, not only for the cheaper tariffs but also as a source of free short term credit. This would lead to increased bad debt costs, and meter exchange costs, if such customers cycle between credit meters and PPMs.
- 20.9 We believe the CMA should therefore consider a version of this remedy that permits suppliers to require a security deposit under a set of defined circumstances where customers are likely to represent a particularly bad debt risk.
- (a) Would this remedy be effective and proportionate in removing the barrier to switching that security deposits can pose?*
- 20.10 A blanket prohibition on charging security deposits would be effective in removing the barrier, but could have adverse consequences in terms of increased bad debt costs (and possibly meter exchange costs) for suppliers. We believe that a more proportionate response would be to prohibit charging of security deposits except in certain defined circumstances where it is reasonable to assume there is a high risk that the customer will fall back into debt if they move to a credit meter.
- (b) Are these the right criteria to apply in determining circumstances in which suppliers can charge a security deposit?*

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- 20.11 As noted above, we believe suppliers should be permitted to require a security deposit in circumstances where the customer is likely to represent a particularly bad debt risk. The CMA suggests that such customers could be identified on the basis that they have ‘not incurred any fines, charges or interest for late payment in the last six months’. We do not think these criteria would work in practice since customers on PPMs cannot in general make late payments, and because most suppliers do not levy fines, charges or interest for late payment.
- 20.12 Instead, we would suggest that suppliers should be allowed to request a security deposit only if one of the following conditions is met:
- (a) the customer is in debt or has been the subject of Court action for debt by the supplier in the last six months; or
  - (a) the customer has returned a credit score or credit record that is within a defined set of criteria to be agreed by interested parties, including the suppliers and Ofgem.
- 20.13 Credit scoring is usually based on the return of a prediction score (typically a figure in the range 0 to 1,000) and on actual event information (e.g. unsatisfied bankruptcy, or unsatisfied County Court Judgment or unsatisfied default of payment registered with a recognised consumer credit reference agency). We would welcome discussion with appropriate parties to agree the principles of when a supplier is permitted to decline a customer request to move to a credit meter.
- 20.14 We recognise the importance of removing unnecessary barriers to switching to credit meters and suggest that this may be an appropriate compromise to prevent energy debt recurring and also helping those who are in the pre-delinquency stage for energy debt.
- (c) What are the potential unintended consequences of being explicit about when customers can be charged a security deposit?*
- 20.15 One possible unintended consequence of setting defined tests for creditworthiness is that customers who are not creditworthy may be able to circumvent the tests. This could result in some customers switching to a credit meter (where they would not have done so if a security deposit had been requested) and running up debt which eventually has to be recovered by reinstalling a PPM. Such risks could be mitigated if there was flexibility for the rules to be revised from time to time.
- (d) Is there a preferable alternative way of mitigating detriment arising from the impediments to switching posed by the potential need to pay a security deposit?*
- 20.16 We are not aware of a preferable alternative. However, we would note that in ScottishPower’s experience, the number of customers who are unwilling or unable to pay a security deposit is relatively small (an average of 359 per year in the period 2012 to 2014) and the detriment is therefore not particularly large.
- (e) Should the CMA implement this remedy itself, or should the CMA make a recommendation to Ofgem to do so?*
- 20.17 We think it would be sufficient for the CMA to recommend that Ofgem implement the remedy, provided that the CMA provides guidance on the circumstances under which security deposits would still be permitted to be charged.

***Remedy 20b – Suppliers are prohibited from charging customers upfront for the cost of a new meter when switching away from prepayment***

- 20.18 ScottishPower ceased charging customers for the cost of a new meter when switching away from PPM in April 2015. Although we do not currently seek to recover the cost of the meter, we think the CMA is correct to limit any prohibition to upfront charges, allowing suppliers to recover costs over time if they wish.
- 20.19 In our own case, we might need to reconsider our policy if the volumes of meter exchanges grew significantly, and more generally, we do not think it is helpful for suppliers to have an incentive to discourage switching (which they would do if they could not charge at all for the cost of the new meter).
- 20.20 If the CMA decides to adopt this remedy, it should also take steps to ensure that suppliers are able to block transfers until such time as the amount owed for the meter exchange has been paid off. (Under current rules, suppliers can object to a transfer on grounds of debt only if they have issued a demand for payment, which would not be the case here.)

***(a) What length of time is reasonable and appropriate to allow the recovery of the cost of the meter and installation?***

- 20.21 We would suggest that suppliers should be given flexibility to set the rate at which the cost is recovered, subject to similar ‘ability to pay’ criteria as are used in recovery of debt from PPM customers.

***(b) Is this a proportionate remedy given the number of cases in which suppliers charge for removal of a prepayment meter?***

- 20.22 The fact that some suppliers do not currently charge for removal of a PPM does not make the remedy any less proportionate: the benefits will be reduced, but so too will the costs.

***(c) Is there an equally or more effective alternative way to reduce the costs of prepayment meter removal and replacement?***

- 20.23 We are not aware of any equally or more effective alternative ways to reduce the costs of PPM meter removal and replacement.

***(d) Should the CMA implement this remedy itself, or should the CMA make a recommendation to Ofgem to do so?***

- 20.24 Given that this is a relatively straightforward remedy to implement, we think it may be appropriate for the CMA to implement directly, but we would prefer it to be included within the supply licence rather than a separate order.

***Remedy 20c – Require suppliers to provide annual notifications to prepayment meter customers setting out their right to switch and highlighting any potential restrictions or charges that may be payable***

- 20.25 We are generally supportive of ‘information measures’ that improve consumers’ understanding of and ability to engage in the market, and we recognise that such a remedy could usefully complement to remedies 20a and 20b, by making customers aware of the relevant changes.
- 20.26 However, given the large volume of information that suppliers are already required to send to their customers - and the consequent risk that such information will be ignored - it will be important to

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design any remedy carefully to maximise its effectiveness. This could involve piloting of different approaches.

*(a) Would this be an effective means of facilitating switches away from prepayment meters?*

20.27 We would expect the remedy to be effective in facilitating some consumers to switch away from PPMs, but would expect that many PPM customers would be unaffected. Short of conducting pilot studies, we cannot see any way of predicting the effectiveness.

*(b) What would be the most effective means of communicating this information to customers?*

20.28 Any communications campaign needs to recognise that customers vary widely in their use of media and preferences for obtaining information. Campaigns will be most effective if they make use of multiple communications channels (letters, emails, websites, social media) and if they can be tailored to the demographics of individual customers.

*(c) What is a suitable frequency with which to contact customers? Would this messaging be more appropriately included alongside other messages or be triggered by particular events (such as outstanding debt being paid off)?*

20.29 We think that an annual communication would be an appropriate frequency. For the majority of PPM customers there will be no obvious event to link the communication to, and we would suggest that either it is included with the Annual Statement or sent as a standalone message at a time of year when customers are likely to be most receptive, such as late Autumn. A relatively small proportion of PPM customers finish paying off their debt each year, but for these customers we agree that this could be an appropriate trigger event.

*(d) Should a prompting remedy such as this be introduced directly by the CMA or should this be an area that Ofgem considers running randomised controlled trials to assess its effectiveness?*

20.30 As noted above, we believe that trialling or piloting will be necessary to achieve maximum effectiveness. It may therefore be appropriate for the CMA to make a recommendation for Ofgem to pursue this remedy. This could be linked to any recommendations that the CMA make in the context of Remedy 9 around providing better information to customers.

## 21. REMEDY 21 – REFORM DAP

*“Reform the protocol for assignment of debt on prepayment meters”*

21.1 The CMA is proposing three measures under the heading of this remedy:

- (a) The ‘objection letter’ sent by an incumbent supplier should not confuse customers as to their right to switch, making clear that the switch will continue; further ‘objection letters’ should only be sent to customers for whom it is established are not eligible to switch.
- (b) The ‘complex debt’ aspect of the DAP should be revisited in order to diminish the instances in which the switch is disallowed.
- (c) Issues relating to multiple registrations should be addressed in order to avoid multiple objection letters being sent to customers with such metering arrangements, causing unnecessary confusion for them and adding cost.

21.2 We agree with all the above proposals. We would note that point (a) is already covered by the Point of Acquisition (POA) process developed by suppliers under the auspices of EnergyUK, and that

suppliers who have signed up to the POA will already be following this process. We would also welcome any steps that Ofgem or the CMA may take to clarify what constitutes ‘complex debt’.

*(a) Would a remedy recommending Ofgem to address the above-mentioned issues be effective in ensuring that adequate changes to the DAP are implemented promptly? Or should the CMA instead use its order-making power to support Ofgem’s ongoing work?*

21.3 We think that a remedy recommending Ofgem to address the above-mentioned issues would be sufficient to ensure that adequate changes to the DAP are implemented promptly. As noted below, we think it will be most effective to build on existing industry initiatives, and this is probably best done via Ofgem-industry interaction than via CMA order making.

*(b) What is the most efficient way for Ofgem and the industry to improve the DAP process in relation to the above-mentioned areas identified by Ofgem in order to increase the switching rates of indebted PPM customers?*

21.4 As noted above, industry has made good progress in improving the process for DAP via the POA initiative. This was done on a voluntary basis, and not all suppliers have signed up to the process to date. We believe any intervention to further improve the DAP process should build on this industry initiative, and that compliance with the process should be made mandatory for all suppliers.

*(c) How would this remedy interact with the other remedies to address the Domestic AEC and/or detriment?*

21.5 We believe this remedy would be complementary to other remedies to address the Domestic AEC.

*(d) Are there other impediments to switching for indebted PPM customers – other than those identified by Ofgem – that need to be addressed? If so, what are these and how should Ofgem or the industry address them?*

21.6 We believe the CMA and Ofgem have identified all the main impediments to switching for indebted PPM customers.

## **22. REMEDY 22 – TRANSITIONAL SAFEGUARD TARIFF CAP**

*“A transitional ‘safeguard price cap’ for domestic prepayment customers”*

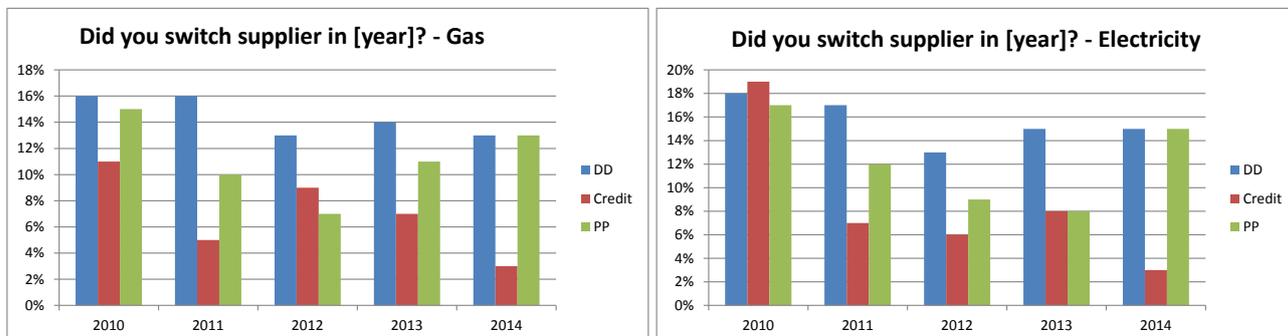
### Introduction

22.1 As with possible Remedy 11 (safeguard regulated tariff), we have serious concerns about a ‘safeguard tariff cap’ (STC) for domestic PPM customers. We believe it would be highly damaging to competition in the PPS and is unnecessary.

22.2 The impact of the STC on switching is likely to be more severe than the Safeguard Regulated Tariff (Remedy 11) since it will cause a proportionately greater reduction in the gains from switching which drive search and switching activity. We previously submitted results of modelling by Oxera which suggested that under reasonable assumptions, Remedy 11 would roughly halve switching rates, and as explained below (para 22.10), we would expect a significantly greater impact in the PPS. There is a real risk that the reduced gains from switching and ‘endorsement bias’ effects will together cause a deep reduction in the current levels of engagement, and that the resulting behavioural change will persist long after the STC has been lifted, negating the competition benefits that smart PPMs would otherwise bring.

22.3 As noted in our response to the APF, current levels of engagement in the PPS are in fact relatively healthy. Survey evidence suggests that switching rates are as high as for DD customers and significantly higher than for SC, despite the gains from switching being much lower (Figure 3).

**Figure 3: Switching rates for PPM customers**



Source: “Customer Engagement with the Energy Market” - Ipsos MORI Tracking Surveys commissioned by Ofgem

22.4 Although small suppliers have been slower to enter the PPS the DD and SC segments, we believe this can be understood in terms of natural market evolution. The systems and infrastructure required to serve DD and SC customers are a subset of those required for the PPS. Although some companies may choose to focus on PPS from the outset, it is natural for most new entrants to focus on the DD/SC segment initially, and then invest in developing the additional systems and processes to support the PPS.<sup>8</sup> There is evidence that this is indeed happening, with switching rates to non-SLEF suppliers growing rapidly in the course of 2015. (See ScottishPower response to the APF section 1).

22.5 In short, the market fundamentals are favourable for much stronger competition to emerge in the PPS: high propensity for consumers to engage, growing activity of non-SLEFs in the segment, and the prospect of technical constraints being removed by the rollout of smart meters over the next 2-3 years. With the additional assistance of measures along the lines of new Remedies 20 and 21, there is no reason to suppose that competitive conditions in the PPS will be any less favourable for consumers than in the DD/SC segments within this timeframe – unless these developments are undermined by the STC.

22.6 The key problem with the PPS identified by the CMA is that gains from switching are substantially less in the PPS than in the DD/SC segments, and we understand the proposed STC is intended to mitigate this issue in the period until smart rollout is established. We do not think that this is necessary as the absence of ‘acquisition’ tariffs is largely a result of the limitations imposed by tariff code availability. If these technical constraints can be mitigated – as we believe they will be by the proposed removal of RMR tariff simplification rules under Remedy 3 – there is good reason to believe that more competitive ‘acquisition’ tariffs will be launched. We have outlined an alternative remedy (‘Remedy 22A’) in the next section which we believe will fulfil these objectives without the risks to competition that are inherent in the STC.

22.7 Finally, although we strongly disagree with the proposal to implement a STC, we believe that if the CMA does decide to do so, it should be done in a way that minimises the damage to competition by limiting the remedy to a subset of vulnerable PPM customers who are disengaged. Our analysis suggests that although there is some correlation between PPS customers and poorer demographics, by no means all PPM customers would qualify as ‘vulnerable’. We understand that the Government is currently considering how the eligibility criteria for the Warm Home Discount can be revised to make them better targeted, and we would suggest that these revised criteria could be a suitable basis for targeting the STC remedy within the PPS.

<sup>8</sup> Including the need to provide cards/keys to new customers and when they are lost, reconciliation of any differences between the cash balances on the meter and those on the central accounting system, priority repairs where customers are off supply due to a fault in the PPM, dealing with misdirected payments when the wrong key is used to charge the meter and so forth.

Adverse consequences of a tariff cap

- 22.8 We explained in our response to Remedy 11 why a price control would be highly likely to reduce engagement, due to a reduction in price dispersion and consequently lower benefits from switching – and also due to ‘endorsement bias’, where customers mistakenly think that if they are on a ‘government-approved’ safeguard tariff, it is unlikely that there is a better deal for them. We also submitted the consumer switching model and accompanying report by Oxera, which set out their analysis of the potential impacts of Remedy 11 on switching by domestic energy consumers. Oxera’s analysis showed that, under a set of reasonable assumptions about remedy design, consumer switching levels (across all payment methods) could fall by nearly a factor of two<sup>9</sup>, before taking into account endorsement bias.
- 22.9 The CMA calculated the average gains from switching for dual fuel SVT customers across the SLEFs to be £183 for those paying by DD and £69 for those with PPMs<sup>10</sup>. These estimates are based on scenario 4b that allows full flexibility of tariff type and supplier but does not allow for change of payment method. It follows that, all else remaining equal, a remedy that reduces the potential gains from switching specifically for PPM customers is likely to have a greater percentage effect on the available gains than the average effect of Remedy 11. This is likely to flow through to the propensity to switch.
- 22.10 The relatively high historic switching rates for PPM customers, combined with relatively low potential gains from switching, suggest that switching by PPM customers may be motivated by lower financial gains than for customers who pay for energy by other means. This also implies that the switching behaviour of PPM customers is likely to be more sensitive to changes in potential gains from switching than for DD and SC customers.
- 22.11 There is accordingly a real risk that measures of this kind may discourage search and accordingly hurt the people they are intended to help. The STC may only be force for 2-3 years, but that is a sufficiently long period for consumers to lose the ‘habit’ of searching for better deals, which would have adverse long-term consequences. Even if the range of tariff options for customers on dumb PPM meters is limited, [CONFIDENTIAL] of customers are debt-free<sup>11</sup> and could therefore move to a different payment method with more competitive tariffs (as Remedy 20 seeks to encourage). Such payment method switching is also likely to be impeded for the same reasons.
- 22.12 Finally, as noted in our response to the Remedy 11 proposals, a tariff cap, even if ‘transitional’ and intended to act as a ‘safeguard’, will increase the perceived regulatory risk and cost of capital for suppliers, and is likely to lead to distortions of competition by discouraging innovation and new entry. It would be complex and expensive to operate, with uncertain impacts on the market and high risks of unintended consequences.

Proportionality

- 22.13 The CMA seeks to justify this remedy (para 49) as “a means to protect domestic PPM customers who could not switch away from a PPM meter, or who would not benefit from increased competition within the PPS resulting from our other remedies (specifically concerning the PPS or more generally the domestic retail energy markets), or both”.
- 22.14 The CMA rightly flags the risks associated with “controlling outcomes in markets”, but then fails to explain why it considers that some PPM customers may not benefit from increased competition resulting from the CMA’s other remedies.

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<sup>9</sup> Oxera’s analysis showed this result to be robust to alternative model calibrations.

<sup>10</sup> See Appendix 7.4 of the Provisional Findings.

<sup>11</sup> Based on analysis of ScottishPower customer base. See our response to the Notice of Addendum to Provisional Findings.

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22.15 As matters currently stand, the case for such an extreme form of intervention has not been made out and we believe that this remedy is disproportionate and likely to be counterproductive for the same reasons as Remedy 11. There are alternative approaches that the CMA should consider instead, which would deliver comparable benefits to PPM customers but without the damage to competition.

*(a) If the transitional safeguard price cap for PPM customers were set relative to other prices in the domestic retail energy markets, how should we identify an appropriate level of prices and how can we ensure the level of the cap remains appropriate for the duration of the period it is in effect?*

22.16 As noted above, we have serious concerns about the imposition of any form of STC. However, should the CMA decide to proceed with this remedy and to set the cap relative to other prices in the domestic retail energy market, it will be necessary to decide:

- (a) how to determine the reference level of prices in the market;
- (b) how to set the maximum amount by which PPM tariffs can exceed the reference level;
- (c) how to measure compliance with the cap.

22.17 If the reference price level is intended to be representative of more competitive conditions, it could reasonably be based on fixed term tariffs offered in the DD segment. The reference level could either be defined in terms of a specified basket of tariffs or as some form of average price paid by consumers. Although the basket approach would be simpler from a data gathering point of view and would be more transparent (since the only information required is the list of tariffs, their weights and the tariff details), it has two disadvantages: there is significant discretion involved in selecting a basket of tariffs and it could potentially be open to gaming (particularly if tariffs with limited availability are included). Although it may be more onerous in data gathering terms, we think that an approach based on average DD fixed term prices would be preferable, since it is likely to be more stable and objective. The average could either be calculated as a mean or median. We do not think it would be appropriate to base the tariff solely on ‘acquisition tariffs’, since these tariffs are often priced on the basis that a proportion of customers will revert to the SVT at maturity, and hence would not be an appropriate reference for an SVT.

22.18 The maximum amount by which PPM tariffs can exceed the reference level (the ‘delta’) would need to take into account the difference in costs between DD and PPM and the headroom needed to mitigate the adverse impacts on competition. The headroom must be sufficient to ensure that there is still sufficient price dispersion to incentivise switching and that new entrants still have an incentive to enter this market. The more aggressive the choice of reference price, the greater the headroom will need to be (see also our response to question (c) below).

22.19 The obligation to comply with the cap could be absolute (i.e. suppliers must comply at all times) or compliance could be measured on an average basis, e.g. over the course of a year, or on a rolling twelve month basis. We think the latter approach is likely to be more practicable, given the significant time required to implement price changes.

*(b) Could the imposition of a transitional safeguard price cap for PPM customers result in energy suppliers reducing the quality of service offered to customers on these tariffs? Is this risk reduced by prepayment customers’ ability to choose alternative, unregulated tariffs or changing to a smart prepayment meter?*

22.20 It is unlikely that a supplier would actively reduce the quality of service offered to customers on a regulated PPM tariff. However, it is likely that introduction of regulated price caps would lessen competition in this segment and weaken the incentives for market entry. This may in turn mean that

suppliers allocate investment and development resource towards other segments, to the detriment of long-term service quality.

***(c) How should the headroom be calculated to provide the right level of customer protection while not unnecessarily reducing healthy competition?***

22.21 The difficulty of finding the optimum point and the risks of getting it wrong are one of the key reasons why we believe the CMA should not adopt such a remedy. There is an inherent contradiction between preservation of competition and a price cap, given that switching is primarily motivated by corresponding financial gains, whereas ensuring effective competition between suppliers is the best way to protect consumers in the long-run. Finding the optimum balance between them is a formidable challenge, which in part involves weighing up the short-term interests of the protected customers against the longer term interests of the customers as a whole who stand to benefit from healthier competition.

22.22 Although the task can be approached in a number of different ways, we think the example of New South Wales cited by the CMA is informative. In the 2010-2013 price control period, the headroom was set significantly higher than in the previous period, resulting in wider differentials between regulated and 'market' tariffs, and substantially greater switching. Whereas in the 2007-2010 price control period, the proportion of customers on the regulated tariff remained around 65%, in the 2010-2013 period it fell from 60% to 40%, leading to complete withdrawal of the price control in 2014. The experience of NSW suggests that the detriment from setting the price too low is likely to outweigh the detriment from setting it too high, and it would be prudent to err on the side of a more generous cap.

***(d) What regulatory information would be required to set the transitional safeguard price cap?***

22.23 The regulatory information requirements will depend on the design of the tariff cap, but are likely to include:

- (a) the relative costs of PPM and DD payment methods;
- (b) details of tariffs to be used in setting the reference price (e.g. fixed term DD tariffs)
- (c) details of customer numbers on different tariffs, if the reference price is to be based on a median or weighted average.

The frequency of collection for each of these items will depend on how frequently they change.

***(e) How long should the transitional safeguard price cap be kept in place? Is it appropriate to include a specific sunset provision, or should there be a commitment to review the need for and level of the safeguard price cap after a certain period of time?***

22.24 We welcome the fact that the remedy is seen as transitional and believe this must be hard-wired into the implementation. We think there should be a sunset clause such that the price control lapses at a particular date (or when a well-defined milestone has been met). In the unlikely event that an extension is required, it would be for Ofgem to propose a licence modification to effect it.

22.25 We believe an appropriate date would be the end of 2018. By that time smart rollout will be well underway, and competitive conditions can be expected to have improved sufficiently that there is no ongoing need for any cap.

22.26 Given the time required to implement an STC and the proximity of the possible implementation date to completion of the smart meter roll-out, we believe that the interests of consumers would be best

served by remedies targeted at increasing consumer engagement with the market in preparation for smart meter roll-out and prioritising such roll-out.

*(f) Should the termination date of a transitional safeguard price cap remedy be linked to the roll-out of smart meters? If so then should this be done explicitly, in aggregate or on a customer-by-customer basis?*

22.27 Yes, the termination date of a transitional STC should be linked to the roll-out of smart meters. See our response to Question (e) above.

*(g) How frequently – if at all – would the level of the cap need to be reassessed?*

22.28 If the cap is set relative to a competitive market benchmark, we would expect that the benchmark would need to be reassessed relatively frequently (say monthly or quarterly), so that any rapid movements in underlying wholesale prices can be passed through sufficiently quickly. The relative costs of PPM and DD and the ‘headroom’ component are likely to be more stable over time and annual review would be sufficient.

*(h) Which prepayment customers should this remedy apply to?*

22.29 If the CMA does decide to implement a STC, it should be done in a way that minimises the damage to competition by limiting the remedy to a subset of vulnerable PPS customers who are disengaged. Indeed, any other approach would raise major concerns from a proportionality perspective. Although there is some correlation between PPS customers and poorer demographics, by no means all PPM customers would qualify as ‘vulnerable’. Based on a purely financial metric (perceived ability to cope on income), the data in Table 2 suggests that no more than 36% of PPM customers would be categorised as vulnerable (depending on whether the threshold is difficult or very difficult).

**Table 2: Perceived ability to cope on income**

<b>Payment method</b>	<b>Proportion perceiving themselves as finding it difficult or very difficult to cope on their income</b>
DD	27.5%
Credit	22.6%
PP	36.0%
Base	25.6%

Source: MOSAIC using survey data provided by TGI (Target Group Index)

22.30 We understand that the Government is currently considering how the eligibility criteria for the Warm Home Discount can be revised to make them better targeted, and we would suggest that these revised criteria could be a suitable basis for targeting the STC remedy within the PPS. After disengagement has been properly defined (which we would recommend is customers who have not switched supplier in the last three years), suppliers would share annually a list of disengaged customers with Government, which would return the file, marking those disengaged consumers that are also economically disadvantaged.

*(i) Which energy suppliers should be subject to the transitional safeguard price cap, and why? Should it be restricted to the Six Large Energy Firms, or should all retail energy suppliers be covered?*

22.31 All suppliers should be subject to the safeguard cap. Consumers would be likely to find it confusing if the scope of the cap was limited to the SLEFs.

*(j) How should the transition from the current arrangements be managed? Should there be a period over which the transitional safeguard price cap is phased in? If so, how long should this period be and how should the transition work?*

22.32 The safeguard price cap may need to be phased in over a period of time sufficient to allow suppliers time to rebalance, where necessary, their standard and non-standard PPM tariffs. Non-standard tariffs are mainly fixed price fixed term deals, so suppliers would need to wait until existing non-standard tariffs had reached maturity before they could adjust them.

22.33 Some phasing would naturally occur if the CMA accepted our suggestion that the SRT would only apply to people who had been on SVT for three years or more.

*(k) Would energy suppliers have the ability to circumvent the remedy, for example, by encouraging domestic prepayment customers to switch on to less favourable, unregulated tariffs, and how could such risks be mitigated?*

22.34 We think the risks of such circumvention are low. Suppliers are subject to a number of licence conditions which oblige them to provide accurate price comparisons/projections for customers considering switching, and which prohibit any form of conduct which is likely to mislead.

*(l) Should the CMA set the level of the transitional safeguard price caps itself, or should the CMA make a recommendation to Ofgem to do so?*

22.35 Ofgem has a good record of undertaking price controls independently in the networks area and is in principle well placed to deal with the ongoing operation of any STC including any calculations, updating etc. In that field, it has been robust in basing controls on tough efficiency targets together with recognition of the need to earn a return. We have a good degree of confidence that Ofgem would be able to set the level of the STC without political interference.

22.36 However, the task here is more complicated in that the proposal is to introduce a 'price to beat' in a previously unregulated market with the aim of assisting rather than hindering the development of competition. (Indeed, it may be impossible to attain the right balance.) There are also important questions as to the design of the STC, e.g. whether it is set on a standalone basis or by reference to some other tariff(s). We therefore think it would make sense for the CMA to set the methodology and initial parameters for the cap, including the necessary headroom, before handing the detail of actually setting the level of the STC over to Ofgem. This could reduce the temptation for political intervention in the headroom level, for example.

22.37 Nevertheless, it must be recognised that setting and running this control would be likely to be extremely difficult given the conflicting aims of protecting disengaged customers and not restricting competition.

22.38 The CMA should also give consideration as to which body (CMA or Ofgem) is responsible for any decisions as to when and how the STC is removed. Our preference would be for a sunset clause, such that the STC lapses at a particular date, in the absence of a formal process to justify extending it. In the absence of such a sunset clause, we think that the decision to remove the STC should be made by the CMA.

*(m) Are there any potential unintended consequences of setting a transitional safeguard price cap, for example, in terms of their potential impact on the level of other, unregulated tariffs?*

- 22.39 There are a number of unintended consequences that could arise from imposing a safeguard tariff cap, including:
- (a) reduced price dispersion in the PPM segment, blunting incentives to search and switch and, in turn, weakening the competitive pressure on firms to offer low prices or innovate;
  - (b) customers on a capped PPM tariff believing that because the tariff is regulated by the Government, it must be a good deal ('endorsement bias'), and therefore opting not to search or switch (including switching to more cost-effective payment methods);
  - (c) the risk (as has happened in a number of other countries) that price to beat tariffs fail to keep up with costs;
  - (d) companies being deterred from entering the PPM segment because of the presence of price regulation (or being deterred from entering the market as a whole because of concerns over a 'slippery slope'); and
  - (e) a serious risk of confusion and unnecessary complexity if Remedy 22 is combined with Remedy 11. The CMA rightly flags this as a possible concern (para 56) and we agree that the introduction of overlapping remedies would be undesirable, leading to a lack of clarity for customers and suppliers as to how the price-capping regimes would apply.

**23. "REMEDY 22A" – ALTERNATIVE PRO-COMPETITIVE REMEDY**

- 23.1 ScottishPower would like to propose an alternative to Remedy 22 ('Remedy 22A') which we believe will address the same concerns as Remedy 22, but in a less intrusive manner and with less risk of detriment to competition. Instead of stifling competition in the PPS (as we believe Remedy 22 will do), our proposed alternative remedy will drive the competitive conditions in the PPS in a similar direction to the SC/DD segment, such that when smart PPMs have been rolled out (and technical limitations removed), competitive conditions can converge.
- 23.2 In our view, the main problem identified in the PPS is the lack of competitive 'acquisition' tariffs, such as are available in the DD/SC segment. The purpose of Remedy 22A would be to enable suppliers to offer similarly competitive tariffs to PPM customers. We think the CMA has been too quick to dismiss the possibility of working round the tariff code technical limitations, and that a viable solution can in fact be introduced. This would involve:
- (a) removing certain RMR tariff simplification rules (which may already be scheduled for removal under Remedy 3);
  - (b) requiring suppliers (notably SLEFs) to reduce their use of tariff codes in order to free up any codes above a specified maximum; and
  - (c) reallocating surplus codes more equitably between suppliers.

Further detail on these aspects is provided in the sections below.

***How can tariff code restrictions be overcome?***

- 23.3 The main constraint on tariff codes is in the gas market, and our proposals are therefore couched in terms of gas codes. These will also apply, *mutatis mutandis* to electricity.

- 23.4 RMR rules require that any payment method-related price differential is the same throughout the country, so that if a supplier's SVT varies by PES region for DD/SC customers, it must have the same regional variation for prepayment customers. Hence a supplier will typically require 14 different tariff codes for its prepayment SVT. If a supplier wishes to offer fixed term tariffs to PPM customers, the RMR four tariff cap means in effect that it must offer a prepayment version of one of its DD/SC tariffs, which is again likely to mean that 14 different tariff codes are required. Our proposal is contingent on removing these two RMR rules, the four tariff cap, and the requirement for geographically uniform payment method differentials.
- 23.5 The main reason for having regionally varying prices is that network charges vary on a regional basis<sup>12</sup>, although suppliers may also use regional pricing as a competitive measure to drive sales in a particular area. Our analysis suggests that regional prices are generally reasonably well clustered, such that a close approximation to existing regional price variations can be achieved with significantly fewer price levels than 14. Our analysis suggests that in ScottishPower's case, taking account of the number of customers in each region and the relative price levels, we could achieve a sufficiently good approximation with three tariff codes (Figure 4). If suppliers who are currently using 14 codes per tariff could migrate to three codes, this would free up a large number of tariff codes for additional tariffs and/or reallocation to other suppliers.

**Figure 4: ScottishPower regional price differences for gas PPM**

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- 23.6 We see the above approach as the main route to offering a greater range of tariffs, but would note that there are two additional ways in which greater pricing flexibility could be achieved:
- (a) Suppliers could use the debt recovery rate (**DRR**) functionality of the prepayment infrastructure to offer significant discounts in the standing charge component of prepayment tariffs (typically in the region of £100 for a dual fuel customer); this would not require any new tariff codes and would not overload the messaging capacity of the infrastructure.
  - (b) Suppliers could offer cash-back incentives to drive sales – as was widely done in the PPS prior to the RMR rules. Although this does not provide an enduring saving, it would contribute to the overall reduction of bills within the PPS.

***How many tariff codes would suppliers require?***

- 23.7 A supplier will need sufficient tariff codes to offer a reasonably competitive range of prepayment tariffs. We assume this means, as a minimum, the SVT plus a single more competitive fixed term tariff. In general, the more keenly priced a fixed term tariff, the more frequently suppliers need to adjust the price in response to wholesale market movements (by withdrawing the old version from sale and replacing it with a new version).
- 23.8 The most competitive tariffs are typically updated monthly on average. Assuming a maximum term of 14 months (so that 14 different versions of the tariff are live at any point in time) and three codes per tariff, this would require 42 tariff codes. If instead tariffs are updated every two months (which would still allow for the tariff to be reasonably competitively priced), the number of codes would be 21. We therefore think a supplier would need a minimum of 24 tariff codes (three for SVT plus 21 for a competitive acquisition tariff) and ideally slightly more than this.
- 23.9 According to the APF there are a maximum of 1,122 tariff codes that can be offered across the industry today. This would be sufficient for up to 34 suppliers (more than are active in the market at present) to have 33 tariff codes each (three 'pages' of 11 codes), assuming the codes can be

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<sup>12</sup> Most suppliers use the electricity regions as a proxy for the gas regions in order to minimise the complexity of marketing, especially for dual fuel offers.

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reallocated equitably. Even allowing for some inefficiencies and delays in reallocation, it should be possible for all suppliers who need them to have slightly more than the minimum 24 tariff codes identified above.

***How would tariff codes be released?***

- 23.10 Our proposal is that the CMA would determine a maximum number of tariff codes that suppliers are allowed to hold. Suppliers would then be required to rationalise their use of the codes and make available to other suppliers any codes in excess of the maximum. The timetable for this process would need to allow sufficient time for suppliers to make price change notifications to customers if necessary, and might be done in stages to allow for existing fixed term tariffs to mature.
- 23.11 We think that an appropriate maximum might be 44 codes (4 pages of 11), subject to checking by the CMA that this would free up sufficient codes for all active suppliers who want them to have at least 33 codes (3 pages of 11). Consideration would need to be given to how to treat white label suppliers.
- 23.12 It would be up to individual suppliers to decide how best to rationalise their use of codes. ScottishPower currently has [CONFIDENTIAL] gas tariff codes, which it uses for its SVT and ‘Cancer Research UK’ (CRUK) fixed term tariff. Allowing for [CONFIDENTIAL] live versions of the CRUK tariff by 1 July 2016, we would expect to have [CONFIDENTIAL] tariffs unused at 1 July 2016 (Table 3).

**Table 3: ScottishPower gas tariff codes**

	<b>Codes</b>
Total codes available	[CONFIDENTIAL]
Standard variable tariff	-14
3 live fixed term tariffs (Cancer Research UK) as at 14 Jan 2016	-42
Expected additional fixed term tariffs by 30 June 2016	[CONFIDENTIAL]
Total Spare as at 1 July 2016	[CONFIDENTIAL]

- 23.13 In order to bring our tariff code usage below a 44 code ceiling we would need to free up [CONFIDENTIAL] tariff codes. This would potentially involve our:
  - (a) changing our PPM SVT so that there are a smaller number of regional prices than the current 14; this could be done as part of the standard SVT price change process and could involve positive or negative regional price adjustments;
  - (b) changing each of our PPM CRUK tariffs so that there are a smaller number of regional prices than the current 14; as these are fixed price tariffs we would need to implement this by revising prices downward in certain PES areas.
- 23.14 For example, if we reduced the number of regional prices to three, this would free up [CONFIDENTIAL] codes. If [CONFIDENTIAL] of these codes plus the [CONFIDENTIAL] currently unused were given up, that would leave us with [CONFIDENTIAL] spare codes, sufficient for us to launch a new competitively priced acquisition tariff.

***How would tariff codes be reallocated?***

- 23.15 We believe the fairest and most efficient way of reallocating tariff codes would be by auction. The CMA will need to give consideration to the design of auction and questions such as:

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- (a) who should run the auction – this should be a strong and independent third party, possibly Ofgem;
- (b) what the frequency of auctions should be – a number of tranches may be appropriate, to allow suppliers sufficient time to release codes that are currently in use, and prospective bidders to formulate their plans;
- (c) how any revenue from the auction should be distributed - ScottishPower had to purchase a number of its tariff codes, and we think that suppliers should be allowed to keep the proceeds from the sale of such codes;
- (d) what provisions could be put in place to ensure that market power cannot be exercised in the auction – possibly involving bidding rules to prevent SLEFs repurchasing codes.

***Will suppliers be incentivised to launch new tariffs?***

- 23.16 The CMA suggests in the APF that technical restrictions may not be the only reason why suppliers have not launched more competitive acquisition tariffs and that there may also be a lack of incentive to compete aggressively in the PPS. As explained in our response to the APF (section 6), we do not believe that this is the case. The recent strong growth in non-SLEF activity suggests that the intensity of competition in the PPS is increasing, and other remedies proposed by the CMA are likely to increase that competition further. We are confident that if steps are taken to enable more tariffs to be offered (as proposed in this remedy) suppliers will respond with more aggressive tariff offerings, along similar lines to those offered in the DD/SC segment.
- 23.17 We believe that it will be sufficient to rely on the market and do not believe that any further incentivisation is required. However, if the CMA has any doubts about this aspect of the remedy, it could consider creating additional incentives. For example, it could introduce a ‘use it or lose it’ provision. If, following the reallocation of tariff codes, a supplier did not make meaningful use of its codes (e.g. by launching a sufficiently attractive fixed term tariff) it could be required to release those codes without reimbursement.