



CMA's provisional decision on remedies – OVO's response

7th April 2016

Contents

1. Introduction	3
2. The problems vs the solutions	4
3. PPM price cap	13
4. Half Hourly settlement	23
5. PCW remedies.....	28
6. Removal of RMR tariff rules	30
7. Marketing database for disengaged customers.....	36
8. Restricted meters	38
9. Other remedies	39

1. Introduction

- 1.1. It is generally acknowledged that the retail energy market is failing to operate in the best interests of consumers. A large portion of customers are being over-charged and under-served by their suppliers. Suppliers are tangled in a complex web of prescriptive regulations. And with the exception of the smart meter rollout, the energy market is failing to innovate at the same pace as other retail markets such as broadband and banking.
- 1.2. For an essential utility, the state of the market is simply unacceptable and it is clear that we are in dire need of radical change. Much hope rested on the CMA's investigation to deliver that change.
- 1.3. However, after many months and a huge commitment of resource from not just the CMA but all stakeholders including suppliers, OVO feels that the CMA's remedies have fallen short of their potential. The remedies will not stop the majority of over-charged customers from continuing to be over-charged. Nor are the remedies likely to bring genuine improvement to customer engagement. The CMA's investigation therefore has been a missed opportunity to re-set the retail energy market and regardless of the impact on suppliers, it is ultimately customers who will continue to suffer.
- 1.4. In the following sections we outline in more detail the reasons for our reaction to the CMA's remedies. Specifically:
 - (a) in section 2, we explain why the CMA's remedies fail to solve the fundamental problems with the market - pricing and engagement, and
 - (b) in sections 3 to 9, we provide our comments in relation to specific components of certain remedies including the PPM price cap.

2. The problems vs the solutions

- 2.1. OVO commends the CMA for identifying the two core problems in the retail energy market - unfair pricing and high levels of customer disengagement. For the purpose of this response we will refer to these two problems as the **pricing problem** and **disengagement problem**, respectively.
- 2.2. However, the CMA's package of remedies fails to provide direct, effective solutions to either problem. We feel this is a considerable oversight on the part of the CMA and we are disappointed with this outcome given the time and resource dedicated to this investigation.
- 2.3. In the following paragraphs we outline our understanding of the pricing and disengagement problems, why we don't believe the CMA's remedies will solve either problem, and what we consider to be viable alternatives (where appropriate).

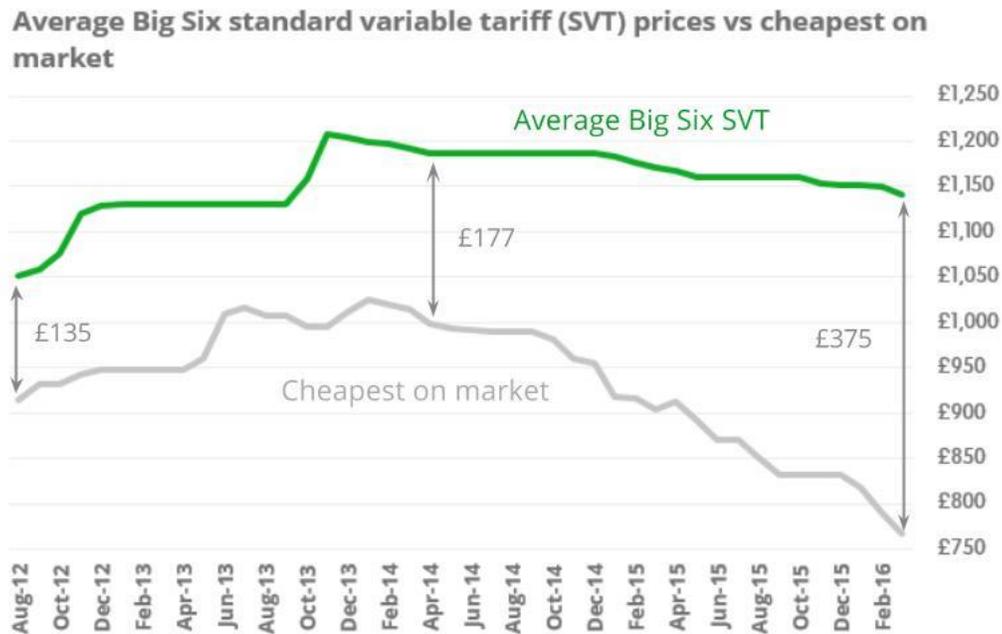
The pricing problem

- 2.4. OVO has consistently stated that the pricing problem is a direct result of the ability of incumbent suppliers to discriminate between the prices they offer to their customers. This in turn has the effect of segmenting the retail market into two distinct tiers:
- The first tier comprises tariffs that are designed primarily to acquire new customers and are predominantly fixed tariffs, and
 - The second tier comprises default SVTs onto which customers roll once their fixed tariff expires (unless they renew or switch away) or which already apply to a large portion of disengaged customers.
- 2.5. In the first tier, there is healthy competition which is driving prices down, with many tariffs being deeply discounted to the point of being below cost in some instances.

- 2.6. In the second tier however, competition is weak as prices are relatively stagnant and suppliers are not incentivised to 'wake up' their disengaged customers who are stuck on these tariffs. As a result we note the CMA has found that approximately 70% of energy customers with Big Six suppliers are on these SVTs and are being over-charged in the amount of approximately £1.7 billion annually.¹
- 2.7. Figure 1 below shows the effect this two tier market has had on pricing in the market. As illustrated by this graph, the differential between the average Big Six SVT and the cheapest tariff available in the market has widened considerably to approximately £375. Ironically, with the influx of new entrants into the market and despite the CMA's investigation, the gap seems to be widening, not narrowing, over time.

¹ CMA's Provisional Decision on Remedies dated 10th March 2016, paragraph 68.

Figure 1



Source: OVO analysis of tariff prices on Energylinx and uSwitch on 02/08/2012 and every subsequent Thursday to 17/03/2016. Data uses Ofgem 2014 typical domestic consumption values for medium users standard consumption profile for dual fuel averaged across all regions.

Engagement problem

- 2.8. The source of the engagement problem is more difficult to identify - it comprises a number of reasons and largely results from the legacy of a once nationalised market that has privatised only in recent times. We discuss several likely reasons below.
- 2.9. Despite good intentions, recent regulatory interventions such as RMR have failed to improve customer engagement. Instead they have succeeded only in introducing more prescriptive rules which have in turn placed more constraints on suppliers - and removed incentives from them - in terms of customer engagement and innovation.

The inertia of the industry codes process and the general complexity of the regulatory framework only exacerbates this stifling of innovation, making it difficult for suppliers to launch new products that are likely to benefit and engage customers.

- 2.10. The continued ability of suppliers to engage in price discrimination is also a contributing factor to disengagement, as incumbent suppliers have a clear commercial incentive to ensure their customers remain disengaged.
- 2.11. Therefore levels of customer engagement remain low. Large numbers of customers remain unaware that they can switch suppliers or indeed how, they remain confused by information on their bills and ultimately they remain distrustful of energy suppliers.

CMA's attempted solutions to the problems

- 2.12. Given the nature and extent of the pricing and engagement problems, the CMA's proposed remedies simply do not go far enough and in some cases are likely to cause only further confusion and disengagement amongst customers. In the following paragraphs we outline in more detail why this is the case and OVO's proposals for addressing the shortcomings in the CMA's remedies.

PPM price cap - why limit only to prepayment customers?

- 2.13. We support the introduction of a price cap for prepayment customers as we acknowledge that it is an under-served part of the market where customers are more susceptible than standard credit and direct debit customers to vulnerability and over-charging.
- 2.14. However, as shown in table 1 below, the number of customers paying by prepayment meter account for only one third of fuel poor customers in England. If we apply this percentage as representative of the entire GB market, it would mean that the other

two thirds of fuel poor households - approximately 1.7 million² households in the market who are most in need of protection - are receiving no direct protection whatsoever from over-charging and predatory pricing practices.

Table 1: Fuel poverty statistics by payment method for electricity

Payment method	No. of fuel poor households (thousands)	Proportion of households within group (%)	Proportion of total households fuel poor (%)
Direct Debit	1,012	7	43.1
Standard Credit	564	15	24.0
Prepayment	771	22	32.8
All payment types	2,347	100	100.0

Source: DECC Fuel Poverty Statistics for Electricity (2013), table 17, published 28 May 2015

- 2.15. In OVO's opinion this is unacceptable. We agree with the dissenting opinion of the CMA panel member Martin Cave that the "significant level of detriment" identified by the CMA (£1.7 billion annually) justifies not only a remedy for prepayment customers but also a specific, direct remedy for "a substantially larger number of customers".³
- 2.16. We acknowledge the CMA's concerns about imposing a price cap for all of the 70% of customers on Big Six SVTs - we recognise not only the operational complexities but the potential risk of distorting competition.
- 2.17. However we do not believe that such concerns justify limiting the CMA's ambitions to the prepayment market alone, thereby excluding the remaining two thirds of fuel

² This figure was calculated by taking the percentage of English households in fuel poverty that pay by direct debit or standard credit according to DECC's 28 May 2015 figures (6.6%) and multiplying this percentage by the total number of households in Great Britain (25.7million) according to the Office of National statistics 2011 Census.

³ CMA's Provisional Decision on Remedies dated 10th March 2016, paragraph 1.20.

poor households from any pricing protections at all. In OVO's mind, given the state of the retail energy market and the urgent need for reform, the need to protect vulnerable customers far outweighs operational complexities and competition concerns.

- 2.18. Taking into account the CMA's concerns, we reiterate our original proposal for the introduction of a 'social tariff cap' - a price cap that would apply to all vulnerable customers, not just prepayment customers. We would ask the CMA to reconsider this proposal given the failure of the current PPM price cap to protect the majority of fuel poor customers.
- 2.19. In practice, we would envisage calculating the social tariff cap using the same methodology as the PPM price cap, which will reduce the operational burden for both regulators and suppliers.⁴
- 2.20. To determine eligibility for the social tariff cap, again to minimise operational burden we would propose suppliers data matching their standard credit and direct debit customers against the Department for Work and Pensions' (**DWP**) cold weather database of energy users who receive the cold weather payment allowance. This process is currently used to identify customers who are eligible for the core group of the warm home discount scheme.
- 2.21. Alternatively a social tariff could be funded from general taxation - in the same way as the cold weather payment allowance. This would remove the cost and operational burden from suppliers and avoid non-fuel poor customers having to subsidise fuel poor customers through potentially higher tariffs.

⁴ In practice this would mean that suppliers cannot charge eligible standard credit or direct debit customers more than the current proposed PPM price cap less the £54 prepayment cost to serve.

PCWs

- 2.22. While we acknowledge that PCWs have an important role to play in providing customers with easily accessible tools to compare and switch suppliers, we do not believe the CMA's remedies in relation to PCWs will solve the pricing or the engagement problems.
- 2.23. First, engagement is not synonymous necessarily with switching via PCWs. While it is currently the predominant channel for switching, there are other direct routes to acquiring energy customers such as door-to-door sales, telesales and retail stores. Therefore, the CMA's remedies bring immediate benefits only to those customers who use PCWs. This might improve engagement specifically within that group of customers but it will not solve the disengagement problem more generally.
- 2.24. Secondly, in terms of pricing, we can see how suppliers might become incentivised to introduce cheaper tariffs as a result of the 'whole of market' requirement being removed. However, we anticipate those tariffs being available only to new customers who visit PCWs. And we don't foresee any downward movement in default SVTs which is where the most over-charging is occurring. In fact, disengaged customers may be over-charged to an even greater extent after the introduction of the CMA's remedies if suppliers increase default SVTs and other tariffs in order to subsidise lower fixed term introductory tariffs that are likely to enter the market.
- 2.25. Therefore we would expect to see the gap continuing to widen between the cheapest tariffs in the market and default SVTs (as shown in Figure 1). And this in turn, most importantly, means that customers who don't use PCWs will continue to be over-charged as they remain on default SVTs or other tariffs that are not available on channels outside PCWs.
- 2.26. Furthermore, by giving PCWs not only additional commercial leverage (through removal of the 'whole of market') but also access to in-depth data via ECOES and

Midata, the CMA is shifting power in the retail energy market - and specifically ownership of customer relationships - from suppliers to PCWs. This is deeply concerning because, in order for suppliers to take responsibility for their actions and be incentivised to innovate products for their customers, they must continue to control their relationships with customers. However by essentially turning PCWs into a proxy for suppliers, there is a danger that suppliers will focus their efforts on managing their relationships and commercial terms with PCWs, rather than on improving outcomes for customers in terms of service and pricing. We can safely predict that this approach would not be in the best interests of customers.

- 2.27. In summary we envisage that the PCW remedies will succeed only in bringing down tariffs that are already zero-margin or loss-leading - i.e., fixing the part of the market that doesn't need fixing - and greatly enhancing the commercial power of PCWs. However we do not foresee the remedies stopping the vast majority of customers continuing to be over-charged and disengaged, thus leaving the two core problems of the market unsolved.

RMR rules

- 2.28. In our recent response to Ofgem's consultation on the future of retail regulation⁵, we discussed at length issues with the current prescriptive regulatory framework and why it is failing to operate in the best interests of consumers. OVO's analysis, in essence, is that in order to reform the regulatory framework, the consumer outcomes Ofgem wishes to achieve need to be clearly stated upfront under three core pillars: Protect, Engage and Innovate. And suppliers need to be made directly responsible for delivering those outcomes. Prescriptive rules may in limited cases be needed to supplement the delivery of those outcomes but they would remain peripheral.

⁵ Ofgem's consultation on the future of retail market regulation - OVO's response dated 11th March 2016 (pending publication).

- 2.29. We drew on RMR as an example of highly prescriptive restrictions that may have prevented suppliers from mistreating their customers in certain aspects, but ultimately were not designed to incentivise suppliers to deliver better outcomes for customers. As a result, suppliers have been focussed on complying with specific rules rather than achieving the underlying policy goals of the rules. Taking information on bills for example, Ofgem and suppliers are so entangled in ticking the boxes of the RMR rules that the underlying objective of making information clearer for customers has been completely lost. As a result many customers remain confused by supplier information and therefore disengaged.
- 2.30. Returning to the CMA's remedies, we see a package of either new rules (Ofgem's marketing database) or the removal of old rules (RMR, 'whole of market' for PCWs) which we appreciate are designed to achieve certain outcomes - more engagement, cheaper tariffs etc. But we see no clear statements of positive outcomes that suppliers are obliged to deliver and therefore we are concerned that the CMA is repeating the mistakes made by Ofgem during RMR. Therefore while we support the removal of the RMR tariff rules in order to promote innovation amongst suppliers, and we commend the CMA for identifying the need for new Standards of Conduct in the licence conditions to replace the rules, we cannot emphasise strongly enough the importance of how those new standards are shaped and enforced by Ofgem in order to avoid a return to pre-RMR pricing practices. This remains the last glimmer of hope in the CMA's package of remedies to address the pricing and engagement problems.

3. PPM price cap

- 3.1. As the CMA has found, the prepayment market suffers more acutely than other parts of the market. This is due to both social and commercial factors such as prepayment customers having more propensity to vulnerability, the limited range of competitively priced tariffs and the technical constraints in the operation of prepayment tariffs. OVO agrees with the CMA's findings in this regard and as such believes there is a greater need to protect prepayment customers from the pricing problem. OVO therefore supports the introduction of a price cap for prepayment customers.
- 3.2. However we do have some concerns with regard to, first, the potential adverse distributional effects that the price cap may have on non-prepayment tariffs in the market, and secondly, the methodology for calculating the price cap. We outline our concerns in further detail below.
- 3.3. From a policy perspective, we believe that it is important for the CMA to consider certain protections in the price cap methodology in order to avoid dis-incentivising suppliers from continuing to invest in their prepayment businesses - i.e., without protections, the commercial risk for suppliers begins to outweigh the benefits of servicing prepayment customers.

Distributional effects of the price cap

- 3.4. Based on the likely value of the PPM price cap, we foresee most if not all suppliers having to reduce their current prepayment tariffs dramatically to fall below the cap. One concern we have is that many suppliers will attempt to recover the significant revenue lost from such reduction by increasing their SVTs or other tariffs, rather than improve their operational efficiencies and cost bases in order to minimise such revenue losses. Furthermore it must be noted that the impact of this potential

increase in non-prepayment prices will be borne by (among others) the two thirds of fuel poor households who are not prepayment customers.

- 3.5. One way of preventing this consequence is to introduce the safeguard tariff that the CMA previously proposed for SVTs. We note however that the CMA has decided against such proposals on the grounds of the operational cost associated with such a remedy and the potential impact such an intervention may have on competition in the market.
- 3.6. The targeted social price cap that we outlined in paragraphs 2.18 to 2.21 would therefore appear to be the best compromise. At the very least a social price cap would reduce the risk of non-prepayment customers who are vulnerable essentially subsidising the PPM price cap through anticipated SVT increases.

Price cap calculation methodology

- 3.7. In specifying how the price cap will be calculated we are mindful of the balance that the CMA wishes to strike between accuracy and simplicity - i.e., ensuring that the price cap is calculated accurately and appropriately, but without over-complicating the calculation.
- 3.8. In light of this balance we are focussed only on how certain individual cost components within the methodology are indexed and updated, namely wholesale costs, network costs and indirect costs.

How wholesale costs are updated - allowing for commodity price spikes

- 3.9. OVO is concerned that by updating the price cap only once a year, there is a risk that if commodity prices increase markedly, growing suppliers will be exposed to potentially significant losses.

- 3.10. Assuming that a supplier purchases 100% of their wholesale gas and electricity (commodity) upfront for the entire 'price cap year' (April to March) in order to lock in their commodity costs (which we anticipate many suppliers will do), a supplier would need to accurately forecast:
- (a) the correct number of customers on supply throughout the entire year, and
 - (b) the expected future consumption of the customers it has on supply.
- 3.11. Accurately forecasting the number of customers is difficult for growing suppliers (such as OVO) where customer growth is more unpredictable than established suppliers with stable customer bases. For growing suppliers, customer numbers are susceptible to regular 'spikes' or 'dips' depending on a range of factors within or outside of the supplier's control. It is even more difficult in the context of a market with a price cap, which may encourage perverse and unpredictable behaviours from suppliers. For example if commodity costs fall during the price cap year, suppliers may identify an opportunity to grow their prepayment base by launching much cheaper tariffs.
- 3.12. Growing suppliers therefore face a greater risk of inaccurately forecasting customer growth which in turn means that they are more exposed to sudden increases in the wholesale commodity market. Furthermore, unlike a stable market where costs to cater for unexpected increases in customer growth can be predicted, such costs are likely to be far higher and unpredictable if the stability of the market were to change. Example 1 below illustrates this risk.

Example 1. How a spike in commodity prices affects growing suppliers

A supplier has 1,000 dual fuel prepayment customers on 1st April 2017.

The supplier expects to grow at a rate of 10 customers per month over the course of the year.

1st April 2017: The supplier goes to the market and purchases enough commodity to cover the expected demand for the year to 31st March 2018 for its current customer base (1,000) plus the additional 10 new customers per month. This equates to £540 per customer for both fuels, or £45 per month per customer.

(This means that for the 10 new customers it has forecasted acquiring in May it buys 11 months of commodity at £45 per customer, for the 10 customers it has forecasted acquiring in June, 10 months of commodity, etc.)

1st June 2017: The price of commodity increases suddenly by 10%. Energy prices are widely reported as rising in the news and therefore customer acquisitions increase suddenly. The supplier acquires 100 new customers rather than the 10 it had originally forecasted.

The supplier has to go to the market again to purchase the additional commodity it needs to supply the additional 90 customers it did not expect. But commodity prices have now increased by 10%. This means that it now costs approximately £4.50 more per month to supply these extra 90 customers.

If we multiply the extra £4.50 cost per month by the number of remaining months in the price cap year (10), that equates to £45 per customer extra cost to the supplier. However due to the price cap, and even with the headroom, the supplier is unable to increase its tariffs to account for the additional cost.

Therefore with a headroom of £50, a commodity rise of just 10% can almost entirely remove the headroom in respect of unexpected new customers.

- 3.13. In light of Example 1 and the risk that growing suppliers face, we believe there needs to be flexibility to update the wholesale index during the year to cater for unexpected spikes in the wholesale market. We would propose to do this by monitoring the index on a quarterly basis and if commodity prices increase by more than a certain percentage, say 10%, the wholesale index updates the following quarter. Suppliers would then be able to update their prepayment tariffs in line with the updated wholesale cost component, but only for new customers. This mechanism therefore

would enable growing suppliers to recover unexpected additional wholesale costs in respect of customer acquisitions which would have been difficult to predict.

- 3.14. We believe this mechanism is fair as it simply reduces the risk that growing suppliers face in complying with the price cap without adding any operational complexity or the potential for suppliers to engage in gaming. Suppliers will also be under no obligation to change their prices if they perceive that the operational costs of doing so outweigh the benefits of recovering the increase in wholesale cost.
- 3.15. Note also that one of the CMA's proposed remedies is to repeal standard licence conditions 22B.30 and 22B.31 which prevent suppliers from offering exclusive tariff prices to new customers. Therefore we do not anticipate that any specific regulatory barrier would prevent suppliers from increasing their tariff prices for new customers within the price cap year under these circumstances.

How wholesale costs are indexed

- 3.16. The CMA has been somewhat vague with regard to the detail on how Ofgem will construct a wholesale energy cost index using commodity prices from ICIS, stating that the index "would be a weighted average of the prices of the relevant future products (month(s), quarter(s) and season(s))..."⁶
- 3.17. Basing the index entirely on forward market prices calculated on one specific date presents a risk for suppliers. This is because (continuing with the assumption that suppliers will purchase commodity in advance) a supplier's wholesale cost incurred prior to the start of the price cap year may differ greatly from the cost set by the index on 1st April, unless the supplier purchases all of their commodity on the precise date that the index updates - i.e., 1st April.

⁶ CMA's Provisional Decision on Remedies, paragraph 7.110.

- 3.18. However in reality it is simply not possible for every supplier to purchase all commodity for prepayment customers on the same day. Therefore we would expect suppliers to leave it as late as possible to purchase their commodity - i.e., as close as possible to 1st April - in order to minimise the risk of there being a differential between the actual commodity cost and the amount set by the wholesale cost index.
- 3.19. The effect of this likely last-minute dash for commodity by suppliers seems unworkable and may lead to detrimental outcomes for both customers and suppliers - e.g., shortage in liquidity of commodity.
- 3.20. Suppliers therefore need far greater foresight of what the wholesale energy cost index is likely to be well in advance of the start of each price cap year.
- 3.21. One way of achieving this is to calculate the wholesale energy cost index on the basis of a daily average of the forward curve prices, weighted by volume, during the three month period October to January prior to the start of each price cap year (1st April). This would enable suppliers to have an early indication of what the price is likely to be based on a three month period rather than a single date.
- 3.22. Using a three month period to calculate the future level of the wholesale index also ensures a greater level of stability, reducing the potential for the price cap to be based on a date when prices might be particularly volatile, or when prices were stable thereby failing to account for future volatility.
- 3.23. This proposal also has the benefit of offering suppliers a three month window in which to purchase commodity prior to the start of the price cap year.
- 3.24. The important over-arching point of our proposal is to ensure that once the CMA makes its final decision in June 2016, suppliers have as much information as possible to forecast what the likely wholesale index amount will be, so that they can start

making arrangements to purchase the commodity necessary and lock in suitable prices in preparation for the start of the price cap year in April 2017.

3.25. We will follow up this response with further details of our proposal.

How network charges are calculated - cost component index

3.26. OVO has two specific proposals with regard to the methodology by which to update network charges annually:

- (a) First, that the CMA uses the charging statements that network companies publish in advance as the means of computing the network cost component (**NCC**) of the price cap, and
- (b) Secondly, that NCC updates bi-annually to accommodate any changes in the price of gas network charges and load factors, both of which are updated annually on 1st October to coincide with the commencement of the gas year.

3.27. Our first proposal is to address our concern with the CMA's proposal to update the network cost index on the basis of allowed revenue to networks companies. We believe the CMA's approach will increase the operational complexity of complying with the price cap for suppliers by introducing a new separate regime when suppliers already use network charging statements, thus creating two different methodologies for calculating networks costs - one for their prepayment customers and another for direct debit and standard credit customers. Furthermore, calculating networks charges on the basis of the network company's allowed revenues offers suppliers little transparency of what the future price is likely to be.

3.28. However OVO's proposal does not involve such complexities and will make it easier for suppliers to comply with the price cap as the network charging statements are published in advance by the electricity network companies and are the basis upon which suppliers price their existing tariffs.

- 3.29. The aim of our second proposal is to reduce the risk to suppliers that changes in the gas network charge and load factors increase the cost of supplying prepayment gas customers for the six months between the date that gas network charges change (1st October) and the date that the prepayment price cap updates (1st April). Our preferred option would be that the gas component of the NCC updates on 1st October to reflect how the cost of changes in gas network charges and load factors affect the cost of supplying domestic gas customers. We consider this to be the most accurate means of ensuring that the NCC remains cost reflective for all customers.
- 3.30. If the CMA has concerns that updating the NCC more than once a year will be difficult to manage operationally, then perhaps the NCC could update in a similar fashion to our proposal for the wholesale index in paragraph 3.13. In other words the NCC would update only if the cost of supplying domestic gas customers increased by more than a certain percentage (say 10%). This upwards-only revision by exception would therefore allow suppliers to recover the added cost of supplying domestic gas customers if they considered the cost of updating their prices and systems justified doing so.

Exclusion of Smart metering costs from cost components

- 3.31. Section 3 of the CMA's Provisional Decision on Remedies outlines how the CMA used the tariff prices of OVO and First Utility as the basis for calculating its competitive benchmark of an efficient supplier's costs to supply a standard energy customer. On the date of the CMA's calculation (30th June 2015) neither OVO nor First Utility will have reflected the increase in costs incurred by suppliers rolling out smart meters and implementing the data communications company (**DCC**).
- 3.32. Therefore the competitive benchmark that the CMA has calculated does not include smart meter costs, which includes (among other things) the cost of installing smart meters and the cost of operating the DCC. While we are relatively confident that the

CMA recognises the need to include these costs, we would like to suggest the cost components under which these costs should sit within the price cap calculation methodology.

- 3.33. With regard to the cost of installing smart meters we have not had sufficient time to calculate what we consider to be a robust estimate of difference in cost between installing and operating a smart meter (not including charges to the DCC) and operating the existing prepayment meter infrastructure (PPMIP). We will endeavour to submit a follow up document to the CMA estimating such difference in cost which will include the methodology and any assumptions we have used.
- 3.34. The operating revenue of the DCC is regulated and paid for by suppliers on the basis of monthly charges that are set in advance. The methodology is therefore identical to the means by which networks costs are calculated. In line with our proposed approach for network charges we suggest that the charges suppliers pay to the DCC would also be included in the NCC of the prepayment price cap and calculated on the basis of the actual charging statements issued by the DCC.

Failure to identify a specific index for certain costs

- 3.35. We appreciate that the CMA is trying to strike the right balance between accuracy and simplicity in the design of the price cap. For this reason we understand the CMA's reluctance to assign every single line item that suppliers pay to a specific cost component in the prepayment price cap calculation. Notwithstanding this recognition, we have concerns that certain line items have not been assigned to cost components or do not have a suitable index by which to be updated (or both).
- 3.36. One example of such a line item is the balancing and settlement use of systems charge (Bsuos). This cost is not remotely correlated to any of the four separate indices the CMA has proposed, namely wholesale, networks, policy and inflation.

Sudden increases in the price of Bsuos will therefore have to be recovered from the headroom.

- 3.37. As yet we do not have a suggestion as to how these costs can be incorporated into the price cap methodology in a straightforward manner. We will endeavour to follow up this response with our suggestion at the earliest possible opportunity.

4. Half Hourly settlement

- 4.1. OVO welcomes the CMA's recognition of the importance of half hourly settlement (**HHS**) to retail energy competition and, as a first step towards facilitating HHS, its proposal to change the half hourly data preference in the Smart Energy Code to be 'opt out'.
- 4.2. OVO views HHS as essential to spurring much needed innovation in domestic energy products and we are confident that such innovation will bring genuine, long term improvement to customer engagement. In particular we believe that HHS can unlock the full potential of smart meters by enabling suppliers to offer products that encourage load shifting and enable customers to take more control of their energy usage. It could also allow customers to maximise the potential of new 'smart home' white goods that are becoming increasingly available in the domestic market.
- 4.3. However the most pressing hurdle currently to the rollout of HHS is the ability for suppliers to proceed with elective HHS before mandatory HHS is ready. We have been engaging with Ofgem and the Settlement Reform Advisory Group (the **SRAG**) and believe that the case for elective HHS is far more compelling than the CMA has been lead to believe, especially as elective HHS can greatly facilitate the delivery of mandatory HHS. Perhaps the most compelling reason to proceed with elective HHS ahead of mandatory HHS is the competitive pressure that will be placed on suppliers by any one supplier starting HHS. An elective approach to HHS therefore harnesses the competitive pressure that has traditionally been absent from major industry changes such as Project Nexus and commercially compels other suppliers to overcome any unwillingness they may have to engage in the process of change. We therefore believe that harnessing this competitive pressure is essential to delivering both mandatory and elective HHS in the most efficient way possible.

- 4.4. We believe that there are also compelling operational benefits to proceeding with elective HHS first. HHS will involve technological development and operational systems changes (among other things) which will be difficult to get right first time and failing to do so will risk the stability of systems and platforms. By doing elective HHS first however, industry participants will have an opportunity to test and trial various aspects, ironing out issues along the way. In other words elective HHS will provide an opportunity to 'dress rehearsal' mandatory HHS. Parallels can be drawn to the smart meter rollout where suppliers have been able to rollout SMETS1 meters first in order to test their systems and prepare for the rollout of SMETS2 meters and DCC 'go live'.
- 4.5. OVO is also anxious about a lengthy and drawn out process for implementing mandatory HHS. As the CMA will be aware previous significant code reviews (**SCR**) have taken significant time - few have lasted less than five years. Other major industry projects such as the smart meter rollout and implementing a number of the CMA's remedies might also interfere with the industry's ability to deliver mandatory HHS in a timely fashion. Therefore while we understand that this lengthy process may be unavoidable for mandatory HHS, given the resource constraints and pressures we think it is crucial to take all available steps to facilitate the delivery of elective HHS sooner rather than later.
- 4.6. OVO considers the most immediate barrier to facilitating HHS to be industry inertia. The existing codes process enables industry parties to stall and delay the progress of any changes if they feel for whatever reason that the changes are not in their interests. We therefore think there is a role for a government or regulatory party to project manage the industry codes process and enable the delivery of elective HHS, to ensure that certain industry parties do not continually delay and frustrate the process of delivering the changes necessary.

Issues to be resolved to enable elective HHS

- 4.7. In the following paragraphs we outline in greater detail the changes necessary to deliver elective HHS, bearing in mind that much of this will also enable mandatory HHS. For further detail on these changes please consult OVO's response to Ofgem's open letter on HHS.⁷

Change of measurement class

- 4.8. The Change of Measurement Class process used to switch a site to HH settlement needs to be reviewed. In particular, the process needs to be able to deal with sites switching in and out of HHS and also be able to handle change of tenancy and change of suppliers. It may also be necessary to ensure that processes can deal with situations where a change of measurement class needs to be applied retrospectively.

Half hourly data and system capacity

- 4.9. There currently exists a sizeable cost barrier in relation to the appointment of half hourly data collection agents (**HHDC agents**) compared to the non half-hourly equivalent. We are supportive of the SRAG's recommendations relating to the requirements of HHDC agents for HHS domestic customers and feel they are likely to bring down costs. However, further clarity is required in this area, in particular relating to how suppliers should get half hourly data from the meter and into settlement.
- 4.10. We also have concerns regarding the capability of central systems to cope with a significant take up of elective HHS. If it transpires that this is a major constraint then planning for any upgrades should start now.

The effect of feed in tariff spill on group correction factors

⁷ [OVO Response to Ofgem's open letter on half hourly settlement: the way forward, 29th January 2016.](#)

- 4.11. A significant amount of output generated by installations supported by the feed in tariff (**FiT**) is unmetered. During periods of high FiT output, the increased quantity of unmetered electricity can significantly depress the value of the group correction factor (**GCF**) within the relevant grid supply point (**GSP**) region. A reduction in the value of the GCF decreases the settled, and hence billed, volume of electricity. This means that all profiled sites within a given region benefit from a decreased GCF.
- 4.12. GCFs are not currently applied to a HHS customer, therefore HHS customers will forego the benefit of reduced GCFs during high FiT output. Forgoing this benefit represents an opportunity cost to switching a domestic customer to HHS. While the long term solution is clearly to have all FiT installations metered, a short term solution would be to continue applying GCFs to HHS domestic customers. We believe this can be achieved by changing the scaling weight applied to measurement class F in the settlement calculations.

TNUoS charging

- 4.13. We believe that charging transmission network use of system (TNUoS) charges on the basis of the triad methodology is not suitable for HHS domestic customers and creates an unnecessary risk to both suppliers and customers. Our proposal is that the existing non-half hourly (NHH) charging mechanism be applied to elective HH settled domestics (i.e. consumption in settlement periods 33-38). We believe this change strikes the correct balance between maintaining an incentive to shift load away from peak periods, without exposing domestic customers to the risk of punitive charges.

Balancing and settlement code cost recovery

- 4.14. The costs associated with the operation of the balancing and settlement code (**BSC**) are recovered through the BSC specified charges mechanism. Currently the charge is £0.6 per site per month, however the amount is ten times greater for an NHH site. We understand that the cost is expected to reduce following the introduction of P272,

however cost parity between domestic customers settled half hourly and non-half hourly is essential. We propose that elective HHS domestic customers are charged the same as NHH customers.

Distributional effects associated with transitioning to HHS

- 4.15. We have also noted the concerns raised by many bodies around the possible distributional impacts associated with allowing a sub set of customers to transition to elective HHS. We are very conscious of the concerns raised, especially for customers with little ability to shift their demand (such as customers reliant on electricity for medical equipment).
- 4.16. In the short term, it is highly unlikely that the transition of a minority of customers to HHS will materially impact the price non half hourly customers pay for their electricity. In the long term a wider policy solution is required to ensure that vulnerable customers who cannot shift their consumption easily do not pay significantly more for their energy were they to become half hourly settled.
- 4.17. Our suggestion is that suppliers could be mandated to install devices such as batteries in the houses of these customers once elective HHS has been suitably enabled.

5. PCW remedies

5.1. We have outlined in paragraphs 2.22 to 2.27 above our comments in relation to the PCW remedies and our concerns that they will not solve the pricing and engagement problems, and may indeed exacerbate them.

5.2. In relation to several specific aspects of the remedies we respond as follows.

Midata programme access

5.3. We disagree that the consent process in relation to Midata should be opt out. We see PCWs' access to Midata as completely different in nature to the Ofgem marketing database. The former is a commercial tool designed to enhance customer engagement - i.e., those who are already engaged to compare tariffs and switch. The latter however is a tool to protect those customers who are completely disengaged - i.e., its primary purpose is not necessarily as a marketing tool but as an engagement tool (which just happens to be implemented by means of marketing).

5.4. As such we believe that customer consent to PCWs accessing Midata should be *opt in*, not opt out. This would be consistent with current best practice in relation to marketing consents and our interpretation of data protection laws and regulations which clearly require pro-active, informed consent to receive marketing.

ECOES database access

5.5. We agree with the CMA's proposal to allow PCWs to access the ECOES database to verify customer details thereby minimising erroneous switches. However we wish to stress that PCWs should be permitted access to the database to verify details only in direct response to a specific request from a customer to switch - i.e., PCWs should not

be permitted to access data relating to its customers at any time, as such use would likely be for marketing purposes.

6. Removal of RMR tariff rules

- 6.1. Broadly OVO supports the CMA's proposal to remove the Ofgem licence conditions introduced under RMR in relation to 'simpler' tariffs. We believe that this removal will give suppliers much greater flexibility to innovate, which will in turn promote more competition between suppliers to acquire and retain customers. We are also confident that new innovative products is the key to improving customer engagement in the long term – and it is imperative that suppliers are incentivised and supported in that regard.
- 6.2. However, we must highlight that while we support this proposal, as with many of the other remedies it does not solve the pricing problem. In fact as we have outlined earlier in this response, removing tariff constraints is likely to result in even lower fixed tariffs but no change or, worse, even higher SVTs, thus continuing to widen the gap.
- 6.3. Furthermore in order to prevent a return to the customer confusion and lack of transparency in relation to pricing that originally led to the RMR tariff rules, it is imperative that new Standards of Conduct are introduced in tandem with the removal of the rules. And it is vital that Ofgem is equipped to pro-actively enforce compliance with the new Standards of Conduct in a proportionate and substantive way – i.e., not the overly formalistic, tick-box approach that is currently the case with prescriptive regulations.
- 6.4. In the following paragraphs we explain how this approach would work as part of Ofgem's future regulation consultation and move away from prescriptive rules towards principles-based regulations.

The principles

- 6.5. Prior to the introduction of the RMR tariff rules there was a clear tactic being used by a number of suppliers to flood the market with multiple similar tariffs, in order to crowd out competition from competing suppliers on pricing tables. The use of this tactic was quite successful and it is clear that small suppliers found it more challenging to enter a market where the larger incumbents could simply introduce new tariffs to instantly undercut their rivals.
- 6.6. The introduction of the RMR tariff rules did address these issues to some extent – there was improvement in transparency and arguably competition, as smaller independent suppliers were for the first time put on a level playing field with the Big Six suppliers and therefore able to compete effectively, increasing their share of acquisitions especially on PCWs.
- 6.7. However despite these improvements, the tariff rules – in particular the four tariff cap – clearly stifled innovation. So, despite the improvement in transparency and competition, there was no noticeable improvement in consumer engagement – i.e., making tariffs clearer and enabling more new entrants to the market did not mobilise the majority of customers to switch, particularly away from high default SVTs with the Big Six.
- 6.8. The introduction of the RMR tariff rules therefore is a lesson in the triumph of prescription over policy. Prescriptive rules were introduced to fix very specific aspects of tariff setting in the market but the underlying policy intentions were not met, primarily because the intended outcomes were not clearly stated and the rules were not designed for those outcomes.
- 6.9. With this in mind, OVO sees the CMA’s remedy not simply as the removal of certain restrictions in the rulebook but an opportunity to *re-cast* rules into outcomes-based principles. To put it another way, customers should have the benefits of a wide

variety of choice in tariffs but without the harm caused by misleading or confusing tariff setting practices. We have discussed this outcomes-based approach with Ofgem recently as part of their future retail regulation reform and will continue to engage with them.

6.10. In the context of tariff setting, we believe the outcomes that need to be achieved and therefore the principles that need to be implemented are as follows:

- The terms and structure of tariffs should be clear and easily understandable by customers.
- A supplier's suite of individual tariffs should be readily distinguishable between each other.
- Customers should be able to easily compare and select the tariffs that are best suited to their needs.

6.11. We would expect these additional principles to supplement the existing Standards of Conduct in the licence conditions in relation to treating customers fairly. We would also expect these principles to prevent suppliers from using white labels to mislead customers, in light of the numerous examples highlighted to the CMA.⁸

6.12. We note the CMA has proposed a new Standard of Conduct "that would require suppliers to have regard in the design of tariffs to the ease with which customers can compare 'value for money' with other tariffs they offer." We think this is a good starting point but it needs to go further in the manner outlined above in order to be explicit in requiring tariffs to be easily distinguishable and not confusing.

6.13. Putting the principles into practice, a supplier should not be able to offer multiple variable tariffs or fixed term tariffs without there being clear differences between the

⁸ CMA's Provisional Decision on Remedies, paragraph 6.77.

tariffs – for example, the length of the term of the fixed tariffs or several variable tariffs which may offer different renewable power guarantees.

- 6.14. In the meantime we would urge Ofgem to issue an open letter as soon as the CMA's final report is published in June 2016, confirming its de-prioritisation of enforcement of the tariff rules until the licence conditions are formally amended.

The enforcement approach

- 6.15. As we have explained to Ofgem, a radical shift is required in the approach to enforcement of principles-based regulations. The current tick-box approach will not work. Instead Ofgem will need to focus on the end result – in this context, whether or not a supplier's pricing tactics have confused customers, for example. And in assessing this end result Ofgem will need to look holistically and substantively at the supplier's behaviour and culture – i.e., its decision making process and whether there has been genuine intention and effort to fulfil the underlying spirit and intentions of the principles, even if the end result was unsuccessful. This is an approach taken by other regulatory bodies that conduct principles-based regulations such as the ICO.

Retaining RMR clearer information rules

- 6.16. We understand that the RMR rules were introduced as one package of remedies. The clearer information rules, for example, were introduced to complement the tariff rules. While certain RMR rules can in theory operate alone, we do not believe this would fulfill the policy intention underlying the rules. We would propose therefore removing the RMR information rules in conjunction with the tariff rules.
- 6.17. Despite good intentions we do not believe the information rules have fulfilled their purpose of making information clearer for customers. In fact, particularly given the complex prescriptive nature of the rules, they are likely to have caused more - not less - confusion. Just today there was an article in The Times claiming that "two thirds

of people still do not understand their energy bills despite new rules intended to make them clearer".⁹

- 6.18. Furthermore suppliers have incurred operational costs and burdens in implementing the rules as significant changes have been required to complex billing and communications systems and platforms. These costs are certainly not justified by the lack of clear benefit of the rules for customers.
- 6.19. In any event, the rules have been enforced by Ofgem in a highly formalistic, tick-box manner which in OVO's experience typically ignores the underlying policy intention of the rules, and indeed the over-arching Standards of Conduct in the licence conditions.
- 6.20. We appreciate why the CMA may not be inclined to remove the RMR information rules at the same time as the tariff rules, and we are mindful of not cutting across Ofgem's future retail regulation project which will inevitably address these rules.
- 6.21. Nonetheless if the RMR information rules are retained suppliers will incur yet further operational costs to adapt the rules for new tariffs that will result from the removal of the RMR tariff rules. This exercise will be complex as it is difficult to predict how the information rules might need to be adapted post removal of the tariff rules. For example, how useful will the Cheaper Tariff Messaging and Tariff Comparison Rates be for customers comparing a 'simple' tariff of one supplier which comprises only single standing charge and unit rates against a 'complex' tariff of another supplier which comprises multiple standing charges and unit rates?
- 6.22. Given this complexity and resource required we are concerned that Ofgem and suppliers will be distracted from much needed work required on Ofgem's future retail regulation reform.

⁹ *Most customers still find energy bills confusing* - The Times, 7th April 2016.

6.23. We would propose therefore that Ofgem de-prioritises compliance with the RMR information rules at the same time as the RMR tariff rules are removed. Our proposal is subject to the introduction of new Standards of Conduct as outlined in paragraph 6.10 above and the appropriate enforcement of Standards of Conduct by Ofgem.

7. Marketing database for disengaged customers

- 7.1. We appreciate the underlying intention of this remedy is to find a way to communicate directly to the "stickiest" and most disengaged customers in the market. However we are not convinced that this remedy will bring meaningful benefits to customers.
- 7.2. As explained in our previous response to the CMA's provisional findings and notice of possible remedies¹⁰ we consider it unlikely that increasing the frequency of supplier communications to customers, in whatever form, represents a long term solution to improving levels of engagement in the retail energy market. From OVO's experience it is the development of new energy products and engagement tools, such as our online platform OVO Live, that have the real potential to genuinely re-engage customers.
- 7.3. While customer disengagement is driven partly by lack of knowledge, it is also driven by lack of trust in energy suppliers. Therefore no amount of communications – whether in the form of marketing or information on bills – will ultimately succeed in improving customer engagement until this lack of trust is resolved.
- 7.4. From OVO's experience the only way for customers to restore their trust in energy suppliers is for suppliers to be held more to account for the quality of their customer service and their substantive approach to treating customers. Ofgem's overly prescriptive regulations, such as the rules introduced by RMR, have failed to achieve this as it has created a regime where suppliers are responsible for formal tick-box compliance with rules. Hence the importance of replacing the current licence

¹⁰ [OVO response to the CMA's provisional findings and proposed remedies, "specific response to remedy 9" \(August 2015\).](#)

conditions with principles based regulations as soon as possible. We have been and will continue to engage Ofgem heavily on this front.

- 7.5. If the CMA is minded to proceed with this remedy, then we would strongly recommend that new Standards of Conduct are introduced in parallel to govern suppliers' use of the database, ensuring that they do not abuse the database and control the volume and nature of information they can send to customers. For example suppliers could be restricted to sending any individual customer an upper limit of communications a year.
- 7.6. Furthermore, given that this remedy is designed to target the most disengaged customers who have remained on Big Six SVTs for extended periods, we would also recommend that this database include only those Big Six customers - i.e., the database should exclude customers who are on SVTs with independents as they are more likely to have engaged with the market.
- 7.7. If this remedy were to be introduced we would support the CMA's recommendation to obtain consent from customers on an "opt out" basis because the database is intended to be a form of indirect "protection" for disengaged customers – i.e., in order to fulfil the purpose of the database it would not make sense for it operate on an opt-in basis. This contrasts PCWs' access to Midata which, as we outline in section 5 above, should operate on an opt-in basis as its primary purpose is for marketing.

8. Restricted meters

- 8.1. OVO broadly supports the CMA's proposals in relation to customers with restricted meters. We agree in principle that those customers need better access to available tariffs.
- 8.2. However we would ask the CMA to be mindful of the operational complexities – and therefore costs – of implementing this remedy. We believe that smart meters should be the simplest solution for the majority of restricted meter customers who wish to take advantage of standard tariffs. In respect of those customers who are unable to have a smart meter installed, or indeed refuse one, we anticipate there could be significant changes required to suppliers' billing platforms.
- 8.3. Another operational complexity involves potential electrical works being carried out at a customer's home – e.g., re-wiring in the home – to enable the solution to work.
- 8.4. It is important therefore that any new regulation contains sufficient flexibility for suppliers to cater for cases involving operational or technical difficulties or having exemptions from complying if after having used reasonable efforts suppliers are unable to comply without expending disproportionate cost and effort.

9. Other remedies

Gas Settlement Reform (Project Nexus)

9.1. We support the CMA's proposals in relation to Project Nexus. Completing gas settlement reform is key to improving market outcomes for all gas customers, particularly domestic gas customers. We think Project Nexus provides a cautionary tale to the CMA about the length of time a significant code review can take in the context of HHS, especially if industry parties are not sufficiently and jointly incentivised to deliver major operational changes in a timely manner.

PPMIP Gas Tariff Pages

9.2. We wholeheartedly welcome the CMA's proposal and commend their decision to implement the suggestions we outlined in our response to the second supplemental notice of provisional findings and remedies. We are hopeful that this remedy will increase the ability of suppliers to launch new tariffs in the prepayment market. It will also give flexibility to issue updated prepayment tariffs if the price cap is adjusted during the year, as we have outlined in section 3 above.