1. **Introduction**

1.1 This submission is made on behalf of RWE npower Group plc, RWE Generation UK plc, RWE Innogy UK Holdings Limited and RWE Supply & Trading GmbH (referred to collectively or individually, as appropriate, as ”RWE”), in connection with the decision of Ofgem to make a market investigation reference to the Competition and Markets Authority (“CMA”) pursuant to section 131(1) of the Enterprise Act 2002 (the “Decision to make an MIR”).

1.2 RWE sets out in the remainder of this document:

1.2.1 An introduction to RWE’s business;

1.2.2 RWE’s overall comments on the Decision to make an MIR;

1.2.3 RWE’s initial comments on certain key aspects of the operation of competition in the British energy markets:

1.2.3.1 Retail suppliers’ control of costs;

1.2.3.2 Impact of regulation on energy markets;

1.2.3.3 Small supplier exemptions;

1.2.3.4 Getting it right for our customers.

1.2.4 Conclusions to this initial submission.

2. **RWE**

2.1 RWE operates in the UK through the following companies:

2.1.1 RWE npower Group plc (”RWE npower”);

2.1.2 RWE Generation UK plc (”RWE Generation”);

2.1.3 RWE Innogy UK Holdings Limited (”Innogy”);

2.1.4 RWE Supply and Trading GmbH (”RWEST”);

2.1.5 RWE Dea UK SNS Limited (”RWE Dea UK”), UK operating subsidiary of RWE Dea AG.
2.2 In addition, certain services (such as audit, accounting, some HR functions etc) are provided across the RWE group through RWE Group Business Services GmbH and its subsidiary in the UK, RWE GBS UK Limited.

RWE npower

2.3 RWE npower is the retail energy supplier for around 5.3 million residential accounts\(^1\) and 210,000 Small and Medium Enterprise ("SME") business accounts\(^2\) in the UK.

2.4 RWE npower is organised into three customer segments as well as Energy Services, each with full ownership of its profit and loss account and end to end processes that impact customers:

2.4.1 RWE npower ‘Domestic’ serves 5.3 million energy customer accounts, which breaks down as follows into electricity and gas customer accounts:

2.4.1.1 3.1 million electricity customer accounts;

2.4.1.2 2.2 million gas customer accounts;

2.4.1.3 Of these, approximately 2 million are both electricity and gas customer accounts.

2.4.2 RWE npower ‘SME’ serves 210,000 customers, 166,000 supplied with electricity and 44,000 with gas. [CONFIDENTIAL]. These customers vary in size from businesses with the same consumption as a Domestic property to hotels and factories.

2.4.3 RWE npower ‘Industrial & Commercial’ ("I&C") supplies approximately 36TWh of energy to 21,000 typically larger business customers with a more bespoke offering than SME.

2.4.4 RWE npower ‘Energy Services’ develops RWE npower’s energy service offerings such as the smart thermostat ‘Nest’ and boiler installation and maintenance. It is responsible for meeting RWE npower’s energy efficiency and environmental obligations, such as the Energy Company Obligation (“ECO” – see below) and feed-in tariffs (“FITs”) and provides metering services to RWE npower and other companies.

2.4.5 These four segments are supported by Sales Portfolio Management, providing the commercial optimisation and commodity risk

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\(^1\) RWE npower supplies to around 5.3 million meters/3.3 million customer accounts.

\(^2\) This figure does not include Industrial & Commercial accounts, which are outside the scope of the CMA's investigation.
management function across the portfolio, and by corporate and financial services.

2.5 For historical reasons, there are several supply licences held by companies within the RWE supply business, all being subsidiaries of RWE npower Group Plc. These are listed at Appendix 1.

**RWE generation businesses**

2.6 RWE’s conventional and renewable generation businesses are described in the sections that follow.

2.7 Over the last six years, RWE has invested more than £6 billion in energy infrastructure for the UK, split roughly 50:50 between investment in conventional power plant and new renewable technologies, including an investment of more than £1.5 billion in two new highly efficient gas-fired power stations at Pembroke and Staythorpe.

**RWE Generation**

2.8 RWE Generation owns, operates and maintains a portfolio of gas, coal and oil fired stations together with a portfolio of smaller open cycle gas turbine generation assets.³

2.9 Additionally its subsidiary, npower Cogen Limited, owns and operates 5 distribution connected combined heat and power and Open Cycle Gas Turbine sites in the UK and also provides services to operate, maintain and commercially optimise combined heat and power sites under contracts with large industrial and commercial customers.

**RWE Innogy**

2.10 The expansion of renewable electricity generation is a cornerstone of RWE Group strategy. RWE Innogy has an operational portfolio of 935 MW and a potential development portfolio of over 4 GW, including wind farms, hydro plant and biomass generation.

2.11 RWEST provides the route to market for all power generated by RWE Innogy (with the exception of volumes associated with sales of Levy Exemption Certificate ("LECs"), Renewables Obligation Certificate ("ROCs") and Renewable Energy Guarantees of Origin ("REGOs") which are sold directly to RWE npower).

**RWEST**

2.12 RWEST is a leading European energy trading house. RWEST is the interface between the RWE Group and global wholesale markets for energy and energy-related raw materials. Based in Essen, Germany, with main UK trading floors in London and Swindon, RWEST is the hub for all tradable commodities, in both their physical and/or derivative forms, including power, gas, coal, freight, oil, weather, emissions certificates and renewable energies.

2.13 RWEST provides the main route to the wholesale electricity and gas markets for the retail and generation businesses in the UK. It also trades on its own account (through the proprietary trading desks). In addition, the Principal Investments business unit invests in energy related businesses or assets including generation assets. Current investments include Lyinemouth Power Ltd, an embedded coal fired power station with the potential for conversion to biomass and a solar farm development.

2.14 The RWEST Commercial Asset Optimisation (“CAO”) team provides services to both the generation and retail businesses.

2.15 With respect to the generation business, the CAO team aims to maximise the value of the generation assets on the wholesale markets, by hedging and optimising generation capacity. The CAO team begins hedging generation capability from a period of up to 3 years before dispatch, with trading and optimisation activities being constantly undertaken until real-time dispatch. The CAO team is responsible for all longer-term commercial input for the generation assets including fuel procurement, scheduling of plant maintenance, investment decisions. These services are provided pursuant to formal contractual arrangements which inter alia ensure that full value is transferred back to the generation business.

2.16 For the retail business, the CAO team manages the residual short term positions of RWE npower from “week ahead” to “within day”, including balancing RWE npower’s final contractual position versus demand. Again, these services are provided to RWE npower pursuant to formal contractual arrangements which inter alia ensure that full value is transferred back to the retail business.

RWE Dea UK

2.17 RWE Dea UK is the UK operating subsidiary of RWE Dea AG and has production, development, and exploration assets on the UK Continental Shelf. RWE Dea UK is the operator of the Breagh, Clipper South, Cavendish, Windermere and Topaz gas fields and partner in the Anglia, Devenick, Kepler, Markham, Mimas, Minke, Orca, Saturn, Tethys and Victor gas fields.

2.18 RWE AG has entered into a contract to sell RWE Dea AG to a third party and the transaction is expected to complete during 2014.
Operation of UK companies

2.19 Each of the RWE companies is a separate legal entity and is independently managed, both in terms of management responsibility and profit and loss accountability, with each of the entities having separate boards of directors\(^4\) and reporting separately to RWE AG. The performance of each RWE company is measured and targeted by RWE AG against separate business plans.

2.20 At RWE AG Board level only, the operation of the whole group is considered. RWE AG agrees the strategy and business plans for each company once a year in line with an overall RWE AG strategy and to deliver an overall RWE business plan. See Appendix 2 setting out the RWE AG Group structure.

2.21 The majority of commercial interactions of RWE npower, RWE Generation and RWE Dea go through RWEST, and these production, generation and retail volumes are traded openly and transparently on the wholesale power and gas markets. Transactions between the different companies in the Group and RWEST, as well as the minority that take place directly between the operating businesses, take place at wholesale market prices and on a "willing buyer/willing seller" basis. More generally RWE has led the way in promoting liquidity in the GB energy markets, and adds significant volume and liquidity to those markets.

2.22 Market conformity/fair-value checks are performed by RWEST Risk Control to ensure the validity of these market prices (with ex-post valuation being carried out if fair value cannot easily be determined). (RWEST Risk Control is independent of RWE npower and RWE Generation, and reports directly to RWE AG.)

2.23 RWE npower buys LECs, ROCs and REGOs from Innogy and LECs from Cogen at market reflective prices and also sources LECs and ROCs from generators outside of the RWE Group.

2.24 In summary, RWE in the UK operates each of its supply, generation, renewables and trading businesses separately, and is, RWE would suggest, a model for how a UK energy group should be structured so as to enhance liquidity and ensure transparency of profits across the value chain. Whilst the Group is vertically integrated it does not and is incentivised not to move money between various parts of the value chain because all trades are done openly and transparently at market value and each entity has its own profit and loss account.

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\(^4\) The Chief Commercial Officer of RWE Generation, a board member of RWE Generation, is also a board member of RWEST. In addition the Head of Commercial Asset Optimisation UK, an employee of RWEST, is a board member of RWE Generation.

Paul Massara, CEO of RWE npower, also holds a role as country chair, under which he is responsible for stakeholder management and managing RWE’s relationship with the government. In this role, in order to ensure that a consistent RWE position is taken, he needs to be sufficiently apprised of the operations of the other group companies. Mr Massara is not involved in commercial decision making in relation to RWE Generation, RWE Innogy, RWEST or RWE Dea UK.
3. **Ofgem Decision to make an MIR**

3.1 As set out in RWE’s response to the Ofgem consultation on its proposal to make a market investigation reference, RWE supports the referral to the CMA.

3.2 RWE believes that an independent, evidence-led investigation by the CMA will demonstrate that, overall, the GB energy market is competitive, and will ensure that the facts about the operation of the market and the way in which suppliers compete are made clear for customers, government, regulators and other stakeholders.

3.3 In particular, there is a need to rebuild consumers’ trust, both by explaining clearly the reasons for rising energy bills in recent years and by ensuring that, on an ongoing basis, consumers are provided with clear and accurate information about what makes up their bills. Any explanation needs to include an explanation of the impact on consumers’ bills of the Government’s policy to reduce the UK’s reliance on high carbon fuels such as coal in favour of lower carbon fuels such as wind, solar, biomass and nuclear. RWE npower has itself sought to shine a light on the different elements of cost that go to make up a typical energy bill for a domestic customer. However, this may not be enough. In our view, consumers may benefit from a regular independent third party review of the factors that make up their bills, and a clear and accurate explanation of this.

3.4 As regards the competitiveness of the market, RWE’s daily experience is that it must compete for the business of all its customers.

3.5 In broad terms, British energy markets are not characterised by supply structures which would ordinarily create competition problems. On a national basis, RWE npower’s own share of domestic accounts is less than 12%\(^5\). Furthermore, RWE is one of six larger suppliers and there are in addition a number of smaller suppliers. We are sure that the CMA will not wish to rely purely on market shares or numbers of companies, but since this is commonly the starting point for a competition investigation we do think that the CMA will nonetheless wish to note that, based on the CMA’s Merger Assessment Guidelines, this kind of market structure would not normally be expected to give rise to competition concerns. Specifically, the Guidelines provide that the CMA has not usually been concerned about mergers that reduce the number of firms in the market from five to four (or above)\(^6\). In fact, while press (and regulatory) focus has been on the so-called ‘Big Six’, RWE notes that similar concerns have been raised with respect to the ‘Big Four’ accounting firms.

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\(^5\) See Cornwall Energy. Electricity and Gas Supply Market Shares, Domestic Survey 30th April 2014. Specifically, pages 5-8, report that RWE npower held 10.9% of total energy accounts and, 11.7% of electricity accounts, 10% of gas accounts and 10.8% of dual fuel accounts.

and the ‘Big Four’ supermarkets and, even with only four main players, the CMA has judged that concerns about the structure of those markets have not justified structural interventions.

3.6 In addition we would note that the overall margins observed in the retail supply market in the UK in recent years are lower than those seen in other sectors that are considered to be competitive, such as supermarkets.

3.7 Ofgem comments, in the Decision to make an MIR (at paragraph 3.37), that it does not consider various areas (including interconnection and wholesale gas markets) warrant specific investigation as part of a market investigation. Given that wholesale gas markets are covered by the terms of reference, RWE would expect the CMA to undertake its own analysis of all the reference markets, and not leave any to one side from the outset. RWE shares the view that wholesale gas markets do not exhibit potentially harmful market features, but RWE believes the same applies to the UK wholesale electricity market, which inter alia is also well connected with other markets. RWE would further note that the high degree of interaction in hedging activity between the UK wholesale electricity and gas markets means that the levels of liquidity are best considered for the two markets together.

3.8 Equally, in the context of gas, in addition to the wholesale purchase or trading of gas for purposes which may ultimately include retail supply, the activities of wholesale and retail gas supply, and activities connected therewith are also clearly included in the terms of reference (these connected activities might encompass, for example, the provision of boiler services; the purchase of which, in RWE’s view, influences customers’ behaviour in relation to the purchase of retail energy).

4. Operation of competition on energy markets in Great Britain

4.1 There will be a variety of aspects of the operation of competition in the British energy markets on which RWE will wish to comment as the CMA proceeds with its investigation, but there are four points which the CMA may wish to consider at the outset of the investigation:

4.1.1 Retail suppliers of energy are in a position to control less than 20% of the costs that go to make up the customer’s energy bill but have a significant risk on other elements. Not all network costs and obligations are known quantities at the time of setting tariffs; and in addition to these there are regulatory and policy costs, and retail suppliers also have to manage market risks (wholesale energy price risk and demand risk); default risks; and operational risks.

4.1.2 The British energy markets have been subject to a wide range of regulatory measures which have affected the way these markets
function. Furthermore, many of these are in our opinion of questionable consumer benefit, are uncoordinated with other regulation and longer term policy development, or are imposed in a manner that is not cost efficient. In addition, many GB energy policies have been subject to multiple revisions (examples include e.g. ECO, SMART, carbon floor price, solar pricing etc), which has led to increased costs and increased uncertainty.

4.1.3 Whilst barriers to entry are low, as evidenced by the number of recent new entrants to the retail supply market, the exemptions for small suppliers from social and environmental obligations imposed on larger suppliers have the consequence of distorting, rather than enhancing, competition across the market as a whole.

4.1.4 RWE npower is acutely aware of the difficulties it has encountered in delivering the levels of domestic customer service to which it aspires, but getting it right for customers is at the heart of the strategy for the business that RWE npower has been implementing.

4.2 RWE’s initial views on these issues are set out in the sections that follow.

5. **Retail suppliers’ control of costs**

5.1 Retail suppliers of energy are in a position to control less than 20% of the costs that go to make up the customer’s energy bill. However, as noted above, suppliers have a significant risk on other elements.

5.2 When the CMA seeks to understand price levels and their movement over time, as well as the profitability of the companies involved across the energy value chain, the CMA will wish to consider the evolution of costs and profitability, including all those elements set out in paragraph 5.3 below.

5.3 For example, RWE estimates that, in 2013, the typical household dual fuel energy bill breaks down as follows (exclusive of VAT, at 5%):

5.3.1 Commodity and production costs - £487 (42%);

5.3.2 Transportation (network) costs - £285 (25%);

5.3.3 Policy and regulation costs - £172 (15%);

5.3.4 Supplier costs - £208 (18%);

5.3.5 Total - £1,152 (100%).

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7 Ofgem’s notional energy consumption values for 2013 of 13.5 MWh gas and 3.2 MWh electricity - costs calculated using 2013 prices.
5.4 The increases in policy and regulation costs and transportation (network) costs since 2007 have been stark. These are estimated by RWE to have risen, respectively, by 129% and 58% over that period. There are no less than 16 separate Government, Ofgem and EU policies that directly impact on energy bills.

5.5 In addition to the increasing policy and regulation costs, retail suppliers have to manage market risks, which impose an additional cost of them. Market risks include wholesale energy price risk and demand risk; default risks; and operational risks. To take the example of demand risk, if the energy supplier did not need to purchase as much energy in the market as it originally anticipated – for example it has fewer customers or lower consumption than planned – it will have a surplus of energy to sell – often at times, during a mild winter for instance, when prices on the spot market are likely to be lower than usual. Unpredictable variations in demand impose a cost on energy suppliers, whether variation in demand leads to unexpected purchases or unexpected sales. The size of this cost is unpredictable.

5.6 Capital costs and commitments to operate in the GB supply market are increasing. Suppliers are required to bear the costs of introducing SMART meters, an obligation which in other countries has fallen to distribution network operators. Changes prompted by the Government or Ofgem, such as changes to direct debit annual assessments, changes to contract renewal processes, and the Retail Market Review changes, add to systems costs. All these factors are relevant when considering the costs and risks of operation at the supplier level.

5.7 RWE accepts that it is vitally important to keep its own costs as low as it can and has undertaken a number of cost reduction programmes across its businesses. Equally, scrutiny and review of policy is important to ensure that costs are falling where they should. We would encourage the CMA to consider the evolution of costs, prices and profitability in the context of all elements of the cost of energy.

6. Impact of regulation on the energy markets

6.1 The British energy markets have been subject to a range of regulatory obligations which, while aimed at achieving important goals such as consumer protection or lowering carbon, may also have had unintended consequences on the functioning of the market. It will be important for the CMA to consider these measures, which include:

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8 Ofgem’s notional energy consumption values for 2007 of 16.5 MWh gas and 3.3MWh electricity.
9 The Renewables Obligation; Contracts for Difference; Feed in Tariffs; Ofgem’s Project TransmiT; the EU Emissions Trading System; the Carbon Floor Price; the Climate Change Levy (business energy cost only); the Carbon Reduction Commitment (business energy cost only); the Smart Metering programme; the Smart Grid programme; Low carbon incentive mechanisms for networks; the Energy Company Obligation; the Green Deal; the Warm Home Discount; Energy Efficiency Advice Provision; the Capacity Mechanism.
6.1.1 measures in the retail markets, such as the effective four tariff limit for domestic customers, which may have been designed to enhance consumer protection and engagement, but may also have the unintended consequence of lessening competition and reducing consumer choice;

6.1.2 operational processes in the retail markets (e.g. complex data flows in connection with customer switching arrangements) which are so burdensome that they distract suppliers from what should be their primary focus: enhancing customer service;

6.1.3 measures in the wholesale power markets which may deter trading of long-term products, and thereby reduce liquidity in those markets;

6.2 It will also be important for the CMA to consider the impact of measures such as small supplier exemptions which, whilst intended to promote competition, are in fact distorting the efficient operation of the market (see section 7 below).

6.3 Furthermore, the myriad regulatory measures in many instances are uncoordinated with one another or are not aligned to energy policy (perhaps because there exists no project management function within DECC or Ofgem, so far as RWE is aware, that might facilitate such co-ordination). By way of example only (the following is not intended to be an exhaustive list), on the retail markets:

6.3.1 the decision to implement numerous regulatory/policy measures through energy bills (see sections 5.3 to 5.6 above where we set out the related costs) are at odds with the Government’s aim of reducing fuel poverty;

6.3.2 the tariff simplification required following Ofgem’s first Retail Market Review (“RMR”) will not suit the level of innovation in tariff structure desired from SMART meter implementation.

**Measures in the retail markets**

6.4 In 2008, Ofgem launched a review of the energy markets in Great Britain, known as the “Energy Supply Probe” (the “Probe”), in response to concerns about rising retail prices. Ofgem concluded that there were “greater levels of competitive activity and consumer switching than almost every other energy market in the world and most other UK consumer services markets”, although Ofgem said it was concerned that price differentials between certain regions and payment types could not be justified by differences in costs.  

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6.5 This led Ofgem to limit the degree of allowed price variation across consumer groups through the Electricity and Gas Supplier Licence Conditions (SLC) 25A.2, which was in force from September 2009 until end July 2012, and SLC 27.2A (still in force):

6.5.1 SLC 25A.2 stated: “the licensee must ensure that in supplying or offering to supply [electricity/gas], the Principal Terms on which it does so do not discriminate without objective justification between one group of Domestic Customers and any other such group.”

6.5.2 SLC 27.2A stated: “Any difference in terms and conditions as between payment methods for paying Charges for the Supply of Electricity [or Gas] shall reflect the costs to the supplier of the different payment methods”.

Impact of the non-discrimination conditions

6.6 The question as to whether, and if so the extent to which, prices for energy should be allowed to vary across customer groups is not a new one – it has been around since at least privatisation.

6.7 A number of well-known economists opposed the introduction of SLC 25A on the basis that it would reduce competition. Professor Stephen Littlechild, who as Director-General of Offer was largely responsible for the introduction of liberalisation in domestic electricity markets, has argued that the condition “adversely affected active residential consumers because they no longer have access to more attractive offers while it has not improved the situation of inactive ones”. He argues that it has reduced potential benefits to customers from shopping around and changing supplier; this is reflected in the reduced churn rates. In Professor Littlechild’s opinion, differential prices are a sign of competition as suppliers charge lower prices to invade other suppliers’ areas. By prohibiting price differentials SLC 25A has reduced competition.

6.8 Professor John Vickers, previously Director-General of the OFT, responded to Ofgem’s consultation in May 2009 stating that:

“First, in competitive conditions, price differentiation may well be cost-justified (and so not discrimination) but the regulator/competition authority might have

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12 Ofgem supply licence conditions for electricity and gas: https://www.ofgem.gov.uk/ licences-codes-and-standards/ licences/licence-conditions

13 Up to 2000 electricity markets were regulated by Offer and gas markets by Ofgas. The two regulators were combined as Ofgem in 2000.

limited cost information. Second, the welfare gains even from optimally targeted bans on discrimination are unlikely to be large. Third, the costs of policy discretion are likely to be considerable, not least in terms of the risks of excessively zealous intervention, and lobbying by would-be beneficiaries of intervention. In sum, price discrimination in competitive conditions (i) can happen, (ii) should not be presumed to be undue.\(^\text{15}\)

6.9 Professor George Yarrow, another notable economist and at that time also a member of the Gas and Electricity Markets Authority (the governing board of Ofgem) also publicly disagreed with the insertion of SLC 25A, and indeed resigned from the Authority in protest at the decision, noting that "[t]here is almost a consensus among economists familiar with competition and energy market issues that, on the basis of best available knowledge, Ofgem’s proposals to “address undue discrimination” can be expected to have harmful consequences for consumers and for competition".\(^\text{16}\)

6.10 Yet another economist, Professor Catherine Waddams (who has extensive experience in the energy sector and is a former CMA panel member), noted in responding to Ofgem’s consultation that "[t]here is a considerable body of economic analysis and literature which indicates that prevention of such price differences is likely to harm competition in the market; and there is little evidence that it will necessarily help vulnerable customers".\(^\text{17}\)

6.11 At the time when the unfair price discrimination provision, among other options, was being considered, RWE stated in a response to Ofgem’s consultation that "these conditions ‘will restrict the operation of competition, where suppliers’ prices vary regionally according to brand strength. These proposed licence conditions will so constrain the ability of companies to offer a range of differentiated tariffs that product innovation and customer choice will be greatly diminished. Given the resulting reductions in consumer incentives to engage actively in the market we believe such invasive measures would act against customers long term interest.’\(^\text{18}\)

6.12 RWE’s experience has confirmed these concerns; the continued regulatory and political intervention in the market has contributed to the customer concerns over transparency and has directly impacted upon competition.

6.13 In late 2012, Ofgem concluded that it was not necessary to extend SLC 25A beyond 2012 because:


\(^{18}\) RWE npower’s Response to Ofgem’s Addressing unfair price differential consultation; p. 4
“many suppliers have already taken remedial steps and launched initiatives to regain the trust of consumers. [Ofgem] therefore would expect suppliers to continue to have regard to the spirit of our proposals and their own individual voluntary commitments when considering pricing strategies, particularly where they may differ between out-of-area and in-area customers”.

6.14 It is RWE’s understanding therefore that Ofgem expects suppliers to continue to comply with SLC 25A notwithstanding that it expired at the end of July 2012.

Retail Market Review and tariff simplification

6.15 Ofgem launched its RMR in November 2010 to review the effectiveness of the energy retail market. As a result of the RMR, Ofgem introduced a number of measures including:

6.15.1 **Four tariff limit**: each consumer should face a choice of at most four tariffs from a given supplier and all tariffs must follow a similar structure of Standing Charge and Single Unit Rate, with comparable discount structures across payment types (SLC 22B). In theory, this is not an absolute constraint on the aggregate number of tariffs that can be offered by a given supplier (because in theory, provided that **each consumer** individually has a choice of only four tariffs, the supplier could offer a greater overall number of tariffs). In practice, RWE npower considers itself limited to four tariffs. First, the purpose of SLC 22B was “to simplify tariff structures and limit core tariff numbers across the whole market”. Second, SLC 25C requires suppliers to be fair, honest and transparent in their dealings with customers, which would be very difficult to achieve if the supplier was offering a series of different four tariff combinations to different consumers/consumer groups. Third, in order to offer more tariffs, RWE npower would need to put in place measures to restrict customers’ access to tariffs, especially online. Therefore, RWE npower has implemented SLC 22B by offering four tariffs to customers whereby the pricing of each differs by payment method and meter type (see further in section 6.15 below). RWE does not believe that the restriction to four tariffs is in the best interests of consumers as it unnecessarily restricts competition, choice and innovation;

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6.15.2 **Cheapest Tariff Messaging (CTM):** each supplier is required to inform customers of their cheapest available tariff, although this may not be the most appropriate for the customer, some of whom may prefer to pay a higher rate for the certainty of longer term fixed prices;

6.15.3 **Tariff Comparison Rate ("TCR"):** a supplier must provide each customer with their TCR which is calculated by dividing a typical customer’s prospective annual bill by notional (i.e. typical customer) consumption. In theory, this allows a customer to make a comparison that takes account of variations between tariffs as regards Standing Charge, Single Unit Rate and discounts. However, this information may not be representative of a given customer’s actual consumption and total cost per kWh. In particular, for customers with high or low consumption, the TCR may be misleading. Put simply, a high consumption customer may pay less on a tariff with a lower Single Unit Rate and a higher Standing Charge, whereas a low consumption customer may pay less on a tariff with a higher Single Unit Rate and a lower Standing Charge. Since the TCR is based on notional consumption, it will not allow high or low consumption customers to make a meaningful comparison. Furthermore, our experience is that there is a degree of customer confusion when also comparing the CTM (which, by comparison, does take account of actual usage – although see the point above);  

6.15.4 **Other informational remedies:** overall, the information that must now be included on a consumer bill is extensive and highly prescriptive, in some cases right down to positioning on the bill and form of wording used, but might not always be helpful to the consumer. These include the “Could you pay less?”, “About your tariff” and “About your Tariff Comparison Rate” sections on bills, in respect of which Ofgem prescribes both content and positioning. However, as illustrated above in relation to TCR, this information is not always helpful to the consumer and in some cases may cause consumer confusion. (Furthermore there is other information that must be provided to consumers over and above the bill, such as an annual summary, which contains a range of key tariff information and must be provided in writing each year; and a tariff information label, which is a table of key facts aimed at allowing consumers to compare the price and non-price features of energy tariffs on a like for like basis, and which must be available on a supplier’s website and by copy on request.)

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Impact of RMR

6.16 These measures are only now being implemented, so RWE’s direct experience to date is limited. RWE npower’s own experience is that:

6.16.1 RWE npower currently has four live tariffs: standard tariff and three fixed price tariffs (one of the fixed price tariffs is sold with ‘NEST’ – the intelligent learning thermostat). The majority of customers, around 3.6 million accounts, are on the standard tariff.

6.16.2 There are a number of tariffs that RWE npower used to offer but no longer offers post-tariff simplification (four tariff limit), including online, floating discount to standard tariff, green tariffs and capped tariffs.

6.17 In RWE’s view, the RMR measures are likely to restrict the options offered to consumers and dampen competition. As RWE npower noted during the consultation process:

“Ofgem’s proposals will significantly restrict customer choice and the dimensions across which suppliers can compete”.

6.18 The regulatory measures are clearly well intended, but have the effect of reducing suppliers’ ability and incentive to innovate with new tariffs and to offer discounts, and therefore RWE expects them be detrimental to consumers. Previously, a supplier who offered a discounted tariff could target it at a particular customer segment. By contrast, under CTM, a supplier who offers a discount will in effect have to advertise it to any customer who (on a particular metric) would be better off choosing the discounted tariff than under their existing tariff. This requirement reduces the incentive to offer discounted products.

6.19 This potential effect of Ofgem’s recent market reforms was highlighted by Professor Stephen Littlechild in his evidence submitted to the Parliamentary Energy and Climate Change Committee. Under the heading “The Proposals to Simplify the Retail Energy Market Would Increase Prices”, he wrote:

“These [Ofgem] proposals are well-meaning, but they fail to look at the implications for energy prices. They would lead to the withdrawal of the best prices and other offers and discounts. They would squeeze out tariffs with no standing charges. They would effectively prevent innovation. This would reduce competitive pressure on other prices.”


Implications of retail market measures for CMA’s investigation

6.20 Overall, the history has been to restrict the degree to which discounting is allowed, with expected consequences for competition. RWE would urge the CMA to consider seriously the effect of these measures on the market.

6.21 It will clearly be for the CMA to consider the measures that evidence competitiveness in the market. RWE would comment that customer switching is just one such measure. The numbers of both major and smaller suppliers in GB may be a better measure. Switching has been used as a measure of competitiveness by some commentators in the GB market without consideration of its suitability (in the context of overall levels of customer engagement) and without consideration of other factors – e.g. internal switching, end of fixed terms, home moves etc – which in RWE’s view any proper assessment of switching must take into account.

Measures in the wholesale markets

6.22 Energy policy in recent years has been strongly focused on decarbonisation of the energy system. RWE fully supports that goal, and recognises the need for measures both to promote decarbonisation and to further other policy objectives such as security of supply and ensuring the integrity of traded markets.

6.23 However, myriad new policies introduced over the last few years, mainly in the electricity markets, have created significant (and unnecessary) complexity and uncertainty for investors and traders. These policies include – among many others – the introduction of electricity market reforms to create a power generation capacity market, which provide incentives to invest in electricity generation and to keep more generation plants open and able to run, and introduce “contracts for difference” for renewable and nuclear energy. The introduction of capacity markets to ensure security of supply is an objective that RWE supports. However, capacity markets can lead to reduced volatility in power markets if scarcity prices become less frequent. In addition, contracts for difference provide certain income to low carbon generators without the requirement to forward hedge. The combination of these two initiatives is likely to reduce liquidity in the forward markets, and hence is at odds with Ofgem’s objective of increasing liquidity in longer-dated products.

6.24 Changes to financial regulation, in the wake of the financial crisis, also affect wholesale market liquidity. The application of new capital requirements in the banking sector, for example, has led some banks to withdraw from the wholesale commodity markets, with a negative impact on liquidity. The application of other revised financial rules – notably MiFID and EMIR\(^{25}\) – could have similar

negative consequences for liquidity and trading costs if physical liquidity providers are required to meet banking rules on capital, collateralisation and trade execution.

6.25 A further example of policy uncertainty, with clear impact on traded markets and on liquidity (which suffers when market players are subject to the “unhedgeable” risks of policy changes), is provided by the recent volatility in forward prices for wholesale power arising from a shift in Government policy with regards to the “carbon price floor”:

6.25.1 The UK Government announced its intention in the 2011 Budget to introduce a floor in the price of carbon from April 2013.\textsuperscript{26} In effect this is a tax on the production of electricity from fossil fuels, intended to increase the incentives to invest in low-carbon generation and to generate greater volumes of electricity from low-carbon sources. As a tax on production, it increases costs and therefore feeds through into wholesale power prices. A lower/higher carbon price floor means lower/higher prices.

6.25.2 When the policy was announced, Government committed to a certain “trajectory” for this tax: the carbon floor price was set at £15.70 in 2013 and was to escalate each year until it reached £30 in 2020.\textsuperscript{27} However, in January this year the Government suggested that it might alter the trajectory of the carbon price floor, with the effect that the level of tax applicable in 2016 would be significantly lower than previously expected. This had the effect of reducing forward prices\textsuperscript{28} for power to be delivered in 2016. Anyone that had previously bought power forward for Winter 2016 therefore suffered a significant and totally unforeseeable loss. The size of this effect was material, of the order of £1-2/ MWh (this figure is significant in the context of the very thin margins obtained in power generation – one standard measure of which is the Clean Taxed Spark Spread which was quoted for Winter 2016 at ∼£1.80/MWh immediately before and ∼£0/MWh immediately thereafter)\textsuperscript{29}. Because of the uncertainty around the government’s apparent change of policy, Winter 2016 prices continued to be more


\textsuperscript{28}This is based on the clean taxed spark spread, which is the theoretical margin of a gas fired power plant selling electricity having paid the costs of the gas and carbon.

\textsuperscript{29}This was the value of the “clean spark spread”, which is the difference for a typical gas-fired power station between the price it would receive for selling one unit of electricity (the wholesale power price), and the cost of fuel and carbon allowances and taxes required to generate that unit of electricity.
volatile than comparable prices for Winter 2015 until after the budget.\(^{30}\)

6.26 While these measures have valid objectives, they may have had the unintended consequence of creating significant complexity and uncertainty and therefore risk for investors and traders.

6.27 This level of political risk has a chilling effect not only on investment, as recognised by Ofgem in its Decision to make an MIR, but also on trading and liquidity in forward markets. While investors and traders live with uncertainty and market risk (indeed the ability to manage such risks is central to the purpose and functioning of traded markets), they are not able to manage political and regulatory risks in the same way. Political risk is idiosyncratic, hard to understand, and difficult or impossible to hedge against.\(^{31}\) RWE accepts that many industries are subject to political risk, but the issue is one of scale.

7. **Small supplier exemptions**

7.1 RWE recognises the arguments made for the introduction of partial exemptions for small suppliers from the delivery of social and environmental obligations imposed on larger suppliers, i.e. that they level the playing field.

7.2 However, it considers that the way these exemptions are playing out in practice is causing distortions in the retail market. The most material of these are the ECO, which places legal obligations on the larger energy suppliers to deliver energy efficiency measures to households, and the Warm Home Discount ("WHD")\(^{32}\), which requires domestic energy suppliers to provide £1.13 billion of support over 4 years to fuel-poor customers.

7.3 As regards the ECO and previous schemes, Carbon Emissions Reduction Target ("CERT") and Community Energy Saving Programme ("CESP"), when these exemptions were put forward by DECC, there was no quantification of the small supplier disadvantage the exemptions were supposed to target. Furthermore, in the case of CERT and CESP, as the costs of these obligations rose, there was no reassessment by DECC of the exemptions, nor any consideration of alternative routes to the provision of these obligations (such as the ability of small suppliers to contract with large suppliers at the average obligation cost).


\(^{31}\) As government recognized in developing the carbon price floor, "...investors and utility companies are experienced in managing gas price uncertainty and gain a competitive advantage from their ability to manage it. Carbon price uncertainty is predominantly driven by wider regulatory uncertainties and the Government might therefore be better placed to manage some carbon price risk."


\(^{32}\) See: [https://www.ofgem.gov.uk/environmental-programmes/warm-home-discount](https://www.ofgem.gov.uk/environmental-programmes/warm-home-discount)
7.4 The CMA will no doubt wish to consider the implications for competition of the current small supplier exemption regimes.

8. **Getting it right for our customers**

8.1 RWE npower acknowledges that it has not always delivered the levels of domestic customer service to which it aspires. We remain dissatisfied with our levels of customer service and are striving to improve them. In order to do so, RWE npower has put in place a series of measures across the entire business to transform the situation. This is a critical part of RWE npower’s strategy to compete.

8.2 RWE npower’s goal is that:

> “By 2015 we’ll become the most trusted and high performing provider of energy solutions to our customers’ homes, businesses and communities.”

8.3 Part of achieving this goal is to become No. 1 in Customer Experience across all markets by the end of 2015.

8.4 It is difficult to over-emphasise the significance of this goal for RWE npower. In this section we provide an outline of the key changes we are implementing. The reforms seek to change the leadership, the structure and also, most importantly, the culture of RWE npower. (See at Appendix 3 a staff document on “Getting it right for our customers”, and a diagrammatic summary.)

8.5 At the beginning of 2013 a new structure was put in place at RWE npower, with a substantially altered management team charged with leading a radical programme of cultural and organisational change which aims to put the customer at the very heart of the business.

8.6 The top leadership team has seen dramatic changes with only 2 of the top 8 leaders being in their current roles before the changes were made.

8.7 The programme of change recognises the critical importance of elements of non-price competition in winning the trust and loyalty of the customer, and the importance of customer service as a tool in winning and retaining business. RWE npower has encountered a number of challenges in implementing the improvements it is making in its customer service, but the foundations are in place, and the culture of the business is already changing.

8.8 For the purposes of internal communication, RWE npower has summarised its new culture of customer focus as a “Customer Pyramid” illustrated below:
Principal organisational and cultural changes

8.9 RWE npower has undergone a complete refocus of its retail business.

8.10 As noted above, the top leadership team has seen dramatic changes and is leading from the top the cultural and organisational changes taking place throughout the business.

8.11 RWE npower has reorganised the company from functional to customer segmental lines. The customer segments are Domestic, SME, Industrial & Commercial, and Energy Services. Each customer segment has full ownership of the profit and loss account and end to end processes that impact customers. A Sales Portfolio Management business unit manages risk, forecasts demand and provides direct cost projections, and sits alongside these four customer focused segments.

8.12 RWE npower introduced a significant Customer Transformation Programme ("CTP") which has a number of core features supporting customer focus,[CONFIDENTIAL].

8.13 At the same time RWE npower is working with leading retail outsourcers Capita and Tata Consultancy Services, by outsourcing back office functions offshore whilst maintaining UK call centres to serve customers. This allows RWE npower to provide enhanced flexibility, capacity and expertise in order to improve customer service.

8.14 RWE npower has also embarked on a people transformation programme to underpin the transformation of the business including change to performance
management, rewards and recognition, and roll out of “Critical Behaviours”. Further details are set out in Appendix 5.

**Principal challenges**

8.15 A principal challenge faced by RWE npower is that the British energy industry has been subjected to requirements to deal with a huge amount of change as a result of Government policy and Ofgem regulation. The retail market has been the subject of near continuous review by Ofgem since at least 2008. In RWE’s judgement, this state of affairs has diverted the attention of companies away from the day to day management of their businesses, to the detriment of consumers. This would have been challenging for RWE npower to deal with anyway, but has been more so as a result of its SAP implementation difficulties.

8.16 RWE npower has invested over £200 million in a new SAP system in order to consolidate the previous systems and to improve customer service. However, issues associated with migration of customers onto the new billing system have been a cause of real operational difficulty and customer dissatisfaction, which have slowed RWE npower’s progress to becoming No. 1 for Customer Experience. The key challenge faced by RWE npower concerns the quality of customer data held in its legacy systems; as this was transferred into SAP and started RWE npower’s billing processes, a significant number of quality issues emerged that were not previously apparent. Going forward, RWE npower’s adherence to absolute data quality will allow it to deliver enhanced service.

8.17 RWE is not happy with its current levels of customer satisfaction. In this section, we have aimed to take the CMA through the extensive efforts under way to change that situation. We believe we can deliver improved services for our customers.

9. **Conclusion**

9.1 RWE supports the referral to the CMA. RWE believes that an independent, evidence-led investigation by the CMA will demonstrate that, the GB energy market is competitive, and will ensure that the facts about the operation of the market and the way in which suppliers compete are made clear for customers, government, regulators and other stakeholders.

9.2 RWE in the UK already operates each of its supply, generation, renewables and trading businesses separately and is, RWE would suggest, a model for how a UK energy group can be structured so as to enhance liquidity.

9.3 There will be a variety of aspects of the operation of competition in the British energy markets on which RWE will wish to comment as the CMA proceeds with

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Critical Behaviours have been identified as follows: accountability; focus; driving performance; customer first; challenge; collaboration; and respect.
its investigation, but there are four points which the CMA may wish to consider at the outset of the investigation:

9.3.1 Retail suppliers of energy are in a position to control less than 20% of the costs that go to make up the customer’s energy bill but have a significant risk in relation to regulatory and policy costs as well as market risks.

9.3.2 The British energy markets have been subject to a range of regulatory measures which, while aimed at achieving important goals such as consumer protection or lowering carbon, may also have had unintended consequences on the functioning of the market; licensees are obliged to comply with these measures once they have been adopted.

9.3.3 Whilst barriers to entry are low, as evidenced by the number of recent new entrants to the retail supply market, the exemptions for small suppliers from social and environmental obligations imposed on larger suppliers have the consequence of distorting, rather than enhancing, competition across the market as a whole.

9.3.4 RWE is acutely aware of the difficulties it has encountered in delivering the levels of customer service to which it aspires, but getting it right for customers is at the heart of the strategy for the business that RWE npower has been implementing.

9.4 RWE wants to see a thriving, competitive and fair energy market. In RWE’s view, the outcome of a market investigation should be a market that:

9.4.1 is a level playing field for all players, with reduced regulatory intervention, in which competition is supported as the best way to deliver the best outcome at the lowest cost for customers;

9.4.2 is open and honest with consumers and provides them with clear and accurate information, thereby enabling the industry to rebuilt trust. An essential part of this is the provision of a proper explanation, supported by all stakeholders, of the drivers of increases in bills over recent years and, on an ongoing basis, the provision of independent information about what makes up consumers’ bills;

9.4.3 provides a level playing field for the customers of all suppliers, regardless of the size of the supplier.

9.5 Any regulation of the market should be independent, appropriate and proportionate, and should protect customers, enhance competition and provide clean, secure and affordable energy to customers.
# APPENDIX 1 - RWE NPOWER SUPPLY LICENSEES

## Electricity supply licences

<table>
<thead>
<tr>
<th>Licence holder (licensee or supplier)</th>
<th>Company number</th>
</tr>
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<tbody>
<tr>
<td>Npower Limited</td>
<td>3653277</td>
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<tr>
<td>Npower Northern Supply Limited</td>
<td>2845740</td>
</tr>
<tr>
<td>Npower Northern Limited</td>
<td>3432100</td>
</tr>
<tr>
<td>Npower Yorkshire Supply Limited</td>
<td>4212116</td>
</tr>
<tr>
<td>Npower Direct Limited</td>
<td>3782443</td>
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<tr>
<td>Npower Yorkshire Limited</td>
<td>3937808</td>
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## Gas supply licences

<table>
<thead>
<tr>
<th>Licence holder (licensee or supplier)</th>
<th>Company number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Npower Gas Limited</td>
<td>2999919</td>
</tr>
<tr>
<td>Npower Commercial Gas Limited</td>
<td>3768856</td>
</tr>
<tr>
<td>Npower Northern Limited</td>
<td>3432100</td>
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<tr>
<td>Npower Yorkshire Limited</td>
<td>3937808</td>
</tr>
<tr>
<td>Npower Direct Limited</td>
<td>3782443</td>
</tr>
<tr>
<td>YE Gas Limited</td>
<td>2571590</td>
</tr>
<tr>
<td>RWE Npower Plc</td>
<td>3892782</td>
</tr>
</tbody>
</table>
NOTE: APPENDICES 2 – 5 ARE PROVIDED AS SEPARATE DOCUMENTS - CONTENTS ARE DESCRIBED BELOW

APPENDIX 2 - RWE GROUP AG STRUCTURE

APPENDIX 3(i) – RWE NPOWER – GETTING IT RIGHT FOR OUR CUSTOMERS (STAFF BRIEFING 2013) [CONFIDENTIAL]

APPENDIX 3(ii) – RWE NPOWER – GETTING IT RIGHT FOR OUR CUSTOMERS (DIAGRAMMATIC SUMMARY) [CONFIDENTIAL]

APPENDIX 4 – RWE NPOWER – CUSTOMER Transformation Programme (PRESENTATION TO CUSTOMER LEADERSHIP TEAM BY PAUL MASSARA, RWE NPOWER CEO, JULY 2012)

APPENDIX 5 – RWE NPOWER PEOPLE Transformation Programme (“SUCCESS THROUGH OUR PEOPLE” PRESENTATION FOR CUSTOMER AWAY DAY MADE ON 21 FEBRUARY 2012) [CONFIDENTIAL]
## RWE Group structure

### RWE Group

<table>
<thead>
<tr>
<th>Conventional Power Generation</th>
<th>Supply/ Distribution Networks Germany</th>
<th>Supply Netherlands/ Belgium</th>
<th>Supply United Kingdom</th>
<th>Central Eastern and South Eastern Europe</th>
<th>Renewables</th>
<th>Upstream Gas &amp; Oil</th>
<th>Trading /Gas Midstream</th>
</tr>
</thead>
<tbody>
<tr>
<td>RWE Generation</td>
<td>RWE Deutschland</td>
<td>Essent</td>
<td>RWE npower</td>
<td>RWE East</td>
<td>RWE Innogy</td>
<td>RWE Dea</td>
<td>RWE Supply &amp; Trading</td>
</tr>
</tbody>
</table>

### Internal Service Providers
- RWE Consulting
- RWE Group Business Services
- RWE IT
- RWE Service

As of 31 December 2013.
Customer Leadership Team
Away Day July 2012

Paul Massara

An RWE company
What’s today about?

> Understand where npower’s customer business needs to go
  - I’ll share my thoughts
  - Debbie and Roger will introduce you to the Customer Transformation Programme and what it means for you

> Get a view across the piece of the current state of play
  - Jodie will provide an update on B2B
  - Giuseppe will provide an update on B2C

> Understand the hot topics of the moment and your role in taking the Customer business forward
  - Interactive sessions on SMART and Green Deal
  - Wrap up and key messages from the day

An RWE company
Customer Transformation Programme

> Why change?
  - Cost leadership
  - Customer satisfaction
  - Simpler tariffs

> We have launched this in Domestic
  - Video on intranet (use quotes on slide?)
  - RWE Consulting started interviews across PUs

> The approach is applicable across all areas – and we will roll it out across SME and I&C once we have embedded it in Domestic
Investing in People

> Our employees are key as they are the face of our business to customers

> We have to focus not only on the ‘What’ but also the ‘How’

> Priorities are:
  - Leadership Development
  - Performance management
  - Culture, eg recognition, critical behaviours
So please remember...

> This is about a refocus on the Customer

> This will affect us all, Domestic, SME and I&C, we are just starting the journey in Domestic

> It will transform the way we work and make npower the place you want to go when you wake up in the morning