

# Energy market investigation

## Case studies on barriers to entry and expansion in the retail supply of energy in Great Britain

**18 February 2015**

This is one of a series of consultative working papers which will be published during the course of the investigation. This paper should be read alongside the updated issues statement and the other working papers which accompany it. These papers do not form the inquiry group's provisional findings. The group is carrying forward its information-gathering and analysis work and will proceed to prepare its provisional findings, which are currently scheduled for publication in May 2015, taking into consideration responses to the consultation on the updated issues statement and the working papers. Parties wishing to comment on this paper should send their comments to [energymarket@cma.gsi.gov.uk](mailto:energymarket@cma.gsi.gov.uk) by 18 March 2015.

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## Summary

1. This paper sets out evidence that we have collected through a series of interviews with independent energy suppliers on the extent and nature of barriers to entry and expansion in the retail supply of electricity and gas in Great Britain (GB).
2. In considering entry and expansion barriers, we studied features of the market that may prevent or restrict companies from exploiting profitable opportunities in a market and hence enable incumbents (ie Centrica, EDF Energy (EDF), E.ON, RWE npower, Scottish Power and Scottish and Southern Energy (SSE)) persistently to raise prices above costs without significant loss of market share.<sup>1</sup>
3. For the purpose of this paper, we use the term 'independent suppliers' to refer to The Co-operative Energy, Ecotricity, First Utility, Haven Power, Ovo Energy, Utilita, Extraenergy and Utility Warehouse. We use the term 'Six Large Energy Firms' to refer to Centrica, EDF, E.ON, RWE npower, Scottish Power and SSE.

## Introduction

4. We conducted eight case interviews with the independent suppliers to discuss their individual market entry and expansion experience and to understand any barriers or issues they encountered.
5. We have also put together a Retail Supply Financial and Market Questionnaire ('Questionnaire') that we circulated to four independent suppliers, namely The Co-operative Energy, Ovo Energy, First Utility and Utility Warehouse. We asked questions relating to their entry and expansion experience in the retail supply of energy in GB market.
6. The independent suppliers are not a homogenous group of suppliers; rather they operate in different parts of the market (ie domestic, small- and medium-sized enterprises (SMEs), prepayment meters, renewable energy, etc) and have different strategies. Consequently each has its own perspective on how the energy market operates.
7. We selected which independent suppliers to interview to ensure we have good coverage of this part of the supply market and were able to get the views of established firms, those new to the market and those that are rapidly expanding. We also sought to cover a range of entry strategies by

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<sup>1</sup> [Market studies and investigations – guidance on the CMA's approach: CMA3.](#)

interviewing those firms that chose to target certain customer segments such as prepayment or smart meters.

8. From each firm we sought to gain an understanding of how they entered the GB energy supply market, to identify what research they conducted before entering, and how they perceived the risks and opportunities in the GB market. We also wanted to understand how their entry plans had materialised and how this compared to their expectations.
9. The views expressed in this paper reflect the experiences of the smaller, and typically non-vertically integrated, market participants who have entered relatively recently and have grown organically without the benefit of an incumbent customer base. This forms part of a broader body of work on barriers to entry and expansion, which will consider the views of other market participants.
10. This paper sets out brief introductions to the eight independent suppliers that we interviewed, followed by a summary of their views noted under key headings of potential barriers to entry and expansion.

## **Independent suppliers**

11. Independent suppliers have continued to see significant growth in the domestic retail market, according to a report by Cornwall Energy.<sup>2</sup> The company's latest survey of market shares found that, in the quarter to 31 October, the 20 companies outside the Six Large Energy Firms added 635,000 domestic energy accounts to reach a total of 4.35 million, giving them an 8.7% share of total accounts. More than 2 million households, equivalent to 10.4% of all households in GB, were buying dual fuel energy from independent suppliers, according to the report. It added that, taken collectively, the independent suppliers now ranked fourth highest by market share in the domestic dual fuel market.
12. The eight interviews were carried out bilaterally over the course of four weeks with the following suppliers:<sup>3</sup>
  - (a) Ovo Energy, founded by Stephen Fitzpatrick in 2009 and headquartered in Bristol. Predominantly a supplier of electricity and gas to domestic customers.

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<sup>2</sup> Independent suppliers surge on to 8.7% of household energy market by taking more than 10% of dual fuel contracts.

<sup>3</sup> CMA desktop research.

- (b) Extraenergy, a new energy supplier who entered the market in 2014. It markets itself as a discount energy provider.
- (c) Utilita, an energy supplier that entered the GB supply market in 2003 and focuses on smart prepayment meters installed at no extra charge.
- (d) Utility Warehouse, an all-encompassing utility provider, founded in 1996. It supplies gas, electricity, landline, broadband and mobile services. Up until December 2013, Utility Warehouse was a 'white label' provider in collaboration with RWE npower. In December 2013, Utility Warehouse brought back in-house the supply of energy from RWE npower.
- (e) First Utility, licensed as a supplier of electricity and gas to the GB market in 2006 and offering mass market energy services from 2008. It is currently the seventh largest energy supplier in the GB market. It was the first company in the GB market to offer smart meters to its residential customers.
- (f) The Co-operative Energy is part of the Midcounties Co-operative, the largest independent co-operative in GB. Its entry into the GB energy supply market occurred in 2010.
- (g) Ecotricity was founded in 1995 and first started to supply customers in 1996. Focused on green energy, it is one of the few small suppliers to operate generation assets as well as supplying energy.
- (h) Haven Power, owned by the large GB electricity generator Drax, which acquired it in 2009. Haven Power was set up in 2006 to supply the electricity needs of small- to medium-sized businesses.

TABLE 1 **Snapshot summary of independent suppliers**

<i>Supplier name</i>	<i>Year of market entry</i>	<i>Ultimate parent</i>	<i>Domestic energy customers</i>	<i>Method of sourcing wholesale energy</i>
First Utility	2006	Impello plc	550,000	Structured deal with Shell
Ovo Energy	2009	Ovo Group Ltd	420,000	Trading and credit arrangement with a third party
Co-operative Energy	2010	The Midcounties Co-operative Ltd	260,000	Wholesale markets (working capital funding from ultimate parent)
Utility Warehouse	1996	Telecom Plus plc (listed)	800,000 supply points	Long-term wholesale supply agreement with RWE npower
Extraenergy	2014	Extra Energie Germany	120,000	Wholesale markets (working capital funding from ultimate parent)
Utilita	2003	Privately-owned	100,000	Wholesale markets (posting cash collateral for trades)
Ecotricity	1996	Ecotricity Group	140,000	Wholesale markets (working capital funding from ultimate parent)
Haven Power	2006	Drax Group Plc	Only SME and I&C	Wholesale markets / Drax Group

Source: Information provided to the CMA over the course of the interviews.

## Summary of potential barriers to entry and expansion

13. We identified three possible methods of entry into the energy supply market in GB:
- (a) Organic entry: this represents the most common method of entry, whereby a potential entrant applies to the Office of Gas and Electricity Markets (Ofgem) for a new supply licence and sets about putting in place the necessary business and systems infrastructure to commence its retail supply operations.
  - (b) Acquisitions: recent examples of entry via an acquisition of an incumbent retail energy supplier appear limited to very large-scale entry as evidenced by the market entry of some of the Six Large Energy Firms' ultimate parent companies, namely E.ON Group, EDF Group, Iberdrola Group (ie Scottish Power), Drax (Haven Power) and RWE Group.
  - (c) White-label arrangement: finally, a less common method of entry is the 'white-label' route whereby a potential entrant achieves a retail presence as an energy supplier (eg by marketing its retail offering under its own brand) through having an arrangement with an incumbent retail energy supplier to supply the energy to retail customers on its behalf. There are two main white-label suppliers, namely Sainsbury's Energy and M&S Energy through their respective partnership arrangements with Centrica and SSE.

14. We identified the following recurring themes from interviews and from the answers we received to the Questionnaire with the independent suppliers:
- (a) costs of market entry;
  - (b) access to wholesale energy:
    - (i) liquidity; and
    - (ii) collateral;
  - (c) vertical integration (VI);
  - (d) supplier IT systems and technical expertise;
  - (e) industry systems and settlement;
  - (f) regulatory risks;
  - (g) customer inertia;
  - (h) reputational risks;
  - (i) economies of scale; and
  - (j) obligations thresholds.
15. In the following section we summarise the views of the independent suppliers under each of these headings.

### ***Costs of market entry***

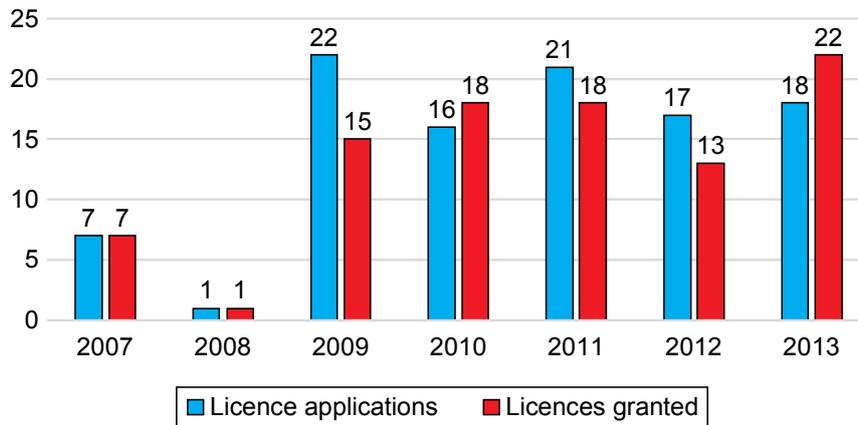
16. In relation to whether the costs of market entry might be considered a potential barrier to entry, we noted the number of applications submitted to Ofgem between 2005 and 2013, of which 91% were granted by Ofgem.<sup>4</sup>

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<sup>4</sup> Source: Ofgem. In some years more licences have been granted than applications received where applications have rolled over from one year to the next. In years with fewer licences granted than applied for, this is because applications were either withdrawn by the applicant or the application cancelled.

FIGURE 1

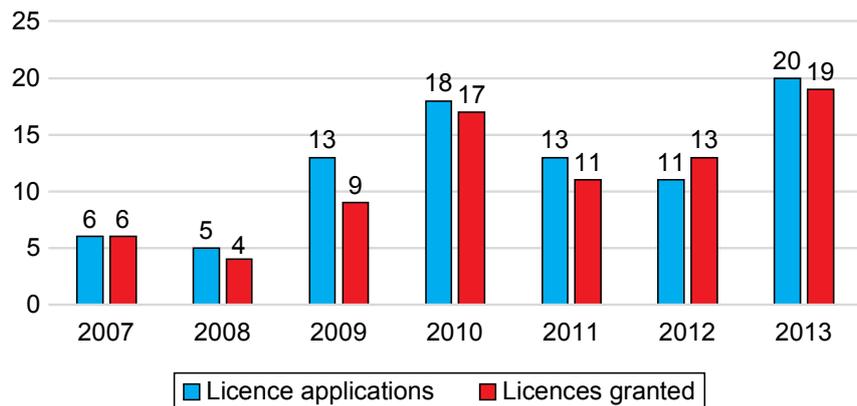
**Electricity supply licences (count)**



Source: Ofgem.

FIGURE 2

**Gas supply licences (count)**



Source: Ofgem.

17. At one end of the spectrum, market entry can take place at a very small scale, requiring a total initial capital outlay of £100,000. We found that financing the initial capital outlay for organic entry was predominantly through equity, eg personal funds.
18. Ovo Energy told us that its founder spent approximately £400,000 to enter the GB supply market. Around half of that was used to set up the systems and obtain the licences required to operate in the GB market. Much of the accreditation process could be outsourced which helps simplify the setting up of a new supplier.

19. Ovo Energy believed that the industry was complicated; it said that it took 12 months prior to launch for it to understand the market well enough to prepare a good enough business model.
20. The Co-operative Energy told us that there was a substantial period of extensive research and planning prior to Midcounties Co-op committing to creating The Co-operative Energy. It saw that it was possible to start at a modest scale, from other independents' experience in the market. The expectations were that the break-even point would be between 20,000 and 25,000 customers.
21. In its answer to the Questionnaire, The Co-operative Energy told us that its initial capital costs were almost non-existent as the system contract it signed was linked to its growth plans rather than a significant initial outlay. It also told us that it would consider recruitment expenditure to be a significant initial non-capital expense.
22. [✂]
23. Extraenergy believed that the cost of market entry in GB was too low and it should be higher with higher barriers to obtain a licence. It believed that it 'should be a certain limitation or a criterion for an entity to come into the market, to show that it has the financial strength to do so.'
24. Ecotricity did not confirm the amount it spent on systems start-up costs at the time when it entered the supply business. However, it told us that nowadays the cost of legal advice was high for a small company, therefore there was a lot of investment that was required for that. Ecotricity estimated this investment to be in the hundreds of thousands of pounds.
25. First Utility spent between £500,000 and £600,000 to get accredited and up to about £750,000 to get the company going. It classified its market entry as a 'lean' entry and it believed that it had invested a lot in the company as it had grown.
26. In its answer to the Questionnaire, First Utility told us that it entered at a small scale in order to test the entry propositions being followed (which included new-build and SMEs and that its approach was pragmatic, in that further investment was made following testing of entry propositions and assessment of the future opportunities.
27. Utilita told us that back in 2003/04 when it looked at entering the market it had to do a full electricity accreditation, which was quite a long-winded, year-long process of getting into the market. However, for gas it got a 'supplier-in-a-box'

licence without any kind of formal market testing. It told us that there were no entry tests for gas.

28. Utilita also told us that when it entered the market, one of the problems for new entrants in the domestic market was the inability to sign a long-term contract. One of the reasons for more market entries into the SME market was the size and length of energy contracts per customer; suppliers could sign a long-term deal with a commercial customer. It told us that suppliers could not do that in a residential market and they were stuck with a 28-day tariff because Ofgem stopped suppliers from signing long-term contracts with residential consumers.

### ***Access to wholesale energy***

#### *Liquidity*

29. Ovo Energy started buying gas and electricity through a third party. With the small volumes it had required initially it was hard to get a cost-effective contract, however it made the point that this had been no more difficult than in any other market. It had also approached other large financial institutions but it had not been interested because in its view, Ovo Energy was too small.
30. Ovo Energy made the decision quite early on that it wanted to buy the most liquid product in the market. Its experience in trading led it to understand that in any market the more complex the product that it was trying to buy the bigger the margin that the counterparty would take, therefore at the beginning Ovo Energy bought base-load products and then managed the shaping risk. It outsourced half-hourly execution to a third party, which ran a 24-hour trading desk on behalf of three large power stations, therefore that third party was also running the execution desk for them.
31. Ovo Energy believed that the reason there was greater market liquidity in countries like Germany was because there was more retail competition. It believed that by improving retail competition the wholesale market would also improve.
32. The Co-operative Energy told us that it had not had any difficulty in getting good liquidity from suppliers in the wholesale market. It had not had any issues with getting the power and gas that it needed. From day one it was able to get all the Purchase Power Agreements (PPA) required for its electricity needs. In its opinion, probably the hardest thing had been benchmarking that price against others in the industry when there was no liquidity. It was able to purchase standard products, and incurred some transaction costs to try to shape the demand on the weeks ahead.

33. Haven Power had difficulty sourcing the power requirements it needed before it was acquired by Drax, in a distressed sale from Carron Energy in 2009. This issue was in part due to the purchasing arrangement it had with Carron Energy which had not been able to purchase the generation capacity that it needed.
34. When Haven Power first considered entering the market in 2003, it spent a lot of time talking to generators. It had one discussion with Drax (in passing) but Drax was not interested in supply at that time. It had many discussions with some of the Six Large Energy Firms and independent aggregators, but it was very difficult to be treated seriously. It had strong interest at the time from banks in terms of providing working capital but despite that, it was difficult to be taken seriously by generators. Haven Power eventually entered the SME electricity supply market in 2007.
35. Extraenergy told us that the exchanges market was not suitable for smaller suppliers without a big customer base, hence all its trades were done over-the-counter (OTC). In terms of having the right customer base to trade on exchanges and being able to build a sizeable customer base when restricted to OTC trading only. It believed that 'it is the chicken and the egg issue'.
36. Extraenergy told us that when starting as an alternative supplier with all of the challenges relating to building up a customer base, and the capital requirements that a supplier needed in order to actually build up a customer base, to actually get into the exchanges market with very little volume was something that was not reasonable. It believed that a supplier needed to grow fast and build up its customer base to levels that made sense to trade on exchanges but in order to do so it needed liquidity, systems and IT.
37. First Utility told us that the biggest challenge to entering the GB energy market was finding someone to buy the energy from. As a small supplier buying shaped products was difficult; small suppliers could only enhance their market position by base-load and peak because of very small volumes. First Utility identified the need to work with a counterparty who provided it with access to the wholesale market and gave it the lower volumes that it needed.
38. In its view, obtaining energy from the Six Large Energy Firms was difficult for First Utility, and therefore, it started making progress with International Power and then Morgan Stanley. Morgan Stanley provided it with granularity and shape, hence it took on that risk. First Utility believed that Morgan Stanley probably aggregated its demand with other customers and managed the risk.
39. In its answer to the Questionnaire, First Utility told us that it was concerned about continuity of access to wholesale markets in the right volumes as it

grew. It raised concerns about liquidity in the spot market and also its fear that wholesale electricity markets were not sufficiently liquid in the products it required to enable normal hedging activities to mitigate market risk to operate smoothly.

40. In addition, First Utility also raised concerns around the wholesale market counterparty options in the Questionnaire. It believed that a genuinely liquid market would attract on a continuing basis innovative providers offering to address market price and volume risk, credit and collateral, working capital, and other challenges for all independent suppliers, including new entrants.

#### *Collateral*

41. Ovo Energy had to pay a premium to an insurer to cover the mark-to-market losses with counterparties in the early stages of operations. It was cost-effective but it had outgrown this arrangement quickly. Such an arrangement was possibly not scalable but suited Ovo Energy at the time of market entry.
42. Ovo Energy made the point that for companies whose businesses were sound and run well it was possible to obtain collateral-free trading. It said that energy trading was neither easy, but nor should it be easy. It did not agree with some other small suppliers that there should be a hand-out or free credit support.
43. In its current agreement with counterparties, Ovo Energy paid a fee per megawatt hour, in lieu of credit support, similar to paying an insurer to underwrite its credit risk. It paid a premium on top of wholesale costs to its trading counterparty to avoid the need to post collateral.
44. Utility Warehouse told us that it originally had access to the wholesale electricity market through Enron Direct. Later when this was bought by British Gas, Utility Warehouse got its electricity from International Power through a new company (called Opus Energy) set up by some of the Enron Direct staff. Opus Energy charged Utility Warehouse a small premium over the mark-to-market price for the hedge book that it was building and ran, but Utility Warehouse was not exposed to mark-to-market calls on any price fluctuations. It believed that on the back of this arrangement, it had built a sensible hedge book for its electricity needs that would have been broadly similar to the shape that the Six Large Energy Firms would have had at that time.
45. Utility Warehouse told us that buying gas was more complicated. At the time of market entry, it was buying gas from BP and shipping through Aquila but it did not have a big enough balance sheet to hedge its gas exposure. The hedging issue arose because of collateral requirements but more importantly

the mark-to-market calls that could have arisen. It ended up buying effectively a month ahead and then balancing in the daily market, through to the autumn of 2005. In the autumn of 2005, there was an interruption to supply, and the wholesale gas price spiked. It believed that because the Six Large Energy Firms were hedged, it could afford to continue to supply its customers at below the market price. In light of all these developments, it had a choice between continuing to sell gas in line with the prices being charged by the Six Large Energy Firms and make a significant loss, or put up prices to reflect the price that it was paying and be uncompetitive and lose customers. It told us that the only solution it saw was to go around to the Six Large Energy Firms and discuss potential solutions. The only one that it got any serious traction with was RWE npower. RWE npower saw the value of its distribution channel and its independent brand and agreed to take over the entire gas and electricity customer base. At that time it had two energy supply companies, Gas Plus and Electricity Plus. RWE npower agreed to take over its gas and electricity customers, supply them from its hedged portfolio, pay the wholesale costs, network and obligation costs and give Utility Warehouse a margin to continue to provide all the customer service elements.

46. Utility Warehouse was able to secure an improved commercial deal with RWE npower in 2011 under which RWE npower provided all the working capital associated with the growth of the energy business and Utility Warehouse would receive an enhanced margin linked to achievement of certain growth targets. In December 2013, it signed a new 20-year supply agreement as part of the buyback of its original supply licences from RWE npower (which included all the Utility Warehouse customer energy contracts). Under the latest agreement, RWE npower would continue providing working capital related to the hedge book and also the working capital related to customer budget plans.
47. The Co-operative Energy told us that it was not required to post cash collateral for energy trades because of its strong parent company guarantee from Midcounties.
48. Utilita told us that collateralisation of trades could be extremely expensive. If it wanted to trade further out than 24 months it became very expensive with certain counterparties. Utilita also found it difficult to get meaningful credit facilities with the banks.
49. Utilita told us that it was going through a process of making forecasting and trading activities more sophisticated and building up more counterparties. In the future, it would like to get back on to exchanges and trade in that manner. It told us that at the moment, it could not afford to collateralise many counterparties, so it had a relatively small number of counterparties to trade

with. It also made the point that the value of trade that Utilita did for a day, to get from a rough hedged position to a half-hourly hedged position, was relatively small, hence getting anyone interested in doing these trades was very difficult.

50. Utilita also told us that the collateral that it was posting on exchanges was cash that it generated within the business, it did not have bank facilities for collateral and that it saw this arrangement as a clear barrier to expansion from its perspective.
51. Haven Power told us that the credit crunch in 2008 had put it in survival mode and it had had to cut back sales dramatically because it could not afford to do anything that required cash flow. That was when Carron (by then called Welsh Power) put Haven Power up for sale and Drax acquired it. In 2008 purchasing shaped products was difficult as there were few suppliers and these came at a premium price.
52. Extraenergy believed that credit liquidity was the main issue in accessing the wholesale markets. [✂]
53. [✂]
54. Ecotricity believed that liquidity was probably less of an issue than it was in the past, but continued to be an issue nonetheless. Credit availability was probably the single biggest issue faced by new entrants in terms of needing cash to enter the market. It believed that it had passed this issue for the moment thanks to its parent company guarantee.
55. First Utility told us that it had recently moved its trading agreements to Shell Energy on a structured basis. Its current arrangement with Shell was that Shell provided it with access to the wholesale market. Shell held a debenture over First Utility's assets. First Utility had the flexibility to purchase any product available in the market and any size. [✂] Nonetheless, First Utility took the shape risk, it bought the total volume it needed, but only the products that were available, and shaped it closer to delivery.

### ***Vertical integration***

56. Ovo Energy said that, as far as it was concerned, not being vertically integrated was an advantage. In its view, the price was set between a marginal seller and a marginal buyer, so the marginal seller should be the most efficient generator of electricity. More efficient generation technology came out all the time and therefore if Ovo Energy owned an old power station, it would have to transfer more expensive electricity into its retail portfolio than it would buy

from the most efficient generator. It told us that it did not see vertical integration (VI) as a barrier to expansion.

57. The Co-operative Energy believed that VI allowed internal pricing to distort the underlying prices. It could not be a completely competitive market without the separation of generation and supply. It believed that ownership under one umbrella still provided a benefit to the ultimate parent, but operational separation of generation and supply with all of the power going through an open market would give the true prices and the price signals for a fair competitive electricity market.
58. The Co-operative Energy believed that it was disadvantaged by not being vertically integrated, because of the uncertainty around the pricing mechanism and its inability to match its position in days. It also believed that the reforms going through at the moment in terms of cash-out would potentially have profound effects for independents in times of volatility.
59. Utilita told us that the smaller suppliers had a bigger proportion of the energy imbalance than the big suppliers that were vertically integrated. As imbalanced costs were paid into a pot and redistributed based on market share, it believed that smaller suppliers paid more into the pot than they proportionately got back.
60. Utilita also told us that it traded on standard products and every week it did a balancing trade. It did not balance on a daily basis because there was not enough value in it. Utilita did not see the value in employing half a dozen traders to trade around the clock to balance its position all of the time. As Utilita's portfolio got bigger, it became more valuable. Utilita made the point that if it were to have generation, then it would have had a more sophisticated trading operation.
61. Extraenergy believed that the generating assets of the Six Large Energy Firms were not necessarily giving them an advantage in the supply market. It strongly believed in distributed generation, from both an efficiency as well as the total cost of ownership point of view. In the GB market the direction should change from an environmental as well as a cost-efficient and energy-efficient point of view; generation should be decentralised. It believed that co-generation should be pushed more significantly.
62. Ecotricity entered the domestic market in 2003 and VI was a key part of its business. Because Ecotricity did not have shareholders and did not pay dividends, it reinvested profits back into the business on the generation side, therefore VI was very important. Ecotricity added that VI also brought price stability, which enabled it to have the most stable prices in the UK.

63. First Utility believed that vertically integrated firms bought energy internally and independents did not have that option. When they went into the market, independents could not find liquidity further out than 12 to 24 months. The generation assets of vertically integrated firms had most of their output locked in OTC contracts, therefore in First Utility's view very little volume was transacted into the market.
64. First Utility believed that there was an advantage to being vertically integrated when it came to liquidity. In regard to liquidity, if not vertically integrated, one would sit on one side, as an independent supplier or generator, and therefore its imbalance was higher. Higher imbalance was a cost that it had to bear because it had to balance on each half hour. First Utility believed that if a supplier was not vertically integrated there were fewer things that it could do to make sure it was balanced. First Utility made the point that the system could be quite penal if one was out of balance. It believed that vertically integrated suppliers had more levers to pull and could easily match generation with supply. First Utility was not in that position.
65. First Utility also told us that it was not interested in becoming vertically integrated because energy supply was complex enough and the idea of attacking another element of this industry was a step too far. Generation was seen by First Utility as being very capital intensive.
66. In the response to the Questionnaire, First Utility told us that VI was more a tool to reduce risks, given the structure of the balancing regime in the GB electricity market, than a way to expand more easily. Also, in its view due to the size of the efficient generation plants in the UK, there was likely to be a minimum independent supplier size before purchasing a power plant would become feasible.

### ***Supplier IT systems and technical expertise***

67. Ovo Energy purchased its start-up systems from an external partner. The general feeling at Ovo Energy was that systems and expertise were available in the energy supply market in GB.
68. Ovo Energy had always had the internal expertise in forecasting which was key in the industry. It had developed the forecasting models in-house, by people with no prior energy expertise. They were very good at demand forecasting, which made its settlement imbalance very low. The limitations in this area were due to the quality of market data and not a lack of systems or expertise.

69. Utility Warehouse told us that significant costs were incurred in the early years in establishing its IT and billing systems. This extended into the millions of pounds and thousands of man-hours and it was particularly complicated due to the need for it to be compatible with Utility Warehouse's incumbent telephony business.
70. Utility Warehouse stated that when it entered the market there was no 'licence-in-a-box' option, as was available today, and it ended up piggy-backing on Enron Direct's electricity licence. Utility Warehouse did all the billing and the customer service. It had always had a completely integrated billing and customer management solution, so that whether a customer had their home phone, broadband, mobile, gas, electricity or all five of those services, they still got one bill from Utility Warehouse that included all the services that the customers were taking up.
71. The Co-operative Energy told us that the availability of back-office systems was a key factor in enabling entry into the market. If the only back-office systems available were the very big systems that the Six Large Energy Firms used then that would be a barrier to entry. When it entered the energy supply market in GB, it was possible to start at a modest scale.
72. The Co-operative Energy told us that its entry level systems had reached capacity. A large investment was underway to upgrade the system. The Co-operative Energy believed that it was the right strategy when it launched the business to go small and those systems had become obsolete in terms of the scale and size that it was and aspired to be. It told us that without Midcounties' support, it would not have been able to make the investment and reached capacity some time ago, [✂].
73. In its answer to the Questionnaire, the Co-operative Energy told us that in order to operate in the market there were a number of key systems/processes that needed to be put in place, including customer relationship, billing and payment collection, demand forecasting and deal capture, and all necessary industry interfaces – including dataflow management.
74. The Co-operative Energy also told us that recruitment of industry experience in key areas was essential; however, start-up companies would not be able to offer industry experts the same packages as some of the much larger, more established companies. It believed that this made it difficult to get the right people in the right roles.
75. When first established, Haven Power told us that it was able to get some very low-cost systems to start operations. It looked at a number of different IT systems and got some very low-cost systems from a company called Gilmond

Consulting, which itself came out of another failed supply business – a company called Eledor that was very short-lived in supply. Eledor had gone bust in 2005, therefore, Haven Power used its systems. It got its licence in September 2006 and made the point that the process was quite straight-forward. It believed that the whole industry had got incrementally more and more complicated since then.

76. [✂]
77. Extraenergy believed that ‘supplier-in-a-box’ was not a technologically sound solution in the market, that would allow new entrants to service customers and grow past half a million meters. In its view, scalable systems did not exist in the GB market at present.
78. Ecotricity told us that it had been restricted somewhat by IT over the years because of the investment required and the difficulty of funding the investment. [✂]
79. First Utility was, in its own words, ‘fairly pragmatic’ in terms of not building something on day one that was going to handle millions of customers, it ended up having 200,000 customers before it had to upgrade. It believed that the new system would scale up to a couple of million customers and that it was a question of adding more hardware rather than upgrading the software.
80. In answer to the Questionnaire, First Utility told us that as an entrant without a credit rating, the security requirements were proportionally large, although they reduced as the supplier built up a credit rating over time. This tied up working capital, restricting the cash available for investment in customer growth/scalable systems. It believed that unless the entrant was backed by a parent with a good credit rating, a certain level of funding was required for a new entrant to cover these base security requirements.
81. Utilita had bespoke systems that suited its needs and were scalable to a point. IT systems, in its view, were not a barrier to growth.
82. Utilita told us that when it entered the market, it had the expertise it needed to understand the industry and the systems. Utilita started with a team of people with extensive knowledge about the market entry process. This was the CEO’s second market entry, having previously been involved in Electricity Direct. Utilita told us that it was relatively easy in terms of sourcing systems and setting up processes. The key issue that Utilita came across was the issue around prepayment meters. The biggest one, in terms of financial impact on Utilita, had been the issue of the way that gas was allocated in the wholesale market.

## ***Industry systems and settlement***

83. Gas metering was an area of concern for Ovo Energy. Through the Annual Quantity (AQ) system, Ovo was billed on an historic basis for gas. This means that customers with falling usage were overcharged and never caught up, particularly if customers moved house. This arrangement acted as a disincentive to more efficient use of energy in the home.
84. Ovo Energy said that metering and industry data were 'a mess' and this suited the big suppliers as it made life harder for competitors. The gas and electricity meters databases were not synced up and meter registration numbers were sometimes wrong. In its view, meter numbers were often not correctly aligned to the right house. It thought that when a supplier got a new customer the meter information held on central databases was incorrect so that the wrong meter or wrong household were set up. It mentioned that there were also a number of overheads when dealing with this issue and they all fell on the supplier to whom the customer was transferring, often a non-Six Large Energy Firm.
85. From The Co-operative Energy's point of view, one of the problems with industry systems was the complexity of the data flows of information within the industry. It was in the process of upgrading its internal systems to a scalable level, which, in its view, was a very big step for any organisation in order to comply with the industry systems.
86. First Utility believed that industry systems were a barrier that independents faced. It found that quite often when customers tried changing suppliers and things went wrong, it was down to the quality of the industry data. It provided the following example: if a previous supplier had not updated the industry systems to say they had replaced an imperial gas meter with a metric gas meter, problems arose.
87. In the answers to the Questionnaire, First Utility told us that industry systems and processes were barriers for independents. It believed that these systems and processes were developed and scaled for large suppliers and generators, increasingly VI with legacy data issues – and it believed that there was little incentive on the part of the Six Large Energy Firms to address data and industry process issues as they did not benefit. The new provider a customer switched to inherited the difficulties arising from erroneous data and poor industry processes. In its view, this created downside in the switching process for customers and frequently the industry issues could be difficult and/or time consuming to investigate and solve, which undermined the reputation of the new supplier the customer switched to, which acted to undermine switching activity in general.

88. Utilita told us that some of the national metering databases were inaccurate, particularly the gas one. It led to mistakes in switching and missing revenue for Utilita. The switching mechanism could be improved for prepayment meters. One of the biggest problems for Utilita was the allocation of gas in the wholesale market. The system allocated way too much gas to a supply point that was a prepayment meter. In its view, this was because it was allocated on a profile that did not reflect prepayment customers. The cost to Utilita over the years was in the region of millions of pounds. With the roll-out of smart meters there was no reason that a reconciliation could not occur on a more frequent basis.

### ***Regulatory risks***

89. Ovo Energy believed that there was a lack of understanding among energy customers about energy bills. Consumers did not know what they were paying per unit and other bill items such as standing charges. As a result, energy companies could deliberately or inadvertently confuse customers and some regulation, including RMR, had made the situation worse. It should be a licence condition that prices charged should reflect the cost of delivering that energy.
90. In relation to the four-tariff rule, Ovo Energy made the point that although it was well-intentioned, it prevented innovation. The four-tariff rule had also failed to prevent large differences in prices between the four tariffs, particularly when it was within the rules to release different versions of the same tariff.
91. In its response to the Questionnaire, Ovo Energy told us that intervention by regulators made the situation worse. The introduction of the Non-Discrimination Clause in 2008 reduced competition in incumbents' home regions but also pushed competition to the smaller 'active switcher' part of the market, further segmenting the market. In its view, this led to further intervention to reduce this proliferation of tariffs, through RMR, which had created its own problems in terms of limiting innovation and adding unnecessary costs. The limits to tariffs were a barrier to innovation, particularly in a market that was moving towards smart meters. The informational requirements on RMR were also burdensome, and it remained unconvinced that many of these requirements were in the best interest of consumers.
92. In addition to the actual regulations, Ovo Energy believed that another barrier to expansion was the overall quantity of regulation. It recognised that some regulation was necessary but made the point that 'much is not'. It found it

difficult to keep up with the quantum of regulation and it found it costly and distracting from the day-to-day running of the business.

93. Utility Warehouse told us that the old regulator, OFGAS, was reticent to give a national supply licence to a new entrant. New entrants could not be granted a full licence until they could prove that their systems worked and were not allowed to take on any customers until they had a licence. Therefore, Utility Warehouse had to get a restrictive licence first.
94. Utility Warehouse stated that the RMR had constrained its ability to bundle as flexibly as it would have liked. It understood the thinking behind restricting the number of tariffs but also believed that it was the wrong solution to the problem. Utility Warehouse thought that the challenge that the RMR had not satisfactorily addressed was the unfairness of having a large number of customers on uncompetitive tariffs effectively subsidising people who could be bothered to switch.
95. Utility Warehouse told us that the 30-day customer notification period did not work well. Previously a customer was told subsequent to a price rise but had a 30-day period within which to complain or switch. It believed that telling customers in advance created additional price risk for the supplier, that results in announced price rises being higher than would otherwise be the case, as suppliers cannot afford to 'wait and see'.
96. In its response to the Questionnaire, Utility Warehouse told us that the RMR was extremely focused on addressing historic behavioural issues within the Six Large Energy Firms. It believed that the RMR had the unintended consequence of stifling innovation, and hence threatening consumer interests.
97. Utility Warehouse also told us that rather than solely focusing on the 'excess' profits of the Six Large Energy Firms, the focus of a responsible regulator should also be on the financial stability and long-term sustainability/capital resources of small and mid-tier suppliers. Small suppliers that adopted a strategy that was financially unsustainable should not be permitted to jeopardise already extremely low levels of consumer confidence in the UK retail energy markets.
98. The Co-operative Energy told us that industry regulation was high up in terms of the significant risks that it had identified prior to entering the market. Some of the reasons were lack of understanding of where regulation might go, and what impact that might have on developing its understanding of it, and also the speed and cost associated with change.
99. The Co-operative Energy understood and supported the principles behind RMR but believed that it had been over-complicated and probably

counterproductive. There were too many tariffs so it agreed that action needed to be taken. It made the point that four tariffs multiplied by the number of payment methods was still quite a wide selection but there was a question mark over whether it restricted innovation.

100. In the Questionnaire, The Co-operative Energy told us that the cost of complying with Ofgem's RMR, government social and environmental policy objectives, and smart metering obligations constituted a barrier for independent suppliers. In addition to cost, it saw the ongoing regulatory change as another barrier to expansion.
101. In regards to industry codes, The Co-operative Energy stated that although it could table its own proposed amendments within codes, the resource required to engage with the process was completely disproportionate to challenger businesses. It believed that whether from desire or accident, the process was very biased towards the Six Large Energy Firms as challenger organisations did not realistically have the resources to push things through. Membership of these panels was dominated by the Six Large Energy Firms. The large amounts of consultation that came out of Ofgem and the Department of Energy & Climate Change (DECC) required significant resource, and lobbying for change would be a significant increase to resource and man-power.
102. Utilita told us that it decided to focus on prepay smart solution in 2007. However, the Government's smart meter project meant that Utilita was installing meters that were non-compliant. The specification also took several years to come into being and this constrained its growth and ability to deliver value to prepay customers.
103. Utilita believed that the modification panels largely consisted of network operators and the Six Large Energy Firms. The composition of the panels had affected the rate of change over the last 20 years. Utilita believed that there was no desire for change with those that sat on the panels.
104. Haven Power told us that the Contract for Differences (CfD) cost recovery proposals were 'madness'. The current proposals were to set the charge for what the cost was expected to be for a year, and review it quarterly. At the end of the year, if suppliers had recovered too much they had to pay back the money to customers. Haven Power believed that it would be much easier and cheaper for customers if the costs were recovered by adjusting the following year's charge.
105. Haven Power also believed that it was difficult to operate in a market where Ofgem was implementing reforms and then reviewing them every six months. It also made the point that it was concerned by the Ofgem RMR proposals on

product restrictions. It could live with the restrictions but it could not necessarily see how sustainable these restrictions were going to be.

106. Extraenergy indicated that it was not able to be flexible with pricing because of GB regulation, which was actually limiting competition significantly. As a new entrant, Extraenergy believed that it would be able to take an even higher market share if it was able to offer a higher number of products. It made the point that having only four price points was a restriction on competition. It thought that all independents preferred the idea of being able to produce different niche products that matched customers' needs.
107. Extraenergy also gave credit to RMR for waking up, in its own words, 'sleeping customers'. It believed that a very large part of the profitability of the Six Large Energy Firms came from 'sleeping customers' who were not aware that they were on a very expensive product.
108. Ecotricity told us that it was unaffected by the RMR four-tariff limit, as it offered only one tariff to all customers whether new or existing. It used to match the Six Large Energy Firms in the standard regions, however it went 100% green and offered a variable tariff to all customers.
109. Ecotricity was dissatisfied with Ofgem's distribution price control because it knew the returns that the distribution companies made and, coupled up with credit difficulties, this became a barrier to entry and expansion for a newcomer. It told us that it was dissatisfied with the above inflation annual increases and the profits that these regulated companies made. Additionally, the fact that these companies requested cash deposits from independent suppliers compounded cash flow problems.
110. Ecotricity believed that licence conditions were a current barrier to entry. Licence conditions used to be straightforward, however nowadays they were 400 pages long. It added that Ofgem had been selective about enforcing the licence conditions.
111. Ecotricity also believed that there was a lot of overlap between DECC, Ofgem and the Department for Business, Innovation and Skills, which caused confusion and sometimes poor communication. It thought that there was poor communication from the three bodies to the suppliers in terms of what their areas of coverage were, which in Ecotricity's view had created confusion over recent years.
112. Ecotricity told us that it had never used the process to change industry codes because of resource constraint. It believed that the modification panel was completely represented by the Six Large Energy Firms.

113. At its case study interview in October 2014, First Utility told us that it saw less deep discounting by the Six Large Energy Firms, which was down to RMR and created more opportunity for independent suppliers.
114. In the answers to the Questionnaire, First Utility told us that it did not consider the licensing processes for gas and electricity or the accreditation process for electricity or the entry process for gas to be barriers to entry. It also believed that while the regulatory and policy interventions of recent years (eg Electricity Market Reform and Feed-in Tariffs) had added to the complexity of the environment and the licences included substantially more requirements (eg RMR and Standards of Conduct), First Utility was not aware of the licensing process itself having become more onerous or constitute a barrier for new entrants.
115. First Utility also told us that it believed that the Electricity Retail Market Reform had the potential to be the biggest single risk to competition in retail energy. The CfD Feed-in Tariff supplier obligation introduced a new and soon-to-be-significant cost and risk which would have to be recovered through tariffs charged to consumers.

### ***Customer inertia***

116. Ovo Energy told us that it attracted most of its customers through price comparison websites and through 'word-of-mouth' which successfully helped to facilitate its entry into the GB market.
117. Ovo Energy believed that entry into the market was not a problem but there were barriers to expansion from the incumbents. It believed that the Six Large Energy Firms charged 'sticky' customers, many of whom are vulnerable, the maximum they could, and then attracted active switching customers through discounted deals that expired after a short period of time when the customer ended up on a more expensive tariff. Ovo believed that the major barrier to expansion in the market for independents was the ability of the incumbent suppliers to segment their customers. The Six Large Energy Firms charged a very high amount to non-switching, loyal customers (who make up around 70% of their customer base). This large incumbent base allowed them to cross-subsidise short-term protective tariffs which acted as a barrier to expansion for new entrants. By contrast, companies such as Ovo only had a small percentage of its customers on a variable tariff (around 20%). As a result every tariff had to be cost reflective. This meant that its ability to offer cheap deals in the market would reflect its more efficient processes, rather than any incumbency advantage.

118. Ovo Energy believed that the Six Large Energy Firms charged those customers who had proven that they were not going to switch, a very high price. In addition, those that had 'white-label' agreements would sell the exact same product through their 'white-label' partner, however rebranded with the supplier's name, leading customers to believe that the 'white-label' supplier was a different business but charged those customers 20% less. The customers got a very competitive price for the same product if they were to buy it directly from one of the Six Large Energy Firms, and then over time the incumbent would transfer those customers onto higher-cost tariffs.
119. Ovo Energy believed that 'customer inertia' had several causes. First, the huge advantage of incumbency. Many customers were not engaged in the market, some were not even aware that they could switch. It made the point that it was widely understood that customers did not really know what a kilowatt hour was and what they were paying per unit. Second, Ovo believed that energy companies could, deliberately or inadvertently, confuse customers to their advantage, and they got away with it because there was no regulation that said, 'the price that suppliers charge any customer has to reflect the cost of delivering energy to that customer'. It made the point that it could not understand how British Gas could save Sainsbury's Energy customers £200 a year when it was ultimately selling the same products to its British Gas customers.
120. In its response to the Questionnaire, Ovo Energy told us that the biggest barrier to expansion for independent suppliers was the use of protective tariffs by incumbent suppliers. Due to a large group of inactive customers, who appeared to some extent price-insensitive, the Six Large Energy Firms were able to cross-subsidise their cheap tariffs which acted as a barrier to expansion for new, growing suppliers. This meant most customers in the energy market (the Six Large Energy Firms have an approx.90% market share and approx.70% of their customers are on an expensive variable tariff) were not benefiting from competition. In effect, there were two energy markets. One for active switchers that was very healthy. For sticky customers, competition was often not working. This could be evidenced by the failure for average Six Large Energy Firms' variable tariffs to drop much over the past year, despite significant falls in wholesale costs for gas and electricity.
121. Utility Warehouse told us that it did not use price comparison websites, did not advertise and did not use direct marketing. Increases in customer numbers were driven solely by 'word of mouth' and by customers who acted as partners to sign up friends and family to earn some part-time income. Utility Warehouse's customer acquisition costs for energy services were close to zero.

122. Utility Warehouse thought that customer inertia was improving and that people understood better than in the past that they could get their energy from a range of different sources. Utility Warehouse also believed that it was unrealistic, and not necessarily desirable to expect a significant proportion of customers to engage (ie switch) on a regular basis, particularly where they were receiving both good service and competitive prices.
123. In its response to the Questionnaire, Utility Warehouse told us that a significant barrier to expansion was the cross-subsidising of tariffs that existed between the 'sticky' customer base of the Six Large Energy Firms and other customers. The majority of suppliers adopted a policy of cross-subsidising loss-leader acquisition tariffs through the exploitation of their less-engaged legacy customers, many of whom were stranded on inflated standard variable tariffs. It suggested that this caused considerable consumer harm and that a possible remedy would be the introduction of a defined maximum delta between the price that suppliers charged their legacy customers and the introductory deals that they offered to new customers.
124. The Co-operative Energy told us that it used switching sites but these delivered price-driven customers. Even when not on the switching sites The Co-operative Energy had managed to grow albeit at a slower rate. When it stopped paying commission to the switching sites the number of customers could dry up as the switching sites only showed those suppliers who were paying commission to the sites. In the Questionnaire, it made the point that there was a need for transparency in the way tariff results appeared on switching sites and how they were a consequence of commission being paid rather than the best deal in the market.
125. The Co-operative Energy made the point that the regulator needed to think carefully about the kind of customer engagement it might want to trigger, because not every member of the public needed or wanted to be engaged in switching suppliers. It made the point that the industry needed to think about serving better those customers that did not want to be engaged, often the slightly more vulnerable who had not moved and might be paying the price. The Co-operative Energy believed that was where the Six Large Energy Firms generated profit. When looking at the profitability of the Six Large Energy Firms' standard variable customers compared with those on the more aggressive new fixed-price products, The Co-operative Energy believed those that were engaged in the marketplace paid less and that it was an issue that needed to be addressed. The Co-operative Energy's view was not just about engagement, it was about people who should be entitled not to engage if they did not want to, but they should also receive a good deal.

126. Utilita saw the inert customer bases of the Six Large Energy Firms as an advantage to the Six Large Energy Firms and that those customers were the ones from which the Six Large Energy Firms got 'super profits'. It believed that even if it reached one million customers it could not generate the profits of the Six Large Energy Firms as those customers were engaged, they had switched and they were likely to switch again for the lowest price.
127. Haven Power told us that it was able to create a new market in the SME sector by offering renewable power at a cheaper cost by passing on the discount (on Levy Exemption Certificates (LECs)) to customers. It was able over the space of a couple of years to use all the LECs<sup>5</sup> that Drax had and also knew that Drax was looking to convert to renewable energy. Other suppliers had had to respond as well and that had improved the market for LECs. It believed that it had had a very good run at winning customers that wanted to switch to renewable energy because it took its competitors a little while to work out what was happening, and that helped Haven Power's growth in business. It made the point that about half the power that it supplied was renewable power.
128. Extraenergy told us that it chose the GB energy supply market because of the size of the market and the tendency of customers to switch; it believed that the switching awareness was very high in GB. Also the levels of competition in the market were not as high as other European markets, ie Germany.
129. [✂]
130. Ecotricity noticed a tendency for customers to move away from the Six Large Energy Firms because of the adverse media that was going on against them.
131. Ecotricity told us that it saw price comparison websites as an enabler in the market, helping customers switch suppliers. However, it did not think that the sites were being investigated properly, and that there was a proper understanding of their transparency or how they worked. It told us that there was a lack of transparency in the way price comparison websites promoted tariffs for which they had contracts. Switching sites had an incentive to promote churn, even when it was not in the interest of the customer. It had also noted that switching sites prioritised price over other factors, such as: customer service and level of 'greenness', which in its opinion were also important to customers.

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<sup>5</sup> Electricity produced from designated renewable sources is exempt from the Climate Change Levy (CCL) and is entitled to LECs which can be bundled with the power when sold to a supplier. The CCL is a tax on energy used by non-domestic consumers. Suppliers add the charge to the bills of commercial users with the money generated used by the Government to fund energy saving measures.

132. First Utility believed that a real challenge for independents was the 'sticky' customer base of the Six Large Energy Firms. In its view there was always going to be a rump of customers who would just never switch, for whatever reason they would not get engaged.
133. First Utility believed that 'faster switching' would help address some of the so-called 'sticky' customer base. With a few simple changes the industry could move from a cooling-off plus three weeks to cooling-off plus three business days for switching. It believed that if suppliers worked together this could be done even in the confines of the current industry systems.
134. In the Questionnaire, First Utility told us that despite the fact that the collective market share of the non-Six Large Energy Firms had increased significantly over the last year, this did not indicate that there were no adverse effects on competition or that entry was acting as an effective constraint on the behaviour of the Six Large Energy Firms. It agreed with the point made by Ofgem in the assessment of the market, published on 27 March 2014, that 'even if small suppliers continued to acquire similar numbers of new domestic customers, it would be some years before any of them could achieve the scale of one of the big six suppliers.'
135. Also in the Questionnaire, First Utility told us that 'the lack of customer engagement' represented a significant incumbent advantage. In addition, incumbent pricing and deep discounting represented a barrier for independents. It had noticed a recent return to deep discounting between standard variable and online fixed offerings and deep discounts around collective switching from the Six Large Energy Firms. The benefits of incumbency manifested in the poor price offerings customers were getting: with large, unengaged customer bases, the Six Large Energy Firms had the ability to collect a high gross margin from a large proportion of their customer base, which afforded potentially greater flexibility to provide a gross margin cross-subsidy to their acquisition tariffs in order to defend their existing base.

### ***Reputational risks***

136. Ovo Energy believed there were some system issues that affected the reputational risk of all suppliers, although perhaps more so the new entrants at the moment.
137. Utility Warehouse stated that there were a number of new entrants in the supply market who were not making much profit. Utility Warehouse believed that if any of these suppliers failed and went into the 'supplier of last resort' process, then this would be damaging to customer confidence and the whole independent supplier sector.

138. At its case study interview in October 2014, First Utility noted that it did not believe that the Six Large Energy Firms had a great deal of retail focus; in its opinion, focus seemed to be more on the generation side. On the retail side the Six Large Energy Firms were focused naturally on retention, ie what they could do to retain customers and not necessarily on innovation, ie how they could do things better for the benefit of customers. First Utility believed that this opened up opportunities for independent suppliers to take up customers from the Six Large Energy Firms through innovative products and customer engagement.

139. [✂]

### ***Economies of scale and scope***

140. Ovo Energy believed that it was a more efficient organisation than the incumbent Six Large Energy Firms which might have legacy issues to overcome. It thought that it had simpler processes and simpler products, so simpler terms and conditions for customers to understand. It had started off with low operating cost, therefore it could compete on price but without any hidden charges for customers. The break-even point when Ovo Energy was first established, in its view, was as low as 3,000 customers.

141. [✂]

142. The Co-operative Energy believed that if it was to triple its customer base over the next three or four years, the Midcounties parent company guarantee would not be enough for it to continue at the same pace and therefore this credit position might limit how much it could grow. The Co-operative Energy believed that in this market, to achieve some of the efficiency an independent supplier needed to get to a sizeable growth position before it could take advantage of economies of scale, would require credit but credit would become an issue for most large suppliers, even for The Co-operative Energy despite being backed by Midcounties.

143. In the Questionnaire, The Co-operative Energy told us that due to its size it came across issues relating to credit availability due to the practices of some wholesale gas suppliers which did not recognise Dun & Bradstreet ratings. Size was a factor in obtaining a widely recognised credit rating.

144. First Utility acknowledged that there were economies of scale as it grew due to the fact that unit costs went down in size for major IT and infrastructure investments performed to assist the company to grow.

145. Utilita did not think that at its current level of customers it had economies of scale. It believed that as soon as a small supplier passed the 250,000

customer accounts threshold, the balance tipped in favour of the Six Large Energy Firms and it favoured them at the disadvantage of smaller suppliers.

### ***Obligations thresholds***

146. Ovo Energy told us that it made the decision not to grow in 2013 because of the cost of the Energy Companies Obligation (ECO). It had decided to wait a year before pushing ahead with its growth plans but the intention had always been to surpass the threshold. Passing the threshold was best to be done at the start of the year to save 12 months of obligations commitments. Ovo Energy made the point that the costs of ECO had substantially fallen.
147. Ovo Energy believed that if the ECO thresholds had not been set in a 'clumsy' way so that one extra customer over 250,000 installations would cost several million pounds, then it would have continued to grow. But because it was a year-end snapshot, and if it had been Ovo Energy's 250,001<sup>st</sup> customer, it would have been subject to ECO contribution for the next 12 months and it did not want to be at 250,001 installations at year-end, therefore it decided to be less aggressive in acquiring customers for a few weeks until the new year.
148. In its response to the Questionnaire, Ovo Energy told us that another key barrier to expansion was the threshold related to the ECO and Warm Home Discount. The nature of the thresholds meant that when a supplier moved from fewer than 250,000 to more than 250,000 accounts they added considerable expense. In Ovo Energy's opinion, this was not just in terms of the size of the obligation itself (a cost of several million pounds for both ECO and Warm Home Discount, in Ovo's estimates), but the additional expertise and compliance costs that were associated with delivering these legal requirements.
149. Utility Warehouse told us that it had a supply and services agreement with RWE npower which meant that RWE npower were responsible for the costs associated with the fulfilment of the ECO, Renewable Obligation Certificates (ROCS) and Warm Home Discount obligations and any similar costs that may arise in the future.
150. Utility Warehouse also believed that the small supplier exemptions for some of the obligations that enable it to offer a lower price compared with other suppliers was unfair and inefficient. In addition the 31 December cut-off date meant that independent suppliers were always underpaying if they were growing fast.
151. The Co-operative Energy told us that it set up a voluntary scheme prior to passing the Warm Home Discount threshold, therefore its customers did not

miss out. The cost of complying with the social and environmental obligations and the associated costs, was high for small suppliers.

152. The Co-operative Energy had passed the ECO threshold on 31 December 2013, therefore it had been delivering ECO in 2014 already. Once it had passed the threshold, it had reassessed its ability to service a growing number of customers with its current systems. In 2014 it took a step back and made sure that it had the infrastructure in place so that it could continue to grow whilst offering a very good customer service.
153. Utilita told us that the ECO thresholds were a massive barrier to growth. The costs of the ECO obligations counted for a big proportion of its gross margin. Utilita thought that it was a challenge posed to it by the ECO threshold and that it needed to grow fairly aggressively next year in order to be able to cover the ECO costs. Utilita thought that the Six Large Energy Firms tried and positioned the ECO threshold as if the small suppliers were getting a benefit, but in Utilita's view, the Six Large Energy Firms were the ones with the inert customer base and the super profits. Utilita told us that it had given a huge amount of its gross margin back to the customer already. Therefore, applying the same ECO cost per customer to small suppliers as to the Six Large Energy Firms meant that it would account for a much bigger proportion of its gross margin.
154. [✂]
155. Ecotricity believed that it may need to manage its customer growth to ensure that it did not cross the thresholds before it was ready. It did not believe that the action of avoiding passing the threshold until the new year felt like the right kind of open market working.
156. First Utility made the point that following a price event in October 2012 it saw a lot of customers switching from the Six Large Energy Firms on to its products. It was able to be price-competitive and acquired 60,000-odd customers, which increased its customers from about 100,000 at the end of 2011 to 175,000 by the end of 2012. It took a conscious decision having debated it at length, to go through that customer threshold and take on the obligations which it has had from April 2013.
157. [✂]