

# COMPETITION AND MARKETS AUTHORITY ENERGY MARKET INVESTIGATION



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**Response to the Updated Issues Statement**

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**27 March 2015**

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## INTRODUCTION

### 1. Summary of key points

- 1.1 This submission is made by EDF Energy plc ("EDF Energy") on behalf of EDF Group companies. We welcome the opportunity to set out our considered views on competition in the energy sector in Great Britain ("GB") in light of the Competition and Market Authority's ("CMA") Updated Issues Statement ("UIS") dated 18 February 2015 and our hearing with the CMA on 11 March 2015.
- 1.2 In most areas, EDF Energy agrees with the overall thinking set out by the CMA. There are a number of areas where we expect to be able to assist the CMA in refining its analysis and some where, on balance, we do not consider an adverse effect on competition ("AEC") is likely to arise.
- 1.3 We set out below what we see as the key aspects of the sector relevant to the investigation then summarise our views on the Updated Theories of Harm ("UToH"). Where indicated, we recommend that our response should be read alongside our detailed responses to the CMA's working papers that accompany the UIS.

#### ***EDF Energy's Trust Agenda, its position at the heart of our commercial strategy and our challenger role***

- 1.4 EDF Energy is a key player in the UK energy sector. It is an integrated energy company with over 15,000 employees and is part of the EDF Group, a leading global energy company which began investing in the UK in 1998. Safety is critical to the EDF Energy business; our day-to-day activity strives to embed a culture of safety throughout the business. Our ambition is to be a successful and responsible long-term energy business, trusted by customers and powering a thriving society and a healthy environment. The aim to be a force for good runs through everything EDF Energy does.
- 1.5 We previously set out a number of salient aspects of our business in our response to the CMA's initial Statement of Issues. We do not repeat them here. For the purposes of this response, we would like the CMA to note how central our 'Trust Agenda' and 'Trust Test', whereby we ask the question as to how customers will benefit with respect to every decision we make, are to our commercial strategy. This is in particular the case in retail markets where the CMA is considering whether AECs may exist. EDF Energy's focus on trust is a rational commercial response to the features of the GB supply market, as well as being a reflection of our culture.
- 1.6 It is relevant to note in this regard that the GfK NOP survey commissioned by the CMA identifies the fact that there is asymmetric trust in the industry on the part of customers<sup>1</sup>. Customers trust their own supplier to a much larger degree than rival suppliers (62% versus 27%). In our view, this must exacerbate any barrier to choosing an alternative supplier. Our own research identified this aspect some years ago. We recognised that trust was lacking in the industry and that market participants needed to address this if they were to gain customers in material numbers.
- 1.7 The customer's perspective in this is vital. The experience of the past decade has been that the prices customers pay for gas and electricity have risen substantially. This has been due to a combination of factors, many beyond the direct control of the energy companies; until recently, rising wholesale energy costs, rising network costs, increasing policy costs and costs associated

<sup>1</sup> Energy Market Investigation, A report for the Competition and Markets Authority by GfK NOP, paragraph 9.

with renewal of infrastructure which is focussed largely on decarbonising the electricity generation sector. There has also been a lot of political and other criticism of, for example, perceived profit levels in the industry. Despite the efforts of energy companies to help customers understand the reasons behind rising bills, the absence of a compelling independent narrative for customers has led to the erosion of trust.

- 1.8 Trust is both part of our culture and also central to our commercial strategy as a long-term sustainable competitor. This dimension, both in retail supply and generation is critical. Being trusted will assist customers in making a choice about who they want to supply their energy and ultimately, and in our case, deciding to switch to EDF Energy from rivals. In addition, customers place their trust in generators to deliver safe, secure and low carbon electricity in a responsible manner. Given our brand, if EDF Energy takes decisions in *any* area that attracts negative publicity (whether it be in generation or in an area that directly affect customers), it may adversely impact our ability to attract and retain customers.
- 1.9 This is crucial to EDF Energy as we are a *challenger* brand at the retail level, both in the domestic and microbusiness areas, as described below.

### ***Retail supply - the Customers business***

- 1.10 The evolution of the competitive gas and electricity markets in GB has brought many benefits to customers through greater choice and innovative tariffs. There is intense competition amongst suppliers in the retail energy market. There are a large number of competitors present and competitive tariffs are available to all customers. A number of smaller competitors have become established competitive threats, particularly over the last 18-24 months.
- 1.11 Competition has brought benefits not just in the prices offered to customers but also in services. Many tariff innovations have been introduced, including fixed-rate deals providing greater choice for customers such as EDF Energy's "Blue+Price Promise", which provides an alert service if there are any deals available which are on average more than £1 per week cheaper (at typical consumption), even if they are offered by competitors. Most suppliers have made substantial investments in Information Technology ("IT") in the last few years to allow their customers to interact with their energy accounts online, which 42% of EDF Energy's customers now do. This has been a rapid change. We would also highlight that a significant number of people are actively engaged with the market, choosing their electricity and gas supplier and the type of tariff they want. Over the last five years, switching levels between energy suppliers, although lower than in previous years, are still comparable with the likes of home insurance and exceed that for telephony and banks<sup>2</sup>.
- 1.12 All of the above has been achieved while also delivering government social and environmental policies through programmes such as the Energy Companies Obligation ("ECO") and Warm Homes Discount ("WHD").
- 1.13 We regard ourselves as a challenger brand - challenging the status quo through consistently lower than average pricing, innovation and social initiatives. We are incentivised to do so by virtue of the fact that historically we were materially smaller in size at the domestic level compared to some of our main competitors. We have recently moved from sixth to fourth in terms of number of residential accounts but remain smaller than our largest competitors. We want to be able to compete for customers of the other firms defined by the CMA in the UIS as the Six Large Energy Firms ("Our Five Largest Rivals"), including those customers that are on standard variable tariffs.

<sup>2</sup> See Figure 3, ICM Online omnibus, January 2014, 2000 UK adults

- 1.14 Our pricing decisions as a challenger brand are firmly driven by our Trust Agenda. A key pillar of this is to offer fair prices and so be seen to be acting fairly and responsibly by both prospective and existing customers who will be prepared to proactively choose EDF Energy as their supplier. We have sought to build our credibility and reputation as a trustworthy supplier and believe that such a reputation can only be built over a long period by consistently acting in a responsible manner.
- 1.15 The result is that EDF Energy has traditionally had one of the lowest standard variable prices in the market. As well as minimising customer losses (by not being one of the highest prices in the market), and also attracting pre-payment meter customers who want a variable tariff, the positioning of our standard variable tariffs is relevant to our ability to gain customers who are choosing a fixed-rate tariff. A change in the standard variable tariff rate is a trigger which encourages customers to consider their choice of energy supplier. We believe that when these trigger events occur, our combination of an attractive fixed-rate tariff together with a brand that is considered to be fair increases the number of customers we gain. We are of the view that this is demonstrated by the increase in customer accounts that we have achieved.
- 1.16 EDF Energy notes that Our Five Largest Rivals may not all have the same incentive with respect to the pricing of standard variable tariffs as they, to differing degrees, have much larger percentages of their customer base on standard variable tariffs. This may influence their price setting decisions - the fewer customers on fixed-rate tariffs a supplier has as a proportion of its customer base, the more likely it is that its pricing decisions could be based on the characteristics of its standard variable tariff customer base. If the customer base is relatively inactive then it is possible that prices may be higher.
- 1.17 Whilst we are of the view that competition overall works well, we do observe that competition at the retail level varies in its intensity, reflecting in our view the impact of a body of inactive or disengaged customers. It can be difficult to reach such customers. Where and how competition now takes place is also influenced by the regulatory framework. Thus, we agree with the CMA in terms of the focus of the next phase of its investigation. However, we characterise the core underlying concern as lack of customer engagement (inactivity) rather than unilateral market power over customers on standard variable tariffs ("UMP in SVT").
- 1.18 It is vitally important that the correct features giving rise to any concerns are identified so that appropriate and proportionate solutions are considered and implemented. Hence, while we recognise that, for the purposes of this market investigation, any likely solutions may be similar to those for a finding of UMP in SVT, we would disagree with this characterisation, particularly with respect to EDF Energy's standard variable tariff customer base.
- 1.19 Our assessment and analysis of the relevant feature is as follows, applicable to both the retail supply of gas and electricity to domestic customers:
  - (a) There are two main categories of tariffs available to domestic customers: standard variable tariffs and fixed-rate tariffs.
  - (b) There are a large number of competitors and competitive tariffs available to all customers, with the choice process being made easier for actively engaged customers by Price Comparison Websites ("PCWs").
  - (c) Customers readily choose between fixed-term offerings. Prices and margins reflect this.
  - (d) Customers will choose tariffs other than standard variable tariffs but the largest numbers tend to only do so after a specific trigger, such as media publicity regarding a standard variable tariff price rise - and then primarily to fixed-rate tariffs.

- (e) The ability to price differentiate is not the issue per se; rather, it is the lack of customer response to material price differentials when such differentials indicate that choosing another tariff or supplier is rational. Our research suggests that the reason for this is customer disengagement.
- (f) As a category, there appears to be a reasonably high correlation between customers on standard variable tariffs and customers that are inactive for the former to act as a reasonably proxy for identifying the latter when the retail sector (gas and electricity) as a whole is examined. This is a feature noted by Ofgem and others - and now the CMA.
- (g) Nonetheless, it must be recognised that not all customers on standard variable tariffs are inactive and the position will vary by supplier. Over 40% of EDF Energy's customers on standard variable tariffs have been customers for less than five years. Identifying disengaged customers is not straightforward. The picture is complex and there are likely to be degrees of inactivity, with some currently disengaged being more readily reached than others.
- (h) As a challenger brand we have undertaken various initiatives to engage customers on standard variable tariffs. Thus, despite the fact that competition in fixed-rate tariffs looks more intense than for standard variable tariffs, from an EDF Energy perspective, we have sought to engage all customers.
- (i) The link between fixed-rate tariffs and the standard variable rate tariffs for EDF Energy is why we submit that it would not be appropriate to reach a conclusion that EDF Energy has UMP in SVT.
- (j) Our approach to competing and winning new business is founded on offering fair prices and acting fairly and responsibly to both prospective and existing customers. In our view, this approach to standard variable tariffs has not overcome the lack of engagement even when the benefits of material price differentials are available. This is illustrated by the fact that when EDF Energy discounted its standard variable tariff rate to Our Five Largest Rivals (being the cheapest major supplier for dual fuel direct debit tariffs for 93 out of the 104 weeks up to 8 March 2015), we experienced very little benefit in terms of customer switching *to our standard variable tariffs*. For example, in 2014 most new wins were in the *fixed-rate tariff* area.
- (k) Our challenger status, and recognition that trust is a key element of customer choice and is asymmetric (i.e. customers trust their own supplier more than a rival supplier), is also reflected in our innovation initiatives, such as our Blue+Price Promise tariff. This seeks to eliminate the fear that some customers have of making a "wrong choice" by keeping them informed of cheaper tariffs (those on average more than £1 a week cheaper at typical consumption) and having no lock in by way of termination fees. We have taken many other steps to further engagement and enhance our reputation (see Table 5).
- (l) Customer inactivity / lack of engagement is a barrier to switching that arises due to a number of reasons. Our experience is that these include complexity, lack of transparency and hence confidence in the gains from switching, lack of clear triggers, and lack of information as to the benefits to the customer as an individual, rather than a hypothetical customer. This analysis is also supported by the 2014 Ipsos MORI Tracking Survey report for Ofgem<sup>3</sup>.
- (m) The customer inertia or inactivity has a geographic aspect. Evolution of competition in the GB market has grown out of the former Public Electricity Supplier ("PES") areas and the

<sup>3</sup> Ipsos MORI, Customer Engagement with the Energy Market: Tracking Survey 2014, Report prepared for Ofgem

single national supplier for gas. While distinct regional characteristics can be observed, changes in market shares on a regional basis are taking place. The exception appears to be in Scotland where there are fewer market participants with material shares of supply.

- (n) The relative pricing of retail electricity and gas by some suppliers, particularly with large incumbent customer bases, needs to be considered as a factor in explaining customer inertia/inactivity.
  - (o) It may be worth the CMA considering whether certain ancillary services (such as boiler maintenance services) may increase barriers to switching through materially increasing levels of customer inertia in the retail supply market. Customers may be unaware that such services are standalone and hence assume that they are tied in. Further, we believe that this may not have been helped by some advertising campaigns.
  - (p) It is also relevant to note that 'inactive' customers do not equate to 'vulnerable' nor that all vulnerable customers are inactive. Waddams Price/Zhu<sup>4</sup> find that well informed vulnerable customers are not necessarily less responsive than others, once expectations regarding gain are controlled for. For EDF Energy, 47% of our Priority Service Register ("PSR") customers are on fixed-rate tariffs, a greater percentage than in the wider population of customers. It should also be noted that there are many definitions of 'vulnerable' and that the PSR register is only one metric for identifying vulnerability. However, it has the advantage that it is readily identifiable from our data.
  - (q) In considering the features that give rise to concerns, it is important that the impacts on vulnerable customers are correctly assessed. EDF Energy is committed to supporting vulnerable customers and this has led to a series of innovations that have put us at the forefront of the industry in this field. For example in 2012, we introduced our unique 'Personalised Support Service' which goes above and beyond legislation to provide a service that maximises support for our vulnerable customers by assisting in five areas: helping such customers find a better tariff and way to pay; reducing their energy use; helping beyond energy; helping with debt; and helping those customers with specific needs so that customers can engage with their energy supplier (e.g. Braille bills).
- 1.20 Note, Waddams Price/Zhu also find that "higher levels of searching and switching are associated with greater anticipated gains and lower expected time needed to switch; this is consistent with anticipated gains stimulating engagement and switching time deterring it"<sup>5</sup>. EDF Energy submits that greater certainty through better price comparisons will help avoid the anticipated gain being less than the reality for a given customer.
- 1.21 We do have some suggestions with respect to quantifying the impact of the gains from switching. While this has been noted by the CMA, the gains from switching identified by the CMA (UIS, paragraph 134) need clarification or refinement through, for example, modelling the impact of increased numbers of customers being on fixed-rate tariffs.
- 1.22 The CMA refers to the question of "rockets and feathers" pricing (UIS, paragraph 127). We have not observed any such pricing strategy. We look forward to exploring this further with the CMA.
- 1.23 With respect to PCWs, EDF Energy believes that there should be a standard requirement, through a strengthened Confidence Code or direct regulation, for any tariff comparison that is not a

<sup>4</sup> Empirical Evidence of Consumer Response in Regulated Markets, section V, discussion and conclusions, Journal of Competition Law and Economics, forthcoming. The authors note their "...findings question the type and value of blanket intervention for groups who may be considered vulnerable because of age, low income or low education achievement. Once other factors are considered, they are neither less active nor less responsive to changes in expected gains and switching time amongst the group who are knowledgeable about opportunities and costs."

<sup>5</sup> Supra.



comprehensive view of the market to be clearly and prominently marked as such. There is a role for commercial PCWs and we are aware that having to show all available tariffs (whether or not there is a commercial relationship) could have unintended consequences such as market exit. Therefore, in our view, it would be acceptable if PCWs did not show all tariffs as standard. We make a number of proposals that we believe strike the right balance between giving customers access to impartial advice and the commercial interests of PCWs in our response to the 'Price comparison websites' working paper. We would advocate the need for consistency in the regulation of PCWs, Collective Switching and White Labels to ensure that there is a level playing field between market participants.

### ***Tacit coordination***

- 1.24 We agree with the CMA that the timing of price announcements does not arise due to tacit coordination but is rational unilaterally for the larger suppliers on a non-coordinated basis: our view is that the strategies of Our Five Largest Rivals do not depend upon the response of competitors (UIS, paragraph 153)<sup>6</sup>:
- 1.25 There are a number of conditions which would prevent tacit coordination taking place. These include the large number of and lack of symmetry between participants, lack of a visible punishment mechanism for not coordinating at any level, apparent ease of entry at the retail level, and presence of maverick rivals. In particular:
- a) There is strong competition in the retail markets overall with different cost structures, such that incentives and business drivers are different across suppliers. The ease of entry and expansion at the retail level has facilitated new entrants to compete for customers and grow market share.
  - b) With respect to competing for customers on standard variable tariffs, the strategies of the larger suppliers with a large inactive customer base are heavily influenced by their own customers' lack of engagement.<sup>7</sup>
  - c) Whilst transparency has increased and tariffs have been simplified, there are still huge amounts of uncertainty in trying to understand competitors' costs and possible strategies.
  - d) As the CMA notes, no announced price rise in relation to standard variable tariff price changes was subsequently reversed due to the response of competitors.
  - e) EDF Energy has a long held strategy of challenging the status quo, whether through having the lowest standard variable tariff (or one of the lowest) or through our drive to increase customer accounts.
  - f) It is also hard to understand why EDF Energy would coordinate with Our Five Largest Rivals when we were not profitable in the supply business; we are incentivised to behave differently.
- 1.26 With respect to customers on standard variable tariffs, were there to be a high correlation with customer inactivity, there is no need for tacit coordination.

<sup>6</sup> We agree that it is also not possible at other levels, as noted by the CMA in its 'Coordination in the retail energy market facilitated by price announcements' working paper. At the generation level, the assets held are materially different and a withholding strategy is not rational. Hedging is too complex to facilitate coordination.

<sup>7</sup> Were coordination to have ever been attempted, it is clear that EDF Energy did not keep to any coordination rules such that, in economic terms, we have 'cheated' without punishment - we have materially increased our non-standard tariff customer base as compared to our standard variable tariff customer base and have adopted strategies that seek to gain rivals' standard variable tariff customers.



- 1.27 For further details, please see our response to the 'Coordination in the retail energy market facilitated by price announcements' working paper.

*Regulation*

- 1.28 EDF Energy supports strong, independent and effective regulation of the energy market and a strong independent regulator. Having a well regulated market is essential to ensure the market works well for both customers and market participants.
- 1.29 It is our view that some of the changes to the regulatory framework that the regulator has introduced have not always had the positive impact sought.
- 1.30 This includes the introduction of the non-discrimination clause (Standard Licence Condition 25A) in 2009. This altered the competitive dynamic with firms responding to the licence change by raising their out-of-area standard variable tariffs, and direct price competition subsequently moved to fixed-rate tariffs.
- 1.31 While this condition has now lapsed, it contributed to the introduction of a great volume of tariffs (as suppliers continued to compete for both fixed-rate and standard variable tariff customers). This can be seen as one of the factors that led Ofgem to introduce its "four-tariff rule" through its Retail Market Review ("RMR") package, as it felt the choice then faced by customers was becoming too complex (see 'Legal and Regulatory' working paper, paragraph 160).
- 1.32 EDF Energy supports clear and simple choices for customers. We were willing to support Ofgem's four-tariff rule at the time, because we recognised concerns that customers were finding the number of tariffs confusing, and we considered that simplifying the offering for customers was paramount at that time. In fact, we had already taken steps to reduce the number of our own tariffs, so the introduction of the four-tariff rule had little practical effect on us at the time. We agree with those (including Ofgem) who have said that the four-tariff rule is not the best way of ensuring simplicity and clarity for customers in the future. In particular, it could be a barrier to customers benefiting from time-of-use pricing with the introduction of smart meters. We support alternative means of simplifying tariffs, for example by unit rate pricing.
- 1.33 Some aspects of the RMR package were beneficial. For example, while we supported the requirement for suppliers to display their cheapest tariff on bills, other reforms, though well-intentioned, fell short of their objective. In particular, Ofgem's Tariff Comparison Rate ("TCR") can be misleading for customers, because it gives a false impression of giving an accurate comparison, when in actual fact the savings shown are for an 'average' customer, and may well not reflect the position for any particular customer. The TCR would not meet our own internal Trust Test for providing fair and accurate information to customers. We believe it hinders rather than helps efforts to promote trust in energy markets and give customers the confidence to choose the tariff or supplier that best meets their needs.
- 1.34 There are also restrictions in terms of the ability to offer discounts and advertise savings. One further factor not referred to by the CMA in its 'Legal and Regulatory' working paper is advertising restrictions. EDF Energy refers the CMA to the Advertising Standards Authority's "Help Note, Price claims in utilities marketing"<sup>8</sup>. This restricts the ability of energy firms to communicate the savings that customers will likely gain when switching from rivals' standard variable tariff rates. It thus creates a barrier to communicating with such customers; we expect that the CMA will want to consider the impact of this on customer engagement.

<sup>8</sup> CAP, Help Note: Price claims in utilities in utilities marketing. <http://tinyurl.com/ppzo2wo>

- 1.35 Similarly, we have significant misgivings around Ofgem's introduction of the Supply Market Indicator ("SMI"). It is intended to provide an independent, forward-looking view of supplier costs, revenues and profitability. However, it has been consistently inaccurate, in particular by overstating revenues and therefore giving a misleading impression of supplier profitability. It has been particularly misleading for EDF Energy for a number of reasons, most importantly:
- Historically, our standard variable tariff rates have been significantly below those of Our Five Largest Rivals.
  - A large proportion of our customer accounts are on fixed-rate tariffs.
- 1.36 We have repeatedly raised these concerns with the SMI with Ofgem, and while there has been some improvement in the methodology used, it remains inaccurate and misleading.
- 1.37 EDF Energy recognises that there are anticipated improvements that will in our view assist customer engagement. The roll-out of smart metering creates transformational opportunities for both customers and suppliers. It will end estimated bills and enable customers to benefit from a greater understanding of their energy usage and provide them with tools to manage their demand. In addition, there will be faster switching times as a result of Ofgem-led changes.
- 1.38 EDF Energy is supportive of both these initiatives. While we expect smart meters to help improve the competitive dynamic, we doubt that they will solve the customer engagement issue alone. There are also a number of hurdles to be overcome, which we explore later in our response.

***Broader regulatory issues - Code Governance***

- 1.39 EDF Energy recognises that the electricity and gas sectors are complicated and require significant systems and processes to operate effectively. These are set out in the industry codes.
- 1.40 EDF Energy agrees with the CMA that the current system of industry codes is unduly complicated. We are not convinced that this is a barrier to entry or competition but it is inefficient. Hence, we believe that reform in this area would be beneficial, in particular for smaller market participants who have fewer resources to devote to following and participating in code modification processes.
- 1.41 We believe that the principle of strong industry involvement in the code modification processes is important. There are many examples where code modifications have been substantially improved as a result of industry assessment. We would be concerned if Ofgem was given increased powers to push through changes without due assessment by experts in the industry.
- 1.42 We believe that the key problems with the current code arrangements are:
- a) Uneven governance – different processes for different codes and some falling short of best practice.
  - b) Processes not always running efficiently (in the main due to resource constraints across the industry).
  - c) Number of codes, and areas of interaction between them.
- 1.43 We recommend three reforms to address these issues:
- a) Further standardisation of code governance arrangements so all codes have the same arrangements and are required to meet best practice standards.
  - b) Greater oversight of the performance of the Code Panels and Code Administrators to ensure best practice is being followed and the codes are being managed efficiently.

- c) A clear vision to have fewer codes, with rationalisation being implemented where possible alongside other industry reforms.

### ***Microbusinesses***

- 1.44 In terms of microbusinesses, we agree with the CMA that there are issues in this market, namely engagement, lack of transparency and the role of brokers or Third Party Intermediaries ("TPIs"). As with the domestic market, we are a challenger in this market, looking to grow our customer base. A number of features of the market make this more difficult, including the lack of an industry-wide recognised delineation with respect to electricity consumption bands. We would encourage the CMA to consider the use of different consumption bands in its further analysis.
- 1.45 For low energy consuming businesses, neither customers nor TPIs / brokers are engaged. This is in contrast to the larger end of the market, where TPIs are active and there are high levels of customer engagement resulting in strong competition. EDF Energy remains engaged in all areas of supply as part of our Trust Agenda.
- 1.46 A significant number of disengaged customers will be on Deemed contracts, that typically have materially higher prices, in part due to the cost of bad debt. EDF Energy is one of the lowest priced competitors; we apply a fair cost and risk plus contribution approach. Currently, suppliers are not able to object to customers with outstanding debt transferring elsewhere. This increases the costs for supplying this customer group that we seek to recover from other Deemed customers. As it is such a significant proportion of the overall tariff, we recommend that the CMA should explore this further.
- 1.47 Transparency is also an issue, as the CMA has identified. It is difficult for customers to make comparisons as prices are rarely published, and similarly difficult for new entrants to demonstrate their pricing and product propositions to win new business. There is also a lack of transparency with respect to the governance of TPIs, and this is why we support Ofgem's moves towards a TPI Code of Practice.
- 1.48 We agree with the CMA that there are concerns about suppliers replacing auto-rollover contracts with potentially higher out of contract rates and have taken a different approach which we believe is fairer to customers.
- 1.49 The CMA will, rightly, look at profitability levels in this area. For EDF Energy, the profitability of its Small and Medium Enterprise ("SME") business has been low (and in our view below the level quoted in the UIS). It is difficult to analyse industry levels of profitability and margins as each supplier defines the segment differently and reports profits differently. We look forward to contributing to the CMA's further work in this area.

### ***Wholesale market rules***

- 1.50 We agree with the CMA that the wholesale electricity market is competitive. The current market rules are such that there is generally adequate liquidity in wholesale electricity products of all kinds. The system of self-dispatch is efficient. Price reporting is robust. Hence, price signals are appropriate. Indeed, EDF Energy relies on the current market design to set prices internally and externally.
- 1.51 In terms of specific market rules, EDF Energy agrees that more marginal pricing in the balancing market is likely to improve market efficiency but we are concerned that there are issues with a "price average reference volume of 1MWh" ("PAR1") and have supported a move to PAR100.
- 1.52 In terms of the interaction between the Capacity Market and Ofgem's proposed cash-out reforms, it is our view that long term investment in capacity is best met by a well-functioning

market-wide technology-neutral capacity market, with cash-out prices incentivising efficient use of the capacity. In that respect, we see the two mechanisms as complementary and we believe that visibility on how and when the two schemes operate is required to ensure consistency. For further details, please see our response to the 'Wholesale electricity market rules' working paper.

- 1.53 EDF Energy notes that a change to locational pricing for constraints and losses has been considered on many occasions by the industry. While it has some attraction in theory, EDF Energy does not consider there to be a likely AEC as a result of the absence of locational pricing. Pricing on such a basis would be very complex and could act as a barrier to entry. In addition, the benefits are likely to be lower than theory might suggest as few generators or customers will have the ability to respond to the price signals. The impact on other aspects of the market design could be considerable, resulting in increased costs and time to implement. For a full analysis, please see our response to the 'Locational pricing in the electricity market in Great Britain' working paper.

### ***Electricity Market Reform ("EMR")***

- 1.54 We are pleased that the CMA has recognised the benefits of Contracts for Differences ("CfDs") and the Capacity Market. The market previously did not send sufficiently clear signals for investment in generation, and in particular low carbon generation. We believe that CfDs and the Capacity Market are appropriate ways of remedying this issue, and we have been strongly supportive of the UK Government's EMR package. The European Commission ("EC") has granted State aid clearance to CfDs and the Capacity Market. Our detailed responses to the questions that the CMA has raised in relation to EMR are set out in our response to the 'Capacity' working paper. We do not believe that any of the issues raised give rise to an AEC.

### ***Generation of electricity***

- 1.55 We agree that no feature or features giving rise to an AEC exists at the generation level. Standard indicators show that there are a large number of competing generators with moderate market shares. It is also the case that a variety of small and medium scale generation capacity is being brought to the market by a diverse mix of market participants. A number of other projects have secured consents indicating that levels of concentration will not increase going forward. The recent Capacity Market auction in December 2014 also evidences a competitive generation market.
- 1.56 Similarly, a pivotal supply analysis and residual supply analysis do not indicate market power. Further, a consideration of the merit order and the issue of withholding of capacity is such that one concludes that neither EDF Energy nor any other generator has market power, and that models that might facilitate the implementation of such a strategy are not robust, as noted by the CMA (UIS, paragraph 68).
- 1.57 The reality is that EDF Energy has never withheld capacity and does not even attempt to identify such possibilities on the basis of its use of stack models or otherwise. Such a strategy would significantly increase price risk as well as being illegal. For further details, please see also our response to the 'Market power in generation' working paper.

### ***Vertical integration***

- 1.58 We agree with the CMA's current thinking that no concerns arise due to "vertical integration":
- a) EDF Energy's structure is one of 'common ownership' of operationally separate generation and supply businesses, as opposed to one of "vertical integration". This is our choice - we feel it is a good one for our customers, for our shareholder and for our employees who have a common sense of purpose that is motivated by an understanding of where and how

electricity is produced and its value to customers. We are well placed to continue to compete as a long-term sustainable competitor. We recognise that is just a choice that we have made and that others may choose differently. In this regard, no substantive issue arises.

- b) There is no one form of vertical integration. Vertical integration in this industry is not 'classical' given the regulatory framework and the existence of the wholesale market and, for example, of a number of independent regulated distribution businesses. Forms of "vertical integration" exist within smaller market participants and across generation and supply. Even existing business models are changing, as evidenced by E.ON's announcement that it will split its operations into two separately owned entities<sup>9</sup>.
- c) There is no input foreclosure - downstream retail competitors have full access to liquid wholesale markets with respect to all standard products. We fully agree that liquidity and price transparency/robustness are adequate. Indeed, EDF Energy is long in generation and, with a large nuclear generation fleet, is incentivised to make output available to all willing purchasers.
- d) There is no customer foreclosure - there are many competitors with increasing market share at the retail level that are short in generation and need to purchase the output of generators to cover the needs of the customers they supply.
- e) EDF Energy therefore agrees with the CMA's analysis (UIS, paragraphs 88-107 and as set out in the 'Foreclosure' working paper).

### *Profitability*

1.59 EDF Energy agrees that a profitability analysis does not indicate any general concern.

- a) Profits at the generation level are not excessive and returns fluctuate. Investment in many generation assets is large-scale, long-term and risky. From EDF Energy's perspective, there are a number of complicating factors in any analysis of generation profitability. Against this backdrop, we have reviewed the CMA's assessment of returns at the generation level and largely agree with the numbers and that these do not indicate a concern; rather, they support the view that no AEC arises.
- b) Retail supply is not characterised by excessive profits. Indeed, EDF Energy's own residential supply division has sustained losses in a number of recent years with only a small Earnings Before Interest, Taxes, Depreciation, and Amortisation ("EBITDA") profit in 2014. Although there were and are some inefficiencies, we have taken a number of steps, driven by competitive pressure, to improve our position at the retail level. This included introducing a new IT system to serve customers better. While the roll-out of this experienced difficulties, now resolved, and helped delay our move to profitability, we moved to EBITDA profitability in 2014, with much reduced Earnings Before Interest and Taxes ("EBIT") losses. We believe this, in part, reflects the success of our Trust Agenda.
- c) Likewise, trading activities are not making excess profits or "concealing" profits from elsewhere. The Ofgem-commissioned review into transfer pricing by BDO LLP concluded that there was no evidence that transfer pricing methodologies within the Six Large Energy Firms were not fair and reasonable<sup>10</sup>.

<sup>9</sup> Found at [www.eon.com](http://www.eon.com); Press releases, 30 November 2014

<sup>10</sup> <https://www.ofgem.gov.uk/ofgem-publications/84249/bdo20report.pdf>

- 1.60 For further details, please see our responses to the 'Analysis of generation profitability', 'Profitability of retail energy supply: profit margin analysis', and 'Analysis of the cost of capital of energy firms' working papers.

## 2. Summary of conclusions on Updated Theories of Harm

- 2.1 EDF Energy's analysis leads to the following conclusions with respect to the CMA's UToHs:
- a) *UToH 1 (The market rules and regulatory framework distort competition and lead to inefficiencies in wholesale electricity markets):* We agree with the CMA that there is no general issue.
  - b) *UToH 2 (Market power in electricity generation leads to higher prices):* There is no market power in generation. There are a large number of competing generators with moderate market shares. Other forms of analysis do not reveal an issue. We agree with Ofgem and the CMA in this respect. A withdrawal strategy is not a feasible strategy in practice.
  - c) *UToH 3a (Vertical integration leads to opaque prices and low liquidity in wholesale electricity markets):* Prices are not opaque at the wholesale level and there is adequate liquidity. Vertical integration has no such effect, not least due to the market rules. No barriers to entry exist in either retail or generation.
  - d) *UToH 3b (Vertically integrated electricity companies harm the competitive position of non-integrated firms to the detriment of customers):* There are a large number of retail energy suppliers with an increasing share of the market. There are also a large number of generators, with many participants in the Capacity Market auction in December 2014. The market rules ensure that the costs of energy suppliers without generation activities or conversely sales of generators without supply activities are not adversely impacted.
  - e) *UToH 4 (Energy suppliers face weak incentives to compete on price and non-price factors in retail markets, due in particular to inactive customers, supplier behaviour and/or regulatory interventions):* We agree in part. The fact that there is a reasonably large cohort of inactive (disengaged) customers, corresponding, to a greater or lesser extent, to customers on standard variable tariffs in certain geographic areas (for a given supplier) or for a particular fuel (i.e. gas/electricity) impacts on the competitive dynamic. Regulatory interventions have not addressed the underlying concern and indeed have created further distortions. The explanation of the observed behaviour that gives rise to any concerns is not tacit coordination but the cohort of inactive customers. This characterisation is a more accurate and appropriate finding and suitable for a subsequent consideration of remedies. A finding of UMP in SVT is questionable and certainly does not apply to EDF Energy. EDF Energy does not have a retail strategy with respect to standard variable tariffs that is independent and/or divorced from its fixed-rate strategy; rather, the two are interwoven. A similar feature (customer inactivity) exists at the very small end of the customers falling within the definition of "microbusinesses", albeit for different reasons. Greater transparency and improved behaviour of TPLs is needed.
  - f) *UToH 5 (The broader regulatory framework, including the current system of code governance, acts as a barrier to pro-competitive innovation and change):* We agree that the code governance system is complicated. We have identified some areas where the current system can be improved although we note many of the points raised by the CMA do not constitute a feature giving rise to an AEC.
- 2.2 The above leads to a consideration of improvements. For the next stage in this investigation, EDF Energy strongly believes that any potential remedies should focus on overcoming the barriers that



prevent customer engagement. Code governance can be standardised to meet best practice, and the codes themselves can be rationalised so that there are fewer codes.

- 2.3 Our current thinking would include the following to address lack of customer engagement:
- a) increased simplicity of tariffs;
  - b) increased transparency, better and clearer information (including from the other institutions e.g. Ofgem's SMI);
  - c) improved triggers to prompt customers to consider their choice of tariff or supplier; and
  - d) increased transparency in the microbusinesses area.

### 3. The commercial rationale for EDF Energy's Trust Agenda

- 3.1 EDF Energy set out a number of salient aspects of our business in our response to the CMA's initial Statement of Issues. We do not repeat them here. For the purposes of this response, we would like the CMA to note how central our 'Trust Agenda' and 'Trust Test', whereby we ask the question as to how customers will benefit with respect to every decision we make, are to our commercial strategy. This is particularly the case in retail markets where the CMA is considering whether AECs may exist.
- 3.2 Our Trust Agenda embodies all of the actions we are taking to be a better kind of energy company. Through our Better Energy Ambitions (Figure 1), we aim to drive progress for people, be a successful long-term energy company, trusted by customers and powering a thriving society and healthy environment.

**Figure 1 - EDF Energy Better Energy Ambitions**



- 3.3 A good example of our long-term approach is around the environment; we believe climate change and environmental protection remain amongst the most pressing global challenges. We are leading the way in cutting emissions from electricity generation. We are extending the lives of our existing nuclear power stations and investing in nuclear new build, in modern efficient CCGTs and in renewables. Our overall aim is to reduce the carbon dioxide emissions from our electricity production to less than 100g carbon dioxide per kWh by 2030 from around 256g carbon dioxide per kWh in 2013. In our offices we have reduced our carbon dioxide footprint per person by 15% since 2010. We are also looking to support industrial and domestic customer efforts to improve their energy efficiency.



- 3.4 Trust is a key issue for customers. It is relevant to note in this regard that the GfK NOP survey commissioned by the CMA identifies the fact that there is asymmetric trust in the industry on the part of customers<sup>11</sup>. Customers trust their own supplier to a much larger degree than rival suppliers (62% versus 27%). Our own research identified this aspect some years ago. We recognised that trust was lacking in the industry and that market participants needed to do something about it if they were to gain customers in material numbers.
- 3.5 EDF Energy's focus on Trust is a rational commercial response to the features of the GB supply market, as well as being a reflection of our culture which is consistent with that of our shareholder, EDF. The belief that we must always act for customers is deeply embedded and this fundamental sense of purpose translates into our strategies and behaviours within EDF Energy.
- 3.6 The attention we pay to building trust with our customers and in our industry more broadly, and the steps we have taken in leading changes to our tariffs, our pricing, and in how we engage with customers should not be seen simply as a collection of benevolent gestures. Our initiatives, gathered together and exemplified by our Trust Test (see below), are rather a keenly commercial response that demonstrate a balance between short term profitability and the long term sustainability of our business. And with our planned investments in new generation plants that may have a lifetime of 60 years or more, it is clear that EDF intends to be actively involved in the GB energy sector for the very long term.
- 3.7 A sustainable business, that is, one that can exist for the long term, must be an expert at understanding and responding to the needs of its customers, have strong customer loyalty, and engaged customers who pay a fair price for the products they receive, and makes a fair profit that is reinvested in the business to improve the quality and range of products that can be offered.
- 3.8 In 2009 we were a long way away from that in the energy supply market in GB as a whole. Trust in energy suppliers was very low. Many customers were not engaged in the market, and were therefore not receiving the product best suited to them. Despite that, profits for suppliers were low or negative.
- 3.9 Since then our goal has been clear: EDF Energy envisages a well functioning market with engaged customers, who can each find it straightforward to identify and opt for the tariff that best meets their needs, from a range of suppliers offering a range of products and services.
- 3.10 Change in the market was necessary for the benefit of customers, and also to ensure the viability of EDF Energy's supply business in this future market. It was clear to us that the gap between public and political perception of our industry and reality was widening. By addressing this challenge ahead of other companies and in a more comprehensive way, we have had an opportunity to drive that necessary change in some cases, and to position our company to succeed relative to our competitors as the market continues to evolve.
- 3.11 As EDF Energy, we perceived the first and most important barrier was the low level of trust between customers and energy suppliers. This led to the introduction of our Trust Test in 2012, which continues to be embedded in our decision making processes in 2015. Overall, this constitutes our Trust Agenda. Our Trust Test was introduced before Ofgem's Standards of Conduct. We subsequently adapted our Trust Test in support of the Standards of Conduct, which is widely embedded in our operations and business decisions, as illustrated below in Figure 2.

<sup>11</sup> "Energy Market Investigation, A report for the Competition and Markets Authority by GfK NOP", paragraph 9.

Figure 2 - EDF Energy "Trust Test"

**We are the feel better energy company**

When deciding on a course of action which impacts any customer, ask yourself

**Is this the right thing to do for our customers?**

The Trust Test	The Feel Better Test
<i>Mandatory questions required to comply with Standards of Conduct Regulation</i>	<i>Additional questions to consider, that will help us be the energy company that our customers are able to love at last</i>
<p>Confirm &amp; document how the activity is:</p> <ol style="list-style-type: none"> <li><b>1. Fair?</b> Do the right thing, balancing the needs of the individual customer with the needs of all our customers and our shareholders.</li> <li><b>2. Professional?</b> Communicate clearly, with respect, and make it easy to get in touch. Do what we say we will do.</li> <li><b>3. Appropriate?</b> Offer products, services and advice which are appropriate to the customer's needs and any known individual circumstances.</li> <li><b>4. Transparent?</b> Ensure accurate communication, providing the information customers need to make an informed decision, in plain English.</li> <li><b>5. Honest?</b> Tell the truth, never mislead. Admit mistakes if they happen and act quickly to put them right.</li> </ol>	<p>Discuss how the activity:</p> <ol style="list-style-type: none"> <li><b>A. Starts with the customer?</b> Do you have a true understanding of the needs of our customers; how are you acting on this insight?</li> <li><b>B. Delivers a feel better energy benefit?</b> What's in it for customers and does it help them to feel better about their energy?</li> <li><b>C. Delivers on our Customer Commitments?</b> Does the activity help to provide Fair Value, Better Service, and Simplicity?</li> <li><b>D. Is delivered with Positive Energy?</b> Are you 'glass half full'?</li> <li><b>E. Is easy to explain?</b> How would you explain this activity to a Daily Mail journalist?</li> </ol>

**It is mandatory to document how any customer-impacting decisions, processes, policies and communications pass the Trust Test and to outline how you pass the mandatory questions.**

- 3.12 We have done a number of things pursuant to our Trust Agenda, including fair pricing in standard variable tariffs, no exit fees on fixed-rate tariffs, early adoption of best tariff information on bills, the development of our "Blue+Price Promise", lessening regional differences as well as publishing standard tariffs for businesses. These are referred to in more detail in the sections below.
- 3.13 Competing and doing the right thing for our customers has cost us money in the short term. We have done this because it is important to our shareholder and us as a business that we are laying the foundations to be a long term sustainable competitor.
- 3.14 As the CMA has already observed, there are limits to the changes to the market that we can bring about by ourselves. We have increased engagement and customer satisfaction for our own customers, but it can be hard to engage many of the customers who are with other suppliers. We would like the outcome of the investigation to be a market where competing and acting in the best interests of customers can also be a profitable strategy in the near future, as well as being the right solution for the long term.
- 3.15 Thus, the Trust Agenda is both part of our culture and also central to our commercial strategy. This reputational dimension, both at the generation level and at the supply level, is critical in that being trusted generally will facilitate customers deciding to proactively choose EDF Energy as their energy supplier instead of our rivals.
- 3.16 This is important as, from EDF Energy's perspective, we regard ourselves as a *challenger* brand - challenging the status quo through lower pricing, innovation and social initiatives. We are incentivised to do so through our culture and also by virtue of the fact that historically we were materially smaller in size at the retail level compared to some of our main competitors. We have recently moved from sixth to fourth in terms of number of residential accounts but remain some way behind the largest competitors. We want to be able to compete on a more level playing

field for customers of Our Five Largest Rivals who are on standard variable tariffs. The position is similar in the microbusinesses area, where we have recently re-entered the gas supply market.

- 3.17 A key pillar of this is to offer fair prices and so be seen to be acting fairly and responsibly by both existing and prospective customers who will be prepared to choose EDF Energy as their energy supplier. The result is that we have had one of the lowest standard variable tariffs in the market. That is, our positioning on standard variable tariffs is relevant to our ability to gain customers who are choosing a fixed-rate tariff. A change in the standard variable tariff is a trigger which encourages customers to consider their choice of tariff or energy supplier. We believe that when these trigger events occur, our combination of an attractive fixed-rate tariff together with a brand that is considered to be fair increases the number of customers we gain. We are of the view that this is demonstrated by the increase in customer accounts that we have achieved.

## 4. The competitive landscape

- **The number of competitors both at the Customers and Generation level is evidence of a very competitive market.**
- **To the extent this is not the case, a clear analysis of the feature or features adversely affecting competition is required.**

- 4.1 This section is not an exhaustive study of the nature of competition in the GB energy sector, but sets out some salient points on EDF Energy's competitors as this is useful context for considering the specific theories of harm and possible AECs that might arise.
- 4.2 The CMA has received a large number of submissions from EDF Energy's competitors, both large and small and present both in generation and/or supply. The number of competitors, on its face, is evidence of a very competitive market. This is also evidenced by, for example, the extensive review of competitors carried out by participants such as EDF Energy.
- 4.3 In particular, we assess competitor strategies on an ongoing basis. This sets out our views on a variety of competitors. Highlights of our December 2014 report (emphasis added) include:

[REDACTED]  
[REDACTED]  
[REDACTED]

- 4.4 Another internal report, also dated December 2014 analyses:

[REDACTED]  
[REDACTED]  
[REDACTED]

- 4.5 This wide focus is evidence of the many competitive threats faced by existing market participants. Given the wide ranging portfolio of competitors, it is important for the CMA to define precisely the feature or features giving rise to any relevant AEC(s). The industry has faced regulatory remedies of one sort or another in relation to domestic supply over a period of years without the underlying issue being remedied. A robust approach to identifying the relevant feature(s) is needed for an appropriate and proportionate remedy.

## UPDATED THEORY OF HARM 1 - THE WHOLESALE MARKET RULES

- **The current wholesale market design is appropriate.**
- **We agree the system of self-dispatch in operation within the GB system is delivering efficient outcomes in the wholesale market.**
- **Locational pricing is unlikely to provide the theoretical gains identified.**
- **We support the introduction of a single imbalance price and more marginal imbalance pricing. We believe that a move to PAR1 is a step too far and have supported a move to PAR100 instead.**
- **We welcome the views the CMA have expressed that there are strong arguments in favour of both the introduction of Contracts for Differences ("CfDs") and the Capacity Market – any ambiguity on this could undermine investor confidence. This has been avoided.**
- **The Government has struck a reasonable balance between promoting a diverse generation mix and minimising costs in splitting the CfD budget into different pots.**
- **We agree that, where possible, competitive auctions are the best way of ensuring efficient allocation of CfDs. We recognise that in specific circumstances, such as for very large projects, it will remain necessary for the foreseeable future to allocate them outside of the competitive allocation process.**

### 5. Wholesale market design

#### *Market Rules*

- 5.1 EDF Energy has reviewed Ofgem's submission (dated 12 December 2014) on "Assessing the Wholesale Market", the summary of Ofgem's hearing with the CMA, as well as the UIS and relevant working papers. We have the following observations:
- a) We consider that the wholesale market design is appropriate and does not give rise to an AEC.
  - b) We agree with Ofgem that the New Electricity Trading Arrangements ("NETA") / British Electricity Trading and Transmission Arrangements ("BETTA") were designed to ensure coordination did not develop and that the design has been successful in this regard.
- 5.2 We do not see any competition issues due to wholesale market design and hence agree with the CMA. In this regard, we have also reviewed the summary of the third party hearing with National Grid on 14 October 2014 as published by the CMA. In broad terms, National Grid is of the view that "there were sufficient numbers of energy suppliers offering bids and offers in the market to enable National Grid to balance the network" (paragraph 5) and "suppliers' contractual and physical supply positions at the trading deadline, known as 'gate closure' (1 hour from actual delivery) normally closely matched the demand which needed to be met" (paragraph 6) such that "the current balancing and dispatch system, which relied on energy generators and suppliers to do the vast majority of the balancing and dispatch themselves, was efficient and was likely to be more efficient overall than a system where National Grid conducted all the balancing and dispatch itself" (paragraph 8). There are some changes that will be implemented in the near future the overall effect of which "especially at times of system stress, should be to increase the incentive on parties to balance" (paragraph 12). EDF Energy agrees with National Grid.

- 5.3 In terms of the question of central versus self-dispatch, EDF Energy agrees that the differences between different dispatch systems are relatively minor, particularly given that there is sufficient liquidity in the prompt market to enable the market to reach an efficient dispatch solution, as reflected in the CMA's current analysis (UIS, 39-41)<sup>12</sup>.
- 5.4 EDF Energy also notes that Ofgem, in its "Assessing the Wholesale Market" paper, concluded that "there is no one market design that automatically ensures better outcomes" and that what actually matters is the interaction between the markets' underlying fundamentals, the market rules, and their characteristics and outcomes<sup>13</sup>.
- 5.5 We would also highlight that it would be a very costly exercise to change the trading arrangements. In doing so, there would be a period of uncertainty in the electricity market that could potentially deter the entry of new non-physical players into the market. A thorough cost benefit analysis would be required to demonstrate that such change would be justified.
- 5.6 There are additional specific potential concerns identified by the CMA. EDF Energy agrees that a single cash-out price and more marginal pricing are likely to improve market efficiency. However, we are concerned that there are issues with a 'price average reference volume of 1MWh' ("PAR1"). We note that the Balancing and Settlement Code ("BSC") Panel has also recently supported a move to PAR100 in its recommendation to Ofgem. We agree with this and discuss it in our response to the 'Wholesale electricity market rules' working paper.
- 5.7 It is our view that long term investment in capacity is best met by a well-functioning market-wide technology-neutral capacity market, with cash-out prices incentivising efficient use of the capacity. We do not share the CMA's concern that the introduction of 'reserve scarcity pricing' ("RSP") may risk overcompensating generators given the potential interactions with the Capacity Market. What is required is certainty on this topic and for this decision to be taken quickly. We set out our position in the response to the 'Wholesale electricity market rules' working paper.
- 5.8 With respect to a change to locational pricing, EDF Energy notes that this has been considered on many occasions by the industry. While it has some attraction in theory, EDF Energy does not consider there to be a likely AEC as a result of the absence of locational pricing. Pricing on such a basis would be very complex and could act as a barrier to entry. In addition, the benefits are likely to be lower than theory might suggest as few generators or customers will have the ability to respond to the price signals. The impact on other aspects of the market design could be considerable, resulting in increased costs and time to implement.
- 5.9 Please see our responses to the 'Wholesale electricity market rules' and 'Locational pricing in the electricity market in Great Britain' working papers for further details on the above.

### ***Capacity Market and Contracts for Difference***

- 5.10 We welcome the views the CMA have expressed that there are strong arguments in favour of both the introduction of CfDs and the Capacity Market. In particular, we agree that there are strong efficiency arguments for replacing Renewables Obligation Certificates ("ROCs") with CfDs. CfDs will be a key component of ensuring value for money for customers by shielding them from the damaging impacts of high and volatile fossil fuel prices. The introduction of the Capacity Market will help ensure that an appropriate level of security of supply is maintained. This should help to improve incentives to invest in and maintain thermal generating capacity and provide greater incentives for Demand-Side Response ("DSR").

<sup>12</sup> As the CMA has recognised, the GB system of self-dispatch is not unique; many countries have a self-dispatch system and there are variations between the systems deployed. For example, the GB system of self-dispatch becomes central dispatch after gate closure whereas, in Belgium, the self dispatch system extends to real-time.

<sup>13</sup> Ofgem, Market Investigation Reference: Assessing the Wholesale Market, December 2014

- 5.11 As we previously noted in the response to the initial Statement of Issues, any ambiguity on EMR could undermine investor confidence. To the extent that the CMA concludes that the EMR arrangements should be reviewed to address any of the issues raised, we believe that these can be best progressed through DECC's arrangements for further review and development of EMR.
- 5.12 The market previously did not send sufficiently clear signals for investment in generation, and in particular low carbon generation. We believe that CfDs and the Capacity Market are appropriate ways of remedying this issue, and we have been strongly supportive of the UK Government's EMR package. The EC has granted State aid clearance to CfDs and the Capacity Market. Our detailed responses to the questions the CMA has raised in relation to EMR are set out in our response to the 'Capacity' working paper. We do not believe that any of the issues raised give rise to an AEC.
- 5.13 With respect to CfD allocation, EDF Energy agrees that, wherever possible, competitive auctions are the best way of ensuring efficient allocation of CfDs and securing good value for customers, and note that it is the Government's intention that all technologies will eventually compete with each other. Due to the differing maturity of the different eligible technologies, this is not currently possible and so that to ensure that different technologies can compete, a set of budgetary pots are used. This is done to ensure that the less mature technologies are able to competitively put forward viable projects to maintain a development pipeline, which is essential to enable these technologies to progressively reduce their costs in the longer term.
- 5.14 We support the Government's approach. It is important that there is energy generation in the UK from a diverse set of energy technologies. In the longer term, technologies that are currently more expensive may offer the potential for substantial reductions in cost and, ultimately, lower prices for the customer than the alternative scenarios.
- 5.15 As noted by the CMA, the Secretary of State also has the power to award CfDs outside the competitive allocation process. This is important for those technologies such as nuclear or carbon capture and storage ("CCS") where it would not be feasible for them to take part in an auction process competing directly with other projects. Reasons for this include:
- the level of expenditure needed to reach the point where a project could enter an auction;
  - the scale of the projects; and
  - development lead times and asset lives.
- 5.16 EDF Energy would highlight that the Secretary of State is expected to use the power to direct the CfD Counterparty to award a CfD to its planned Hinkley Point C nuclear power station. The agreement on key commercial terms between EDF Group and the UK Government in October 2013 was subject to a rigorous scrutiny of cost estimates and had a strong focus on securing value for money for customers. We would expect the same for any other CfDs allocated in this way. EDF Energy believes that it will remain necessary to allocate CfDs outside the competitive allocation process for some future very large projects, including further nuclear new build. For further details, please see our response to the 'Capacity' working paper.



## UPDATED THEORY OF HARM 2 - MARKET POWER IN GENERATION

- **EDF Energy agrees with the CMA that there is no Unilateral Market Power (“UMP”) in electricity generation that leads to higher prices.**
- **An analysis of market shares using standard and bespoke indicators does not reveal any competition issues.**
- **We agree with the CMA’s identification of important practical constraints on the ability and incentive to exercise UMP, relating to uncertainty and forward trading.**
- **There is a suitable regulatory framework for investment decisions in generation at present such that there is no barrier to entry.**
- **The results of the recent Capacity Market auction in December 2014 indicate a variety of generation plant will be available in the near term, evidencing a competitive market.**
- **We agree that the profitability analysis does not indicate excessive profits in generation.**

### 6. Unilateral Market Power in Generation

- 6.1 EDF Energy agrees with the CMA’s analysis of the competitive nature of the generation sector. We find that its conclusions are completely consistent with the evidence that we see, namely that electricity is traded in a well-functioning wholesale market. Taking a broader review of the conditions of competition relating to the generation of electricity, there is no feature giving rise to an AEC.
- 6.2 We have analysed the competitiveness of the generation market through consideration of shares of installed capacity and standard indicators such as the Herfindahl–Hirschman Index (“HHI”), which is currently about 1000<sup>14</sup>. These do not reveal any issues; there are a large number of competing generators with moderate market shares.
- 6.3 We recognise that the results of the standard indices need to be interpreted carefully for electricity and so have also considered the Residual Supply Index (“RSI”) <sup>15</sup>. The Market Surveillance Committee (“MSC”) of the Californian Independent System Operator (“ISO”) has recommended that for a competitive electricity market, the RSI should not be less than 110% (i.e. nearly pivotal) for more than 5% of the hours in a year (around 438 hours)<sup>16</sup>.
- 6.4 On this basis, the evidence supports the CMA’s assessment that no issue arises. Since 2002, there have been a limited number of occasions where there have been generators who were nearly pivotal to the market. However, in no year was there a case that a generator was nearly pivotal for more than 5% of the year.
- 6.5 The competitive nature of generation can also be seen in the following, which evidences the fact that concentration levels will not become a concern in the near future:

<sup>14</sup> HHI is a measure of the size of firms in relation to the industry and an indicator of the amount of competition among them; it is an economic concept widely applied in competition law. It is recognised as relevant to market investigations in Annex A of the Guidelines for market investigations (CC3) at paragraphs 5 to 7.

<sup>15</sup> The RSI is simply the total supply minus seller’s supply over total demand. Receiving a result bigger than 100% is an indication that the generator in question is not pivotal. With an RSI smaller than 100%, the generator is pivotal and could easily exercise market power. The RSI has been used by the Market Surveillance Committee of the Californian ISO to assess the potential for the breach of competition in the power market.

<sup>16</sup> See Newbery, Green, Neuhoﬀ and Twoney (2004), “A Review of the Monitoring of Market Power”, Report prepared at the request of ETSO, page 28.



- a) The list issued by DECC of all the successful/unsuccessful capacity units in the first capacity auction, found at Annex A of its Provisional Auction Results<sup>17</sup>. Of the 49.3GW procured, about 70% related to capacity owned by the Six Large Energy Firms with the remainder coming from other market participants.
  - b) A diverse range of generators have received planning consent for future thermal projects (i.e. fossil fuel and nuclear), with a total capacity of around 21GW. In addition, there is currently around 1.5GW of consented onshore wind generation and 4GW of offshore wind generation.
- 6.6 On a forward looking basis, the current National Grid 10 year statement<sup>18</sup> indicates that there is currently a minimum of 30GW of excess capacity over peak demand, indicating that there is limited capacity for any generator to influence prices (although we note that this does not take into account availability factors).
- 6.7 A proper assessment of the merit order and the question of withholding of capacity is also such that one concludes that there is no market power in generation. In this regard, the CMA's UMP model supports the conclusion that no issue arises<sup>19</sup>. While there are certain scenarios where it theoretically appears profitable to withhold capacity and raise price, the uncertainties and risks involved with such a strategy far outweigh the potential profit for EDF Energy and other operators, as the CMA rightly acknowledges. EDF Energy agrees with that assessment. For EDF Energy, given just a £1/MWh change in the within-day price results in an annual revenue change in excess of £50 million the risks of adopting such a strategy would be extremely high.
- 6.8 It is also relevant to note that:
- a) such activity is illegal; and
  - b) any withdrawal strategy would be easily detectable.
- 6.9 In addition, EDF Energy makes investment and operational decisions on the basis of safety, technical, and regulatory considerations ahead of market price considerations.
- 6.10 EDF Energy notes the CMA's brief examination of the necessary conditions for firms to be able to exercise coordinated market power, and agrees with the conclusion that none of these conditions are likely to be met.
- 6.11 Additional evidence of the competitiveness of the generation sector comes from the CMA's initial analysis of profit margins earned, where the CMA concludes that returns are low or in line with the cost of capital. EDF Energy agrees that there are no excess profits being earned.
- 6.12 It is also the case that the introduction of the Capacity Market will strengthen the incentive of generators to remain available with their committed assets and generate at time of system stress to preserve their capacity remuneration and avoid penalties.

<sup>17</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/389832/Provisional\\_Results\\_Report-Amendment.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/389832/Provisional_Results_Report-Amendment.pdf)

<sup>18</sup> <http://www2.nationalgrid.com/UK/Industry-information/Future-of-Energy/Electricity-ten-year-statement/>

<sup>19</sup> EDF Energy is also of the view that these types of models can be used to demonstrate a lack of market power. However, it is much more difficult to use them to demonstrate market power.

## UPDATED THEORIES OF HARM (3a,b) - RELATING TO VERTICAL INTEGRATION

- **There is no single business model used in the industry.**
- **EDF Energy's model is one of common ownership of generation and retail supply. We believe this choice provides benefits to both EDF Energy's customers and the country at large.**
- **We agree that no AEC arises due to vertical integration in the sector.**
- **Liquidity is adequate and no input or customer foreclosure issue arises. The choice on operating model made by EDF Energy - and the choices made by our competitors - do not disadvantage or preclude the success of any third party.**

### 7. EDF Energy's choice of structure – common ownership

- 7.1 As the CMA has recognised, there is no single business model used in the industry. EDF Energy, as part of the EDF Group, is committed to a model with both a generation and supply business within our UK operation. We believe that this gives us an appropriate basis for being a long-term sustainable competitor.
- 7.2 From our perspective there are a number of benefits that arise due to common ownership and/or scale, and the culture of the EDF Group. As indicated in EDF Energy's response to the initial Statement of Issues, these include the improved ability to make long-term commitments and to withstand challenging market conditions; the ability to take a long-term view across the value chain in customers' interests rather than promoting 'silo' business interests, and the ability to contribute to a high-quality policy debate.
- 7.3 In our view, companies present in retail supply and generation build expertise, enabling them to manage the increasingly complex electricity system, including exposure to international markets, intermittency, and regulatory requirements, such as the impact of smart meters. Indeed, such companies are well placed to understand the full system implications of such measures, can help the UK to prepare for the future through Research & Development ("R&D"), and can help to roll out and deliver policies.
- 7.4 Ultimately, large, diverse companies such as EDF Energy are well placed to be able to withstand challenging market conditions, reducing the potential for disruptive business failures, and act as suppliers of last resort. In addition, a strong credit rating (often as a result of scale) reduces the cost of collateral for trading and other market functions, as well as the amount required. Presence in both generation and supply can also reduce collateral requirements. This will benefit customers.
- 7.5 We recognise that this business model is our choice and others choose differently. There are no impediments to the success of any given model.

### 8. Liquidity and price transparency

#### *Liquidity*

- 8.1 Liquidity is a key element of the CMA's current assessment. We agree with the CMA's analysis that liquidity is sufficient. We set out further observations in support of this in our response to the 'Liquidity' working paper.

- 8.2 As we have previously emphasised, we rely on liquidity for our own business and find it adequate for our needs. We trade multiples of our generation and supply volumes in the market. We welcome the CMA's analysis which indicates that Our Five Largest Rivals also transact enough in the market to meet their individual supply or generation requirements.
- 8.3 EDF Energy also finds the CMA's analysis that most suppliers hedge their electricity requirements on a similar timescale to their gas requirements to be persuasive evidence that electricity liquidity is sufficient to meet hedging needs.
- 8.4 We are supportive of Ofgem's Secure and Promote reforms, which are designed to improve market liquidity and availability of products attractive to smaller suppliers. We also note that the greater interconnection of the UK system with Europe in the coming years should increase liquidity. However, we agree with the CMA that a step change in liquidity is unlikely to be achieved without attracting financial institutions to the market.

### *Price Transparency in the Electricity wholesale market*

- 8.5 Related to the above, EDF Energy submits that no concerns arise relating to price transparency. Again, we agree with the CMA's current thinking in this regard. We agree that Over the Counter ("OTC") trades in brokered markets are transparent, as all data is available to any participant who purchases a Trayport licence. We are working through Energy UK to make such data available even more readily. We welcome the CMA's analysis that the vast majority of trades either take place through this route or through cleared exchanges; which is in line with our own experience of the market.
- 8.6 It is also worth noting that EU-wide regulations on energy market integrity and transparency ("REMIT") requires firms to publically disclose any information, such as outages and capacity changes, that can have a significant impact on wholesale prices. This must be done before that information is traded on. In addition, the EU Third Energy Package includes additional transparency requirements for network system operators and generators. Together these ensure that there is a very high degree of transparency in energy markets, including GB.

## **9. Foreclosure**

- 9.1 EDF Energy agrees with the CMA's current thinking, namely that no concerns arise out of the "vertical integration" that exists in a number of different industry participants. We agree with the CMA's conclusions that vertically integrated firms do not have the ability to foreclose generators or to disadvantage independent retailers. We also agree with the CMA's conclusions around incentives and effect. We agree that no AEC due to vertical integration arises, for the reasons below, which echo those set out by the CMA in its 'Foreclosure' working paper.

### *No single model in the industry exists such that incentives differ*

- 9.2 There is no single business model of "vertical integration". There are large and smaller market participants that are present in various parts of the generation and/or supply markets. Some have distribution networks and/or energy services; others do not. The mix of generation plant differs across competitors as well. Such variety leads to materially different outcomes in terms of competitive strategies.
- 9.3 Indeed, the concept of vertical integration in this sector is not of a classical variety given the existence of a liquid wholesale market. EDF Energy does not operate in a classic vertically integrated structure, and instead either trades on the market or transfers between business units on a market-reflective basis. Specifically, dispatch decisions for our flexible plant are always made based on market information, rather than to match our own demand requirements.

***No foreclosure concerns arise***

- 9.4 As noted by the CMA, there is no input foreclosure i.e. with respect to the acquisition of wholesale electricity.
- a) There is no market power in generation. The generation market is fragmented. The recent Capacity Market auction results indicate sufficient capacity margin. No issue arises in any given half-hour as withholding capacity is not a credible strategy (see above).
  - b) There is sufficient liquidity and price robustness in relevant wholesale products for downstream participants (rival retail businesses) (see Section 8 above).
  - c) EDF Energy does not create unique shape or flexible products for its own operations. We are not aware of any "standard" flexible/shape products that would not be available to any party (even if so, they may be available on a bilateral basis).
  - d) EDF Energy is long in generation on a simple annual total basis, and also has an interest in selling to third parties in the long term to manage its financial risk. In reality EDF Energy trades many multiples of its net position, and would trade even if it had a balance between generation and supply in order to manage risk. The analysis carried out by the CMA and presented in the 'Liquidity' working paper implies that this is also the case for other companies.
- 9.5 There is no customer foreclosure.
- a) All generators are able to access supply businesses through a number of routes, including the wholesale market as well as through separate bespoke agreements.
  - b) There are a large number of supply businesses at present with smaller participants gaining an increased share (customer base).
  - c) Many supply businesses are available as purchasers. This is further enhanced by Ofgem's Secure and Promote reforms as outlined above.

## UPDATED THEORY OF HARM 4 - B2C

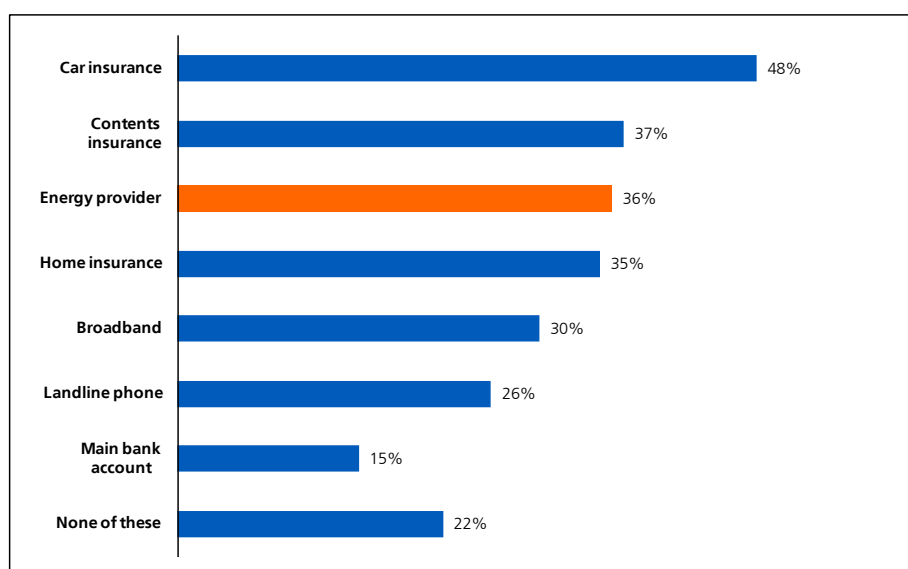
- The retail market is competitive overall as evidenced by: a large number of supply companies; many new entrants taking an increasing level of market share from the historic incumbents; a wide range of tariffs available to all customers.
- There is intense competition for customers on standard variable tariffs but this is through offering them fixed-rate tariffs. These customers can be difficult to reach.
- Competition for customers on fixed-rate tariffs is also intense with many customers switching supplier at the end of their tariff term.
- There are price differentials in the market both between suppliers and between types of tariffs. Without these differentials, customers would have less incentive to switch.
- The available savings through switching, both internally and externally, are higher than the level of £150 that customers say they need but significant numbers still do not switch.
- Our research shows that customers have trouble engaging in the market. Amongst the market features making engagement difficult are market complexity, difficulty accessing unbiased information about available tariffs, perceived difficulty of switching, and a lack of trust in rival suppliers.
- EDF Energy has done much to encourage engagement. This has largely been driven by taking a longer-term view of our relationship with customers. As a result we have a relatively large share of fixed-rate tariff customers (40%).
- However, we have been limited in our course of action as taking action unilaterally in a competitive market can lead to a commercial disadvantage.
- In our view, we are likely to be different from most or all of Our Five Largest Rivals. EDF Energy wants to be able to compete directly, and on a level playing field, for all our rivals' often valuable and currently inactive customers.
- We have compelling evidence that customer engagement can be significantly improved through tariff simplification, increased transparency of the market, and triggers to engage.
- 'Rockets and feathers' pricing is not a feature that we observe.

## 10. The nature of competition in the domestic retail energy market

- **The retail market is competitive overall as evidenced by: a large number of supply companies; many new entrants taking an increasing level of market share from the historic incumbents; a wide range of tariffs available to all customers.**
- **However, we recognise customer disengagement is an issue (as with many other markets) and discuss this further below.**

- 10.1 As indicated above, there are sufficient competitors active across all areas of the market to indicate that strong competition should exist. Much of what we see in terms of outcomes reflects this. The evolution of the competitive energy market in the UK has brought many benefits to customers, including in services and innovation.
- 10.2 Most suppliers have made substantial investments in the last few years, in particular in IT to allow their customers to interact with their energy accounts online, which 42% of EDF Energy's customers now do.
- 10.3 A significant number of people are actively engaged with the market, choosing their electricity and/or gas supplier and the type of tariff and customer service they want. Over the last five years, switching levels between energy suppliers, although lower than in previous years, are still comparable with the likes of home insurance and exceed that for telephony and banks (see Figure 3).

**Figure 3 - Survey answers to the question "For which of the following, if any, have you switched provider in the last five years?"**



Source: ICM Online omnibus, January 2014, 2000 respondents

- 10.4 More recently, we have seen significant growth in small suppliers, which has been rapid since the final quarter of 2013 (see Figure 4).

**Figure 4 - Growth of small suppliers since 2010<sup>20</sup>**

- 10.5 Many tariff innovations have been introduced through the competitive market including fixed-price deals providing greater choice for customers. These include EDF Energy's Blue+Price Promise, which provides an alert service if there are any cheaper deals available (on average more than £1 per week cheaper at typical consumption), even if they are offered by competitors. All this has been achieved while also delivering government social and environmental policies through programmes such as the ECO and WHD. The rising cost of these obligations and, until recently, of wholesale energy costs has resulted in significantly higher energy bills in recent years. In EDF Energy's view, what has been lacking is a compelling independent narrative for customers to understand why this is the case. The result has been an erosion of trust in the industry.
- 10.6 The level of competitiveness is, prima facie, indicated in shares of supply. The largest share of residential accounts is held by British Gas, particularly so in terms of residential gas accounts. Otherwise, shares of supply are reasonably fragmented: see Figure 5.

**Figure 5 - Market share as at 31 October 2014, by number of residential accounts<sup>21</sup>**

- 10.7 The changes in shares on a regional basis also indicate competition is taking place, as shown in Table 1.

**Table 1 – % change in domestic electricity accounts by region for the Six Large Energy Firms - 18 months to 31 October 2014<sup>22</sup>**

- 10.8 Similar changes, including significant losses, can be seen in domestic gas accounts (not shown).
- 10.9 One element of competition is customer service. This is particularly important for us as part of our Trust Agenda. During 2011 we implemented a new customer information IT system to enable us to better compete in the market. As part of the migration, we experienced problems that impacted on our service, as can be seen in Figure 6 below. We were under enormous competitive pressure to address this and our attempts to do so are reflected in recent improvements.
- 10.10 In particular, EDF Energy has seen improvements in our customer service contact channels throughout 2014 and into 2015. As a result EDF Energy is now ranked first out of the major energy suppliers in the UK Customer Services Satisfaction Index.<sup>23</sup>
- 10.11 During 2014, our Customer Services team continued to focus on the timely resolution of all customer complaints, with over 85% of complaints resolved in one day and over 95% resolved

<sup>20</sup> Based on Cornwall Energy data.

<sup>21</sup> Based on Cornwall Energy data.

<sup>22</sup> Based on Cornwall Energy data.

<sup>23</sup> Source: Institute of Customer Service – UK Customer Service Satisfaction Index January 2015 Report.



within 30 days. As a result, the proportion of Ombudsman complaints relating to EDF Energy steadily decreased during 2014 compared to other suppliers.

**Figure 6 - Customer Satisfaction and Complaints Handling - External Surveys - position of EDF Energy<sup>24</sup>**

Survey	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	Q1 2015
EnergyHelpLine (Satisfaction)													2nd		
EnergyHelpLine (Customer Service)													2nd		
NCSI UK			6th				1st				=2nd				
UKCSI			3rd				5th		4th		3rd		3rd		1st
uSwitch		5th				4th				2nd				2nd	
Which?		5th				5th				2nd				=3rd	
Which? Best & Worst Brands									5th				1st		
Citizen's Advice (Complaints handling)	6th	6th	6th	On Hold				5th	5th	4th	4th	4th	4th		
Consumer Moneyfacts Awards			3rd				3rd				1st				1st
MoneySavingExpert (Customer Service)												2nd	1st		

- 10.12 Although EDF Energy believes that the market is generally competitive, we recognise that there are barriers to switching caused, in our view, by customer disengagement. This means that the competitive playing field is not level in all areas. We discuss this in detail later in our response.

## 11. Incumbency and entry

- Incumbency effects still exist but are diminishing over time.**

- 11.1 The CMA makes some observations on incumbency. From our perspective, evolution of competition in the GB market has grown out of the 14 original PES regions for electricity and the single incumbent supplier for gas. Whilst distinct regional characteristics can be observed, changes in market shares on a regional basis are taking place, evidencing competition is taking place (see Table 1).
- 11.2 One indicator of incumbency is the number of customers who have remained with their original supplier. For electricity, this can be seen in part in the difference in number of "in-area" and "out-of-area" customers. (With gas, this concept does not exist as there was a single monopoly supplier at the time of liberalisation.) For EDF Energy<sup>25</sup>, [X]% of all our customer accounts are in-area. The pattern for electricity and gas is slightly different with [X]% of our electricity customer accounts in-area as compared to [X]% of gas customer accounts. The pattern of in-area versus out-of-area customers, whilst having characteristics related to liberalisation from circa 1999, has evolved significantly since that time. An exception appears to be Scotland where EDF Energy has less than a [X]% residential market share in both electricity and gas in Scotland. EDF Energy is not alone in this regard - there are just three main market participants in Scotland at the retail level. As at 31 October 2014<sup>26</sup>, EDF Energy had a share of supply of electricity

<sup>24</sup> These rankings are based on our position in relation to Our Five Largest Rivals.

<sup>25</sup> Based on Cornwall Energy data.

<sup>26</sup> Based on Cornwall Energy data.

residential accounts of [REDACTED]% in Scotland. For gas, the corresponding figure is [REDACTED]%. This compares to its total GB market share of [REDACTED]% in electricity and [REDACTED]% in gas.

- 11.3 Another potential measure of incumbency is the proportion of customers on standard variable tariffs. It is striking that a large established base of standard variable customers exists for the majority of Our Five Largest Rivals, as indicated in Figure 7.
- 11.4 However, care must be taken in using this as a proxy for either incumbency or, indeed, customer engagement, as we discuss below. The competitive indicators, such as market shares and number of new entrants, must also be considered.

**Figure 7 - Estimated split of customers between standard variable and fixed-rate tariffs by competitor<sup>27</sup>**

[REDACTED]  
[REDACTED]  
[REDACTED]

## 12. Impact of regulation on price competition

- 12.1 The CMA also makes some observations with respect to the impact of regulation on price competition. We agree that there has been an impact but note, for example, that the impact has been to *change* the way competition takes place, not to eliminate the incentive for a challenger brand such as EDF Energy to compete for customers on standard variable tariffs. Our comments on regulation are set out in Section 25.

## 13. Relationship between standard variable tariffs and non-standard tariffs

- **From an EDF Energy perspective, standard variable tariffs and non-standard tariffs are linked.**
- **In line with our Trust Agenda, EDF Energy's strategy of fair pricing in standard variable tariffs is fundamentally linked to our ability to successfully compete for fixed price customers.**
- **EDF Energy does not have UMP in SVT.**

- 13.1 Given the asymmetric trust issue, that is, customers trust their own supplier significantly more than the market as a whole (as per the GfK NOP Survey), we recognise that how we price *in terms of standard variable tariffs* is relevant to our ability to gain customers *who are choosing a fixed-rate tariff*. [REDACTED] Offering fair prices to all customers is an important pillar in developing this trust and so we are not incentivised to have one of the highest standard variable tariffs in the market but rather one of the lowest (thus going beyond merely defending our standard variable tariff customer base).
- 13.2 EDF Energy's experience of "new acquisitions", as summarised below, reflects this dynamic:
- a) For 2014, [REDACTED]% of all new wins/acquisitions were on to fixed-rate tariffs, and [REDACTED]% on to standard variable tariffs.

<sup>27</sup> [REDACTED]

- b) For 2015 year-to-date, [%] of all new wins/acquisitions have been on to fixed-rate tariffs, and just [%] on to standard variable tariffs.
- 13.3 The fact that there is such a strong competitive dynamic in relation to fixed-rate tariffs and that trust is a key element in how we compete is also reflected in EDF Energy's development of innovative products. As explained in EDF Energy's response to the CMA initial Statement of Issues, EDF Energy has demonstrated both price and non-price competition through the development of our Blue+Price Promise tariffs, which offer a fixed price for a given period of time, with no termination fees.
- 13.4 EDF Energy's Blue+Price Promise tariffs have generally been very competitively priced and are backed by a unique commitment to tell customers at the point of sale (and on an ongoing basis) when and where they could save £1 per week or more at typical consumption, including when it is with a competitor. From inception in April 2012, EDF Energy had sent out around [%] price alerts to customers as a result of this commitment. So far in 2015, we have sent out a further [%] alerts. [%][%][%]. If we price our standard variable tariffs in a manner that attracts negative publicity, our success in the fixed-rate tariffs segment is jeopardised.
- 13.5 We note that Our Five Largest Rivals may not all have the same incentive with respect to the pricing of standard variable tariffs as they, to differing degrees, have much larger percentages of their customer base on standard variable tariffs, as shown in Figure 7, above. This may influence their price setting decisions - the fewer customers on fixed-rate tariffs a supplier has as a proportion of its customer base, the more likely it is that its pricing decisions could be based on the characteristics of its standard variable tariff customer base. If this customer base is relatively inactive then it is possible that prices may be higher.
- 13.6 We also note in this regard the lack of response of competitors to our customer engagement and pricing strategy. In terms of pricing, EDF Energy has offered the cheapest standard variable dual fuel direct debit tariff for 93 out of the 104 weeks up to 8 March 2015 compared to our Five Largest Rivals. We have also attempted to differentiate ourselves in this segment of the market e.g. by freezing prices over the winter period whilst other suppliers increased theirs. While we believe these were successful from our perspective, the impact is diluted when viewed across Our Five Largest Rivals. Hence, such initiatives did not provoke a strong competitive response.
- 13.7 The link between fixed-rate tariffs and the standard variable rate tariffs for EDF Energy is why we submit that it would not be appropriate to reach a conclusion that EDF Energy has UMP in SVT. The various initiatives that we have taken as part of our approach to competing and winning new business reflective of this dynamic are set out in Section 20 below. Thus, despite the fact that competition in fixed-rate tariffs looks more intense than in standard variable tariffs, from an EDF Energy perspective we have sought to engage all customers.
- 13.8 Since 1 November 2013, EDF Energy has launched 16 new fixed-rate tariffs – including two new tariffs launched in March 2015, as summarised below:

**Table 2 - New fixed-rate tariffs (1 November 2013 - 14 November 2014)**

Tariff Name	Tariff Launch	Tariff End	Tariff Length (Months):	Typical Annual Dual Fuel Direct Debit Bill (£):
Blue+Price Promise April 2015	01/11/2013	30/04/2015	18	£1,084
Blue+Price Promise June 2015	31/01/2014	30/06/2015	17	£1,099
Blue+Price Promise July 2015	08/04/2014	31/07/2015	16	£1,070
Blue+Price Freeeeze July 2017	08/04/2014	31/07/2017	40	£1,210
Blue+Price Promise August 2015	25/04/2014	31/08/2015	16	£1,049
Blue+Price Promise February 2016	26/06/2014	29/02/2016	20	£1,049
Blue+Fixed Prepay October 2016	08/07/2014	31/10/2016	28	£1,238
Blue+Price Promise March 2016	10/09/2014	31/03/2016	19	£1,039
Blue+Price Freeeeze May 2018	10/09/2014	31/05/2018	45	£1,210
Blue+Price Promise April 2016	06/11/2014	30/04/2016	18	£1,039
Blue+Price Freeeeze February 2018	06/11/2014	28/02/2018	40	£1,171
Blue+Fixed Price January 2017	18/12/2014	31/01/2017	26	£1,055
Blue+Price Promise May 2016	18/12/2014	31/05/2016	17	£999
Blue+Fixed Prepay March 2017	11/02/2015	31/03/2017	26	£1,229
Blue+Price Promise July 2016	05/03/2015	31/07/16	17	£965
Blue+Fixed Price February 2017	12/03/2015	28/2/2017	24	£999

*All tariff lengths shown are to the nearest month, with the Dual Fuel Direct Debit bill values based on Ofgem typical annual consumption - including VAT - and then rounded up to the nearest whole pound.*

- 13.9 With respect to pre-payment customers, due to the physical limitations of the national infrastructure, competition takes place between suppliers using standard variable tariffs. There is limited scope to offer fixed-rate tariffs as the total number of different prices (across all suppliers) and the overall level of data flows that the national prepayment systems can support is constrained.

## 14. Costs and standard variable tariffs

- **We agree with the CMA's observation that the gap between costs and standard variable tariff levels has widened over time, although we believe that, as currently shown, the analysis overstates the increase.**
- **However, the issue is complex and we have suggestions as to how to make the CMA's analysis more robust. We discuss this further in our response to the 'Cost pass-through' working paper.**

- 14.1 The UIS notes that the gap between Ofgem's SMI measure of direct costs and the average standard variable tariff seems to widen over time, and particularly from around 2009 onwards (UIS, paragraph 125). EDF Energy agrees with the CMA's observation.

- 14.2 The non-discrimination clause has had an impact on the size of the gap but this does not necessarily indicate a weakening of competition. Prior to the introduction of SLC 25A competition was via lower out-of-area standard variable rate tariffs. When these were effectively prohibited, the more actively engaged out-of-area customers generally moved away from

discounted standard variable tariffs to fixed-rate tariffs and other non-standard tariffs. This would naturally result in the average standard variable tariff increasing.

- 14.3 As previously discussed with Ofgem, we have serious concerns over the validity of key assumptions within the SMI, including the average revenue figure quoted, the 18 month assumed hedge and its underestimation of various costs, such as ECO, in earlier years.
- 14.4 More detailed comments are contained in our response to the 'Cost pass-through' working paper.

## 15. "Rockets and Feathers" pricing

- **It is difficult to reliably analyse the issue of 'rockets and feathers' pricing given the data available.**
- **The fact that profits are not excessive indicates no substantive concern.**

- 15.1 One, oft repeated, "accusation" for the industry is that "rockets and feathers" pricing occurs in the retail markets for gas and electricity domestic accounts, whereby (it is postulated) falling wholesale prices have been slow in leading to price reductions for customers. The CMA makes reference to this as an issue to be explored.
- 15.2 We do not observe rockets and feathers pricing. We are aware that the 2011 Ofgem paper<sup>28</sup> looking at the issue stated that its "analysis found some evidence that energy bills follow an asymmetric trajectory". However, we would highlight that it went on to state that "because of the number of plausible reasons for finding asymmetry, the implication for consumer harm is not clear cut". Moreover, Ofgem's analysis had significant methodological flaws (as critiqued by NERA in a paper for Energy UK in May 2011<sup>29</sup>). Ofgem's analysis (which has not been repeated) should not, in our view, become, therefore, a "stylised fact" without the evidence being conclusive or assessing its implications for competition.
- 15.3 We note that it is difficult, given the lack of data, to analyse this topic on an econometric basis and the issue is complex, with hedging and other factors being relevant.
- 15.4 One way of considering the topic is to assess profitability. We note that profits for the industry as a whole are not excessive such that, even if asymmetry in pricing is observed, any such pricing would not indicate that there is a substantive concern. Suppliers are therefore not disadvantaging customers as an overall group.
- 15.5 We cannot comment on rivals' strategies. To the extent that outcomes consistent with "rockets and feathers" pricing may be found, there are a number of possible explanations. One factor that has been relatively unexplored is the common sense observation that customers react more readily to price rises than price falls i.e. that they will more readily become active if the cost to them is increasing as opposed to falling - even if the gains from switching may be just as great if not greater in a "falling" market.<sup>30</sup>

<sup>28</sup> Ofgem, Do energy bills respond faster to rising costs than falling costs?, March 2011

<sup>29</sup> NERA Consulting, Asymmetrical Price Response in Energy Supply: A Review of Ofgem's Analysis, May 2011

<sup>30</sup> c.f. Peltzman, S. (2000) "Prices rise faster than they fall" Journal of Political Economy, 108(3), 466:501; Tappata, "Rockets and Feathers: Understanding Asymmetric Pricing, The RAND Journal of Economics, Vol. 40, No. 4 (2009), pp. 673-687; and Matthew S. Lewis "Asymmetric Price Adjustment and Consumer Search: An Examination of the Retail Gasoline Market", Journal of Economics & Management Strategy, Volume 20, Number 2, Summer 2011, 409-449, who notes "The asymmetric effect generated by the reference price search assumption is straightforward. If a cost increase puts upward pressure on prices, consumers expectations of the price distribution (based on last period's

## 16. Inactive customers

- **There are a significant number of customers that are disengaged. This is the key feature that explains the competitive dynamics observed in the industry.**

- 16.1 In the CMA's initial Statement of Issues, Theory of Harm 4 stated that energy suppliers face weak incentives to compete on price and non-price factors in retail markets due in particular to inactive customers, supplier behaviour and regulation. In its response, EDF Energy recognised that each of the explanations needed to be explored. In EDF Energy's view, what is now very clear is that the current competitive dynamic is down to customer inertia.
- 16.2 Academic observers have also identified the fact that a large cohort of customers are inactive. Waddams Price states:
- "... analysis of consumer activity in the fifteen years since choice of supplier became available indicates that many households do not switch supplier (regularly, or at all), even though there are substantial gains available, around £350, or 30% of the bill, for those who have never switched supplier and are using 'traditional' payment methods. Some of this 'inertia' can be explained by preference for a particular supplier or payment method or high costs of searching and switching. But there is particular focus on the energy sector because of its rising cost and price (for environmental and security of supply reasons), and the affordability problems which face many low income households."<sup>31</sup>
- 16.3 We agree with the above.
- 16.4 Ofgem states in its January 2015 submission<sup>32</sup> :
- "3.5. The combination of a high proportion of sticky consumers in the legacy supplier customer base, the uneven distribution of sticky consumers between legacy suppliers and independent suppliers and the ability of suppliers to segment the market between sticky and active customers, weakens competitive pressure on the legacy suppliers. Because they can compete by providing competitive tariffs to their active consumers, without having to drop prices and worry about losing their sticky customer base, legacy suppliers are likely to have weakened incentives to take steps which might benefit all consumers such as improving customer service or improving overall efficiency."
- 16.5 EDF Energy disagrees with Ofgem's description. In addition to our experience that our actions in standard variable pricing directly impact our ability to compete in gaining customers on our fixed-rate tariffs (as described in section 13 above), Ofgem does not recognise the difference in positions *between* the so-called legacy suppliers. It is important to understand, empirically, the profile of a given supplier's customer base, including how many and what proportion of their customers are inactive.
- 16.6 Our experience strongly points to the explanation of the competitive dynamic seen in the market being the impact of inactive customers, some of whom face real or perceived barriers to engaging. We feel that the matter is more complex than Ofgem articulates. With our larger fixed-rate tariff customer base and incentive to grow, EDF Energy perhaps has a different competitive incentive to some of our larger competitors who have a much larger inactive

prices) will tend to be too low, causing them to search more than they otherwise would. More search leads to lower margins and less price dispersion. On the other hand, when costs and prices are falling, consumers will tend to search less generating higher margins and price dispersion." These models are independent of market power and any form of collusion/coordination.

<sup>31</sup> Waddams Price, Simplifying Tariffs in Regulated Industries, October 2014, paragraph 4.

<sup>32</sup> Ofgem, Incumbency in the retail energy market, January 2015

customer base. These inactive customers are a much higher proportion of their customer base and so these suppliers may not have the same incentive to price their standard variable tariffs so as to position themselves to win more customers on fixed-rate tariffs.

- 16.7 That said, it is difficult to be precise as to what constitutes an inactive customer. It is not simply a customer who is on a standard variable tariff or one who can be readily identified by length of term, at least for EDF Energy. This is illustrated below in Figure 8. It can be seen that there are a material number of customers who are on non-standard tariffs even if they have been with EDF Energy over five years.

**Figure 8 - EDF Energy customer base by length of term split by tariff type (as at 1 March 2015)**

[REDACTED]  
[REDACTED]  
[REDACTED]

- 16.8 In our view, it may be helpful for the CMA to examine the issue as a percentage of total customers in an area who have been with the incumbent for more than 10 years (or whichever period the CMA considers appropriate), rather than simply consider customers on standard variable tariffs. The least active of such customers are those on electricity-only standard variable tariffs. On this basis, an analysis of our own data would be as follows:
- a) There are [REDACTED] million customers (electricity, gas or dual fuel) that would be classified as in-area for EDF Energy (London, South East and South West regions). EDF Energy supplies [REDACTED] million of these customers, or [REDACTED] %.
  - b) Of these [REDACTED] million customers, [REDACTED] have been with us more than 10 years and of these [REDACTED] are on standard variable tariffs.
  - c) We have [REDACTED] electricity-only customers in-area that have been with us for more than 10 years.
  - d) Therefore, when considering our total customer base of [REDACTED] million, [REDACTED] % of our customers might be considered inactive if using this measure. We would recognise that there are degrees of inactivity and the line may be drawn in a different place by the CMA.
- 16.9 At times, the terms “inactive” and “vulnerable” are used interchangeably by some stakeholders. EDF Energy believes that a more nuanced view is necessary and that all inactive customers are not ‘vulnerable’, and neither are all vulnerable customers inactive. Our evidence demonstrates this point. There is no single measure of “vulnerability” but one simple metric that helps to explain the issue is the number of customers on the PSR. EDF Energy has around [REDACTED] such customers and of these, around [REDACTED] or [REDACTED] % are in the most inactive category described in (c) above. There is therefore no difference in terms of proportion of inactive customers as defined by this measure for this cohort of vulnerable customers as compared to our customer base as a whole. Indeed, 47% of PSR customers are on fixed-rate tariffs, as compared to standard variable tariffs, which is greater than the proportion for EDF Energy’s customer base as a whole (40%).



## 17. Gains from switching

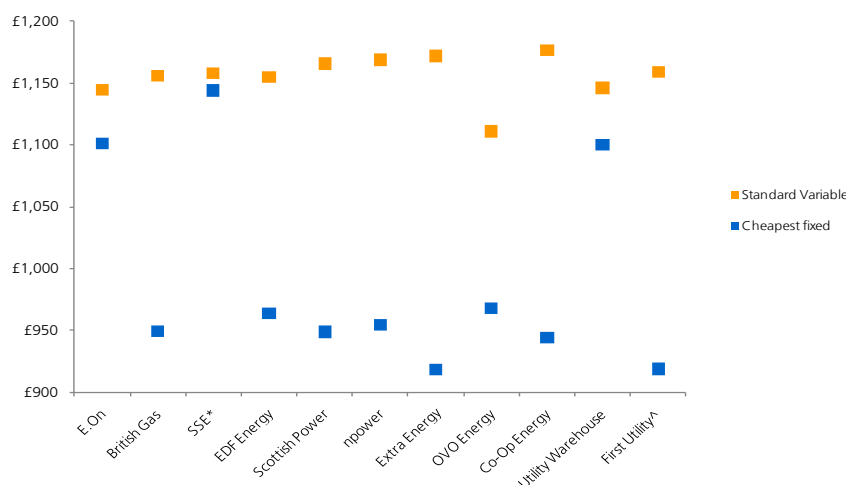
- **Price differentials exist and are normal. Indeed they are essential to drive engagement.**
- **We agree that significant gains from switching are available to some customers.**
- **The potential switching gain is generally higher than customers say they need to switch. This may indicate that an issue with engagement exists.**
- **Care needs to be taken in the analysis and presentation of results on this topic. It is our view that the CMA's analysis can be developed to provide a more robust picture of the current situation.**

- 17.1 Price differentials are not a problem per se, and can reflect a competitive market. Indeed price differentials are essential to drive engagement as they constitute a signal to switch through indicating the gains from doing so. We note the fact that prices remain materially higher in standard variable tariffs as compared to fixed-rate tariffs without substantial switching may indicate an underlying substantive concern. Research indicates that the vast majority of customers say they will switch for the savings available today<sup>33</sup>. In reality, they do not.
- 17.2 In its January 2015 submission to the CMA, "Incumbency in the retail energy market", Ofgem states that:
- "3.3. Most recently competition has focussed on the price charged for fixed-term deals. As shown on the chart below [omitted], dual-fuel customers of large suppliers on standard (ie evergreen) tariffs and those on standard single fuel offers pay more than those on fixed-rate tariffs (ie cheapest dual-fuel online tariff). Most recent trends have shown an expanding differential between those on evergreen tariffs and those on the cheaper online fixed tariffs.
- 3.4. In December 2014 a consumer on a single-fuel tariff on standard credit with their incumbent supplier could save up to £350, 27 per cent, by switching to the cheapest online dual-fuel deal and a consumer on an evergreen standard direct debit tariff with a large supplier could save on average over £200, 20 per cent."
- 17.3 Ofgem has continued to comment on the price differential, most recently in a press release of 23 January 2015:<sup>34</sup>
- "Recent research from Ofgem has shown that the gap between average variable tariffs and the cheapest fixed tariffs is so wide most consumers would be better off on a fixed deal. Despite the recent cuts to variable prices, the potential saving of up to £250 means that most consumers would be better off moving to a fixed deal."
- 17.4 In the UIS, the CMA identifies some potential gains from switching. For any given relevant customer, we agree that there are substantial savings to be made. Our own analysis illustrated in the graph below is that switching from standard variable tariffs to fixed-rate tariffs without changing supplier (i.e. the least effort switch) would result in an average saving of £164 (£191 for EDF Energy) for a given customer. It should also be noted that the differential pricing between fixed and variable is not confined to large energy suppliers; the largest difference we observed was for Extra Energy, which has a differential of £254.

<sup>33</sup> Ipsos MORI, supra footnote 3. This finds that on average that customers would switch for a saving of ~£150.

<sup>34</sup> <https://www.ofgem.gov.uk/publications-and-updates/energy-customers-who-don%E2%80%99t-fix-could-be-paying-%C2%A3250-more-needed>

**Figure 9 - Gains from switching - standard variable tariff compared to cheapest fixed-rate tariff available for that supplier (as at 9 March 2015)**



\* Indicative prices effective from 30 April 2015 ^ Effective from 1 April 2015

- 17.5 We agree with the CMA's view, as stated in the working paper 'Gains from Switching', that the potential savings calculated in our analysis should be interpreted as a measure of domestic customers' engagement with the market and price differences among suppliers, whilst we note that price is not the only factor a customer considers when making a choice.
- 17.6 We also agree that the results cannot be relied upon to measure aggregate welfare loss, as the equilibrium prices for retail gas and electricity would be likely to change if all customers who are currently paying higher prices switched. However, we note that this was still reported as such in the media. The fact that under such a scenario the size of available savings would be expected to reduce significantly and that some customers would actually see price increases has not been clearly communicated or explained in the analysis.
- 17.7 Overall, while we recognise the CMA's interest in considering the size of potential savings available to customers, it is important that a more robust model and assessment is developed before it could be used in the design of any remedies.
- 17.8 For further details, see our response to the 'Analysis of the potential gains from switching' working paper.

## 18. Barriers to engagement

- **Our research shows that customers have trouble engaging in the market. Amongst the market features making engagement difficult are market complexity, difficulty accessing unbiased information about available tariffs, perceived difficulty of switching, and a lack of trust in rival suppliers.**
- **EDF Energy has done much to encourage engagement. This has largely been driven by taking a longer-term view of our relationship with customers. As a result we have a relatively large share of fixed-rate tariff customers (40%).**
- **However, we have been limited in our course of action as taking action unilaterally in a competitive market can lead to a commercial disadvantage.**

### *Introduction*

- 18.1 We respect the right of customers to choose to be active to a greater or lesser degree. However, the level of switching, particularly given the significant level of gains available for some customers, does illustrate that barriers to switching should be considered. Some observations are set out below. We note that many of our views, which are based on customer research, seem to be reflected in the GfK NOP survey.
- 18.2 At the simplest level, the reason customers have not switched, or do not switch more often - or consider doing so - is because the perceived benefit is not considered to outweigh the perceived effort: see Waddams Price and Waddams Price/Zhu<sup>35</sup>. The latter state:
- "Our model predicts well the factors associated with consumer market activity in our sample, finding that *higher levels of searching and switching are associated with greater anticipated gains* and lower expected time needed to switch; this is consistent with anticipated gains stimulating engagement and switching time deterring it. Moreover while the time to search has little deterrent effect, suggesting that it may be intrinsically more enjoyable or less stressful than the switching process, the expected time to switch seems to discourage both searching and switching." (emphasis added)
- 18.3 The fact that there is further work to do to identify all the drivers is also noted:
- "...while our findings can inform strategies to increase activity amongst those who are already reasonably well informed about the market, effects may be very different amongst the more 'disengaged' half of households who disproportionately represent lower income and older (and younger) households. If activity among this latter group is to be encouraged, research is clearly needed to understand further the drivers of (in)activity."

### *Understanding inactivity*

- 18.4 In discussing barriers to engagement, it is important to recognise that not all customers who have not switched, or do not intend to switch an energy fuel face a barrier to do so, whether practical, economic or emotional. Their choice must be respected.
- 18.5 Within the groups who are not switching energy supplier there are drivers which range from "neutral" to "actively positive" on both practical and emotional considerations. Customers can remain with a single supplier while also being engaged.
- 18.6 Considering price and the potential gains from switching, it is our view that some dual fuel customers consider they have already gained from the most substantial saving available as part of

<sup>35</sup> Empirical Evidence of Consumer Response in Regulated Markets, supra.

their original switch and have a sense of assurance from having at least switched once. This assessment by customers will range in its rational basis from a hunch to actually checking prices.

- 18.7 In general, EDF Energy's experience is that people are active when there is a clear benefit to doing so, or equally to avoid a negative aspect such as financial loss<sup>36</sup>. For a customer to consider and complete an energy switch, certain fundamental factors need to be satisfied:
- *Confidence* - they understand the market well enough to make a decision;
  - *Reassurance* - that switching is the right thing to be doing and that they are not being taken advantage of; and
  - *Risk Mitigation* - that the decision they are making has minimal risk associated with it.
- 18.8 A key issue is that some customers perceive that it is difficult to compare tariffs and as a result they are not sure that they will make the correct decision. Indeed 73% of customers believe that energy tariffs are deliberately confusing which makes comparing them hard and switching less likely<sup>37</sup>. However, the reality is that amongst those that have switched at any time in the past, 73%<sup>38</sup> agree that it was easy.
- 18.9 Evidence suggests that simplifying the structure of tariffs would make comparison much easier for customers and increase the rate of switching. In an Ofgem survey<sup>39</sup> removing the variable standing charge doubled the number of people that identified the best deal, improved the speed of decisions and the probability of switching.
- 18.10 A similar survey on unit rate pricing conducted by EDF Energy found that when the tariff structure was simplified twice as many customers were able to pick the cheapest tariff and on average they did this in half the time. We would be happy to share these results with the CMA.
- 18.11 In our view, the most commonly occurring aspects of a possible switching decision include the following:

**Table 3 - Rational and emotional drivers of switching**<sup>40</sup>

Positive	Negative
Preference for a particular brand or product	The inability to differentiate between energy tariffs or services
Active and educated research-based decision for no action	The risk and uncertainty of making a wise decision
Rational assessment of saving available and decision for no action	The potential to unknowingly be paying more than before the switch
Long service history with no problems	The potential impact of service disruption

- 18.12 When directly questioned as to why they had not switched, single fuel (with mains gas) customers responded as shown in Figure 10.

<sup>36</sup> See also Ipsos MORI, Customer Engagement with the Energy Market: Tracking Survey 2014, A report prepared for Ofgem, supra.

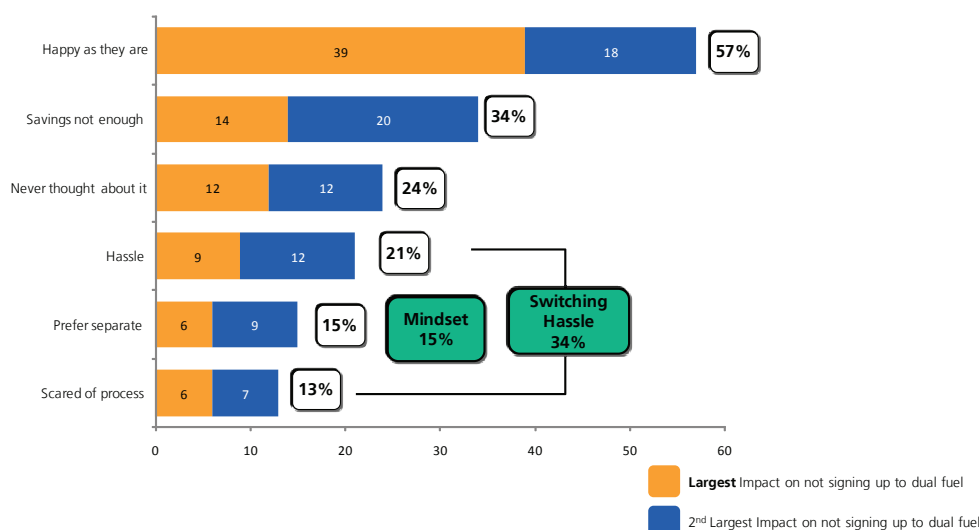
<sup>37</sup> RMR baseline survey 2014, 6151 quantitative F2F interviews. Commissioned by Ofgem with TNS BMRB.

<sup>38</sup> Supra.

<sup>39</sup> Consumer reactions to varying tariff comparability 2011, 2000 online & 202 F2F quantitative interviews, Commissioned by Ofgem with Ipsos MORI

<sup>40</sup> Source: EDF Energy. Points made are based on the qualitative projects cited, and also drawn from the full range of EDF Energy's insight activity.

**Figure 10 - Strongest reasons for not taking Dual Fuel (agreement with statements, summarised to category)**



Source: ICM Research, online omnibus January 2012, 200 sample

- 18.13 57% of customers being 'happy as they are' is a material amount. However, some of the other reasons are concerning from a competition perspective.
- 18.14 Care must be taken when interpreting this data as a survey of this type cannot reflect the entire complexity of decision drivers, and indeed these drivers are likely to have changed significantly over the period since the energy sector was opened up to competition.<sup>41</sup> Figure 11 shows the summarised results from EDF Energy's 'losses' survey<sup>42</sup>.

**Figure 11 - Summarised Losses Reasons to Leave / Triggers - Q3 2014 v Q3 2009**



- 18.15 The reasons to leave have not changed much over the period but the triggers to leave have done, due to the evolution in sales channels. In 2008, energy switching rates peaked at an annual 20% rate, with approximately 70% of these switches driven by a salesperson. When these channels were withdrawn, the impetus for switching shifted on to the customer. This has removed an important trigger for switching to take place.
- 18.16 The survey data from the Ipsos MORI Engagement tracker 2014<sup>43</sup> conducted for Ofgem with a focus on those groups who might be considered vulnerable also provides some useful indicators:
- The fundamental barrier to engagement with the energy market would be lack of knowledge that it is possible to switch to a different supplier. The characteristic that appears to display the most significant differential on this question is Ethnicity.

<sup>41</sup> The ways in which these drivers influence an energy purchase decision are highly influenced by the sales channel, which has changed greatly in the last few years.

<sup>42</sup> This is a monthly survey completed by an external research partner which contacts customers to find out the reason why he or she left EDF Energy.

<sup>43</sup> Supra.

- b) A similar disparity can be seen comparing the lowest socio-demographic groups to the highest (71% awareness for DE groups compared to 94% in AB groups). These awareness gaps then translate into similar differential in 'ever switched' proportions.

18.17 The report states:

"Among those who never switched supplier, awareness that it is possible to do so is stable at 84%. Those still unaware comprise 9% of all energy customers. These are primarily people on PPMs ["Pre-Payment Meters"], standard credit or quarterly direct debit, social grades C2, D and E, those from BME groups and those who rent their homes. They also comprise disproportionately of those who are falling behind or occasionally struggle to pay their household bills." (page 7)

18.18 The GfK NOP report identifies customers' trust in their own energy supplier, which is far higher (62%) than for others (27%), as something which may be a powerful barrier to change for those who are uncertain. This chimes with a point made previously by EDF Energy, namely that there is a need for the regulator to contribute to 'trust' as otherwise customers are likely to be more reluctant to switch.

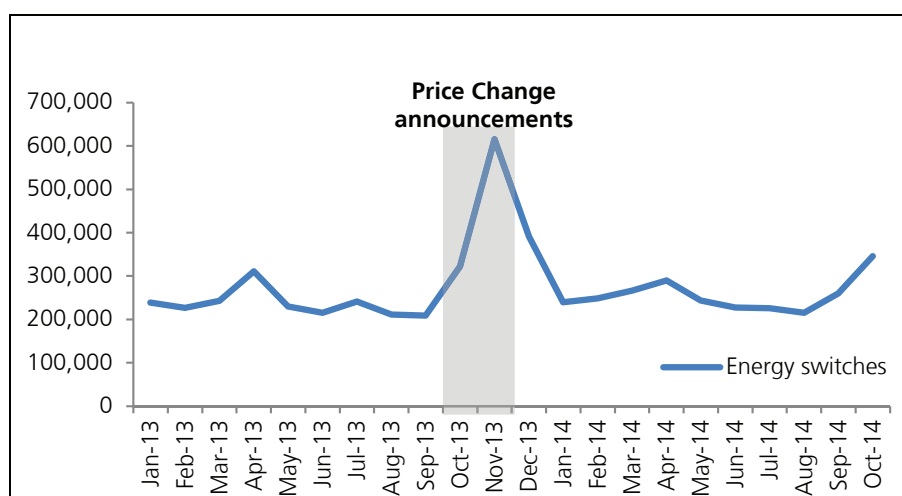
### *Behavioural factors and the importance of triggers*

18.19 There are "behavioural" factors that help explain (in part) the inertia or lack of engagement identified, and these factors have become increasingly important with a reduction of 'push' sales channels such as doorstep selling and outbound sales calls as described above

18.20 The trigger to review and switch supplier has evolved in recent years, and at least partly explains any changes in switching rates through time. Overall the types of barriers to switching have remained consistent, but their impact varies depending on the trigger to switch. For example, triggers more likely to cause the consumer to react (e.g. contact from other supplier) can help overcome the inertia because the customer is prompted with a clear compelling reason to choose another supplier as part of the sales process. The changing landscape of the switching channels used and the growth of fixed-term tariffs (and therefore contract expiry) has meant that switching in the energy market has become heavily reliant on customer triggered engagement.

18.21 Home move and contract end now provide two of the biggest triggers to choose another supplier. Trigger events can also be market wide. For example, the price change events and increased media scrutiny seen in Q3/Q4 2013 drove very high switching volumes.

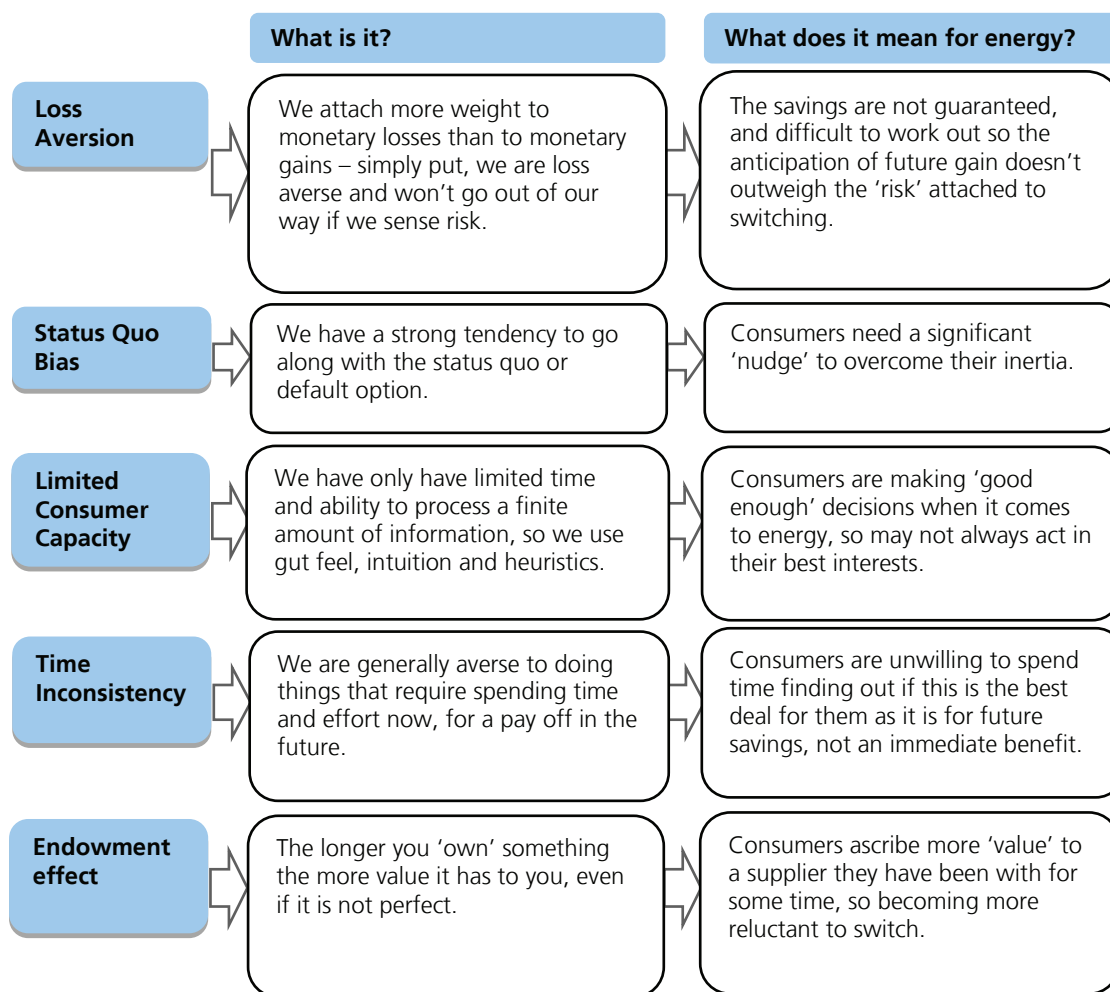
**Figure 12 - Impact of price change announcements on switching levels**



Source: Energy UK switching figures

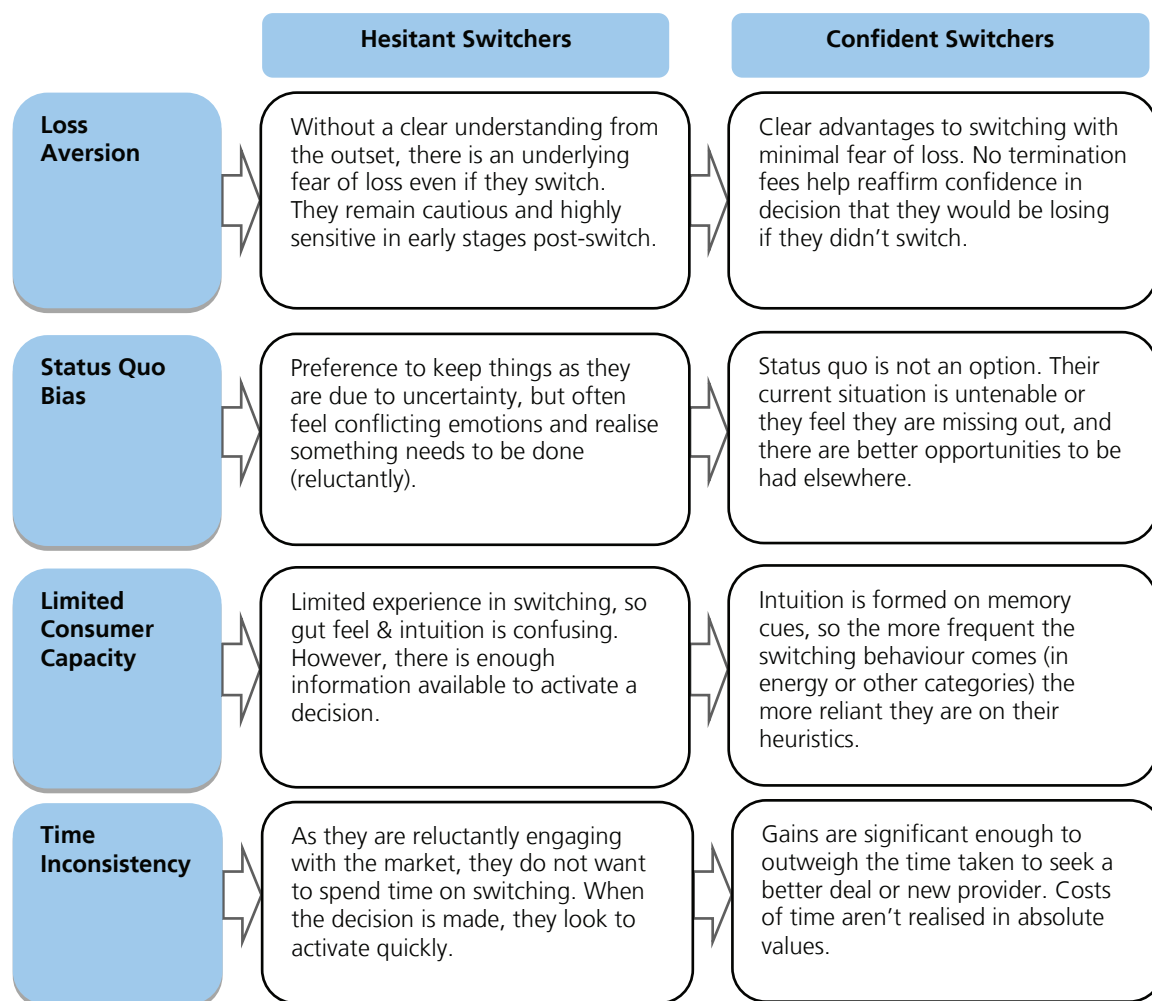
18.22 Our research suggests that it is helpful to examine customer behaviour in terms of confident switchers and hesitant switchers. This is illustrated below in Figure 13 and Figure 14.

**Figure 13 - Behavioural framework of activity<sup>44</sup>**



<sup>44</sup> Source: EDF Energy internal view



Figure 14 - Hesitant Switchers v Confident Switchers<sup>45</sup>

*EDF Energy observations potentially relevant to the CMA*

18.23 This has led us to the following conclusions / observations, which may be relevant to the CMA going forward:

- a) Clearly, active engagement in the energy market includes those who switch between energy suppliers for one or both fuel types<sup>46</sup>.
- b) We would highlight that being active does not equate simply to those who have switched. Rather, it relates to those customers who have engaged, i.e. those who have made an active choice. In this regard, activity, or engagement, could be argued to relate to those moments during which customers actively consider their choice of energy supplier, energy tariff or ancillary energy service or when they seek advice or information about energy usage or the energy market in general. With this in mind there may not always be visible indicators for activity, as these considerations may not necessarily result in positive, demonstrable action.

<sup>45</sup> Source: EDF Energy internal view

<sup>46</sup> Switching rates have been in decline over a number of years since their peak in 2008. This has been due to a number of factors, in particular the shift from push sales channels, such as door to door, to pull sales channels, such as online. The reduction in the use of the push sales channels has led to a reduction in the triggers for customers to engage and switch supplier, and in turn an increase in the proactive engagement needed from customers to switch.

- c) Hence, an active customer also includes one that considers internal switching from a tariff such as standard variable to a fixed-rate tariff<sup>47</sup> and those that consider switching but do not change for positive reasons.
- d) There is a likely 'status quo' bias which prevents customers choosing another supplier which will be amplified by apathy. The GfK NOP report for the CMA (February 2015) appears to confirm this (see paragraph 8).
- e) Triggers are important for customer engagement. Key triggers for engagement in general can be summarised as follows<sup>48</sup>:
  - i. Existing fixed tariffs coming to an end, meaning people are 'in the market'.
  - ii. Market disruption in the form of price change events.
  - iii. Other providers can push people out with bad service and other bad experiences.
  - iv. Direct Debit reviews can act as a trigger to seek better value.
  - v. Although word of mouth and third party feedback can be a barrier, it can also act as a trigger.
  - vi. Other providers offering better value and making people aware of it (better tariffs).
  - vii. Life changing events such as moving home can present a chance for fresh change and a market review.
  - viii. Household circumstance can also trigger a review of the market (decreased income, general review of all suppliers).
- f) The mere receipt by a customer of a letter saying that there are options available does not indicate engagement. This is illustrated by tariff closure letters. An analysis of this mode of triggering engagement shows that some customers can become active by having clear information but that there nevertheless exists a cohort of customers that remain inactive. For example, [X]% of residential customers on an EDF Energy product closing in Q1 2014 took action at this point - but a substantial body did not respond. A number of proactive steps were necessary by EDF Energy to achieve this result, which are not necessarily replicated across all suppliers.
- g) It may be worth the CMA considering whether certain ancillary services (such as boiler maintenance services) may increase barriers to switching through materially increasing levels of customer inertia in the retail supply market. Customers may be unaware that such services are standalone and hence assume that they are tied in. Further, we believe that this may not helped by some advertising campaigns.

<sup>47</sup> One of the key measures of customer engagement is the proportion of customers who actively choose to sign up to a fixed-rate tariff versus remaining on an evergreen, generally standard variable, tariff. If this move is made within the customer's existing supply relationship then it will generally not be counted by the 'switching rate' metric that is the headline figure for consumer energy engagement. In fact, this engagement can be undercounted multiple times as these customers may engage and renew with the same supplier multiple times.

<sup>48</sup> Source: Strategic Target research 2014, 10 in home qualitative depth interviews & 6 qualitative mini-groups, Commissioned by EDF Energy with Relish Research.

## 19. Barriers to engagement: Vulnerable groups

- 19.1 One perceived barrier to engagement and activity is vulnerability. EDF Energy's insight, despite the fact that some commentators have tended to treat the concepts of 'vulnerability' and 'disengaged'/'inactive' as synonymous, shows that from a quantitative data perspective this is not correct. While there are some significant correlations between 'never switched' groups and some of the characteristics that could contribute to vulnerability (e.g. age), it is not correct to simply equate the concepts. 47% of our customers on our Priority Service Register are on fixed-rate tariffs compared to 40% of our overall customer base:
- 19.2 If, for example, we look at the EDF Energy tariff that offers the longest price security and take a typical 'vulnerable' group label such as age 75+ and in socio-economic groups D/E, we find that the proportion on the Long Term Fix product is almost the same as in the general population (7% v 8%). This group has actively engaged in the product market and chosen a product that offers price security. In fact, across the EDF Energy Blue fixed-rate tariff range, older age groups are actually over-represented. As previously noted, having once made this tariff choice these customers would then tend to engage on an ongoing basis as they go through the ongoing renewals/product transfer process.
- 19.3 This is further supported by Waddams Price/Zhu<sup>49</sup>, who state:
- "Our findings question the type and value of blanket intervention for groups who may be considered vulnerable because of age, low income or low education achievement. Once other factors are considered, they are neither less active nor less responsive to changes in expected gains and switching time amongst the group who are knowledgeable about opportunities and costs. Indeed all show signs of responding more to these stimulants than other groups in the population."
- 19.4 There may be a need to improve competition for, or to protect, vulnerable customers who are also disengaged and cannot be reached by a general remedy, although they may be difficult to identify accurately. In the past, EDF Energy has tried to offer a dedicated 'Price Reassurance' tariff to such customers but we were forced by commercial factors to withdraw this. The steps taken by EDF Energy with respect to vulnerable customers over time are set out below in Table 4.

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<sup>49</sup> Supra.

**Table 4 - What EDF Energy has done for vulnerable customers**

Initiative	Voluntary	Regulated /Funded by Warm Homes Discount
<b>Independent Trust Fund</b>	2003-2011	April 2011 onwards, funded as part of our non-core obligation for WHD
<b>Social tariff for vulnerable customers</b>	2006-2011	April 2011- Sept 2013, funded as part of our non-core obligation for WHD. [REDACTED]
<b>Citizens Advice debt line</b>		Launched 2012. Funded as part of our non-core obligation for WHD. Award winning service receiving a Business in the Community ("BiTC") award for Building Stronger Communities in 2012. The Helpline has been recredited a 'Big Tick' by BiTC for the third year in a row.
<b>Personalised Support Service</b>	2012 Goes beyond what is required by regulation to support our customers	
<b>Internal campaign on vulnerable customers</b>	April 2014 – Customer Service briefing, Pulse, Face2Face	
<b>Benefit Check and Support Service</b>		2014: funded as part of our non-core obligation for WHD. Customers accessing the service increase their household income by average £350 per annum - can make long term, sustainable difference to household budget
<b>Digital tool for Personalised Support Service</b>	Jan 2015: accessible to customers, third party organisations and our own customer service agents. Helps identify the services vulnerable customers are entitled to from EDF Energy	
<b>Vulnerable customer price change campaign</b>	9 March 2015: email and direct mail to around [REDACTED] customers (PSR and those claiming WHD in past) to contact us to check if they can get better/ cheaper tariff and let them know about digital tool	

## 20. EDF Energy's initiatives with respect to customer engagement

- 20.1 The framework of analysis described in Section 18 has assisted EDF Energy in its attempts to encourage activity amongst energy customers. In particular, EDF Energy has been able to increase this by providing a "nudge" for engagement. We have sought to do this through reassurance and transparency. In tariff terms, this gave rise to our fixed price Blue+Price Promise tariffs.
- 20.2 [REDACTED]
- 20.3 There are a range of indicators from our Blue+Price Promise customers to indicate that they have the most positive relationship with EDF Energy in comparison to our standard variable customer base, and in that respect are our most engaged customers. The 'Net Promoter Score'<sup>50</sup> ("NPS") for this group, ([REDACTED]), is high against industry norms, and product knowledge is good ([REDACTED]% aware of Fixed Price element, [REDACTED]% aware that there is no termination fee, [REDACTED]% aware of the Price Promise feature and [REDACTED]% aware of the low carbon generation source).

<sup>50</sup> The NPS measures how likely a customer would be to recommend a company. Customers respond on a 0-10 point rating scale and are categorised as one of "Promoters", "Passives" and "Detractors". NPS is calculated as the percentage of customers who are Promoters less the percentage that are Detractors.

- 20.4 Furthermore, EDF Energy's strategy to engage all customers can be summarised as a set of activities as shown in Table 5 below.

**Table 5 - EDF Energy's engagement strategy for standard variable tariff customers**



- 20.5 The effect of such steps in terms of customer engagement can be seen in the evolution of EDF Energy's customer base and overall product mix, including as compared to some of our main competitors.
- 20.6 The evolution of our customer base over time is illustrated in Figure 15 below.

**Figure 15 - EDF Energy customer accounts by tariff type over time<sup>51</sup>**



- 20.7 Thus, to a certain degree, EDF Energy has been successful in engaging with its customers, taking the increase in fixed rate tariff customers as evidence of that. The majority of these are on to our Blue+Price Promise tariffs.
- 20.8 While EDF Energy believes that this is evidence that many customers engage when they can see significant and easy to access savings<sup>52</sup>, despite EDF Energy's efforts a substantial body of customers remain disengaged. We believe that taken together across the largest suppliers, the number of disengaged customers is likely to be significant (using standard variable tariff customers as a crude proxy).
- 20.9 As stated above, EDF Energy recognises that some such customers are 'loyal'; trusting their supplier and being happy with the service quality they receive and price they pay; they are "positively" inactive. We note that it may sometimes be difficult to distinguish between the two (as loyal customers may be aware of their ability to switch but feel no great need to assess their options at a given point in time) and there remains a large cohort of customers in the domestic retail energy sector that are inactive in the sense that they do not choose another tariff or supplier even though it is rational for them to do so from a price perspective.

### ***Conclusion***

- 20.10 It is the combination of customer inactivity and the ability to identify such customers that gives rise to the issues identified by the CMA. EDF Energy can state this with reasonable confidence as our Trust Agenda has focussed on customer-centric considerations supported by a long-standing commitment to customer research. To put this into context, during 2014 EDF Energy drew insight from approximately [redacted] customers.
- 20.11 EDF Energy has had a strategy of encouraging engagement and the adoption of fixed-rate tariffs, and this has been relatively successful. We have continued to communicate with all our customers on standard variable tariffs that better deals are available, under Ofgem's mandated Cheaper Tariff Messaging on Bills and Statements, and our initiatives have actively sought to overcome inactivity rather than to maintain it. However, we face difficulties in competing for the inactive customers of our competitors.

<sup>51</sup> Source: EDF Energy.

<sup>52</sup> A change of tariff on EDF Energy's systems is instantly available and EDF Energy does not have termination fees on any of its tariffs, so customers can move between tariffs at will.

- 20.12 The great efforts needed in order to engage customers, the fact that engagement is incomplete, and the high number of standard variable customers of competitors all constitute evidence in support of the concerns identified by Ofgem and now the CMA. The steps that EDF Energy has taken do not enable us to reach a large number of the inactive standard variable tariff customers of our rivals.

## 21. Price Comparison Websites

- 21.1 PCWs represent an important channel for sales. In 2013, we paid £[X] million commission for the [X] switches that took place. In 2014, we paid £[X] million commission for the [X] switches that took place.
- 21.2 We believe PCWs have an important role to play in the market but recognise that there is a tension between earning commission and offering impartial advice. This may lead to outcomes which are not in the best interests of customers
- 21.3 EDF Energy believes that there should be a standard requirement, through a strengthened confidence code or direct regulation, for any tariff comparison that is not a comprehensive view of the market to be clearly and prominently marked as such. There is a role for commercial PCWs and we are aware that having to show all available tariffs (whether or not there is a commercial relationship) could have unintended consequences such as market exit. Therefore, it would be acceptable if they did not show all tariffs as standard.
- 21.4 It is our view that PCWs are currently not all as transparent as they should be. By default some PCWs only show the tariffs which they are paid commission on and sell to customers, and the ability to display all available tariffs in the market is not clearly indicated to customers.
- 21.5 We therefore support clear and prominent labelling of tariff comparisons where they do not include all available tariffs in the market and transparency regarding commissions.
- 21.6 In addition, the standard personal projection view of savings (as defined by Ofgem) could potentially mislead customers as to the size of the savings they can make against their current energy prices. We support development of a revised standard savings calculation.
- 21.7 We believe that suppliers should be able to offer different prices for customers approaching them directly as opposed to through a PCW. Under RMR, this can only be achieved by using one of our four tariffs as it is currently not possible to sell the same tariff at two different prices. Suppliers cannot provide a cash discount as this would not be considered an allowable discount under the RMR. The four-tariff rule does not provide sufficient options to enable suppliers to offer separate direct-only tariffs.
- 21.8 We also believe that Collective Switching deals should be available to both new and existing customers and that Ofgem's current exemption should be removed. We would highlight that there may be "auction design" issues around Collective Switching - if the supplier does not know how many customers they will gain and likely volumes, it is less incentivised to lower its price as there is uncertainty with respect to volumes it is bidding for - and, under auction design theory, uncertainty reduces value.
- 21.9 EDF Energy has expressed the view in other fora that PCWs should sit alongside an independent tariff comparison service, available through online and offline channels, funded by the industry that includes every tariff available in the market – targeted at those who cannot engage but open to all. Such a service may, for example, be used to reach very inactive and/or inactive vulnerable customers.

## 22. Smart meters

- 22.1 The CMA seeks further views and evidence on the likely size of the benefits of moving to smart meters, and on any regulatory or other barriers to ensuring the benefits of smart meters are realised in practice.
- 22.2 EDF Energy is fully committed to the rollout of smart metering across Great Britain. Smart metering creates transformational opportunities for both customers and suppliers, by ending estimated bills and enabling customers to benefit from a greater understanding of their energy usage and by providing tools to assist customers in managing their demand. Smart meters also open the door to the potential for a wider range of energy related products and services to be brought to market. Smart metering is a critical enabler to the future integration of low carbon technologies (electric vehicles, heat pumps and micro generation) along with Smarter Grids, in to the wider industry infrastructure, and will help the UK to meet its carbon targets.
- 22.3 Great Britain's approach to smart metering is unique, and tends towards a greater complexity and cost compared to other programmes worldwide. The GB Smart metering programme is attempting to deliver many unproven technologies and approaches, including: sophisticated and leading edge metering technology, home area communications, machine-to-machine national communications infrastructure, a centralised communications hub serving 30+ enterprise users, multiple communications protocols and public key infrastructure as part of end-to-end security.
- 22.4 While we expect smart meters to help improve the competitive dynamic, we doubt that they will solve the customer engagement issue alone. There are also a number of hurdles to be overcome, which we explore further in the Annex, alongside our views on the costs and benefits of the smart metering programme.

## 23. Supplier behaviour

- 23.1 The CMA refers to not yet having "taken a view on the strength of arguments that the Six Large Energy Firms attempt to keep their SVT customers disengaged, so as to retain them on high tariffs" (UIS, paragraph 145). Whatever the position may be for Our Five Largest Rivals, EDF Energy submits that this is demonstrably not the case for ourselves. Indeed, EDF Energy's reasonably strong views on customer inactivity as a barrier to switching and a feature giving rise to competition concerns stems from the results of our *proactive* strategy to be a challenger. This is centred on establishing a reputation of trust, part of which has been to seek to *increase* the levels of engagement of our customer base, including customers on standard variable tariffs.
- 23.2 As such, EDF Energy would observe that, no matter what findings the CMA may draw from an analysis of EDF Energy's competitors' behaviour, EDF Energy has not engaged in behaviour designed to maintain its customers on standard variable tariffs. One element of this has been for EDF Energy to try and encourage its customers to take the best deal for them. The steps taken are covered in more detail in Section 20.
- 23.3 Overall, we have increased the proportion of fixed-rate tariff customers. Comparing the position to 2011, there are now [X] more EDF Energy customer accounts on fixed-rate tariffs as compared to standard variable tariffs, such that we now have [X]% of customer accounts<sup>53</sup> on a fixed-rate tariff. This would be greater but for the limitations that currently exist with respect to offering tariffs to customers on pre-payment meters. We believe that this should be addressed by the roll-out of smart metering.
- 23.4 The table below illustrates the impact of the Blue+Price Promise tariff:

<sup>53</sup> For EDF Energy in 2014 this equated to 40% of customers.



**Table 6 – Volume of internal customer account switching to fixed-rate tariffs from standard variable tariffs (up until 25 January 2015)**

[X]

[X]

[X]

## 24. Tacit coordination on price announcements

- 24.1 EDF Energy agrees with the indication of the CMA's thinking, namely that there is no tacit coordination with respect to price announcements, or any other aspect of the retail markets.
- 24.2 There are a number of conditions which would prevent tacit coordination taking place. These include the large number of and lack of symmetry between participants, lack of a visible punishment mechanism for not coordinating at any level, apparent ease of entry at the retail level, and presence of maverick rivals. In particular,
- a) There is strong competition in the retail markets overall with different cost structures, such that incentives and business drivers are different across suppliers. There is significant and ongoing new entry taking increased market share. This means that any coordination could not be maintained.
  - b) In terms of standard variable tariffs, the strategies of those larger suppliers with a large inactive customer base are heavily influenced by their own customers' lack of engagement.<sup>54</sup> We have noted above how engaged EDF Energy's customer base is.
  - c) Whilst transparency has increased and tariffs have been simplified there are still huge amounts of uncertainty in trying to understand competitors' costs and possible strategies.
  - d) As the CMA notes, no announced price rise in relation to standard variable tariff prices changes was subsequently reversed due to the response of competitors.
  - e) EDF Energy has a long held strategy of challenging the status quo, whether through having the lowest standard variable tariff and through our drive to increase customer accounts.
  - f) It is also hard to understand why EDF Energy would coordinate with our rivals when we have been loss making in our domestic supply business. We are incentivised to behave differently.
- 24.3 In addition, with respect to customers on standard variable tariffs, if there were to be a high correlation with customer inactivity, there is no need for tacit coordination.
- 24.4 For further details, see our response to the 'Coordination in the retail energy market facilitated by price announcements' working paper.

## 25. Regulatory Aspects

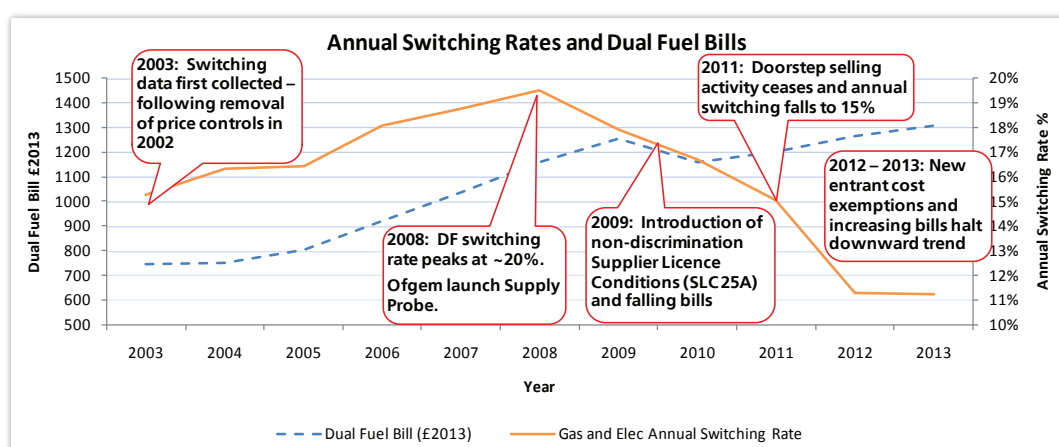
- 25.1 Regulation is an important feature of the energy market. EDF Energy supports strong, independent and effective regulation of the energy market and a strong independent regulator. Having an appropriately regulated market is essential to ensure the market facilitates fair competition amongst suppliers who in turn can provide clear and transparent offers for

<sup>54</sup> Were coordination to have ever been attempted, it is clear that EDF Energy did not keep to any coordination rules such that, in economic terms, it has 'cheated' without punishment - we have materially increased our non-standard tariff customer base as compared to our standard variable tariff customer base and have adopted strategies that seek to gain rivals' standard variable tariff customers.

consumers. It appears that at present there is a greater degree of regulation than is necessary to achieve this objective, and some of the regulation appears counterproductive.

- 25.2 We note that some of the changes introduced by Ofgem in recent years have been aimed at improving customer engagement. We are very supportive of that aim, and have been supportive of some of the initiatives (for example the requirement to put Cheapest Tariff messaging on bills). However, some of the changes introduced by Ofgem have not had the positive impact sought, and any positive impact they might have had has been undermined by other initiatives, such as the SMI and commentary on 'rockets and feathers' which have negatively impacted the level of trust consumers and other stakeholders have in suppliers, and indeed in Ofgem itself.
- 25.3 In some instances, there has been a cascade effect, whereby unintended consequences of poorly designed regulation have resulted in more regulations being imposed.
- 25.4 In terms of the impact of Ofgem's interventions on customer engagement, we note that the period over which these interventions were introduced has in fact seen a decline in switching rates (one measure of customer engagement) as shown in Figure 16.
- 25.5 Our specific comments on aspects of regulation are set out below.

**Figure 16 - Annual Switching rates and Dual Fuel Bills, with regulatory interventions**



### *SLC 25A - the non-discrimination clause*

- 25.6 EDF Energy has read with interest the submissions of Professor Littlechild and the summary of his hearing with the CMA (11 December 2014) as well as his subsequent submission.
- 25.7 We agree with his assertion that the result of the introduction of the non-discrimination clause (SLC 25A) in September 2009 was that energy suppliers raised their out-of-area standard variable tariffs. Whilst fixed-term tariffs had been available alongside standard variable tariffs before SLC 25A, this change moved direct price competition away from standard variable onto variable and fixed price fixed-term tariffs, and ultimately to almost solely fixed price term tariffs.
- 25.8 In practice, the condition was not an efficient solution to the substantive concern identified<sup>55</sup>. We agree, therefore, with the CMA's intention to investigate the impact of the prohibition further (UIS, paragraph 159).

<sup>55</sup> "From a competition perspective it is encouraging that companies continued to compete for some consumers, despite the opportunity offered by the non discrimination clauses to retreat to their own home areas, where they could charge higher prices; but the regulator then became concerned that this proliferation of tariffs was confusing customers and reducing switching." Waddams, supra.

- 25.9 While SLC 25A has now lapsed, we have not seen suppliers re-introducing differentials between in and out-of-area standard variable tariffs over and above what would be cost reflective. In part this has been due to a perception that Ofgem has expected the prohibition to continue in practice, even though formally the requirement has been removed. And in part it is simply because competition in the market has moved and suppliers now compete most strongly on fixed-term tariffs.

#### ***RMR - tariff rules - Tariff simplification***

- 25.10 As the market matured and the initial savings customers on standard variable tariffs could make through switching supplier, and through moving from two suppliers to one began to be exhausted, suppliers started to introduce increasing numbers of more innovative offerings to try to attract customers. This can be seen as one of the factors that led Ofgem to introduce its four-tariff rule as it felt the choice then faced by customers was becoming too complex.
- 25.11 EDF Energy supports the simplification of choice for customers. We were willing to support Ofgem's four-tariff rule at the time because we recognised concerns that customers were finding the number of tariffs confusing, and we considered that simplifying the offerings to customers was paramount at the time. In fact, we had already taken steps to reduce the number of our own tariffs, so the introduction of the four-tariff rule had little practical effect on us at the time.
- 25.12 We agree with those (including Ofgem) who have said that the four-tariff rule is not the best way of ensuring simplicity and clarity for customers in the future, and it also limits choice for customers. In particular, it could be a barrier to customers benefiting from time-of-use pricing with the introduction of smart meters. In our view, a straightforward way to make the comparison process easier would be to simplify the structure of tariffs.

#### ***Tariff Comparison Rate***

- 25.13 The Tariff Comparison Rate ("TCR") was introduced by Ofgem with the intention of making it easier for customers to compare tariffs. In our view, it is not helping customers to engage, and is potentially encouraging them to make the wrong personal choice. The problem is that it requires suppliers to express their tariffs on a national average Direct Debit typical consumption basis. EDF Energy considers it to be misleading for customers as it assumes a typical annual electricity consumption of 3.2MWh or a typical annual gas consumption of 13.5MWh rather than the customer's actual consumption. The TCR is based on a single average annual consumption (Ofgem typical). The standing charge and unit rate components are not visible. Therefore a customer with higher than typical consumption could inadvertently select a tariff with a proportionally lower standing charge versus unit rate, leading to outturn costs above that predicted by the TCR.
- 25.14 Furthermore, the TCR for a given tariff is calculated on a national average basis by averaging the TCRs across regions - the wider the regional price differentials, the increased likelihood that the TCR of a particular region will differ from the national average quoted. Therefore even for a typical user, it is not possible for a national average TCR to accurately represent the actual TCR of the customer in a given region. This is especially the case now SLC 25A is clearly understood not to be in force.
- 25.15 When changing standard variable tariff rates, this could therefore incentivise suppliers to balance their standing charges/unit rates and regional differentials in such a way as to minimise the quoted national average TCR. We would highlight that EDF Energy has unilaterally restricted regional differences in its pricing given its Trust Test.
- 25.16 Therefore the tariff with the lowest TCR may not be the cheapest tariff for a customer's actual consumption. Comparing tariffs in this way incentivises behaviours that lead to outcomes that,

whilst minimising the average price that will appear in national media, are not truly available to the majority of customers. It also distorts the competitive process.

- 25.17 Moreover, the TCR, according to our own research, does not seem to provide clarity in a manner that facilitates switching. The findings from the "Relish - Post RMR Bill Design Research", November 2014, indicated that the TCR is "Currently long-winded and difficult to understand and does not necessarily 'sell' the benefits of having this information on the bill". In relation to the personal projection, this "Appears in multiple locations on the bill, with two different total amounts. This confuses people as to what the Personal Projection is and what it's trying to tell them".

### *Ofgem's Supply Market Indicator*

- 25.18 EDF Energy considers the provision of accurate cost movement and profitability data by influential stakeholders to be of vital importance in rebuilding trust and ensuring that customers can and will engage with confidence.
- 25.19 Ofgem's SMIs are meant to provide an independent forward looking view of supplier margins based on revenues and costs. However, it has been consistently inaccurate, in particular by overstating revenues and therefore giving a misleading impression of supplier profitability. It has been particularly misleading for EDF Energy for a number of reasons, most importantly:
- Historically, our standard variable tariffs have been significantly below those of Our Five Largest Rivals.
  - A large proportion of our customer accounts are on fixed-rate tariffs with lower prices.
- 25.20 Although Ofgem has continued to develop the SMI, discrepancies in many assumptions continue to exist, which lead to the estimated profits being overstated. In terms of energy profits, we note that the SMI tends to gain much more media attention than the Consolidated Segmental Statements which present, we believe, a much more accurate picture of generation and supply profitability and are audited by Ofgem's auditors to verify their accuracy.

### *Advertising restrictions*

- 25.21 As noted by the CMA, the RMR has placed restrictions on the ability of suppliers to offer price discounts. There is also a restriction on the ability to advertise in the manner an energy firm may wish to in order to compete for standard variable tariff customers. In particular, the Advertising Standards Authority's 'Help Note' for marketing materially restricts the ability of a firm to direct advertising towards persuading a rival's standard variable tariff customers from switching<sup>56</sup>. The guidance requires firms to assume that all customers are rational and requires a comparison of similar products if they are available from the relevant rival. Advertising based on a methodology similar to that used by the CMA in calculating gains from switching is inhibited by the guidance. The guidance states:
- " 3.4 A comparison with a competitor's dissimilar tariffs is acceptable only if the ad states prominently that the competitor offers a tariff lower than the one featured. That explanatory statement should be both near to and similar in size to the savings claim or text in a table."
- 25.22 Thus, while we recognise that the frequency of prices changes in terms of fixed-rate tariffs may make it difficult, we do not see the customer benefit of this particular guidance given the concern identified: more direct advertising may give some inactive customers the necessary comfort to choose another supplier. Having to advertise a competitor's non-standard rate

<sup>56</sup> [http://cap.org.uk/~media/Files/Copy%20Advice/Help%20Notes%20new/utilities\\_prices\\_claims.ashx](http://cap.org.uk/~media/Files/Copy%20Advice/Help%20Notes%20new/utilities_prices_claims.ashx)

disincentivises the communication. EDF Energy would highlight that we would also take our Trust Agenda into account in any advertising.

### *White labels*

- 25.23 There are distortions of competition created by Ofgem's regulation of white labels. In particular, for a period, Ofgem only allowed British Gas and SSE to have white label arrangements - effectively, to price discriminate without making it clear to its own (largely standard variable) customer base that a cheaper offering was available from, in substance, the same supplier. We advised Ofgem when it consulted on the measure that it would have detrimental impacts on both customers (i.e. those who would not be informed of a cheaper tariff) and competition (by allowing certain suppliers to segment their customer base in a way that was not permitted to other suppliers).
- 25.24 Ofgem has now moved to allowing white label arrangements by other competitors and requiring the white label tariff to be referenced by the relevant supplier as its cheapest (where applicable). EDF Energy considers that this is an appropriate position.

## **26. Social and environmental obligations and policies**

### *Allocation across fuels*

- 26.1 EDF Energy agrees with the CMA that social, environmental and upstream policies (such as ROCs, Carbon Price Support ("CPS"), CfDs and Capacity Market) costs are disproportionately borne by electricity users relative to gas users and that this will increasingly be the case in the future. This will impact the viability of electrical heating as an alternative to gas.
- 26.2 Customers heating their homes with electricity would be the main benefactors of any rebalancing, including a number of fuel poor customers.

## **27. Settlement and reconciliation**

- 27.1 EDF Energy agrees with the CMA that the Annual Quantity ("AQ") process is flawed (UIS, paragraphs 170-171) and has been supportive of the project to update the gas settlements system. We do not consider the programme of change to be deficient, although the pace of change has been slow due to the complexity of the industry and variety of differing stakeholder needs. We believe that the vast majority of the issues identified in relation to the gas market will be addressed by the implementation of Project Nexus in October 2015.
- 27.2 EDF Energy also agrees that half-hourly settlement (UIS, paragraph 174) is essential to achieve the full benefits of smart metering. We have participated in BSC and Ofgem working groups to achieve the industry transition, and recognise that a number of logistical challenges remain. In particular, adequate Data Communication infrastructure and a critical mass of Smart Metering Equipment Technical Specification ("SMETS") v 2 compliant meters are a pre-requisite.
- 27.3 The issues of settlement and reconciliation are addressed in more detail in our response to the 'Gas and electricity settlement and metering' working paper.

## UPDATED THEORY OF HARM 4 - MICROBUSINESSES

- EDF Energy agrees with the CMA's assessment of the issues as summarised in the UIS and relevant working paper, namely engagement, lack of transparency and role of brokers or TPIs.
- When considering potential issues, it is helpful to look at different consumption bands. Domestic consumption levels (3.2MWh per annum) and the point where brokers become interested in the customer (20MWh per annum) are two useful points of delineation.
- Engagement is a clear concern and varies depending on customer size. For low energy consuming businesses, neither customers nor brokers are engaged. This is in contrast to the larger end of the market where TPIs are active and there are high levels of engagement resulting in strong competition.
- We remain engaged in all areas of supply as part of our Trust Agenda.
- Deemed contracts and auto-rollover contracts should be examined when considering customer engagement.
- A lack of transparency is an issue with customers finding it difficult to make price comparisons, and conversely for new entrants to demonstrate their pricing and product propositions to win new business.
- In particular there is also a lack of transparency with respect to the governance of TPIs and this is why we support Ofgem's moves towards a TPI Code of Practice.
- It is difficult to analyse industry levels of profitability and margins as each supplier defines the segment differently and reports profits differently. We therefore believe that further work is required in this area.

### 28. Introduction

- 28.1 There are many suppliers competing for microbusinesses, especially for customers with relatively large consumption levels. Indeed, we are a recent re-entrant in terms of the supply of gas. The nature of competition in this area is impacted by certain factors, in particular the characteristics of the customer, primarily in terms of consumption level.
- 28.2 In terms of microbusinesses, we agree with the CMA as to the issues identified in the UIS. The position has some similarities to the supply of energy in the domestic market in that there are some customers that are inactive although we recognise that there are different factors at play.
- 28.3 As with the domestic market, we are a challenger. We are looking to grow our customer base and a number of features of the market make this more difficult.
- 28.4 It is helpful when considering potential concerns to narrow the spectrum of customers being considered. In particular, the definition of "microbusinesses" as set out in the CMA's terms of reference is very broad and covers a wide spectrum of customers, as the CMA recognises.
- 28.5 Although there is no clear delineation, EDF Energy finds it helpful to consider the following points on the spectrum in terms of characterising customers in terms of consumption/value of business:
- 28.6 At the smaller end of the consumption spectrum, EDF Energy has many SME customers who consume less than the average domestic customer (3.2MWh per annum). [X] % of our

customers consume less than the average domestic customer and pay less than £[REDACTED] per year for their electricity. Towards this end of the spectrum, there tends to be less engagement.

- 28.7 At the larger end, typically above 20MWh per annum, Third Party Intermediaries (“TPIs”) are active, and while in this part there is intense competition the concern is that they may not be accessing all supplier offers through TPIs in a transparent and like-for-like manner. Price transparency is lacking across the whole spectrum, and in the governance of TPIs in the greater than 20MWh segment, which is why we support Ofgem’s moves towards a TPI Code of Practice.
- 28.8 Figure 17 below provides a breakdown of the number of customer accounts by consumption for our SME electricity portfolio:

**Figure 17 - SME electricity accounts by size for EDF Energy**

[REDACTED]  
[REDACTED]  
[REDACTED]

## 29. Engagement

- 29.1 The fact that the degree of engagement is generally higher for larger customers is indicated in the proportion of customers on generally cheaper fixed-term and fixed-price deals. Less than [REDACTED]% of customers consuming less than the average domestic customers are on fixed-rate tariffs compared to [REDACTED]% of larger entities. The remainder will be supplied on Deemed, Former Tariff and Extended supply rates.
- 29.2 EDF Energy has acted to actively engage with such customers. The CMA should note that EDF Energy introduced a “New Start” tariff in Q4 2012, after listening to and engaging with the Federation of Small Business (“FSB”). This gives new businesses a fixed-rate product for a period of six to nine months, facilitating the success (it is hoped) of such enterprises.
- 29.3 A significant number of disengaged customers will be on Deemed contracts ([REDACTED]% of EDF Energy’s portfolio). There are specific issues with Deemed contracts, with prices being materially higher than for fixed-rate contracts. EDF Energy is one of the lowest priced competitors, with a [REDACTED]% premium over our fixed-term contracts. We apply a cost and risk plus contribution approach. The vast majority of the premium is due to the risk of bad debt. We are of the view that the debt position is exacerbated by the fact that deemed customers ([REDACTED]% of whom are unknown) can transfer to another supplier without the existing supplier being able to object due to outstanding debt. In effect, other Deemed customers are paying for the risk of a customer transferring without paying their outstanding debts. As it is such a significant proportion of the overall tariff, this is something which the CMA should explore further.
- 29.4 In addition, it appears that the regulatory obligation not to price “unduly onerously” is being interpreted in significantly different ways by different suppliers. We expect the CMA will want to examine this issue. EDF Energy prices for this portfolio are set on a risk-reflective basis which is explained further in our response to the ‘Microbusinesses’ working paper.
- 29.5 The issue of auto-rollover contracts also appears to relate to customer disengagement. As the CMA has noted, the response of most suppliers to concerns around auto-rollovers was to replace them with potentially more expensive out of contract rates.
- 29.6 We have adopted a different approach. We carried out research which indicated that the main problem identified by customers was the fact that the opportunity to switch was very time limited. We also found that they preferred fixed-priced contracts rather than higher variable



rates i.e. they value certainty. We therefore adapted our product offering to allow termination of the auto-rollover contract on limited notice and with no fee.

- 29.7 Our decision was based on providing the fairest solution to customers, with the certainty of a fixed price but the freedom to switch supplier or to another contract with EDF Energy. As a result we are taking on a higher level of risk but we feel that this is appropriate when considered against our Trust Agenda.

- 29.8 [REDACTED]

### 30. Lack of transparency

- 30.1 Lack of transparency is also an issue, as the CMA has identified. For smaller customers, prices are not readily available. They are not published by most competitors and price comparison websites do not address such customers. EDF Energy published our “Freedom” prices and provides an online quote within 60 seconds in a readily accessible manner.<sup>57</sup>
- 30.2 For larger customers, the position is similar in terms of transparency. They can access prices via brokers, but this also carries with it separate concerns, as noted below.

### 31. Behaviour of brokers

- 31.1 We agree with the CMA that brokers may not be operating effectively or fairly. For example, the relevant TPI is not obliged to inform them of the best deals on offer, potentially limiting the products they offer to the customer based on the commission they earn.
- 31.2 Some TPIs/brokers may be incentivised through payments to promote a particular supplier's offering. This is of concern given TPIs receive around £[REDACTED] million per annum across the whole non-domestic sector in commissions.
- 31.3 We support greater regulation of TPIs and believe appropriately designed regulation is needed in this area. We note that the Ofgem's TPI Code of Practice is currently on hold while the energy market investigation is completed.

### 32. Profitability

- 32.1 The CMA will, rightly, look at profitability levels in this area. Currently, we do not recognise or understand the numbers the CMA identifies with respect to profitability. For the industry, it is difficult to analyse market levels of profitability and margins as each supplier defines the segment differently and reports profits differently, as the CMA has recognised. The figure of 8.6% for average margins in the SME segment is materially higher than we consider likely perhaps due to issues with the way costs have been allocated.
- 32.2 [REDACTED]

### 33. Microbusinesses conclusion

- 33.1 In short, we believe that the key issues in this area are driven by lack of price transparency, lack of TPI regulation and customers being able to switch while in debt. The challenge of low

<sup>57</sup> Other competitors will provide quotes but only after increased information is provided via mandatory fields.

customer engagement is a feature of the smaller end of the market and analysis of the market by customer consumption band highlights this.

- 33.2 There are steps that we have taken to improve customer choice, but these are not commercially sustainable as unilateral actions.
- 33.3 For further details, please see our responses to the 'Profitability of retail energy supply: profit margin analysis' and 'Microbusinesses' working papers.
- 33.4 We look forward to contributing further in this area.

## UPDATED THEORY OF HARM 5 - CODE GOVERNANCE

- We agree with the CMA that the current system of industry codes is unduly complicated.
- We are not convinced that this is a barrier to entry or competition. Nonetheless, there is clear scope to improve the operation of code processes, bringing benefits to all market participants and in particular smaller players.
- Much of the content of the codes is necessary, but it would be beneficial to reform governance arrangements and to rationalise the structure of the codes and reduce their number.
- We recommend three reforms:
  - Further standardisation of code governance arrangements so all codes have the same arrangements and are required to meet best practice standards.
  - Greater oversight of the performance of the Code Panels and Code Administrators to ensure best practice is being followed and the codes are being managed efficiently.
  - A clear vision to have fewer codes, with rationalisation being implemented where possible alongside other industry reforms.
- It is very important that industry experts should continue to have a strong role in code modification processes – our experience is that their expertise substantially improves code modifications. We would be concerned about an outcome that gave Ofgem increased powers to push through changes without due assessment by experts in the industry.

### 34. Codes and code governance

- 34.1 There has undoubtedly been a significant growth in the extent and complexity of regulatory requirements over the last few years, including in the regulated industry codes and agreements. In its favour, we note:
- a) There is no evidence that the number of codes is an insurmountable material barrier to entry or growth in the sectors: this is evidenced by the entrance and growth of new suppliers.
  - b) Ofgem undertook a Code Governance Review (“CGR”) concluding in 2010 and made a number of changes to improve and address perceived issues and barriers for smaller suppliers.
  - c) Ofgem has also developed a “Licence Lite” approach for small suppliers/ community schemes (refreshed in 2014) to exempt them from some of the code requirements - albeit we note that there has been no take up.
  - d) While there is only one main code in gas, this has many sections which essentially bring together under one document what is currently split out in electricity.
  - e) The make-up of the different Panels does not appear to be dominated by the Six Large Energy Firms. (We also note that most of the Code Panel members are required to be independent from their organisation.)
  - f) Most code modifications proceed ultimately to Ofgem for a decision and cannot be “stopped” by the governance process.

- g) Smaller firms raise modification proposals and are active in industry governance. Some key changes are currently being proposed by the smaller firms, for instance Mandatory Half Hourly Settlement. We do not see any material delays that are not warranted.
- 34.2 That said, we agree with the CMA that there is scope for further standardisation of code processes, and rationalisation between codes – if we were starting afresh, we would not end up with what we have now.
- 34.3 Standardisation and rationalisation would benefit all parties to the Codes. This would enhance competition and would probably be likely to be of particular benefit to smaller market participants, who have fewer resources to devote to participating in Code developments.
- 34.4 We would support any reform that resulted in a lessening of the regulatory burden, while recognising the following:
- a) There is a great deal of the content of the Codes that is necessary. As the CMA has acknowledged, they deal with very important issues to do with the rules and systems for participating in the market. They need to be comprehensive and precise, and means that there is only so much streamlining that will be possible.
  - b) There is a balance to be struck between how much rationalisation can be achieved, and how disruptive that process would be. Reforms that involve rationalisation of the content of codes, and potentially combining some of the codes and code administration, are most likely to be cost and resource-efficient if they can be delivered alongside other significant industry developments.
  - c) It is very important that industry experts should continue to have a strong role in the process – we would be very concerned about an outcome that gave Ofgem increased unilateral powers to push through changes.
- 34.5 Subject to these caveats, we would be very supportive of further standardisation and rationalisation, and we set out three areas for potential reform below.

***Areas for potential reform***

- 34.6 Firstly, further standardisation of the governance arrangements for code changes across the codes is a simple and beneficial step – so that you have a single set of best practice governance arrangements across all codes. This could bring clear benefits to the accessibility of the codes.
- 34.7 We note that Ofgem has already set out best practice for industry codes in its CGR and the Code Administration Code of Practice (“CACoP”) further describes expected processes and behaviours. At present this only has the status of guidance, and it is not being applied evenly for all codes, so some arrangements are falling short of best practice. EDF Energy considers that compliance with the arrangements set out in the CGR and CACoP should be mandated so that best practice is the standard across all industry codes and the governance arrangements are simplified accordingly.
- 34.8 Secondly, there is a case for greater oversight of the Code Panels and Code Administrators against these best practice guidelines, so that there is scope to constantly review this best practice and undertake comparator analysis across the Codes, Code Panels and Code Administrators. This could be achieved, for instance, by an annual report by Ofgem that set out relative performance across all codes building on the existing Code Administrators’ key performance indicators. This would ensure that the code modification processes in full were kept under review to ensure that they were effective and efficient and prompt action where needed. We consider that this strikes the right balance of retaining industry control of the processes,

whilst at the same time bringing greater transparency and a means of driving efficiency and achieving best practice.

- 34.9 Thirdly, it would be better to have fewer codes, and where possible to rationalise their content and identify synergies. The challenge with this is that it would take a lot of work and resource to rationalise the codes. It is most likely to be cost and resource-efficient if delivered alongside other change programmes that affect the codes. We believe that there should be a clear vision of the optimal structure and number of codes which sets the direction of travel, and then steps taken to achieve this vision at suitable opportunities. Rationalisation only being undertaken coincident with other significant reforms to codes, e.g. with the implementation of smart metering, part of this programme would be to combine the relevant parts of the BSC, Smart Energy Code ("SEC") and Master Registration Agreement ("MRA") into a Retail / Smart code, and implementation of the EU Network Codes will provide another opportunity for change.
- 34.10 At this stage we do not have a firm view on what this rationalisation looks like. We consider that this proposal needs developing to both identify the greatest interactions and synergies and also if and when there are opportunities to make these changes at least cost. We note that Ofgem through its smarter markets programme has already identified some potential for change in this area.
- 34.11 For further details, please see our response to the 'Codes' working paper.

## CONCLUSION

### 35. Concluding statements

- 35.1 EDF Energy considers that competition in the energy market overall works well. In EDF Energy's view the generation and wholesale markets are highly competitive and do not give rise to an AEC, although there are a number of features relating to the retail markets, primarily due to the inactive nature of a large body of customers on standard variable tariffs and certain regulatory features, where we agree that further consideration by the CMA is appropriate.
- 35.2 EDF Energy wishes to be able to compete for all customers on a level playing field and in a situation where customers are confident that they are choosing the right deal for them.
- 35.3 The key, therefore, is designing suitable and proportionate remedies. EDF Energy looks forward to discussing both the analysis above and appropriate remedies in due course.

**EDF Energy**

**March 2015**

## ANNEX 1

### 36. SMART METERS

- 36.1 As stated in Section 22, we note that the CMA seeks further views and evidence on the likely size of the benefits of moving to smart meters, and on any regulatory or other barriers to ensuring the benefits of smart meters are realised in practice. We present our findings below.

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