Competition & Markets Authority

ENERGY MARKET INVESTIGATION

Summary of hearing with Co-operative Energy on 9 March 2015

Background

1. Co-operative Energy (Co-op) was formed in 2010 by Midcounties Co-op, a regionally based retail co-operative with a turnover of over £1bn a year. Co-op had [✂] customers, [✂] of whom were dual fuel.

2. Co-op did not supply energy to small and medium enterprises (SME) or large businesses.

3. Co-op was operated on behalf of its members and, unlike most of its competitors, pursued a business model that did not solely focus on maximising profit.

Efficiency of wholesale markets

4. Co-op felt that the wholesale electricity market was efficient. It had concerns over the size of the large energy firms and who controlled the wholesale market.

5. Co-op believed the wholesale market had sufficient liquidity, transparent trading and was competitive. They said the challenge was in acquiring energy far enough in advance, where the market was less liquid and there were fewer suitable products.

6. Co-op said that there was a perception by potential entrants that large vertically integrated energy suppliers had distorted the market and prevented entry by new suppliers. Co-op felt there was no evidence of this in practice.

7. Co-op said that changes to cash out prices would greatly increase volatility in the market pricing and balancing system. Price volatility, however, might provide energy companies with the financial incentive to improve demand management and storage technology. These innovations might prove easier to manage for large energy companies who were able to balance their inputs and outputs via generation. Co-op welcomed changes to a single cash out price.

8. Co-op had purchased renewable energy via Power Purchase Agreements and directly from generators as they had committed to supplying electricity with carbon content below half the national average. They accomplished this by buying energy derived from low carbon sources from large organisations such as [✂], and others.

Market power in electricity generation

9. Co-op agreed that there was little evidence that the market share in generation held by large energy companies led to higher prices. There existed, however, a perception that tacit coordination was possible because of the small number of generators with a large concentration of market share.

10. At the time that Co-op began to supply energy, it was more common for independent suppliers to struggle securing energy from generators on suitable terms that accounted for forward buying and terms of credit. The situation had improved, in part by the Six Large Energy Firms providing credit that helped open up the market.

11. Co-op said that it was difficult to secure long term energy supply via the over-the-counter market. Independent suppliers may also not have the credit worthiness to buy two years' worth of energy at the shape they need to offer particular products.

12. Co-op secured liquidity by [✂].

Incentives to compete

13. The Co-op's standard variable tariff was lower than the Six Large Energy Firms and competitively priced compared to other independent suppliers. It was available on direct debit, quarterly credit, paper billing, and paperless billing. It considered this to be its full service tariff that offered a range of billing options and supportive customer service.

14. Co-op had operated a hedging policy that was prudent but that tried to keep its standard variable tariff in the cheapest quartile in the market.

15. It also offered a fixed price tariff that was self-serve, online, dual fuel and direct debit only, with quarterly meter reads. This permitted a competitive price and low cost to serve. This was in response to an increasingly competitive market where independents were largely offering only fixed price products.

16. The two tariffs served two different markets and it was not expected that significant numbers of customers would transfer from the fixed to standard variable tariff. Co-op's fixed price tariff was not a loss-leading tariff as each product had to be profitable.

17. Co-op's original 10,000 customers were considered to have joined due to a strong commitment to the Co-operative brand and ethos. Its business practices were similar to what Ofgem was trying to achieve through regulation, such as simpler tariffs and clearer bills. A high percentage of its original customers had never switched supplier or only switched once, prior to joining Co-op.

18. Owing to its membership system, Co-op knew that [✂] customers were [✂]. These customers sought a trustworthy supplier and wanted to interact via post and access personalised customer service.

19. Co-op introduced new fixed tariff products to compete for 'sticky' customers belonging to the Six Large Energy Firms. [✂] was a key part of Co-op's plan for growth. It also embarked on traditional media campaigns regionally through radio, print media and billboard advertising. Advertising campaigns focused on the Co-op brand, customer fairness, and the right price proposition.

20. Co-op said most of its customers were [✂].

21. Co-op planned to meet expectations of a growing customer base by investing in a new billing and customer service system, information technology, and personnel. It was a high priority to improve customer service and return to high standards that it had set during its first year.

Price comparison websites

22. Co-op advertised on a small number of price comparison websites.

23. Co-op had been critical of the practices of price comparison websites. It believed they had a place in the market, but did not provide the answer to problems facing the market. This was because comparison websites filtered prospective energy suppliers by whether or not the website received a commission. This added to the cost that energy suppliers then had to charge customers. Recent changes that required price comparison websites to display options from the whole market might improve price transparency.

24. Co-op felt that a not-for-profit price comparison website ought to be set up by either the government or a government-sponsored consumer organisation. This would provide customer-focused independent information and advice,

similar to that of the Money Advice Service. Alternatively, there was the model provided by MoneySavingExpert that notified subscribed users when a tariff became available that met their prescribed parameters. Co-op emphasised that it did not wish to see the end of price comparison websites, but that solutions to better serve the public ought to be pursued.

25. The prominence of price comparison websites in the switching market meant that energy suppliers risked low growth if they did not advertise on those websites.

26. Ofgem's confidence code was only adopted by a small minority of price comparison websites.

Smart meters

27. Co-op felt that smart meters should improve the switching process and customer confidence in their energy supplier.

28. The switching process had a reputation with consumers for being problematic and drawn out. Co-op believed this was driven by poor procedures and poor quality data in the industry, which smart meters should remedy. Co-op was sceptical, however, that it would reassure inactive 'sticky' customers to switch or significantly change consumer behaviour.

29. Co-op felt that smart meters were already an outdated technology and that technology such as British Gas' Hive and Google's Nest indicated the future of energy consumption. In the future suppliers might seek out non-traditional business models that provided a comprehensive service, such as providing devices for instant usage data, software and smart home management.

30. Co-op believed the structure of the energy sector was designed in the 1990s to facilitate privatisation, with much of the information infrastructure inherited from the 1980s.

Regulatory interventions

31. Co-op agreed that the energy market was too heavily regulated and that the CMA energy market investigation should consider the benefits of a principles-based regulatory regime.

32. The prescriptive nature of Ofgem's retail market review undermined its intention by making bills for Co-op's customers contain more complicated information.

33. Co-op did not know what regulations ought to be introduced to unlock the high percentage of inactive consumers. However, technological changes will require regulatory changes, such as time of use pricing and its effect on consumer behaviour.

Settlement

34. Co-op felt that the gas settlement system was not fit for purpose and that new entrants to the market suffered disproportionately compared to large firms. This was due to a higher proportion of their customer base being new with no customer history.

35. Co-op was optimistic that Project Nexus would improve gas settlement.

36. Co-op considered accurate and timely readings from smart meters would be highly beneficial to their organisation. It would be a long time, however, before half hourly settlements were commonplace. Accurate real time data would be vital for a robust settlement system to effectively manage demand and efficient use of renewables.

Microbusinesses and small and medium enterprises

37. Co-op had considered entering a segment of the SME market, [✂].

38. Two sectors existed within the SME market: single manager-owners who operated small business that ought to be treated similar to domestic customers; and larger businesses that were more commercially aware.

39. There was a demand among microbusiness customers for tariffs similar to domestic contracts, with standard variable tariffs and no terms and conditions regarding termination dates. There existed the same demand in the SME market for a supplier that could be trusted and one that didn’t require yearly switching to maintain fair pricing.

Industry codes

40. Co-op said the codes were numerous, lengthy, detailed and acted as a barrier to entry and effective competition.

41. Independent suppliers were prevented by limited resources in being involved in changing the codes. Co-op prioritised its involvement in changing codes based on the likelihood of affecting change. This led to the codes being biased in favour of those who have the resources to participate in the consultation process, namely the Six Large Energy Firms. The Six Large

Energy firms also had greater motivation for maintaining the status quo and preventing costly changes.

42. The codes were not designed to enable radical change but were an inheritance from a time of monopolistic practice and old technology from the 1980s.

43. Co-op felt that a radical rethink of the code structure and a move to being principles-based was necessary.

44. Co-op expressed its support for the direction Ofgem was leading regarding industry codes.

Profitability

45. Co-op believed it had a strong gross margin level because of the investment in able staff and software to avoid settlement imbalances. [✄]. In addition, affiliation with its parent company permits a longer hedging view and improved creditworthiness that protects it from volatile wholesale prices. Some power purchase agreements were guaranteed by its parent company.

46. Reaching profitability in 2013 was attributed to being under the customer threshold for Energy Companies Obligation (ECO) and receiving support from its parent company. [✄].

47. Co-op felt that profit margins of [✄].