

## **ENERGY MARKET INVESTIGATION**

### **Summary of hearing with RWE on 18 March 2015**

#### **Overall views**

1. RWE's view of the generation market was that liquidity was sufficient, prices were transparent and that generators and suppliers had access to sufficient products to manage their risks. It did not consider that it or other generators had a real ability or incentive to be able to exploit any market power they might have in generation.
2. RWE Npower considered that the supply market was competitive with pressures on margins, increasing switching between suppliers and entrants gaining market share. Political and regulatory risks and environmental and other obligations, such as the installation of smart meters, had increased in recent years. Consumer engagement with the market was increasing. The fixed and standard variable tariff (SVT) customers should be considered as part of one market rather than separately. A customer's bill was made up of a number of different costs, of which an energy supplier only controlled less than 20%; the rest being made up of commodity, policy and network costs.
3. The regulation of the market had been inconsistent, had increased in volume and complexity, and had restricted competition. The governance of the industry would be assisted by the appointment of a fully independent adjudicator with narrowly defined economic objectives.

#### **Market rules and regulatory framework**

4. RWE considered that overall the arrangements for the short-run dispatch of electricity were technically and commercially efficient. It was very competitive and produced very clear price signals for the market. The balancing mechanism allowed participants to see that power plants were competing against each other. It noted that the current balancing mechanism did not correctly take account of losses and that this could lead to inefficiencies.
5. RWE did not advocate going back to a mandatory pool system with central dispatch and did not believe that such a system would be more efficient than the current self-dispatch system. A pool that was simply a day-ahead auction would also produce results similar to those of the current system, so it would

not see any advantages of this. The current system encouraged participants to reduce their imbalances and encouraged efficiency.

6. As far as reforms to the cash-out mechanism were concerned, RWE was in favour of more marginal pricing in order to ensure that scarcity was properly reflected in energy markets. It would support including scarcity pricing elements in the cash-out mechanism but considered that more work was needed on this aspect.
7. The reformed cash-out mechanism, with a single cash-out price, would remove the penal element involved in dual pricing and would give a single price that better reflected the opportunity cost of balancing the system in real time.
8. RWE supported the introduction of Contracts for Difference (CfDs) as a way of supporting low-carbon investment. It regarded the competitive auctioning of these contracts as important, especially since factors such as planning permission for offshore wind farms were given relatively little weight in the Final Investment Decision Enabling for Renewables award assessment process for investment contracts despite these being a prerequisite for CfDs applications RWE had participated in the first CfDs auction and had been successful with some of its onshore wind projects but unsuccessful with its one offshore wind project bid.
9. RWE was also supportive of the capacity market as this would help its conventional generation plants recover their ongoing fixed costs in the face of increasing amount of low marginal cost renewables. It was concerned that the capacity market, like other aspects of the regulatory regime, was stated to have one objective but was in fact being used to achieve a number of other aims that it was not originally intended for, with the potential for unintended consequences. For example, demand-side response technology and existing power stations were not eligible for 15-year contracts, while new stations were. It argued that this meant that the capacity auction might not produce the most efficient price for a unit of capacity. The auction system ought to take into account whether capacity would actually be required in 15 years' time.
10. RWE thought that the current arrangements for including interconnectors in the mechanism on the basis of their ownership were flawed. It ought to be possible to develop a model that would allow the generator on the other side of the interconnector to participate in the market rather than the owner of the interconnector itself.
11. As far as recovering the costs of the capacity mechanism from consumers was concerned, RWE believed that these costs should be spread out across

the year to reflect the fact that scarcity events can occur at any time. However, the current system that looked to recover costs during winter peak periods was broadly acceptable and it did not advocate moving the current system to a triad basis.

12. RWE's bids did not specifically take account of [X].
13. RWE's capacity auction bids had taken into account the most important factors such as coal and gas prices. It had not taken account of [X]. It was also not clear how the cash-out mechanism would feed into forward prices and how this would be factored into the capacity market.
14. RWE was in favour of more locational pricing, particularly in the case of transmission charging (Transmission Network Use of System charges). If this was done correctly, then power stations would be better sited and this would reduce the amount of losses and constraints. It was currently challenging the Office for Gas and Electricity Markets (Ofgem) about its decision to dilute locational pricing in favour of windfarms in Scotland. It did not advocate the introduction of zonal markets, but it would be in favour of locational pricing for infrastructure. Locational pricing of transmission losses was important for efficient dispatch of stations. Further work would be needed to update the previous analysis of the value to customers of zonal losses. Introduction of locational pricing for losses would mean constraints would become a lesser issue.
15. Current policy led to renewable generation, especially wind, being located where there was wind rather than where power was needed. This led to increased connection and transmission costs, which were dealt with in a way that did not accurately reflect the costs of renewable energy, especially from a consumer perspective.

### **Generation: Market power and profitability**

16. RWE agreed with the CMA's initial assessment that generators did not have market power in the generation market. It noted that by the day-ahead stage, its power stations would be fully hedged and any increase in price would not immediately affect its profits. Also for a generator to profit from having unilateral market power, the market power would have to exist for a sustained period of time, rather than just a half-hour, its timing would need to be predictable, and the whole market would need to believe it existed so that forward prices would increase over a longer-term period. Therefore, it considered that generators did not have the ability to influence prices in this way, and even if they did, they lacked the incentive.

17. Also, RWE had confidence that the regulation governing the generation market, a combination of competition law and the Regulation on Wholesale Energy Markets Integrity and Transparency, was robust enough to prevent any abuse. The reputational consequences for a firm like RWE of attempting to influence the market in this way would be significant.
18. RWE had invested significantly in recent years in generation plant in the UK (over £2 billion on conventional power stations in the past five years), and it had been noted by the wider RWE group that the returns on this investment were now [REDACTED]. While this was also currently the situation in a number of European markets, where renewable energy, such as solar, had increased its market share, this underperformance was a real concern for the UK business, and the losses it had made in 2014 demonstrated this. [REDACTED] It was also conducting a major cost reduction programme across the whole of its generation business.
19. One of the plants that RWE was keeping under review was Didcot, which had suffered the loss of three cooling towers in a recent fire. Didcot was still operational, and thanks to cost savings achieved at the plant, it was likely to remain operational for the foreseeable future. It was noted that closing a plant involved its own costs, so it was sometimes less expensive to keep a loss-making plant open in the short to medium term than to close it. As it owned both gas and coal-fired plants, it theoretically had a hedge against fuel prices. Generally if gas prices fell relative to coal prices income from coal stations would fall and income from gas stations would increase, and vice versa, if coal prices fell relative to gas prices coal stations income would increase and gas station income would decrease. Currently gas prices were highly volatile.
20. RWE based its future profit projections on forward prices, particularly the coal to gas price spread, [REDACTED]. It also took into account what it considered to be the current oversupply of power generation in the UK. In its view there were a number of older, less efficient power stations in the UK that it would have expected to close or be closing, but this had not happened.
21. RWE did not currently have any firm plans to build new conventional power stations in the UK. It was making significant ongoing investments in its existing plants, even at its new combined-cycle gas turbine plants at Staythorpe and Pembroke. It had also made, and would continue to make, significant investments at some plants for environmental reasons.
22. RWE had also made large investments in off-shore windfarms, and it had been successful in the auction for three onshore wind projects under the CfDs regime. [REDACTED] How profitable any future renewable projects would be was

unclear due to increased competition and development risk arising from the CfDs auctioning process.

## Liquidity

23. RWE considered that the energy market was sufficiently liquid, but it would like to see increased liquidity. Secure and Promote had been quite a successful way of stimulating liquidity. Its effects had generally been positive as it had increased the number of transactions during trading windows and improved price transparency, especially during peak periods. On the negative side it had reduced liquidity outside of trading windows as transactions were increasingly focused on trading within specific windows. It had also required the implementation of a sophisticated IT system to ensure 100% delivery of the undertaking. It would support extending the length of trading windows, which would increase liquidity over an extended period providing there was a reduction in the exacting nature of the undertaking.
24. Liquidity could be increased further by increased stability and clarity in regulation, eg by making it clearer what the level of the carbon floor tax would be in future years. The gas markets were more liquid than the electricity market, and this was partly because the number of regulatory interventions and changes was lower.
25. Gas was actively traded on exchanges and this meant that financial entrants were attracted to that market and its liquidity was increased. If this could be replicated in electricity then that market's liquidity would improve. The fact that electricity trading had become focused on particular time periods meant that financial firms, which were not trading electricity in order to meet customer demand and which might want to trade outside of particular windows, were less attracted to this market.
26. It was possible to buy some shaping products in advance. From a retail perspective, RWE considered that there was adequate liquidity for it to manage its risk in both electricity and gas. It considered shape to be a second-order risk and would initially focus on hedging away its volume risks and then refining its position ahead of the trading deadline. In managing its position, it would make a number of trades, which contributed to the market's overall liquidity.
27. Market conditions had been fairly stable for the past few years, but RWE considered that even if they became more volatile, shape would remain a second-order concern for it. The demand for shape came from the retail part of its business. On the generation side, it was not really possible to forecast detailed dispatch shape until around 24 hours before a trading deadline as it

was not possible to predict generation output for a given half-hour on a particular day until near the time. Although it was difficult to trade electricity more than two years ahead of time because it was hard to quantify risks, it did have some products with a timespan of over two years, but it was possible for it to hedge to cover the risks these presented. Most of its domestic, small business and large business fixed-price customers preferred fixed contracts lasting up to two years.

## **Foreclosure and vertical integration**

28. RWE agreed with the CMA's initial assessment that it did not consider that there was scope for energy firms to engage in customer or input foreclosure. It noted that as its generation and retail businesses were separately managed and operated and made commercial decisions independent of each other, it did not have the ability to foreclose. Also the good level of liquidity in the market meant that foreclosure was difficult. Its retail business dealt with its generation business on an arm's length basis, so had the same access to its energy products as the rest of the market. It considered that the separation of its generation and retail businesses and the fact that it sold into and bought from the market at market prices helped to create transparency and liquidity in the market and increased trust.
29. RWE considered that it benefited from owning generation, trading and retail businesses because it had experience in running each type of business and could achieve some collateral and credit risk benefits and operational cost savings, but it did not consider that there were significant benefits in running all the businesses as a vertically integrated entity. Its collateral requirements were based on its global net position, so its UK business benefitted from being part of a larger business. It currently had made no decisions on whether or not to split up its businesses in the way E.ON was proposing.

## **Retail market**

### ***Pricing***

30. When setting prices RWE Npower [REDACTED]. RWE Npower's approach to pricing [REDACTED]. RWE Npower priced [REDACTED] so there was no loss-leading approach employed.
31. In order to attract customers in the face of competition from other suppliers, it was necessary for RWE Npower to offer discounts from its SVT. Because [REDACTED].

32. RWE Npower [redacted]. Its focus was on reducing overall costs while improving its customer service. There were [redacted], and there were some differences [redacted].
33. RWE Npower made [redacted]% average margin across all its domestic customers during the relevant period. It could not sustainably operate its business if it only offered one-year fixed-term tariffs.
34. New suppliers had a number of advantages such as exemptions from the Energy Company Obligation (ECO), newer IT and accounting systems, and being able to focus on particular groups of consumers with lower service costs. RWE Npower's view was that the smaller suppliers' business model, which focused on attracting new customers via discounted fixed-term tariffs was sustainable, and this was supported by the numbers of customers switching to them and their continued growth. It acknowledged that the wholesale energy market had been relatively benign in recent years. It thought that if the smaller suppliers ran their businesses and their hedging strategies sensibly; then they should be able to survive increases in wholesale prices.
35. RWE Npower had undertaken a number of pieces of work as to how it should approach the market, eg [redacted]. This analysis had shown that it had [redacted]. The degree of [redacted]. Its recent reduction in its standard gas tariff had been greater than most of its competitors. It considered that it had to be competitive in both fixed term tariffs and the SVT and aimed to be [redacted] suppliers in terms of price.
36. The vast majority of RWE Npower's new customers [redacted]. It was important for it to be competitive on the SVT as well since SVT customers could switch away from SVT. It [redacted]. It had one tariff, the 'Feel Good Fix', where the upper price was capped but the price could fall if the SVT went down, which was attractive to consumers. It had to [redacted].
37. RWE Npower considered that it, the other large suppliers and smaller suppliers all had a similar business model that involved discounting their fixed-term tariff products and having higher SVTs. The advantages that smaller suppliers had enabled them to offer larger discounts. The uncertainty of the recent political environment had also made it more difficult for suppliers to change their SVT. As smaller suppliers grew and lost their ECO exemptions and if wholesale prices rose, the gap between fixed-term tariffs and SVTs would likely narrow.
38. RWE Npower wanted to encourage loyalty in its customers and to be able to offer them other products. This was difficult when it was not able to offer loyalty rewards to its longstanding customers under the Retail Market Review (RMR). The current industry business model was open to misunderstanding

that longstanding SVT customers were treated badly compared to new customers and those that switched regularly. However, it noted that this business model, which was based on price and used introductory discounts, existed in a number of other industries. What was different about this industry was that the restrictions on tariffs make it difficult for suppliers to innovate and offer customers something new.

### ***Price and tariff innovation***

39. RWE Npower thought that the introduction of smart meters would enable the introduction of new tariffs, such as time-of-use, and create new ways for suppliers to communicate with and engage their customers. Its 'Nest' product was an initial foray into giving customers more information and feedback about their energy use. Simply giving consumers smart meters would not increase engagement but working out how to use the data and how to help customers use it would do so. Smart meters should also benefit consumers by enabling quicker switching and more accurate billing as well as better enabling them to understand their energy use.
40. RWE Npower considered that the simplification of tariffs which it had started prior to RMR and which had continued under RMR had enabled customers to better understand and engage with the market. Consumer engagement was already increasing and smart meters should increase it further. It now had only [%] of customers on its SVT tariff and had suffered significant losses of customers in the last six or seven years, which it saw as indicative of increasing engagement.
41. RWE Npower presumed that [%].
42. RWE Npower had considered [%].
43. RWE Npower did not have 'online-only' accounts where customers could only contact them online; 'online' was purely to do with how bills were provided to customers.

### ***Pricing and incumbency areas***

44. RWE Npower's average revenues in its incumbency areas (the Midlands and Yorkshire) from 2011 to 2013 [%]. It considered that [%].
45. Part of RWE Npower's pricing policy, [%] Ofgem had clarified the position on Standard Licence Condition 25A (SLC 25A), so it was clear that suppliers were free to have different pricing policies for their incumbency and non-incumbency areas, [%].



## ***Economies of scale***

46. RWE Npower did not think that there were material economies of scale for retail businesses. Even though its customer base had [✂]. More generally, it had seen a reduction in its indirect cost base (measured through the Consolidated Segmental Statements) on an underlying basis as it had implemented efficiency programmes, which had enabled it to integrate systems, close sites, reduce management layers, reduce functional costs and so on. It also considered that [✂]
47. The only area in which RWE Npower had specifically looked at economics of scale in the past was in relation to ECO and the exemptions that had been granted to small suppliers, to establish whether there might be a benefit from being a large supplier in terms of delivering a lower ECO cost. Whilst it established that there might be a small economy of scale benefit over the small suppliers, this was nowhere near the order of magnitude of the ECO exemptions given. It considered that any exemption from ECO should apply to both large and small suppliers. It could, for example, be applied to a supplier's first 100,000 customers, with the ECO charges payable on incremental customer numbers above this threshold, which seemed more logical than the current scheme.
48. In the market place, RWE Npower was aware that small suppliers could often get a 'system in a box' and also tended to target customers with low costs to serve, such as dual fuel, direct debit and online customers. It believed that this enabled these firms to be very competitive on costs. While larger suppliers might have some economies of scale relating to IT platform investment costs, they would also have other responsibilities and costs that smaller supplier might not, coupled with numerous legacy issues and having to transform systems, processes and operations for current requirements on a big scale.

## ***Customer engagement***

49. RWE Npower thought it was oversimplified to say that customers on SVT were likely to be less well educated, less well-off and less likely to have considered switching. Its analysis of the characteristics of inactive customers suggested that they were more likely to be [✂]. It had found no difference for those customers who had an annual income [✂]. In fact, inactive customers were [✂]. There was no real correlation between customer activity and social issues.
50. RWE Npower did not think there should be concern about the number of customers on SVTs in the market. 89% of energy customers were aware that

they could switch provider, and regular media coverage helped to maintain awareness levels. The fact that suppliers had to inform customers as to whether or not they were on the cheapest tariff had also driven engagement, and it noted that the number of customers it had on SVTs had fallen from [X] to [X]% suggested that consumers were increasingly engaged. It was the case that some SVT customers were happy with their providers and their SVTs and did not want to switch.

51. While energy had lower levels of engagement than some other markets (car insurance), it had similar levels of engagement to other markets (mobile phones) and was better than some (mortgages, current accounts) and levels of engagement have substantially increased. It was also important to consider levels of internal transfers as well as switching between suppliers, which taken together meant that engagement levels were higher than in some other markets. On average every year around [X]% of its customers had either switched to it from another provider or internally transferred to another product. On average every year around [X]% of its SVT customers regularly switch internally or externally, so it was not the case that there were was a group of customers who regularly switched and a group that did not; customers move from time to time between these. Across the market, the number of customers on SVTs was declining and the number of suppliers was increasing and overall levels of engagement were increasing.
52. It was important to consider the interaction between competition and social policy and a decision would need to be made as to whether to use competition policy or other tools to implement social policy objectives in relation to some groups of SVT customers.
53. RWE Npower thought that in a few years the proportion of its customers on SVTs would fall to around [X]%, and that this proportion might continue to decline beyond that point. This would depend on a number of factors, including whether small suppliers could continue to leverage the advantages they gained from ECO exemptions, the range of products suppliers were allowed to provide, and the extent to which suppliers were better able to engage with customers, eg through smart meters. It would rather be able to offer customers loyalty discounts and cross sell to them.
54. Over the past five years, suppliers had moved from attracting customers by direct sales methods to indirect methods, such as price comparison websites (PCWs). Similar trends had been seen in other markets but regulation had also played a role in this industry. RWE Npower noted that RMR had restricted the use of certain sales channels and appeared to restrict the use of some others, such as white-label, although the position here was somewhat unclear and inconsistent. It had found that engaging customers [X]. It agreed

that it had been right to end doorstep selling, as while it had been effective in reaching some customers who might not have otherwise engaged, there were a number of issues with the channel. There were other ways which customers could be engaged with directly, [REDACTED]. The advent of smart meters would open up further opportunities to engage with customers in this way.

55. Prepayment customers accounted for around [REDACTED]% of RWE Npower's customer base. The introduction of smart meters would help to reduce the logistical costs of serving these customers and might help to create a market more akin to prepay mobile phones. Although the costs of serving prepayment customers were higher, it did not charge them more than its other receipt of bill standard customers.

### ***Smart meter roll-out***

56. RWE Npower had a number of concerns about the smart meter roll-out programme. The UK was the only country in Europe where responsibility for implementation had been given to energy suppliers, and this meant that it had to spend money to provide its customers with meters without any guarantee that it would obtain a return from doing so. The smart meter programme also had not been coordinated with other programmes, such as ECO and the Green Deal, and this created complexity for it in carrying out its obligations under them. [REDACTED]% or more of changes it had made to its systems arose from government regulations and policies. Its estimates of the costs of implementing its share of the smart meter programme [REDACTED]. Installing all the meters by 2020 presented significant logistical and health and safety challenges. Germany had decided to extend its deadline for implementation to 2032, and it was still compliant with EU law. There had not been a proper economic assessment of the benefits smart meters would provide to consumers, particularly low energy consumers.

### ***Regulation***

57. RWE Npower agreed that since 2009 SVT bills had increased by a level [REDACTED]. It noted that in its view, during the earlier part of this period, [REDACTED]. It also suggested that the Ofgem's Supply Market Indicator (SMI) calculation was flawed in that it was based on gross margin, overstated consumption, failed to take into account that SVTs had been discounted for a time, and the hedging pattern was incorrect and its associated costs were excluded. Since 2009, the industry had improved its returns. More recently the possibility of a price freeze should Labour win power had distorted the market and affected how much suppliers adjusted their SVTs. During the period, competition had also

moved from SVTs to fixed-term tariffs, and the SMI calculation did not include this.

58. After 2009, SLC 25A and RMR had reduced suppliers' ability to discount their SVT products. RWE Npower's [✂]
59. RWE Npower noted that NERA and Energy UK had done evaluations of Ofgem's SMI estimation of suppliers' costs which showed that this work had significant gaps in it and was even inconsistent with the analysis in Ofgem's Consolidated Segmental Statements.
60. RWE Npower had been surprised by the introduction of SLC 25A as it appeared to be a move away from competition. Its impact had, naturally, been to reduce regional variations in prices, and it had contributed to competition moving from SVTs to fixed-term tariff products.
61. The proliferation of tariffs that followed the end of door-to-door selling and the introduction of SLC 25A had been the result of participants in a market looking to find new ways to compete. RMR's introduction and the limitation of the four-tariff rule had led to suppliers competing by deeper discounting tariffs.
62. RWE Npower did not think that all of RMR had been wrong, but it did argue that aspects of it had been implemented in ways which were totally unsatisfactory. It had to change its arrangement with Telecom Plus largely because it would not have been able to remain compliant with the four-tariff rule.
63. RWE Npower considered that the fact that under RMR suppliers that had white-label supply arrangements did not need to show this on their own bills (if a white-label tariff was the cheapest provided by a supplier) was wrong. It did agree with letting customers know if their supplier did have a cheaper tariff available. The way the four-tariff rule had been implemented had limited innovation. It did think that tariff simplification and giving better information to customers, which it had begun prior to RMR, had helped engagement.
64. More generally, RWE Npower considered that the current regulations did not apply equally to all participants in the market. In theory, a principles-based form of regulation would be fine but without some guidance, it would be difficult for a supplier to know whether or not it was complying properly. Based on its experience, it considered that the current regime ranged from being rules-based in some respects to one that, unhappily, fell in between a principles-based and a rules-based one. Moving to a principles-based regime would be a major cultural shift for industry participants and Ofgem.

### ***Price comparison websites***

65. RWE Npower considered that the existing regulation of PCWs (Ofgem's Confidence Code) did not go far enough. There needed to be stricter regulation of PCWs so that consumers could have confidence in the price comparisons they were shown. An increasing number of consumers used PCWs to compare and purchase energy products, so they were taking on a more important role in the market, and the level of regulation should reflect this. This was an important part of rebuilding trust in the market.
66. RWE also had concerns about the fact that PCWs currently only focused on short-term price and did not take other characteristics into account. As a secondary issue, it had concerns that the way PCWs were required to calculate customers' potential savings. Whatever approach was used, it was crucial that it was consistent and transparent as to all the costs, commissions and fees that a consumer was paying, either directly or indirectly, when using a PCW.

### ***Settlement***

67. RWE Npower shared the CMA's concerns about the way the gas settlement system used historic data and how this could mean that energy efficiency improvements might not be reflected in the charges paid by suppliers. Whilst there was not a big gap between ECO obligations and Annual Quantity, it noted that the risk was there. It was in favour of more accurate metering and settlement and was working to ensure it was ready for the October implementation of Nexus, which would bring the gas settlement system more in line with the electricity one and make it more accurate.
68. In respect of electricity settlement, RWE Npower had concerns that the schedule for the rollout of smart meters was too compressed, but it was in favour of smart meters and thought they would improve customer engagement. It was also in favour of half-hourly settlement but considered it should only take place once enough households had a smart meter. There would be issues around having two settlement systems operating during the transitional period.

### ***Small businesses and microbusinesses***

69. The small and medium-sized enterprises (SMEs) marketplace was very diverse, with a wide range of types of businesses with varying energy requirements. It shared a characteristic with the domestic market in that there were normally ongoing products for regular customers alongside discounted products designed to attract new customers. However, it differed from the

domestic market in that many customers did not own their own premises and that there was a significant number of business start-ups and failures, particularly in the microbusiness segment. Microbusiness customers tended to be very focused on delivering their core business and less concerned about investing in their premises than domestic or larger businesses which might have greater energy intensity.

70. This variety of customers meant that it was important for an energy supplier to establish relationships with its customers in order to understand their needs and how it could best supply them. Operating in this market was challenging for energy suppliers because of the transitory nature of the customers. In each of the last three years, [REDACTED].
71. Over the five years from 2009 to 2013, RWE Npower's EBIT margin for this sector was [REDACTED]. However, this figure reflected [REDACTED]. It had [REDACTED] but it had subsequently improved its customer service and [REDACTED]. It noted that the first half of the period was characterised by the fallout of the financial crisis and a reduction in the number of new businesses, meaning it was an unusual period over which to look at profitability.
72. RWE Npower marketed its products to customers [REDACTED]. Its telesales team would make [REDACTED] calls a year to SMEs. There were over 1,000 participants (including third-party intermediaries (TPIs)) in this market, so small businesses were routinely contacted by energy suppliers. In order to acquire a high-quality customer, it would [REDACTED].
73. RWE Npower did not publish prices for business products (with the exception of deemed which are available on their website). It was usual for business customers looking to switch supplier to get three or four quotes. This would likely involve a business spending a couple of hours talking to energy suppliers – it would typically take under 30 minutes to get a quote from a single supplier. It tried to be clear with customers about whether there were better deals it could offer them. Businesses knew their own situations best and could find out what deals were available to them more easily than it could find out if a business was on a secure footing and will pay its bills and what product was right for them.
74. When one of RWE Npower's SME customer's contracts was coming to an end, it [REDACTED]. Deemed customers were those who moved into premises served by it but had not contacted it to arrange a contract [REDACTED].
75. RWE Npower favoured a consistent approach to the regulation of auto-rollovers of existing customers on to new contracts. While it and some other suppliers no longer rolled over customers, this was something it had

voluntarily decided to do, and there were many suppliers that still automatically rolled-over customers at the end of their contracts. It was currently difficult for a customer to know whether the supplier it was signing up with used automatic rollovers or not.

76. RWE Npower also favoured a consistent approach to how prices were expressed so that customers could compare them more easily. While its [REDACTED].
77. [REDACTED]
78. RWE Npower acquired around [REDACTED] of its new SME customers from TPIs. TPIs were beneficial to the market as they helped customers to compare offers and actively engaged customers in a way PCWs could not. It was in favour of mandatory regulation of TPIs as it, as an energy supplier, did not have enough visibility to know whether the TPIs it used were offering customers the best deal they could. There was no impediment to PCWs entering this part of the market, but they would need to offer prices that reflected a business's particular characteristics. Overall, it thought that the SMEs market was working well and was competitive, but that it could be improved by some further regulation of TPIs.

### ***Profitability***

79. Overall margins for RWE Npower's industrial & commercial (I&C) business had been [REDACTED] for EBIT margin. Its I&C business handled a small number of very large companies, and this was very different from dealing with domestic and small business customers. I&C customers were willing to take on a number of costs on a 'pass-through' basis, such as network cross-charges, and risks, such as volume risks, which smaller types of customers could or would not.
80. The I&C business's approximate annual turnover was £[REDACTED], and it typically made a yearly profit of between £[REDACTED]. RWE Npower's SMEs business had an annual turnover of £[REDACTED] and made a profit in 2013/14 of approximately £[REDACTED]. The I&C business sold around [REDACTED] as the SMEs business. This meant that it saw the two businesses as [REDACTED].
81. RWE Npower's indirect costs [REDACTED] submitting CSS reports to Ofgem during the relevant period. Over the past few years, it had undertaken an extensive cost reduction programme while also looking to improve its customer service. It believed [REDACTED].
82. RWE Npower's performance on [REDACTED]. It was able to gauge its performance on certain aspects from the information in the published segmental statements. [REDACTED]. Additionally, as part of a multi-national group, it had to compete with

other parts of the company in order to attract investment, so it needed to show it could produce reasonable returns.

## Industry codes

83. RWE considered that each of the industry's codes were necessary for its operation. However, it did have some concerns about the codes' governance arrangements and considered that these might be improved in various ways such as the introduction of a single administrative body for all codes, a standard process and timetable for code modifications, and possibly the creation of a code adjudicator with a clear set of objectives and the ability to oversee all of the codes' operation. Rationalisation of the governance arrangements might, in time, lead to some rationalisation of the codes themselves.
84. The codes' complexity required industry participants to devote significant resources in monitoring their development. However, the prescriptive nature of the codes could make it easier for participants as procedures were set out in great detail, which made them easier to follow. Code administrators such as ELEXON assisted and trained new participants about their respective codes.
85. As far as participation on the codes' governing panels was concerned, smaller participants which might not have the resources to participate individually could have their interests protected by third party representatives who would act on behalf of groups of smaller suppliers. Disagreements about code modifications were often between large suppliers rather than between large and smaller ones. The code modification process was open and transparent, but there were times when the decision-making process could get bogged down, and RWE suggested that streamlining the process and having firmer deadlines would improve it.
86. Giving Ofgem a greater role in initiating modifications could lead to a conflict of interest as Ofgem's approval was required for all modifications and its neutrality in making these decisions could be compromised where it had initiated a modification. Ofgem also had a range of objectives that went beyond those of the codes, and it sometimes rejected modifications on these grounds, such as sustainability, rather than on whether the modification would or would not benefit the efficient operation of the market and benefit customers.
87. RWE's view was the codes worked well and enabled what was a complicated industry to run efficiently although their governance could be improved. It would also be helpful if Ofgem's objectives could be streamlined and brought more in line with those of the codes, eg by basing them on economic



customer welfare benefits only. If Ofgem's objectives were revised in this way, then it could perhaps play the role of an independent code adjudicator, which would consult on rules and resolve disputes. It noted that it might be necessary to create another body to perform this role if Ofgem's independence could not be assured. Increased use of timescales and deadlines would help to reduce delays to the code modification processes, and the presence of an overall code administrator would help to make the approval of modifications and their implementation more orderly.