Opus Energy Response to the Notice of Possible Remedies

CMA Energy Market Investigation
About Opus Energy

Opus Energy has been operating as a ‘challenger brand’ in the business energy sector for twelve years. We supply 240,000 business sites in the UK including the supply of electricity and gas to more than 160,000 SMEs and microbusiness sites.

Known for providing a high standard of service and innovative products, Opus Energy was ranked first by B2B energy buyers for customer service for small to medium-sized enterprises by independent research agency Datamonitor. It is a market leader in providing accurate bills, having been rolling out free smart meters to all of its customers since 2008, and was the first supplier to offer flexible products to multi-site corporate groups – a practice which is now standard across the industry.

The company’s group turnover for FYE 2015 was £524 million with an EBIT of £38.2 million. At the start of 2015, the company officially overtook one of the ‘Big 6’ suppliers in terms of customer numbers and on that basis is now the sixth largest supplier to the business sector in the UK.

Please find below our views on the effectives and proportionality of the proposed remedies as requested in your Notice of Possible Remedies document. In summary we support the informational remedies proposed for microbusinesses, but do not support the proposal of a ‘safeguard tariff’ in the business sector on that basis that it:

- does not comply with EU Legislation and would be unlawful;
- fails CMA’s own test of proportionality;
- would damage competition by removing / reducing incentive to switch; and
- with no justification, would promote failing microbusiness consumers to the detriment of other microbusiness consumers.

Key Submissions

- We welcome the CMA’s energy market investigation and its comprehensive review of wholesale trading arrangements.

- We support those of the CMA’s remedies designed to enhance our business customers’ ability to make informed choices. We feel they complement the remedies implemented by Ofgem under its Retail Market Review for Non-Domestic Consumers. These measures were widely supported by suppliers and consumer groups alike and are already having a demonstrably positive effect on customer engagement in the business sector.

- We have grave concerns over the proposal to introduce price regulation into the UK business energy sector. The proposed remedy (of a ‘safeguard tariff’) cannot be said to be proportionate. It would damage competition and hence create harm to business consumers. For these reasons it would be unlikely to comply with current EU legislation. This requires full liberalisation of energy markets and only allows for price regulation where such intervention can be demonstrated to be proportionate (eg in the case of vulnerable consumers) and limited in time.

- The decision by the CMA to propose the introduction of price regulation to the UK business sector is partly based on a mistaken assumption that energy retail supply is simply a homogenous product for the business sector. We would challenge this view. When a consumer enters into an energy supply agreement what they are actually purchasing is a range of services from a supplier. These services include: assessing the amount of energy consumed, providing an accurate and easy to understand bill, promptly answering the telephone call or email when the consumer has a query etc.
• Customers will pay a premium for that service and also to avoid the cost and risk of switching to a supplier that may provide a worse service. To that extent they behave rationally. The CMA does not recognize that service may play a part in customers’ decisions.

• We also feel that the CMA has not yet made a clear enough distinction between (i) consumers who do not have the capability to properly engage with energy markets (ie vulnerable customers in the domestic sector) and (ii) consumers who have made a rational choice not to switch. Before implementing price regulation into any sector, we consider it will be necessary to apply a separate test of proportionality to each of these distinct customer groups. It is our view that price regulation in the business sector would be damaging to competition and that as a consequence it would harm consumers more than it would protect them. Therefore we consider that the introduction of price regulation into the UK business sector would fail upon a test of proportionality.

• In addition a ‘safeguard tariff’ price cap is likely to lead to reduced consumer engagement by reducing the saving that could be made by switching. It may be that those on the ‘safeguard tariff’ feel there is no longer any need to engage as they are now ‘protected’ by the government.

• There are further practical difficulties with the introduction of a ‘safeguard tariff’ in the business sector. There are material differences in creditworthiness between different microbusiness customers. These can give rise to cost differentials of up to 75%. If there is a cap on microbusiness tariffs, it is likely that the cost of supply for poor credit / failing businesses will be above the cap, and that they will end up being subsidized by ‘good’ businesses. What is the economic or social justification for this? It is appropriate in a domestic market where it has been agreed by society to support vulnerable individuals. How can this work within a portfolio of business customers? Would we ask the successful small businessperson to support the bills of a neighbouring business which is failing?

• Further details of the above views are provided in section 1 of this response. The legal importance of the proportionality test is outlined further in section 2.

• We challenge the CMA’s assertion that average prices have been substantially above the level one would expect to see in a well-functioning competitive market and that average prices offered by the Six Large Energy Firms were 5% above the competitive level in the domestic sector and 14% above the competitive level in the SME segment. This is patently not the case.

• If it were true that average prices are significantly above a well-functioning market, there would be a slew of equity chasing after these ‘super returns’ – there has not been. The well-funded investment-grade organisations who service the I&C sector (who already have the right skills and systems to service domestic and microbusiness consumers) would also enter these markets. They do not. Secondly, were average prices reduced to what the CMA has identified as the ‘benchmark’ level, some of the Six Large Energy Firms and all of the independent suppliers (who make less returns) would be loss making and the industry would not be sustainable. It is our view that such assertions are unhelpful, and because they feed misleading headlines, they hinder the progress of returning trust between consumers and suppliers. We give further views on what we consider to be serious omissions within the CMA’s analysis of ROCE and benchmark profits in section 4.
1 GENERAL REVIEW OF PROPOSED INFORMATION REMEDIES AND THE PROPOSED ‘SAFEGUARD TARIFF’ REMEDY

1.1 What we have learnt from past experience is that mixing price regulation with competition doesn’t always lead to the expected result. Instead it can hinder or even permanently damage competition. The intervention to limit domestic suppliers to 4 tariffs was a prime example. This intervention failed to increase customer engagement (switching levels fell) and it stifled innovation in product offerings.

1.2 In contrast the business remedies implemented by Ofgem for the business sector, which were focused on improving customers’ access to contract information, have had a positive effect as planned. Eighty-four per cent of fixed term contract holders now know when their contract ends and 73% know when they are able to start renegotiating or giving notice of termination. Both of these indicate higher awareness since 2013 (63% and 65% respectively).¹

1.3 It is also important to support remedies that have been recently been put in place which are having a demonstrably positive effect for consumers. The ban on rollover contracts has been an effective way of increasing switching away from incumbents and putting pressure on customer prices. Centrica state in their Annual Report 2013 that ‘The tough economic and competitive environment continued to put pressure on business energy supply margins, which were also impacted by our programme to end the auto-rollover of contracts at renewal’ and in their Annual Report 2014 that ‘The number of business supply points fell by 62,000 in 2014 reflecting the highly competitive conditions in the business energy market and our decision to lead the industry in ending the auto-rollover of contracts at renewal.’

1.4 Where intervention is deemed necessary in a competitive market it is sensible that such intervention should be targeted and proportionate. This principle is to be found in EU law which, being a member state of the EU, the UK is bound to comply with. Under the Third Package² directives require the full liberalisation of electricity and gas markets. This means, as interpreted by the Court of Justice of EU ‘that the price for the supply of natural gas [and electricity] must…be determined solely by the operation of supply and demand.’³ Where price regulation is adopted, it is subject to considerable restraints. These were expressed by the CJEU as follows:

'[obligations restricting the price that may be charged]…must comply with the principle of proportionality and…those obligations may compromise the freedom to determine the price for the supply of natural gas [or electricity] only in so far as is necessary to achieve the objective in the general economic interest which they pursue and, consequently, for a period that is necessarily limited in time.’

1.5 In its current form, the proposed ‘safeguard tariff’ remedy fails the test of proportionality. This is because the CMA has failed to properly differentiate between two very distinct customer types and then apply the ‘safeguard tariff’ in a targeted way. There is a singular difference between (i) consumers who do not have the capability to properly engage with energy markets (ie vulnerable customers in the domestic sector) and (ii) consumers who have made a rational choice not to switch.

1.6 The decision not to switch might be for a number of reasons: The consumer might have determined that the opportunity cost of the time spent on switching is not outweighed by the saving to be made; or

² In particular the Electricity (2009/72/EC) and Gas (2009/73/EC) Directives
³ Federutility and Ors v Autorità per l’energia elettrica e il gas [2010] 20.04.2010 (Case C-265/08), paragraph 18.

The relevant provisions in Directive 2003/55/EC, as well as the Electricity and Gas Directives in the Third Energy Package, are found in Article 3(2).

Page 3 of 23
they might have assessed the risk of the switching process going wrong and the hassle this will cause them (again assessing the opportunity costs of this not being outweighed by the savings); or they might have decided that they are happy to pay a premium in return for a service and / or product which is better than they will receive elsewhere.

1.7 When a consumer enters into an energy supply agreement what they are actually purchasing is a range of services from a supplier. These services include: assessing the amount of energy consumed, providing an accurate and easy to understand bill, promptly answering the telephone call or email when the consumer has a query etc. Customers will pay a premium for that service and also to avoid the cost and risk of switching to a supplier that may provide a worse service. To that intent they behave rationally. The CMA does not recognize that service may play a part in customers’ decisions.

1.8 On a shallow analysis, it might appear that a price cap does no harm for microbusinesses, but this is not the case for two reasons.

(a) If a price cap reduces average supply prices (and hence average supplier margins) it may cause challenger brands to withdraw from the market. The EBITs of these challenger brands currently lie between 0 and 5% making this is a very real possibility. If suppliers do withdraw from the market, the service and products that the rational consumer was happy to pay a premium for may be withdrawn from that consumer. Hence the interventionist policy will have forced the consumer who was experiencing no harm to take a product of lower quality at a lower price. The consumer has been forced onto a product which the regulator has determined is better for that consumer even though this is not the consumer’s preference. This inferior outcome occurs because the remedy was not appropriately targeted. It affected a group of customers who were not experiencing harm.

(b) Customers are often willing to pay extra for something that is better. In the case of energy supply this might be more accurate bills, better customer service, a supplier who answers the phone in a timely fashion. A supplier who provides the better service and the better product wins additional margin. This fact attracts entrepreneurs and innovators to a sector. These innovators drive forward the price and product innovation and raise the standards of care. It becomes necessary for the incumbents to keep up or lose customers. This is at the heart of how competitive markets make progress. If you thwart this process, then you also thwart progress.

1.9 We consider it is unlikely we would have been able to build our company and bring the products and services to market that have provided innovation and progress if there had been price caps and price regulation in place. Price regulation harms challenger brands as much, if not more, than incumbents who are vertically integrated and/or investment grade multi-national entities.

1.10 Once service and product innovation are taken into account, it cannot be said that the harm that price intervention will bring (by damaging competition) is outweighed by the benefit of the remedy for the business sector.

1.11 There are also significant differences between the number of consumers on the ‘default’ tariffs – 70% in domestic sector and 45% in the non-domestic sector. Of the non-domestic consumers 26% are supplied under rollover contracts for which a remedy (restriction on auto-rollover contracts) has been

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4 See section 3 for further analysis of what returns are required by independent suppliers for them to offer a sustainable long term challenge to incumbents
proposed and for the 8% on deemed tariffs there is a licence condition to ensure the tariff is not unduly onerous.

1.12 For these reasons we consider that under any fuller analysis the proposal to introduce price regulation to the non-domestic sector would fail upon a test of proportionality.

1.13 For the domestic vulnerable group, price intervention still brings harm by damaging competition but it is more likely that this harm will be outweighed by the benefit of the remedy for these consumers. Here the intervention is specifically ‘giving up’ on competition in the belief that a regulated price environment would suit them better as they are not able to make an informed choice even with improved informational remedies. It is possible that for vulnerable consumers a ‘safeguard tariff’ may be said to be sufficiently targeted and proportional and hence an appropriate remedy.

1.14 For business consumers the correct approach is to ensure that businesses have the correct tools and information at hand to be able to make informed choices and receive the full benefit of competition. This principle underpinned Ofgem’s RMR business remedies and we support those of the CMA’s remedies which are also underpinned by this principle.
LEGAL REVIEW OF EU LEGISLATION REGARDING PRICE REGULATION IN ENERGY MARKETS

2.1 The UK, as a member state of the EU, is bound to comply with EU law. The CMA is an 'emanation of the state', and as such is also bound to comply with EU law. Specifically, it must act consistently with EU Directives, even where they have not been implemented into UK national law. It seems clear from the CMA's Provisional Findings Report (the Report) that it has neglected to consider its obligations in this regard and therefore risks falling into fundamental legal error where this is not rectified.

2.2 EU energy legislation has evolved by way of successive tranches, or 'packages', of legislation, the latest of which is the Third Energy Package – in particular, the Electricity Directive (2009/72/EC) and the Gas Directive (2009/73/EC).

2.3 As recognised in Appendix 2.1 to the Report, one of the fundamental drivers behind successive energy packages has been the full liberalisation of the electricity and gas retail markets. So, for example, the 3rd recitals of both the Electricity and Gas Directives state that –

‘The freedoms which the Treaty guarantees the citizens of the Union — inter alia, the free movement of goods, the freedom of establishment and the freedom to provide services — are achievable only in a fully open market, which enables all consumers freely to choose their suppliers and all suppliers freely to deliver to their customers.’

2.4 In order to achieve such liberalisation, the Electricity and Gas Directives require that from 1 July 2007 member states must ensure that all customers are free to purchase electricity and gas from the supplier of their choice.

2.5 The Federutility case required the Court of Justice of the EU (the CJEU) to consider the meaning of the same requirement in Directive 2003/55/EC – the Gas Directive which formed part of the Second Energy Package – against the background of end-user price regulation by the Italian national energy regulator. In that case the CJEU was clear that the requirement to ensure that all customers were free to purchase from the supplier of their choice was to be interpreted as meaning 'that the price for the supply of natural gas [and electricity] must, as from 1 July 2007, be determined solely by the operation of supply and demand'.

2.6 The starting point for compliance with the requirements of EU law is therefore that prices should not be set by the state.

2.7 However, the CJEU held that there are other provisions in Directive 2003/55/EC – which are again contained in the Third Energy Package – that require the protection of consumers, and in particular vulnerable consumers, and under which it may be lawful in certain cases to adopt price regulation through the imposition of certain Public Service Obligations on energy suppliers.

2.8 The imposition of Public Service Obligations which require suppliers to charge regulated prices must be reconciled with the duty to ensure market liberalisation. As such, where price regulation is adopted, it is subject to considerable restraints. These were expressed by the CJEU as follows –

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5 Articles 2(29) and 37(1)(c) of the Gas Directive and Articles 2(12) and 33(1)(c) of the Electricity Directive.
6 Federutility and Ors v Autorità per l'energia elettrica e il gas [2010] 20.04.2010 (Case C-265/08), paragraph 18.
7 The relevant provisions in Directive 2003/55/EC, as well as the Electricity and Gas Directives in the Third Energy Package, are found in Article 3(2).
[obligations restricting the price that may be charged]...must comply with the principle of proportionality and...those obligations may compromise the freedom to determine the price for the supply of natural gas [or electricity] only in so far as is necessary to achieve the objective in the general economic interest which they pursue and, consequently, for a period that is necessarily limited in time.\(^8\)

2.9 In addition, to being necessary, proportionate and time limited, price controls must also be 'clearly defined, transparent, non-discriminatory and verifiable'.\(^9\)

2.10 Price controls do not have to be limited to 'vulnerable customers' only. But the more they move away from protecting the vulnerable, and in particular where they are applied to businesses, the harder it is to justify them as proportionate. For example, in relation to non-domestic customers, the CJEU held that it would be necessary –

'to take account, in assessing the proportionality of the national measure in question, of the fact that the situation of undertakings is different from that of domestic consumers, the objectives pursued and the interests present being not necessarily the same'.\(^10\)

2.11 Indeed, in view of the differences between them, the requirement of proportionality would not, in principle, be complied with if both domestic and non-domestic customers were to benefit from price regulation in an identical manner.\(^11\)

2.12 The impetus towards liberalisation enshrined in the EU energy packages is reflected in the longstanding energy policy of the European Commission (the Commission). For example, in a Commission Communication in 2012, it was noted that –

'price regulation in many Member States prevents suppliers from offering attractive services and tailor-made and dynamic pricing schemes. It discourages new entrants that could challenge the incumbents.'\(^12\)

2.13 In fact, contra the CMA's position, a Commission Communication from 2013 explicitly stated that, together with other reforms, the removal of regulated prices, rather than their imposition would facilitate changes in consumer behaviour and involvement in energy markets.\(^13\) Most recently, a Commission Communication from 15 July 2015 states –

'Regulation of retail prices can represent a particularly strong barrier to effective competition as the Energy Union communication points out. Member States often cite an under-performing retail market or social protection needs as justification for price regulation. Social policy objectives such as protecting vulnerable consumers with general regulated tariffs lack

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\(^8\) Federutility, paragraph 33, emphasis added.

\(^9\) Federutility, paragraph 44. The requirements outlined by the CJEU in relation to the imposition of Public Service Obligations have been applied to similar provisions in successive EU energy packages and in relation to both gas and electricity – see for example, Enel Produzione SpA v Autorità per l'energia elettrica e il gas [2011] EUECJ C-242/10, paragraph 42, and Castelnou Energia, SL v European Commission (Judgment) [2014] EUECJ T-57/11, paragraph 149.

\(^10\) Federutility, paragraph 42.

\(^11\) Federutility, paragraphs 42 – 43.

\(^12\) COM(2012)663, p. 10.

\(^13\) C(2013) 7243 final, p. 9.
transparency and may actually increase energy costs for vulnerable and non-vulnerable consumers alike.\textsuperscript{14}

2.14 The Commission’s policy thus dovetails with the legal position at EU level and it routinely cites the requirements outlined in the \textit{Federutility} case in formal communications with, and infringement proceedings against, member states concerning the imposition of regulated prices.\textsuperscript{15}

2.15 Indeed, in 2011 the Commission wrote formally to Italy stating, among other things, that the same measure which the CMA is proposing – the regulation of end-user prices for domestic customers and small enterprises who have not actively signed a contract with a supplier on the competitive market – went beyond what was necessary to protect customers.\textsuperscript{16}

2.16 It should be noted that opposition to price regulation in policy terms is not confined at EU level to the Commission. For example, last year the Agency for the Cooperation of Energy Regulators said the following –

‘Regulated end-user prices are not compatible with the objective of establishing liberal competitive retail markets. Therefore, CEER [the Council of European Energy Regulators] will develop guidance, based on experiences at national level, on the approaches to be used to facilitate the phasing out of regulated end-user prices, as soon as practicable, whilst ensuring that customers are properly protected where competition is not yet effective.’\textsuperscript{17}

2.17 As an emanation of the state the CMA is required to comply with the legislative requirements in the Third Energy Package. This includes the requirement for full liberalisation of the gas and electricity markets. Although full liberalisation may be tempered in particular circumstances by the imposition of Public Service Obligations which impose price controls, such controls must meet the requirements laid down by the CJEU in \textit{Federutility}.

2.18 There is currently no evidence in the CMA’s Provisional Findings Report that it has considered the requirements of EU law in framing its recommendation for the reintroduction of price controls. In particular, it has presented no analysis as to how its recommendations in this respect are necessary and proportionate. This is particularly important in respect of its recommendation that price controls are put in place for microbusiness as well as domestic customers as both the CJEU and the Commission have been clear that a member state must carefully consider why such a measure should be applied to both types of customer given the fundamental differences between them.

2.19 It is our view that because the CMA has not yet undertaken the required analysis, it is not currently in a position to say that the reintroduction of price controls in the UK energy market is necessary and proportionate, whether for microbusiness customers or any other kind of customer.

2.20 Without this analysis, the CMA risks breaching its obligations in domestic public law as well as EU law.\textsuperscript{18}

2.21 The CMA is under a public law obligation to have regard to all relevant considerations in arriving at its

\textsuperscript{14}SWD(2015) 141 final, paragraph 2.1.2(a).
\textsuperscript{15}See, for example, IP/11/590, IP/12/542 and IP/13/580.
\textsuperscript{16}IP/11/414.
\textsuperscript{17}Agency for the Cooperation of Energy Regulators, \textit{Energy Regulation: A Bridge to 2025 - Conclusions Paper}, 19 September 2014, paragraph 51.
\textsuperscript{18}Associated Provincial Picture Houses Ltd v Wednesbury Corporation [1948] 1 KB 223, 229
recommendations. The substantial opposition to price regulation at EU policy level is clearly an important example of such a consideration and the CMA will need to have regard to the fact that its recommendation to reintroduce price controls runs significantly against the grain of EU energy policy.

2.22 Prior to the publication of its final recommendations, the CMA must therefore undertake a careful analysis of whether its recommendation to impose price controls complies with the requirements set down by the CJEU, having regard to the fact that EU energy policy is weighted against such a move. For the reasons given in the remainder of this document, we submit that any such analysis must lead to a conclusion that the imposition of price controls in the UK energy market is neither necessary nor proportionate, particularly in the context of microbusinesses.

3 ROCE & BENCHMARKS

3.1 There is a fundamental problem with the profitability analysis laid out in section 10 of the Provisional Findings Report (and accompanying Appendices). The analysis is not complete and as a consequence (i) it does not stand up to scrutiny, and (ii) it has led the CMA to some inappropriate conclusions.

3.2 The underlying flaw of the analysis lies in the assessment of VI advantage.

3.3 An investment-grade, vertically-integrated player has a significant financial advantage over a retail supplier who is not vertically-integrated or investment-grade (‘VI Advantage’). Some of this advantage is down to economies of scope and the ability to avoid bid/offer spreads, but the main differential comes from the ability to weather the volatility of wholesale market prices over a sustained time horizon.

3.4 The underestimation of VI Advantage has led to inaccuracies in each strand of the profitability analysis, with the principle case being that none of the benchmarks the CMA offers constitute a credible commercial proposition. As such, we believe the CMA is mistaken in its conclusion that (i) ‘SLEF prices between 2009 and 2013 were 5% above the competitive level in the domestic sector and around 14% in the SME sector’ and (ii) that they should ‘gain assurance that different sources of evidence on profitability give broadly consistent results’. Our detailed review of each of the benchmarks is given in sections 3.7 to 3.44 below.

3.5 Most of the of the ‘challenger brands’ who operate in the domestic and microbusiness retail sectors are neither VI nor investment grade. Unfortunately, by undervaluing the financial advantage that VI brings, the CMA has proposed a remedy which would materially harm both the established and nascent competition to the Big 6. As these companies bring new products to market, raise standards of service and provide a competitive threat to incumbency, it seems strange that a competition authority should propose this.

3.6 Our conclusion is that further analysis is required by the CMA to specifically address this issue before final remedies can be proposed.

3.7 ROCE ANALYSIS

3.8 We support the methodology used by the CMA to assess the differential between ROCE and a ‘fair’ benchmark. Whilst we understand that such analysis may be more difficult for an asset light business, capital has none the less been employed and a return derived from it which may be more or less than that expected once risk is taken into account.

3.9 However,

(i) we do not agree with the differential calculated (of 5% for domestic and 14% for SME) as we believe there are omissions in the analysis, and

(ii) we do not understand why the CMA has made a leap from determining there is an excess of profits being made by the SLEFs to a proposing a remedy which is applied to all market players regardless of

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20 181 Summary of Provisional Findings Report
21 10.138 Provisional Findings Report
whether they have VI Advantage or not; and

(iii) we are concerned that analysis has been carried out with a focus on the domestic sector, but that remedies have then been proposed which would apply to the business sector.

3.10 We believe the CMA has made this leap because it is not taking into account the full financial benefit of being an investment grade VI player (a ‘VI Retailer’) over a non-investment grade, non-VI player (a ‘Stand-alone Retailer’) and analysed this difference in a robust fashion sector by sector.

3.11 THE ROCE ADJUSTMENT

3.12 The CMA states that its methodology was to ‘start with accounting profits and the balance sheets for the SELFs’ retail supply businesses and then make adjustments to arrive at an economically meaningful measure of ROCE’.

3.13 10.22(b) goes on to state that the CMA has ‘added a small percentage (X%) uplift to wholesale energy costs to estimate the additional costs that would be incurred as a Stand-alone Retailer trading in the wholesale markets, and without the benefits of a parent company with a large balance sheet.’ It is understood that this uplift is based upon the Shell trading premium for market access and that there is no further addition for notional capital.

3.14 If the intention of this adjustment is to scale back SLEF ROCE to become equivalent to that of a Stand-alone Retailer, then the uplift detailed in 10.22b materially underestimates the cost differential between a VI retailer and a Stand-alone Retailer. This is because the CMA has taken an inappropriate level of comfort from the service provided by Shell and has not included the true risks and consequent costs of being a non vertically-integrated, investment-grade retailer. Further details of these costs are outlined in sections 3.20 to 3.29 below.

3.15 THE BENCHMARK WACC of 10%

3.16 We consider the same flaw lies within the CMA’s assessment of an appropriate benchmark return.

3.17 The Provisional Findings Report states ‘the competitive margin that is implied by our ROCE analysis can be calculated by applying the WACC to capital employed. This produces an average implied EBIT margin across the Six Large Energy Firms of 1.3%’.

3.18 10.102 then goes on to suggest (though without any robust backing for the assertion) that ‘margins in the range of 1 to 3% would appear to provide a guide to the competitive EBIT margin based on current business models’. Unfortunately this assertion (that 1% to 3% is a guide to competitive EBIT margin) is not correct. The error lies in CMA’s statement that ‘the main activities [of retail supply] are sales and marketing, metering and billing and customer service’. However, sourcing wholesale product from volatile energy markets is a major risk for a stand-alone energy supplier without any generation assets and one which we are constantly focused upon. As far as we can see, the detailed analysis used to determine benchmark WACC and associated EBIT is based upon investment grade entities with generation assets.

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22 10.21 Provisional Findings Report
23 10.28 Provisional Findings Report
24 10.39 Provisional Findings Report
3.19 The findings state that retailers can ‘manage residual demand risk and wholesale price risks through the use of effective forecasting and hedging’. This is true, but there can be significant costs and capital involved in this activity, particularly when the risk to be managed is viewed over an appropriate time span.

3.20 In a similar error to that outlined in 3.13, the CMA has taken an inappropriate level of comfort from the service provided by Shell. Without the ‘benevolence’ of a trading intermediary, a Stand-alone Retailer must source its energy products from the wholesale markets and post collateral. This requires significant access to working capital/credit facility. For a supplier the size of Opus Energy (with around 4TWh forward position), this equates to £100 to £120 million of available capital to independently hedge the portfolio.

3.21 To be able to raise a working capital facility of this level, a supplier must be able to demonstrate to the capital providers that it has a profit level which would support such a credit position, and which is sustainable long term. A VI Retailer (which is investment grade rated) may be able to do this with 1% or 2% EBIT; but importantly a Stand-alone Retailer who is not investment grade credit and who is earning only 1% or 2% is unlikely to be able to do this.

3.22 A turnover of £500 million at 1-2% EBIT gives an EBIT of £5 to £10 million. It would be impossible to raise debt or attract equity to finance the required £100 to £120 million facility needed to independently trade on the basis of this income. This is further backed up by our analysis of Just Energy in section 3.34 below.

3.23 Without incorporating this distinction into its analysis, the CMA ends up proposing a benchmark which is not a credible commercial proposition for any supplier (other than a VI Retailer).

3.24 The reason why a finance provider will require sufficient sustainable returns before providing financing is because it will look at risk over a longer time horizon than the five years that the CMA has investigated and carry out a more robust analysis of the risk of being a Stand-alone Retailer. The typical UK Stand-alone Retailer is not a desperately attractive proposition when viewed from a historical perspective.

3.25 The last five years have been a benign period for Stand-alone Retailers in terms of wholesale volatility. Figure 3.1 below shows movements in the 1 year wholesale gas and electricity indices over the last five years. There was been a gentle rise in prices over the period.
3.26 However, as can be seen from figures 3.2, the markets have not always been so benign. A supplier must be able to withstand the types of price shocks which have not been experienced in the last five years, but which have been experienced in the last 10 to 15 years.

3.27 In 2008, price shocks caused the Stand-alone Retailers Bizz Energy and Electricity for Business to fail and exit the market. Their customers were acquired by Centrica (a SLEFs).

3.28 The trading intermediary providing services to Bizz Energy at that time was BHP Billiton.
subsequently withdrew this product from the market place.

3.29 By relying upon the product offering of Shell as a proxy for the differential between the VI Retailer and the Stand-alone Retailer, the CMA shapes a market where the competition to incumbency can only survive if this wholesale trading intermediary decides to continue offering products to market. We doubt that offering shape product to UK niche energy retailers is core to Shell and as such it is difficult for the CMA to suggest this is an appropriate market mechanism on which to base competition for the UK’s energy sector. Were there a range of wholesale intermediaries this might be a different matter. There are not. That is why Ofgem introduced the Secure and Promote licence conditions on the SLEFs.

3.30 Putting aside the fact that the CMA has only used domestic suppliers (and then extrapolated to propose remedies for a business market), the CMA must properly consider the extent to which the chosen benchmarks could raise collateral to support continued growth in the absence of a solution from Shell.

3.31 The CMA reference Just Energy as an example of a Stand-alone Retailer which is now posting collateral. In Appendix 10.3 of the Provisional Findings Report the CMA suggest that Just Energy hedge their entire portfolio through an $80m cash position on their 2015 Balance sheet and “this demonstrates that that a stand-alone supplier of scale could adopt more cost-effective means of accessing the wholesale market than the fee arrangement that we have assumed”.

3.32 This analysis is simply wrong and is selectively using data to underpin the CMA’s argument.

3.33 Whilst Just Energy had a cash position of $79m on its balance sheet this does not tell half the story. From note 26 of their 2015 accounts they had Long term gas and electricity contracts totalling some $4.1 billion. In order to hedge the commodity part of these contracts Just Energy has a $210m credit facility and in addition it has some further $674m of long term debt. The finance costs of this debt including the $210m credit facility was some $74m per annum. In the accounts it notes that “Just Energy is required to meet a number of financial covenants under the credit facility agreement. During the year ended March 31, 2015, the Company requested and received amendments with respect to covenants within the credit facility. As at March 31, 2015, the Company was compliant with all of these covenants.” The details of these covenants are not publicly available but given that requested amendments were made, one may be able to assume that the profitability was not way in excess of what was needed to be able to support a credit facility of $210m.

3.34 In the year ending 2015 Just Energy had an EBITDA of $180.4 on sales of $3.895bn representing an EBITDA of 4.6%. Public information is not available as to the EBIT required by the syndicate of lenders for the $210m credit facility but we would expect it to be higher than 1-2%, principally on the basis that an EBIT of 1-2% would not be enough to cover the finance costs on its long term debt financing of $74m per annum.

3.35 Over the last four years, Just Energy has sustained an EBITDA of 4.6 to 6.6%. Annual figures are shown in the table below:

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25 Appendix 10.3 Paragraph 74
26 All figures related to Just Energy are Canadian Dollars
3.36 The CMA presents Just Energy as proof that hedging can be carried out at a “cost several multiples” less than the Shell deal. In fact the credit facility is several multiples higher than the $80m suggested by the CMA and issued on the basis of an EBITDA of nearly 5% which is several multiples higher than the benchmark EBIT proposed by the CMA as a sustainable return.

3.37 This finding is consistent with evidence we produced to the CMA as the EBIT margin required by a Stand-alone Retailer to be able hedge its portfolio in a stable and sustainable fashion.

3.38 On the basis of the above evidence, we urge the CMA to:

(a) Widen the time frame of its analysis from 5 years in order to be able carry out a fuller analysis of the risk undertaken by a Stand-alone Retailer in sourcing wholesale products for its customers;

(b) Properly assess the cost advantage of being a VI Retailer over a Stand-alone Retailer and carry out this exercise separately for the domestic and the non-domestic markets; and

(c) Reassess the appropriate benchmark WACC using a sustainable EBIT margin for a Stand-alone Retailer in both the domestic and business sectors – both of which should constitute a credible commercial proposition for that sector.

3.39 COMPETITIVE BENCHMARK PRICES AND COSTS

3.40 Similar to our views given above, we consider that a company operating with the benchmark costs outlined in section 10.43 to 10.57 of the Provisional Findings Report would not be a credible commercial proposition for a Stand-alone Retailer. The operator with these benchmark costs would have to be an investment grade, VI retailer to survive long term.

3.41 This is because:

(a) Wholesale Costs - A Stand-alone Retailer would not be able to achieve a wholesale cost base equivalent to that of the lower quartile of the SELFs and, for the reasons outlined in sections 3.20 to 3.27 above, the small uplift added (related to the Shell trading premium) would not act as an appropriate proxy for the additional costs a sustainable Stand-alone Retailer would face;

(b) Indirect Costs – We feel that, with regard to indirect costs, the CMA has omitted to take the customer into account. The UK energy supply sector has one of the worst net promotor scores of any industry in the country. This is partly down to the poor levels of service provided to customers. Should there be some consideration of the service that would be provided by a

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Table 2 para 75 CMA A10.3-46

<table>
<thead>
<tr>
<th>YE2015</th>
<th>YE2014</th>
<th>YE2013</th>
<th>YE2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue (CAD$m)</td>
<td>3,896</td>
<td>3,535</td>
<td>2,882</td>
</tr>
<tr>
<td>Base EBITDA (CAD$m)</td>
<td>180.4</td>
<td>167.7</td>
<td>142.5</td>
</tr>
<tr>
<td>Margin</td>
<td>4.63%</td>
<td>4.7%</td>
<td>4.9%</td>
</tr>
</tbody>
</table>

Source

Revenue: Just Energy Annual reports 2012-2015

Base EBITDA: Just Energy Annual report FYE Mar 2015 page 16
company with indirect costs equivalent to a low investor in service costs?

3.42 In relation to the analysis of wholesale costs, we consider the analysis is lacking when it comes to the microbusiness sector. There are material differences between supply to micro business and domestic which do not appear to have been taken into account (as laid out below). In addition, the analysis does not include an independent business supplier for benchmarking analysis. We do not consider that this can therefore constitute a robust analysis of benchmark for the SME sector and question any conclusion based upon it.

(a) PAYMENT IN ARREARS v PAYMENT IN ADVANCE

In the domestic sector, payment by customers is often in advance of supply. One of the benchmark suppliers chosen by the CMA actively encourages customers to leave deposits with them. This is not possible in the business market, where business customers expect payment to be predominantly in arrears. For example Ovo Group Limited (re-named Imagination Industries Limited) from its latest published accounts ending Dec 13 has negligible capital and significant retained losses, yet increased its cash balances four fold during the year in excess of £8million. A loss making SME supplier in a similar financial position, without capital, would have had to stop trading by this point. A supplier to the business sector faces a higher working capital requirements from a supplier to the domestic sector.

(b) HEDGING PROFILE

Domestic customers are predominantly supplied under 30 days’ notice contracts (with a 12 to 18 month forward hedge profile) or under a 12 month fixed term (with a 12 month forward hedge profile). In contrast, suppliers to business customers must be able to offer products of up to 36 months’ in tenor. This creates collateral requirements for business suppliers which are significantly above those of domestic suppliers. For this reason also, a supplier to the business sector faces higher working capital requirements compared to a supplier to the domestic sector.

3.43 It is essential that the CMA conducts a more robust analysis of what would constitute a credible Stand-alone Retailer benchmark including a separate analysis for each distinct market. If it does not do this it will (i) support the creation of a marketplace in which only VI Retailers will be able to survive price shocks, (ii) will propose price intervention which can only be borne by the VI Retailers and (ii) will disproportionately damage competition in the business market and bring harm to microbusiness consumers.

3.44 MARGIN BENCHMARKING

3.45 We find the CMA’s conclusion in relation to margin benchmarking concerns us on two aspects.

(i) It is proposing remedies for the business sector based upon analysis of benchmark mid-tier suppliers from the domestic market.

(ii) The proposed remedy of price intervention, if implemented with the desired effect of capping SVTs and reducing average retail prices for all suppliers, would (by our assessment) cause at least one of the benchmark mid-tier suppliers to become loss making.

3.46 If the proposed remedy (of a ‘safeguard tariff’) successfully reduces average prices for the Big 6, yet at the same time drives challenger brands out of the marketplace, can this be said to be a net benefit for
consumers? We would argue not.

3.47 CONCLUSION ON ROCE AND BENCHMARKING

3.48 To conclude, we challenge the CMA’s assertion that market average prices have been substantially above the level one would expect to see in a well-functioning competitive market and that average prices offered by the Six Large Energy Firms were 5% above the competitive level in the domestic sector and 14% above the competitive level in the SME segment. We feel that the analysis underlying this conclusion is fundamentally flawed.

3.49 We also see that it is evidentially not the case that market average prices of domestic and microbusiness sectors have been substantially above the level one would expect to see in a well-functioning competitive market.

3.50 If it were true, there would be a slew of equity chasing after these ‘super returns’ – and there has not been. The well-funded investment-grade organisations who service the I&C sector (who already have the right skills and systems to service domestic and microbusiness consumers) would also enter these markets. They do not.

3.51 It is our view that such assertions are unhelpful. They feed misleading headlines and they hinder the progress of returning trust between consumers and suppliers.

3.52 Were average prices reduced to what the CMA has identified as the ‘benchmark’ level, some of the Six Large Energy Firms and all of the independent suppliers (who make less returns) would be loss making and only vertically integrated investment grade players would be able to run sustainable supply businesses.

3.53 We consider this mistaken conclusion has been arrived at because the analysis has failed to take into account the true costs faced by Stand-alone Retailers (compared to VI Retailers) and the returns needed to support a Stand-alone Retailer over a prolonged period of time.

3.54 We suggest the CMA needs to do further analysis to understand the environment needed to support challenger brands through wholesale price shocks and full economic cycles. Otherwise the CMA’s proposed remedy creates a marketplace in which consumers are being forced to take incumbents’ products at slightly reduced margins, and choice, service standards and product innovation may fall away.

3.55 We would also request that the CMA refocuses its efforts on finding ways to improve the products and services provided to customers and help the industry to restore trust. Unsubstantiated figures designed to grab headlines and perpetuate a myth that the big 6 are ripping customers off is no solution. The industry has a lot to deliver customers over the next few years - a move to smarter markets, HH settlement, raising general service levels up to appropriate standards, figuring out how to continue to green our economy without making UK businesses uncompetitive and without loading costs onto fuel poor vulnerable customers. This is going to involve all government bodies truly putting the customer at the heart of what they do, supporting challenger brands and ensuring that policy recommendations are properly assessed for their full and true impact on consumers.
Appendix 1 – Response by Question

Remedy 1 – Introduction of a new standard condition to electricity generators’, suppliers’, interconnectors’, transmission, and distribution licences to require that variable transmission losses are priced on the basis of location in order to achieve technical efficiency

If it is considered that this remedy will reduce customer bills by better allocating capital, we support this. As the supplier cannot influence the pricing of losses, we would suggest that this should be a condition within network operator licences. To ensure customers do not receive unexpected price movements within contract term, we would recommend that any changes are signalled over a three year period prior to implementation.

Remedy 2a – DECC to undertake and consult on a clear and thorough impact assessment before awarding any CfD outside the CfD auction mechanism
Remedy 2b – DECC to undertake and consult on a clear and thorough assessment before allocating technologies between pots and the CfD budget to the different pots

We support both of these proposals as they would ensure that CfD subsidies would in future be provided in a manner which is least cost to consumers.

Remedy 6 – Ofgem to provide an independent price comparison service for domestic (and microbusiness) customers

We have a concern that were a regulator to provide this service it might reduce the financial viability of commercial ventures continuing to offer this service. This might mean that high quality switching sites are withdrawn from consumers only to be replaced by an inferior government provided service and this will lead to fewer customers switching.

Remedy 7 – Measures to reduce actual and perceived barriers to accessing and assessing information in the SME retail energy markets

Remedy 7a – Introduction of a new requirement in the licences of retail energy suppliers to provide price lists for microbusinesses on their own websites and to make this information available to PCWs
(a) Would this remedy be effective in increasing price transparency for microbusiness gas and electricity tariffs? Would it serve to make comparisons between different suppliers easier, either directly or by encouraging the development of PCW services for microbusinesses? If not, are there other measures that would encourage this development either as an alternative to this remedy or in conjunction with it?
(b) Do microbusinesses have sufficient access to the information they need (for example on their meter types) in order to engage effectively in the search and switching process?
(c) How long should energy suppliers be given to provide the required information?
(d) Should energy suppliers be permitted to fulfil this requirement by providing an automated quoting service on their websites (where microbusinesses can put in their details in order to obtain quotes) rather than a list of prices?

We support a requirement on suppliers to offer these services as it will enhance a microbusiness customers’ ability to search for prices and to compare product offerings. Care must be taken to ensure that the provision of prices to PCWs does not force suppliers to shoe-horn their product offering into standard formats and thereby prohibit product innovation.

For microbusinesses, an automated quote service would be preferable to a price list as business tariffs are typically more differentiated than domestic tariffs according to the customer’s meter type and this will assist a customer easily finding the right tariff.

Consideration will need to be given as to how to handle differences in credit profiles.

Remedy 7b – Introduction of rules governing the information that TPIs are required to provide to microbusiness customers
(a) Would this remedy be effective in improving transparency over incentives and trust in TPIs in the energy sector? How could the CMA ensure that this remedy was enforced, ie that TPIs were providing the specified information?

(b) What information should be provided by TPIs to microbusinesses in order to enable them to make informed choices?

(c) Could the provision of certain types of information have unintended consequences (eg customers choosing tariffs based on commission rates rather than total price)? If so, are there any steps that could be taken to mitigate this effect?

(d) Should the specified information be provided to customers in writing or orally (or both)? At what stage in the sales process should this information be provided?

(e) Should this remedy be introduced in addition to Ofgem’s proposed code of conduct? Or should only this remedy (or only Ofgem’s code of conduct) be introduced?

(f) Are there any additional measures that should be implemented alongside this remedy to enhance its effectiveness?

We support the proposal to introduce the suggested rules for TPIs. For some time most suppliers in the industry have been supportive of the introduction of regulation into the TPI sector in the way proposed by Ofgem (ie TPI code of practice and a requirement on suppliers to only work with TPIs registered to the code). We consider this work is essential to help restore trust in energy markets and TPIs.

We are concerned that Ofgem’s work in this area has been delayed – many of the questions posed here were already being considered by the TPI working group, which is now on hold. We suggest that the CMA’s recommended inclusions to the TPI regulation work are incorporated into the Ofgem working group’s agenda for consideration and for Ofgem to determine with the group how best to implement them.

Remedy 8 – Introduction of a new requirement into the licences of retail energy suppliers that prohibits the inclusion of terms that permit the auto-rollover of microbusiness customers on to new contracts with a narrow window for switching supplier and/or tariff

(a) Would this remedy be effective in allowing microbusiness customers greater opportunity to engage (by removing the narrow window in which they can choose not to roll-over automatically)?

(b) Are there any means by which energy suppliers could circumvent this remedy to continue to lock customers into energy tariffs that they have not chosen for extended periods of time?

(c) What is the minimum or maximum notice period that customers should be required/allowed to give in order to exit a contract that they have been rolled on to?

(d) Should energy suppliers be required to inform customers that they are nearing the end of their contract and prompt them to switch?

All of these questions have already been the subject of lengthy consultations as part of Ofgem’s business RMR. This determined that it would be appropriate for the industry to cease the use of autorollover products but, following voluntary agreement by all of the largest microbusiness suppliers, Ofgem stopped short of implementing a ban in the licence.

We support the proposal to prohibit auto-rollover in the supplier licence. We do not feel that voluntary product withdrawals are the best way to ensure market-wide and long lasting protection for consumers.

With regard to the questions about what information should be given to customers reaching the end of their contract, we would again point to the beneficial work carried out under the RMR business review. This recommended a range of informational measures designed to improve engagement, which have been implemented by suppliers and which are providing demonstrable improvements in customer engagement.

Any further work in this area should really be based on a assessment of the impact of the recent changes (after allowing enough time for them to take effect), and a consultation in conjunction with consumer groups as to the best direction to take to build on successes and also how to apply the lessons learnt from this work to the domestic sector, where we understand the RMR proposals have not been so effective.

Remedy 9 – Measures to provide either domestic and/or microbusiness customers with different or additional information to reduce actual or perceived barriers to accessing and assessing information

(a) Does the current format and content of energy bills facilitate engagement by customers? Is there additional information that should be included on bills? Should the quantity of information on bills be reduced to enhance clarity?
Our own research into customer preferences discovered that customers like to have the important facts about the bill in a clear and easy to read fashion and for additional information to be available at a lower profile should they wish to read it. It is important that requirements from different policies are not creating an overwhelming level of information that needs to appear on bills (e.g., environmental notices, complaints signalling, switching prompts, contract reminders) such that the key messages that the consumer themselves wish to get from their bills are lost.

(b) When customers seek to switch tariffs, are they given enough/too much information on the terms and conditions of their new contract?

Please see our response to remedy 8. We support the work carried out by Ofgem in the non-domestic RMR and feel it has demonstrably improved customer engagement. We would suggest that it used as a template for ‘good regulation’ in terms of promoting switching in the domestic sector.

(c) Should customers be prompted to read their meters (quarterly or annually), either by information on their bill or by a phone call from their energy supplier? Would this increase engagement by improving the accuracy of billing?

Ensuring accurate bills for customers should be a high priority and best achieved through the roll out of smart meters for non domestic customers.

(d) Once customers reach the end of a contract period, should subsequent bills highlight that they have now been moved onto the standard variable tariff and/or other default tariff and encourage them to check whether they are on the most appropriate tariff for them?

Please see response to Remedy 8.

Remedy 10 – Measures to prompt customers on default tariffs to engage in the market

(a) What information should be included in the prompts to customers on default tariffs in order to maximise the chances that they are acted upon?

(i) Should customers who have failed to engage be informed that they are ‘no longer under contract for energy’, that they have been ‘rolled onto a safeguard tariff’, or an alternative message, for example, emphasising how many customers in their area have switched in the last year?

(b) How should prompts be communicated to customers? For example, there is some evidence from the financial sector that text prompts are particularly effective at raising awareness in terms of overdrafts etc.

(c) What should be the timing and frequency of prompts in order to balance effectiveness in terms of encouraging engagement with the cost and potential irritation that might arise from repeated prompts?

(d) Who should provide the prompts: customers’ energy suppliers, Ofgem or another party?

(e) Are there particular groups of customers who should receive prompts at specific points? For example, should house-buyers be prompted to engage with the market on completion of their purchase?

(f) Is there benefit in others in the markets, such as rival energy providers or TPIs, being made aware of which customers remain on default tariffs (or have been rolled on to the safeguard tariff)? In this respect, data protection issues would need to be carefully considered. The ability of other market participants to identify inactive customers, however, has the benefit of potentially encouraging the customer to switch tariffs once out of contract.

Please see response to Remedy 8.

Remedy 11 – A transitional ‘safeguard regulated tariff’ for disengaged domestic and microbusiness customers

We do not support the proposal to introduce a ‘safeguard tariff’ into the non domestic sector. Our reasons for this are outlined in detail in the body of our response above.

Remedy 12a – Requirement to implement Project Nexus in a timely manner
This remedy would require Xoserve and the gas suppliers, together, to ensure that Project Nexus is implemented within a given time frame in order to address most of the current inefficiencies in the gas settlement system without undue delay.

a) How long should parties be given to implement Project Nexus
b) Should the CMA implement this remedy directly (eg. via an order and/or licence modification) or should it make a recommendation to Ofgem to implement the remedy?

We support the steps already taken by Ofgem to strengthen the governance, management and assurance of Project Nexus in order that the benefits to consumers are delivered as soon as is possible. Considerable progress has been made by both the project assurance manager and the industry steering group in regards to assessing the state of play of the implementation of Nexus and the complexity of issues faced by industry parties, resulting in a revised implementation plan for all parties to work to. We feel that there would be little benefit at this stage for the CMA to implement this remedy directly and that it would not improve on the current implementation timescales.

Remedy 12b – Introduction of a new licence condition on gas shippers to make monthly submissions of Annual Quantity updates mandatory

a) Is it proportionate to require the mandatory monthly updating of AQs? Would it be more proportionate to require less frequent updating of AQs? Would less frequent updates remove the scope for gaming?

The potential for ‘gaming’ AQ updates should be largely removed by the implementation of Nexus. Post implementation, all sites will automatically get a new AQ monthly as long as they have had new reads and all sites will be reconciled to reads so there are limited incentives for gaming - as with LSPs in the current world. The shipper has no influence on what the new AQ value will be or when it gets changed (except maybe a few immaterial error processes). The only scope for gaming would be to deliberately not submit certain reads but this would be easily visible and they would have to be submitted eventually. We would suggest the UNC modification UNC 520 which proposes introduction of Performance Assurance Reporting requirements due to Settlement risks associated with Project Nexus is a better and more proportionate solution to this issue rather than mandated monthly AQs.

Remedy 13—Requirement that domestic and SME electricity suppliers and relevant network firms agree a binding plan for the introduction of a cost-effective option to use half-hourly consumption data in the settlement of domestic electricity meters

We suggest that Ofgem use the Electricity Settlement Project (Smarter Markets Programme) to develop and agree a plan in conjunction with industry to introduce a cost effective option to use half-hourly consumption data in the settlement of domestic electricity meters.

We note the work already undertaken by Ofgem’s Smarter Markets programme which included the launch of an electricity settlement project in 2014. The project focussed on domestic and smaller non domestic customers (profile classes 1-4) and included the settlement of both import and export. Two areas of reform were considered by an expert group, convened to inform thinking - the options for optimising certain parts of the existing arrangements for settlement with HH data, so that they can accommodate millions of sites in a cost-effective way, and the options for how to transition the market to any new arrangements for sites that are not currently settled using HH data. From this, Ofgem shortlisted potential options including: the timing of settlement; how data is collected and prepared for settlement; the process for estimating data when it’s unavailable and the rules for the timing of transition to new arrangements.

We understand that as well as this, the Profiling and Settlement Review Group (PRSG) are undertaking a project to reduce settlement timescales in the short to medium term.

In regards to next steps for these projects, we would ask that real consideration is given to the impact of concurrent regulatory change in the market and the ability of market participants, particularly independent participants who do not necessarily have a high level of resource available to manage multiple IT change projects. It would be less risky to the successful implementation of any reform in this area if incremental implementation of the options identified is used, particularly in consideration of the current reforms underway, ie the Smart Meter rollout, Electricity Market Reform (EMR), switching reforms and centralised registration, along with the current programmes for implementation of P272 ‘Mandatory Half Hourly Settlement for Profile Classes 5-8, the Theft Risk Assessment Service (TRAS) and Project Nexus.
Remedy 15 – More effective assessment of trade-offs between policy objectives and communication of impact of policies on prices and bills

a) Are such assessments of the impacts of policies on prices, bills and on the trilemma trade-offs carried out to a sufficient extent currently? Are there specific areas where such assessments are not currently carried out, or might be undertaken more comprehensively?

b) Are the assessments sufficiently scrutinised?

c) Are the assessments sufficiently disseminated to interested parties? Which parties need to be informed about these assessments?

d) Is there an additional role for either Ofgem and/or DECC in carrying out assessments of the impacts of policies and trilemma trade-offs, or communicating the results of them?

e) Should further, authoritative analysis be published to assist the public discussion? What form might this take?

f) Which existing bodies are best positioned to undertake this role?

g) Is there a sufficient case to justify creating a new, independent body tasked with scrutinising the impact assessments of policymaking bodies and/or providing authoritative analysis to inform the public debate?

We have consistently struggled to get DECC to consider the impact on cost for consumers of new policy measures. To date, we have not had this difficulty with Ofgem, who have been open to understanding the wider implications for consumers of policy proposals.

We agree that a more effective assessment of the costs and benefits for consumers of policies across all government bodies would be beneficial. Creating a consumer champion with understanding of economic issues might be the solution, but this may be a costly way to achieve it. It may be that all that is needed is a robust impact assessment process for all energy policy generating bodies which includes an assessment of the policy’s likely impact on domestic and business consumer bills with an objective to minimize these on par with other objectives.

Remedy 16 — Revision of Ofgem’s statutory objectives and duties in order to increase its ability to promote effective competition

We support this proposal.

Remedy 17 – We have no comment to add in relation to Remedy 17.

Remedy 18a – Recommendation to DECC to make code administration and/or implementation of code changes a licensable activity

a) Is this recommendation likely to result in a positive change in the initiation, development and/or implementation of code changes that pursue consumers’ interests?

b) Would this remedy be more effective if certain functions currently carried out by code panels and/or network owners (eg setting up working groups) were transferred to code administrators?

Further standardisation of the governance arrangements for code changes across the codes is a simple and beneficial step leading to having a single set of best practice governance arrangements across all codes; this could bring clear benefits to the accessibility of the codes via the change process.

It is already recognised that there is a need to update and improve the governance arrangements of the industry codes that support the gas and electricity arrangements in Great Britain, in particular to improve transparency and accessibility for all industry participants, particularly smaller parties and new entrants, by better aligning the modification processes and establishing common principles across the industry codes. Another important issue is the outdated structure of the voting weighting system, which doesn’t reflect the number and variety of suppliers in the market today. The current voting weighting allows dominance by the Big 6 in all decisions, there is limited to no opportunity for an independent supplier to influence voting decisions and voting needs to change to fairly reflect the views and needs of independent challenger brands.

Remedy 18b - We have no comment to add in relation to Remedy 18b.
Remedy 18c – Appointment of an independent code adjudicator to determine which code changes should be adopted in the case of dispute

a) Are there benefits in terms of independence, impartiality and/or industry know-how of an independent code adjudicator that are not available with Ofgem, given its other responsibilities, when undertaking the adjudicator role?

b) Would there be unintended consequences, arising for instance from an increased lack of coordination between code modification governance, licence modifications and legislation?

The establishment of an overarching Design Authority could benefit the code modification process by delivering a joined up approach to code changes which may deliver efficiencies in implementation, development and structure of the codes. The governance, remit and representation on this body would need careful consideration to ensure it does not simply add further bureaucracy. If implemented, this should be industry led with sufficient representation from across the network codes and should also not preclude parties from raising modification proposals at any time.

The code adjudicator could also be tasked with ensuring code changes promote competition and take into account any impact on consumer bills.