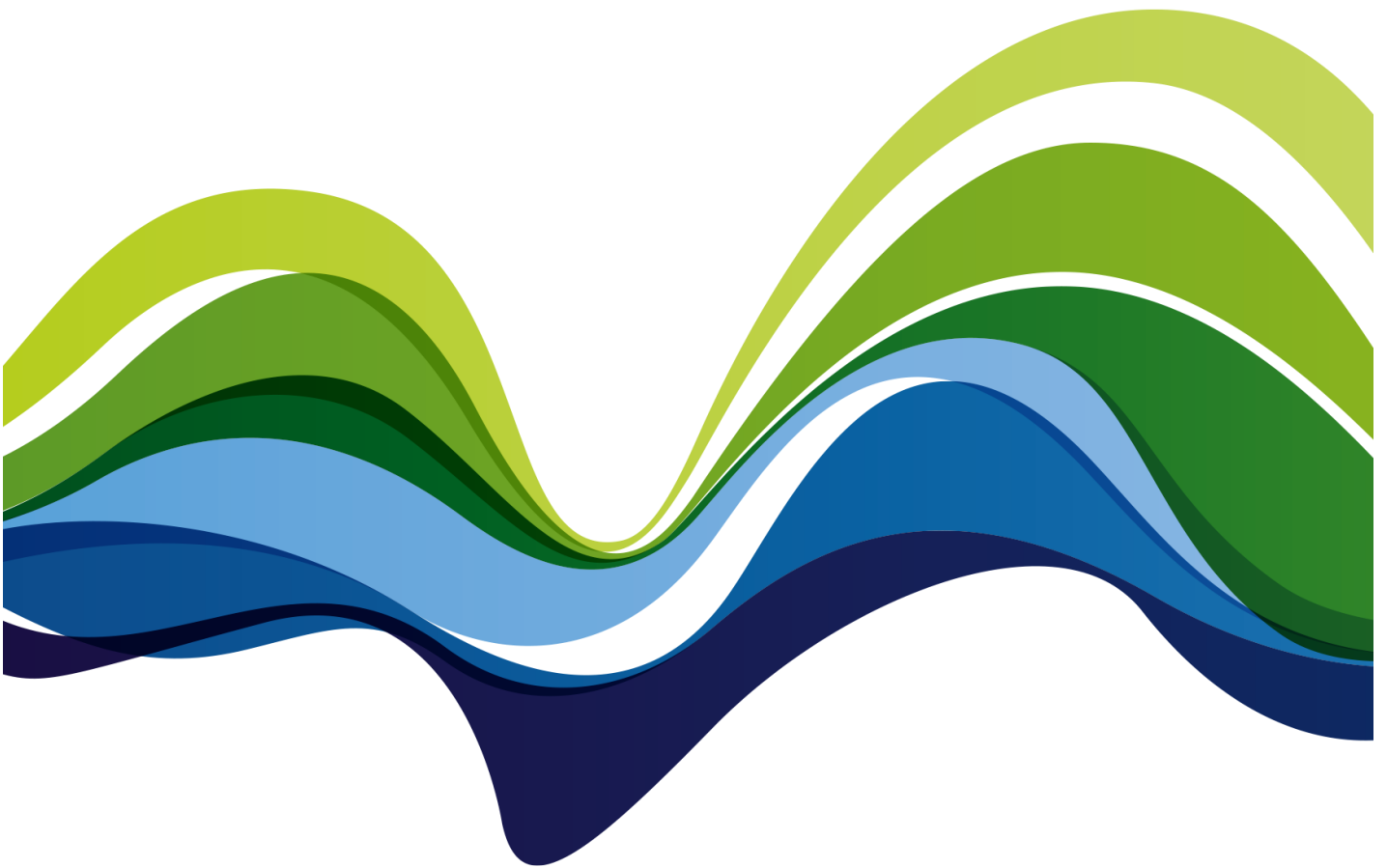


# SSE: Response to Provisional Findings

5 August 2015



## TABLE OF CONTENTS

1.	Introduction .....	1
2.	Executive Summary .....	4
3.	The provisional finding that an “ <i>overarching feature</i> ” of weak customer response in the domestic sector gives rise to an AEC is not supported by the evidence .....	12
4.	Removing the “ <i>simpler choices</i> ” component of the RMR rules will enable suppliers to compete and innovate more effectively and address any AEC in relation to domestic retail markets.....	39
5.	The PFs’ analysis of specific demographic groups that are “ <i>less likely</i> ” to be engaged in domestic retail energy markets does not provide a reliable basis for robust conclusions to be drawn and risks over-stating the extent of disengagement of vulnerable-type customers.....	44
6.	Revising the current system for gas settlement would reduce distortions and incentivise innovation and efficiency .....	50
7.	Moving to HH settlement for domestic customers should, in due course, enable suppliers to compete and innovate more effectively .....	52
8.	The provisional finding that an “ <i>overarching feature</i> ” of weak customer response in the microbusinesses sector gives rise to an AEC is not supported by the evidence .....	53
9.	The provisional finding that the absence of locational pricing for transmission losses gives rise to an AEC is not supported by the evidence.....	63
10.	The provisional finding that the mechanisms for allocating CfDs give rise to an AEC is not supported by the evidence .....	67
11.	The provisional finding that the lack of a regulatory requirement for clear and relevant financial reporting is a feature of the market that gives rise to an AEC is not supported by the evidence .....	70
12.	Improving the robustness and transparency of regulatory decision-making would help to avoid future regulatory distortions and promote pro-competitive outcomes for consumers.....	73
13.	The system of governance of industry codes offers scope for improvement .....	74
14.	The analysis of customer detriment provided in the PFs is seriously deficient.....	77

## SSE: RESPONSE TO PROVISIONAL FINDINGS

**1. Introduction**

- 1.1.1 This paper provides the response (the **Response**) of SSE plc (**SSE**) to the Provisional Findings Report (**PFs**) issued on 6 July 2015 by the Competition and Markets Authority (**CMA**).
- 1.1.2 In the round, the PFs provide a thorough and well-evidenced record of the overwhelmingly positive features of the GB energy markets. In particular the PFs set out that:
- The key elements of the wholesale market are working well and are highly competitive. The generation sector is competitive and diverse. Wholesale electricity markets are liquid,<sup>1</sup> offer prices that are transparent,<sup>2</sup> and operate efficiently.<sup>3</sup> The wholesale gas market is “*relatively unconcentrated*” and “*healthy*” on “*all measures of liquidity*.”<sup>4</sup>
  - There is “*no evidence*” that vertical integration (**VI**) is “*likely to have a detrimental impact on competition for independent suppliers and generators*.”<sup>5</sup> In particular, VI does not “*affect liquidity*” and raise barriers to entry.<sup>6</sup> The VI model offers significant potential for efficiencies and benefits to consumers.<sup>7</sup>
  - A significant number of positive features are identified in the domestic supply markets. There has been a “*rapid expansion*” in the market shares of suppliers outside the six large energy firms, leading to “*falling levels of concentration in energy supply*.”<sup>8</sup> The PFs also contain extensive examples of suppliers seeking to compete on price, innovative tariffs, or through a wide variety of different product offerings. The CMA also notes the various strategies of energy suppliers aimed at “*improving customer service, promoting trust and providing value-added products and services*.”<sup>9</sup> The PFs highlight a number of supplier initiatives to support and engage vulnerable-type

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<sup>1</sup> PFs, Appendix 6.1, paras. 89 – 91 and 102.

<sup>2</sup> PFs, para. 5.20.

<sup>3</sup> PFs, paras. 5.17 – 5.18.

<sup>4</sup> PFs, paras. 4.21, 4.38.

<sup>5</sup> PFs, paras. 72 – 79.

<sup>6</sup> PFs, para. 6.27.

<sup>7</sup> PFs, para. 79.

<sup>8</sup> PFs, para. 7.101 – 7.102.

<sup>9</sup> PFs, Appendix 7.3, para. 11.

customers, and highlight that all of the six large energy firms have “*offered discounts to vulnerable domestic customers.*”<sup>10</sup>

- Market developments will have (and are already having) a positive impact on the market. For example, the roll-out of smart meters will “*increase competition within energy supply markets.*”<sup>11</sup> Other measures are in train to “*increase the reliability and speed of switching, as well as reducing its complexity and cost.*”<sup>12</sup> Furthermore, recent liquidity initiatives adopted by Ofgem have had positive effects in terms of “*increased transparency*” and have “*facilitated the engagement of (small) parties.*”<sup>13</sup>

1.1.3 Notwithstanding these positive features the CMA has identified, the PFs identify some potential indicators of competitive harm within the retail sector. The assessment is often at odds with SSE’s experience of the market and is not supported by the evidence. In particular:

- (a) *Customers are engaged.* The CMA’s survey underlines that the vast majority of customers are aware of their ability to switch tariff, payment method, and supplier, that switching rates are material (and increasing), and that there are high levels of customer satisfaction (with over 70% of customers being satisfied with their supplier).

SSE has on average, gained 1 million customers and lost 1.2 million customers every year since 2009. Switching levels compare favourably with those in other consumer markets, including those that the CMA might consider less “*homogenous*”, and therefore on the CMA’s analysis more likely to switch (such as mobile phones), or that typically account for a higher proportion of household expenditure. Customers also engage in a wide variety of other ways; for example, SSE had 1.4 million internal tariff switches in 2014 (up from 500,000 in 2013).<sup>14</sup>

The CMA’s assessment of engagement relies mainly on its customer survey and gains from switching analysis. However, the evidence has not been properly assessed in the round against a reasonable counterfactual of a well-functioning market.

- (b) *High quality customer service is a key part of SSE’s competitive offering.* The CMA’s survey underlines that high quality customer service is an important consideration for the majority of customers (more than 80% of customers rate good customer service as essential or very important when considering their choice of supplier). SSE has

<sup>10</sup> PFs, Appendix 7.3, para. 48.

<sup>11</sup> PFs, Appendix 8.6, Annex C, para. 6.

<sup>12</sup> PFs, para. 8.116.

<sup>13</sup> PFs, para. 11.156.

<sup>14</sup> This figure does not include customers changing payment method or billing type.

consistently been voted best for customer service since 2006 in the uSwitch Customer Satisfaction Reports and leads the six larger energy suppliers in terms of complaints handling. The Energy Ombudsman has praised SSE's complaints handling before the CMA.

- (c) *Prices are not excessive.* The CMA's analysis of "*competitive*" prices is not grounded in a realistic assessment of a well-functioning market. In order to be "*efficient*," on the approach in the PFs, a supplier is assumed to have perfect foresight in its energy purchasing decisions, despite the fact that this is an impossibility over time given the inherent uncertainties around fluctuating demand and wholesale costs. Once these assumptions are corrected, it is clear that average retail prices are fully competitive.
- (d) *Profits are not excessive.* By the CMA's own assessment, industry retail margins are 3.3%. In the 2014/15 financial year, SSE made a profit of only £69 per dual fuel customer. At an average of 5.9%, SSE's SME margins are considerably lower than the industry average of 7.9%. The CMA's return on capital employed (**ROCE**) analysis is not a robust measure of retail supply profitability in principle and in practice the CMA's ROCE figure translates into a margin of just 1%, or £8 per customer account, which is very close to the CMA's WACC. In addition to being at odds with the CMA's own observed margin of over 3%, this level of return would clearly be unsustainable and would adversely impact competition by deterring new entrants. The CMA's analysis of profits is therefore internally inconsistent and produces wholly implausible outcomes. These errors need to be corrected and a more robust assessment of industry profitability factored into other elements of the PFs including the assessment of customer detriment.

\* \* \*

- 1.1.4 The remainder of this Response first sets out an overview and executive summary on the CMA's case (*see Section 2*), before in turn addressing each of the adverse effects on competition (*AECs*) identified by the CMA in relation to the retail sector (*see Sections 3-8*), the wholesale sector (*see Sections 9-10*), and the structure and governance of the regulatory framework (*see Sections 11-13*). This is followed by an analysis of the CMA's assessment of consumer detriment (*see Section 14*).

## 2. **Executive Summary**

### 2.1 **AECs identified in relation to the retail sector:**

2.1.1 **The provisional finding that an “*overarching feature*” of weak customer response in the domestic sector gives rise to an AEC is not supported by the evidence** (see Section 3). The CMA’s case is undermined by a series of errors of fact and assessment, combined with extreme assumptions in a series of analyses. This results in conclusions which are divorced from the realities of the market. In particular:

- (a) *Evidence of customer engagement is weighted highly selectively.* The customer survey does not support the conclusion that there is a “*material percentage*” of customers who are disengaged and other available evidence (including in the same survey), which demonstrates significant levels of customer engagement, is ignored. For example, the survey underlines that the vast majority of customers are aware of their ability to switch tariff, payment method, and supplier, that switching rates are material (and increasing), and that there are high levels of customer satisfaction (with over 70% of customers being satisfied with their supplier).
- (b) *The analysis of the potential gains from switching overstates customers’ real-life incentives to switch.* The CMA’s gains from switching analysis overstates the gains available, as well as ignoring relevant evidence on drivers of customer decision-making (e.g., in relation to the importance of non-price factors such as quality of services) from the CMA’s customer survey. The gains available from switching are only around £76-£117 for the median dual fuel customer (before other relevant factors that will influence customer engagement and switching levels, such as search costs, are taken into account).

*The evidence on switching is fully consistent with a high level of engagement.* For the vast majority of customers surveyed who were unlikely to switch supplier in the next three years, the gains from switching available to them were less than their reported required savings (consistent with Ofgem survey data indicating that customers would require a minimum saving of £158 to encourage them to switch). This is fully consistent with a high level of engagement, and has no material connection to the other observations in the PFs about certain categories of customer that the CMA considers less likely to switch.

*The analysis disregards the reality of a competitive market.* Price differentials will always exist in any competitive market to stimulate external switching and other forms of customer engagement (and benchmarking against other consumer industries suggests that customers in the energy sector are highly engaged and competition is working well). The CMA’s analysis therefore leads it to an incorrect

assessment, contributing to the construction of an AEC without regard to material considerations.

- (c) *The “features” of the market that give rise to the alleged AEC are not a function of a lack of customer engagement.* The PFs examine a series of “features” of the market considered to demonstrate a lack of customer engagement. The alleged impact of these features is often over-stated and is not consistent with the findings from the customer survey (which indicates, for example, that the vast majority of consumers find it easy to switch). The PFs also fail adequately to address the consequences on engagement of a material market feature, namely the regulatory framework (in particular the Retail Market Review (**RMR**) rules), and the impact that this has had on customer activity.
- (d) *SSE does not price its standard variable tariffs (SVTs) above the level that is justified by costs or price discriminate between SVTs and non-standard tariffs (NSTs).* Any differences in the pricing of SSE’s NST and SVT tariffs are driven by regulatory or cost considerations. None of these factors imply that there is less competition for SVT customers than for customers taking up NSTs. The CMA’s cost pass-through analysis provides no evidence that suppliers are pricing SVTs above a level justified by cost, in particular because the CMA’s analysis has materially underestimated the extent to which costs have increased over the Relevant Period.<sup>15</sup>
- (e) *SSE’s profits are not excessive by any relevant benchmark.* In principle, ROCE is not an appropriate measure of retail supply profitability, given the asset-light nature of the business, and that the estimations and assumptions required are liable to lead to extreme conclusions that are detached from the market reality, as has happened in the present case. The PFs disregard the internal inconsistency of the ROCE figure, which translates into a margin of just 1%, compared to the CMA’s observed margin of over 3%. Furthermore, this 1% margin equates to a profit of just £8 per customer account. This level of return would clearly be unsustainable and would adversely impact competition by deterring new entrants. The CMA’s ROCE analysis is vitiated by errors and unsound assumptions, in particular:
  - (i) Factual errors relating to the asset value of Renewables Obligation Certificates (**ROCs**) (which is understated) and imbalance costs (which are excluded completely) over-state SSE’s out-turn profitability by over [X] percentage points.
  - (ii) The costs of managing the levels of risk associated with energy retailing are fundamentally understated. The CMA assumes that such business risks can be entirely accommodated through

<sup>15</sup> The Relevant Period means the five-year time period beginning 1 January 2009 and ending 31 December 2013 – see CMA, *Retail Supply Financial & Market Questionnaire* (the **SQ**), p. 1.

arrangements with third party intermediaries (although little meaningful evidence is provided to support this position). Based on SSE's experience of the market, the arrangements suggested in the PFs are wholly unfeasible for a stand-alone supplier of scale and certainly were not available during the Relevant Period. Even if such arrangements were to become more widespread, the CMA's analysis suggests that they would not cover all relevant risks or the collateral required for trading in near-term markets. The CMA's analysis also neglects to reflect properly the impact of the charge over assets that a supplier would be required to provide under such arrangements.

- (iii) Irrespective of the role that a trading intermediary might play, the PFs' treatment of capital employed and the need for regulatory collateral is wholly inadequate. The CMA's analysis underestimates the level of working capital that would be required and wrongly rules out the need to include any regulatory capital.
- (iv) Despite SSE's adjustments being conservative, SSE's analysis suggests that, once these errors and unsound assumptions are corrected, the estimated ROCE for SSE would fall to [~~8~~] % and the estimated average ROCE of the six large energy firms to 16%. The average ROCE is very close to the CMA's WACC. SSE is at that level, as is another firm; a third firm is loss-making. In view of this analysis, it is clear that the CMA's analysis provides no robust and reliable evidence to suggest that the ROCE across the six large energy firms is at a level that would be consistent with excessive profits.
- (v) The suggestion that the results of the ROCE analysis are consistent with what the CMA considers to be the "*most informative*" comparators (*i.e.*, the gross margins of mid-tier suppliers and I&C customers) is simply not correct. The PFs ignore the fact that the gross margins of the mid-tier suppliers are too low to be directly comparable (because of differences in the customer mix of the mid-tier suppliers and the altogether different stage of the business cycle of those firms). The CMA apparently accepts that the I&C sector is lower risk but then arrives at the perverse conclusion that a business that is higher risk (*i.e.*, serving domestic and SME customers rather than I&C customers) should attract a lower margin.
- (f) *Average consumer prices are consistent with the levels that would be expected in a well-functioning market.* The CMA's analysis of "*competitive*" prices is not founded on a benchmark consistent with the CMA's own guidance, and is based on a wholly implausible cost model.



- (i) The CMA’s proposed adjustments to energy costs are based on a series of unrealistic assumptions. The costs of an “*efficient*” supplier are assessed by reference to the lowest quartile of energy costs achieved in each year (despite the fact that no single supplier has achieved costs that place it consistently in the lower quartile over the Relevant Period). The approach taken by the CMA seems to imply that a supplier would be expected to re-open a concluded long-term contract with a generator, setting aside any contractual constraints, at the point at which the contract became (even temporarily) less beneficial to the supplier, but fails to consider the knock-on effect that this would have on the generation market (*i.e.*, less plant would be available) and wholesale prices (*i.e.*, prices would be higher).
- (ii) The CMA’s proposed adjustments to indirect costs incorporate material errors of fact and assessment and do not reflect reality. Again, the costs of an “*efficient*” supplier are assessed by reference to the wholly unfeasible standard of the lowest quartile of indirect costs achieved in each year (despite the fact that no single supplier has achieved costs that place it consistently in the lower quartile over the Relevant Period).
- (iii) The CMA’s proposed adjustments to the capital base also incorporate material errors of fact and assessment and do not reflect reality. In particular, the CMA’s crude approach of combining debtor days on the lower quartile and creditor days on the upper quartile ignores commercial reality and produces a working capital benchmark that is lower than that achieved in practice by any supplier.

2.1.2 **Removing the “*simpler choices*” component of the RMR rules will enable suppliers to compete and innovate more effectively and address the AEC in relation to domestic retail markets** (*see Section 4*). The PFs correctly recognise that certain of the RMR measures have restricted suppliers’ ability to innovate and offer tariffs tailored to customers’ personal circumstances. SSE considers that other concerns identified in the PFs could also be addressed by amending existing regulations, for example by reducing the prescriptive rules imposed on customer communications, facilitating customer choice and supplier innovation in tariff design and removing the bureaucracy associated with customer requests to change their payment or billing method.

2.1.3 **The PFs’ analysis of specific demographic groups that are “*less likely*” to be engaged in domestic retail energy markets does not provide a reliable basis for robust conclusions to be drawn, and risks over-stating the extent of disengagement of vulnerable-type customers** (*see Section 5*). SSE is keen to support the CMA in its efforts to consider how best to assist vulnerable-type customers. In SSE’s experience, however, there are few “*hard and fast*” trends within these customer groups, with significant differences in behaviour observed within each group. The CMA’s analysis fails to

disentangle the key drivers of customer disengagement from the factors that are merely correlated with these drivers. The evidence shows that demographic variables such as age and income do not have a significant effect on switching behaviour and attitudes to switching, once key factors such as internet access are controlled for. The CMA's intentions, while laudable, therefore fail to achieve their stated purpose (and the analysis provided would not be capable of supporting wide-ranging remedies of the type that appear to be under consideration in the Notice of Possible Remedies).

- 2.1.4 **Revising the current system for gas settlement would reduce distortions and incentivise innovation and efficiency** (*see Section 6*). The PFs correctly recognise that the current system of gas settlement can lead to the inefficient allocation of costs and reduce efficiency. SSE agrees that Project Nexus, once implemented, will effectively address the vast majority of these concerns.
- 2.1.5 **Moving to half-hourly (HH) settlement for domestic electricity customers should, in due course, enable suppliers to compete and innovate more effectively** (*see Section 7*). The PFs correctly recognise that the use of HH consumption data should, as smart meters are rolled out, incentivise suppliers to introduce new and innovative tariffs. Given the relatively early stage of smart meter roll-out, it is premature to conclude that the absence of any “concrete proposal” for the introduction of HH settlement gives rise to any AEC.
- 2.1.6 **The provisional finding that an “overarching feature” of weak customer response in the microbusinesses sector gives rise to an AEC is not supported by the evidence** (*see Section 8*). The CMA's case is undermined by a series of key errors of fact and assessment, which in combination with extreme assumptions in a series of analyses results in findings divorced from market realities. In particular:
- (a) *Evidence of customer engagement is weighted highly selectively.* The CMA's analysis of tariff types attaches undue weight to a relatively small number of microbusiness customers on default tariffs (and is incapable of supporting the CMA's conclusion that these tariffs are “highly prevalent”). The analysis of switching rates is highly partial, and fails to give sufficient weight to the wider body of evidence that switching rates for microbusiness customers are already significant, and increasing. The PFs also fail to address adequately the significant evidence of forms of microbusiness customer engagement other than switching.
  - (b) *The “features” of the market that give rise to the alleged AEC are not a function of a lack of customer engagement.* The impact of these features is often over-stated (in particular given the extensive evidence of customer engagement and activity in the microbusiness sector). The CMA also largely ignores the impact of recent market developments (such as the majority of suppliers, including SSE, putting an end to auto-rollover tariffs), which effectively address many of the concerns that it identifies.

- (c) *Profits and pricing for microbusinesses are not excessive by any relevant benchmark.* The fundamental flaws in the CMA’s profits and pricing analyses are noted above (and explained in detail in [Section 3.5](#) of and [Annex 1](#) to this Response). SSE’s electricity SME margins have fluctuated year-on-year but, at an average of 5.9%, were considerably lower than the industry average of 7.9% for the segment observed by the CMA (with the difference between SSE’s SME and domestic electricity margins being only [~~8~~](%)).

## **2.2 AECs identified in relation to wholesale markets:**

- 2.2.1 The provisional finding that the absence of locational pricing for transmission losses gives rise to an AEC is not supported by the evidence** (*see Section 9*). The purported benefits of locational pricing for losses are, at best, relatively low (around 10p/MWh) and uncertain. Many of the claimed benefits will accrue in any event as a result of existing market developments (such as the planned closure of existing plant) rather than as a result of locational pricing for transmission losses. The introduction of locational pricing for transmission losses would have a negative effect on market certainty and complexity, as well as material cost impact on broader policy objectives. It is out-of-step with EU policy on market coupling and runs the risk of creating competitive distortions between European generators (to the disadvantage of GB generators).

- 2.2.2 The provisional finding that the mechanisms for allocating Contracts for Difference (CfDs) give rise to an AEC is not supported by the evidence** (*see Section 10*). The PFs’ assessment of the Final Investment Decision enabling for Renewables (*FIDeR*) process is unsound and, in particular, fails adequately to consider the transitional nature of that regime (which was, in SSE’s experience, competitive in any case). The PFs also provide no direct evidence to credibly support the assessment of the “*detriment*” that was considered to arise. SSE considers that CfDs should be awarded through a clear and objective process and, in this regard, considers that the division of the budget into pots incentivises the development of new technologies and promotes a broad and competitive mix of technologies in the longer-term.

## **2.3 AECs identified in relation to the structure and governance of the regulatory framework**

- 2.3.1 The provisional finding that the lack of a regulatory requirement for clear and relevant financial reporting by energy firms is a feature of the market that gives rise to an AEC is not supported by the evidence** (*see Section 11*). The suggestion that energy firms are unable readily to provide “*all of the market-orientated financial information*” required by regulators and policy-makers is not supported by the evidence. Where policy and regulation have negatively impacted the market, a lack of company-specific financial information has not been the root cause of this problem.
- 2.3.2 Improving the robustness and transparency of regulatory decision-making would help to avoid future regulatory distortions and promote**

**pro-competitive outcomes for consumers** (*see* [Section 12](#)). As explained throughout this Response, some regulatory initiatives since 2009 have had a negative impact on competition and consumer outcomes. Many of the features of the regulatory decision-making process highlighted in the PFs (including a lack of effective communication of the impact of energy policies, the composition and balance of Ofgem’s statutory duties, and the absence of a formal mechanism for Ofgem and DECC to reconcile policy outcomes) are likely to have had an impact on these unhelpful outcomes. SSE would therefore welcome measures intended to address these concerns.

- 2.3.3 **The system of governance of industry codes offers scope for improvement** (*see* [Section 13](#)). The PFs correctly recognise that a large number of code modifications can be expected in the future and that this work needs to be effectively prioritised and planned. SSE agrees, in particular, that the current code modification processes do not contain an effective mechanism to ensure efficient prioritisation and would welcome measures to address that concern.

## 2.4 **The CMA’s assessment of consumer detriment:**

- 2.4.1 **The PFs’ analysis of the degree and nature of customer detriment relating to the alleged AECs is also seriously deficient** (*see* [Section 14](#)). In the retail sector, the CMA relies principally on its analysis of profitability and competitive benchmarking to establish consumer detriment. As explained above, however, this analysis is fundamentally flawed. Addressing the flaws in the CMA’s approach would show that SSE’s profits are not excessive by any relevant benchmark and that average consumer prices are consistent with the levels that would be expected in a well-functioning market. The degree and nature of consumer detriment suggested by the CMA is therefore materially overstated.

- 2.4.2 In the wholesale sector, the analysis in relation to the FIDeR process is highly speculative (indeed, the CMA acknowledges that the potential efficiency losses that it identifies are merely “*indicative*”). The CMA’s assessment of detriment in relation to a lack of transmission losses for locational pricing is similarly unsound. The claimed benefits are highly theoretical, uncertain in practice, ignore material costs, and are significantly overstated.

## 2.5 **Summary of conclusions**

- 2.5.1 There is much to welcome in the PFs. However, SSE does not agree with the CMA’s findings in a number of key areas and many of the alleged AECs do not reflect the reality of the well-functioning GB markets. For the domestic and microbusiness retail markets in particular, the PFs make a number of material errors of fact and assessment. The PFs fail to give due weight to the totality of the evidence properly, and assumptions and judgments applied are often unreasonable.
- 2.5.2 The CMA’s provisional conclusions that: the “*overarching feature*” of weak customer response in the domestic and microbusiness retail segments; the absence of locational pricing for transmission losses; mechanisms for allocating CfDs; and the lack of clear and transparent financial reporting by

energy firms give rise to AECs, pursuant to section 134 of the Enterprise Act 2002, are therefore not supported by the evidence and the standard of proof, *i.e.*, establishing an AEC to the balance of probabilities, is not discharged.

**3. The provisional finding that an “overarching feature” of weak customer response in the domestic sector gives rise to an AEC is not supported by the evidence**

**3.1 Introduction and overview**

3.1.1 The CMA bases its case that weak customer response in the domestic sector gives rise to an AEC on four findings:

- (a) *First*, the CMA examines various indicators (in particular its customer survey and gains from switching analysis) relating to domestic customer inactivity and lack of engagement as a “*potential source of competitive harm*.”<sup>16</sup> (See Section 3.2.)
- (b) *Second*, the CMA examines the “*specific features*” of the market (*i.e.*, barriers to engagement that the CMA considers that consumers are likely to face) that it considers give rise to the alleged AEC.<sup>17</sup> (See Section 3.3.)
- (c) *Third*, the CMA considers whether this lack of engagement provides suppliers with unilateral market power (*UMP*) over their inactive customer base, which they exploit by pricing their SVTs materially above a level that can be justified by the costs incurred.<sup>18</sup> (See Section 3.4.)
- (d) *Fourth*, the CMA considers whether this is reflected in profit and price levels that are higher than would be expected in a well-functioning market.<sup>19</sup> (See Section 3.5.)

3.1.2 However, as explained in the remainder of this Section, the CMA’s case is undermined by a series of errors of fact and assessment, combined with extreme assumptions in a series of analyses. Moreover, they fail to take account of key differences between market players which is further evidence that market-wide findings are unsound. Accordingly, many of the findings on which the CMA relies are not supported by the evidence. This results in conclusions which are divorced from the realities of the market.

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<sup>16</sup> PFs, para. 8.3.

<sup>17</sup> PFs, para. 8.81.

<sup>18</sup> PFs, para. 8.159.

<sup>19</sup> PFs, para. 10.2.

### 3.2 The CMA's assessment of customer activity and engagement is not supported by the evidence

- 3.2.1 The PFs' assessment of the "*indicators of engagement*" that it considers to establish that customers are inactive and disengaged is highly selective and is undermined by a failure to address all relevant evidence. The "*indicators*" on which the CMA primarily relies – *i.e.*, its customer survey and gains from switching analysis – are treated highly selectively, with other relevant evidence being downplayed or omitted completely.
- 3.2.2 As Littlechild *et al.* point out: "*the CMA's analysis and recommendations are not based on a realistic view of how customers behave, and how their interests are best advanced, but on a theoretical view of how the CMA thinks they ought to act in a hypothetical 'well-functioning market'.*"<sup>20</sup>

#### **The CMA's customer survey does not support the conclusion that there is a "material percentage of customers who are disengaged in the retail energy markets"**

- 3.2.3 The CMA's customer survey demonstrates that consumer engagement is high. In particular:
- (a) Switching levels are commensurate with other markets, including those which the CMA considers are more differentiated.<sup>21</sup>
  - (b) A significant majority of respondents (over 65%) have considered switching or have switched.<sup>22</sup>
  - (c) Consumers are well aware of their ability to switch: 76%, 81% and 89% of respondents were aware that they could switch tariff, payment method, and supplier respectively.<sup>23</sup>
  - (d) Consumers who have switched found the market to be straightforward and navigable; over 65% found shopping around "*easy*."<sup>24</sup>
  - (e) Consumers are satisfied with their suppliers. Dual and single fuel customers record satisfaction ratings of over 70%.<sup>25</sup>
- 3.2.4 These significant findings are wholly inconsistent with the picture that the CMA paints of a "*material percentage of customers who are disengaged in the retail energy markets*."<sup>26</sup>

<sup>20</sup> Littlechild *et al.*, *Submission on Summary of Provisional Findings Report and Notice of Possible Remedies* (16 July 2015) (the **Littlechild PFs and NPR Response**), para. vii.

<sup>21</sup> GfK NOP, *Customer survey report* (20 February 2015) (the **GfK Survey**), p. 15. The CMA has recut the data from the GfK Survey to draw up its customer survey at Appendix 8.1.

<sup>22</sup> *GfK Survey*, p. 18.

<sup>23</sup> *GfK Survey*, p. 39.

<sup>24</sup> *GfK Survey*, p. 51.

<sup>25</sup> *GfK Survey*, p. 28.

- 3.2.5 The CMA's analysis of its customer survey also consistently mischaracterises and understates the extent of engagement in the market for two main reasons, namely, non-price factors and customer satisfaction.
- 3.2.6 **The CMA consistently ignores the survey findings that non-price factors are significant drivers of choice for customers.** In choosing their supplier, consumers take into account a wide range of factors other than price. As the survey shows, consumers place a high value on customer service (which was "very important" to 51% of respondents and "essential" to 32%), a supplier's brand ("very important" to 21% of respondents) and the additional services a supplier is capable of providing ("very important" to 17% of respondents). This evidence underlines that consumers do not regard electricity and gas as "homogenous" products. It also demonstrates the obvious point that consumers have diverse preferences. The CMA may consider that consumers should be overwhelmingly motivated by price decisions but the fact is that, at prevailing prices and available gains from switching, other factors are also at least as important for a substantial proportion of customers.
- 3.2.7 Consumers who consider non-price factors to be essential are less likely to switch over any given period than consumers who consider price to be essential.<sup>27</sup> This is partly attributable to the fact that non-price elements of service across suppliers evolve more slowly than differences in price. It is therefore to be expected that consumers who value customer service over price will switch suppliers less frequently. For example, 28% of those who consider cheap tariffs essential have switched within the past three years. In contrast, 23% of consumers who consider customer service essential, 14% who consider reputation/brand essential, and 15% who consider a range of other services essential have switched within the same time period.<sup>28</sup>
- 3.2.8 The CMA's customer survey therefore establishes that non-price factors are a significant driver of consumer decision-making. This is a relevant consideration that the CMA has largely ignored, in particular in its gains from switching analysis (in which the CMA wrongly assumes that consumers' decisions to switch suppliers are entirely price-driven).
- 3.2.9 **The CMA consistently ignores the survey findings that a significant proportion of consumers choose not to switch because they are satisfied with their current arrangements.** The evidence shows that the vast majority of consumers are happy with their current supplier (74% across dual and single fuel consumers). Moreover, of consumers who had never considered switching supplier, 41% stated that they had not considered switching because they were satisfied with their existing tariff, and a further 18% cited the

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<sup>26</sup> PFs, para. 118.

<sup>27</sup> SSE analysis of CMA customer survey. Throughout SSE's analysis, survey results have been weighted according to the weights used by the CMA.

<sup>28</sup> SSE analysis of the CMA's customer survey.



quality/reliability of their existing supplier as reasons for not considering switching.<sup>29</sup>

- 3.2.10 The CMA chooses to disregard this evidence entirely (suggesting, without justification, that these views must be irrational, because such consumers have failed to shop around and are therefore unaware of the gains that are available to them). This ignores, however, that shopping around requires significant time and effort on the part of consumers. Consumers take an average of 1.7 hours to consider their existing tariff and energy usage prior to shopping around and then an additional 2.2 hours on average shopping around.<sup>30</sup>
- 3.2.11 It is only logical that consumers choose to shop around when they consider that there will be net gains. As explained later in this Response, in the vast majority of cases where consumers do not intend to switch, the potential gains available do not exceed those required in order to switch. It is therefore entirely reasonable that, given the effort and time spent in shopping around, these customers would not shop around for alternative suppliers.

**The PFs' analysis of the potential gains from switching cannot support a finding of a lack of customer engagement**

- 3.2.12 The CMA's gains from switching analysis overstates the gains available, as well as ignoring relevant evidence on drivers of customer decision-making (e.g., in relation to the importance of non-price factors such as quality of services) from the CMA's customer survey. The gains available from switching are only £76-£117 for the median dual fuel customer, before other relevant factors that will influence customer engagement and switching levels, such as search costs, are taken into account. Taking account of these costs is essential. The customer survey shows that the vast majority (65-81%) of consumers who are not likely to switch supplier in the next three years report required savings that would exceed their potential gains from switching. This is consistent with Ofgem's survey which found that customers who had never switched required a minimum saving of £158 to encourage them to switch.<sup>31</sup> The gains from switching analysis therefore does not show that consumers are somehow disengaged from the market, but rather, on the contrary, that they are exercising rational choice in their search and purchasing decisions.
- 3.2.13 **The CMA's analysis overstates the gains available in many cases.** Assumptions on consumption in the CMA's analysis have been adjusted to a more reasonable level since the Updated Issues Statement (*UIS*). However, the CMA's analysis still effectively uses a mean value for savings available (albeit a lower figure). This means that the levels of savings identified will continue to be materially overstated for low consumption customers. Higher

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<sup>29</sup> GfK Survey, p. 42.

<sup>30</sup> SSE analysis of CMA customer survey. These are conservative estimates, as SSE has used the lower bound of each of the time brackets to calculate the average.

<sup>31</sup> Ipsos MORI, *Customer Engagement with the Energy market - Tracking Survey 2014: Report prepared for Ofgem* (June 2014) (the *Ofgem Customer Engagement Survey*), Section 2.3.

savings are more likely to exist for larger consumers, but the energy bills for these consumers are likely to account for a much lower proportion of household income. On the other hand, potential savings will be relatively more significant for households on lower incomes, but the generally lower consumption in this group will lead to smaller absolute savings. This breakdown across consumption groups is masked by the use of average savings in the CMA's presentation of its analysis, which results in an overstatement of the available gains from switching for the majority of consumers. As a result, the PFs' assessment of vulnerable-type customers is flawed (*see Section 5* below).

- 3.2.14 When a correct assessment is used, the gains available (as with switching rates) are fully consistent with a high level of engagement, and have no material connection to the other observations in the PFs about certain categories of customer that the CMA considers less likely to switch. Price differentials will always exist in any competitive market to stimulate external switching and other forms of customer engagement. (Benchmarking against other consumer industries suggests that customers in the energy sector are highly engaged and competition is working well.)
- 3.2.15 **The CMA's analysis ignores relevant evidence on drivers of customer decision-making, in particular in relation to non-price factors.** As described above, the customer survey clearly establishes that consumers take a wide range of factors into account, including non-price factors, when choosing their supplier and tariff.
- 3.2.16 The PFs recognise that non-price based preferences can be a relevant consideration in customer choice. For example, customers on green tariffs are excluded from the analysis on the basis that "*customers subscribed to such tariffs are likely to value non-monetary characteristics of a tariff more highly than most other customers.*"<sup>32</sup> However, the same approach is not adopted consistently in relation to other non-price features, despite the evidence establishing that customers also attach a material value to those features:
- (a) *The approach applied to quality of service is inconsistent with the CMA's customer survey.* The preference for a supplier with better customer service is discounted as a relevant consideration despite the results of the CMA's own customer survey showing that 83% of customers rated good customer service as being "*essential/very important.*"<sup>33</sup> The PFs state that quality of service need not be taken into account at all because net promotor score (*NPS*) data suggest that there is no clear relationship between cheaper suppliers and particularly poor (or good) customer service.<sup>34</sup> This is not correct, because NPS data are not a measure of how customers value quality of

<sup>32</sup> PFs, Appendix 7.4, Annex B, para. 5.

<sup>33</sup> PFs, Appendix 8.1, Figure 24.

<sup>34</sup> PFs, paras. 8.59 - 8.68.

service.<sup>35</sup> The directly relevant evidence of the importance that customers attach to service quality is the CMA's customer survey, in which customers who had chosen not to switch cited good customer service as being more important than cost (suggesting that customers are at least willing to pay more than the lowest possible tariff to retain their current levels of customer service).<sup>36</sup> In such circumstances, it is inconsistent and contrary to the available evidence for the CMA to disregard the value customers place on high-quality customer service.

- (b) *The approach applied to tariff characteristics is inconsistent with the evidence from the customer survey.* Similarly, the PFs' summary dismissal of customers' actual preferences, *e.g.*, in choosing NSTs that are not at the lowest cost in the market,<sup>37</sup> or SVTs that may have "*beneficial non-price properties*,"<sup>38</sup> is also unsound. The CMA cannot disregard evidence in the customer survey which shows the value that consumers place on non-price characteristics offered by these tariffs to support an artificial construct of "*homogeneity*".
- (c) *The approach applied to discounts and rewards is selective and inconsistent.* The CMA's analysis excludes discounts and rewards because it considers that they are not "*material in size*" and therefore that their exclusion does not introduce "*a systematic and material bias*" into the estimates.<sup>39</sup> As a starting matter, certain SSE benefits and discounts that have been excluded could make a material difference to the CMA's analysis (*e.g.*, discounts through the *moneysavers* tariff could amount to up to £300 per year). Their exclusion should therefore be reconsidered. In addition, by averaging the value of all non-dual fuel discounts and vouchers across the customer base, the CMA has reached a low figure that does not accurately represent the effect of these on the specific customers to which the larger, tariff-specific discounts and vouchers apply. Finally, many of the benefits of these types of tariffs are non-monetary and have not been captured at all in the CMA's analysis (even though the loss of these benefits would clearly be a factor in any switching decision).

**3.2.17 The CMA's analysis ignores relevant evidence from the customer survey in relation to the minimum financial savings that customers require to switch.** The CMA fails to compare the financial gains available to customers

<sup>35</sup> As the CMA recognises (*see PFs*, para. 8.64, fn. 409), NPS data measure whether an existing customer of a supplier would recommend that supplier to a friend (and therefore takes into account all facets of that supplier's offering rather than just customer service).

<sup>36</sup> *GfK Survey*, p. 36.

<sup>37</sup> *PFs*, para. 8.47.

<sup>38</sup> *PFs*, para. 8.49.

<sup>39</sup> *PFs*, Appendix 7.4, para. 27.

against the minimum financial savings that these customers require in order to incentivise them to switch.

- 3.2.18 According to the customer survey, the vast majority (65-81%) of consumers who are not likely to switch supplier in the next three years, report required savings that exceed their potential gains from switching (based on different switching scenarios).<sup>40</sup> Only 10-20% of consumers are unlikely to switch in the next three years despite facing net financial gains.

**Likelihood of switching supplier within the next three years**

Within the next three years...	Scenario s3a	Scenario s3b	Scenario 4	Scenario 4a	Scenario 4b
Likely to switch	44%	44%	44%	44%	44%
Not likely to switch because costs exceed gains	45%	43%	36%	41%	38%
Not likely to switch despite net gains	10%	13%	20%	15%	18%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

*Source: SSE analysis of CMA customer survey*

- 3.2.19 This underlines that the observed level of switching is consistent with the vast majority of customers rationally evaluating the costs and benefits of switching supplier, and choosing whether to switch accordingly (and also with the Ofgem survey data indicating that customers would require a minimum saving of £158 to encourage them to switch).<sup>41</sup> The CMA's narrow definition of gains from switching, which does not take costs into account, therefore leads it systematically to understate the level of switching in the market.
- 3.2.20 Indeed, this is also the case for low-income customers (who the CMA suggests are less likely to switch).<sup>42</sup> As shown in the table below, low-income customers on average face significantly lower potential gains from switching than customers with higher levels of income, and do not require lower gains to switch. The evidence from the customer survey therefore contradicts the CMA's unevicenced assumption that low-income groups should be more likely to switch suppliers.

**Average gains from switching and required average gains (£) by income group**

Income group	Scenario s3a	Scenario s3b	Scenario 4	Scenario 4a	Scenario 4b	Required gains
<£18,000	24	55	128	83	106	233
£18,000 and above	33	66	164	110	145	206

*Source: SSE analysis of CMA customer survey*

<sup>40</sup> SSE analysis of CMA customer survey.

<sup>41</sup> Ofgem Customer Engagement Survey, Section 2.3.

<sup>42</sup> SSE analysis of CMA customer survey.

- 3.2.21 **The dynamic nature of the energy market means that potential gains are not a reliable measure of customer engagement.** More generally, the CMA's analysis rests on the proposition that any saving available to a customer means that the customer is not fully engaged in the market. However, the dynamics of the competitive energy market mean that there will always be savings available, even when customers switch on a regular basis (*e.g.*, in the previous quarter).
- 3.2.22 Even if every domestic customer in the UK switched supplier once every year, quarterly changes in the cheapest tariff could mean that 80% of customers would still stand to save from switching in any given quarter over the 10-quarter period considered by the CMA. This suggests that the results presented by the CMA relating to the proportion of customers who could save by switching at any one time are consistent with a high level of customer engagement, and do not provide any meaningful evidence of customer inertia.
- 3.2.23 **Gains from switching are consistent with high levels of engagement.** As the dynamics of the energy market mean that there are always likely to be gains available, the most robust approach to the analysis of engagement would be to compare available savings and switching levels against other consumer markets.
- 3.2.24 In contrast to the approach adopted in relation to other competitive metrics (*e.g.*, pricing and profitability), the CMA makes no attempt to compare available savings and switching levels against relevant benchmarks. The CMA recognises that gains from switching are "*likely to be present in most markets.*"<sup>43</sup> However, the CMA attaches particular significance to the fact that gains are available at "*such levels*" because gas and electricity are "*homogenous goods*" that "*constitute a significant proportion of household expenditure.*"<sup>44</sup>
- 3.2.25 Switching rates in the energy market compare favourably with those in other consumer sectors: for example, the CMA's customer survey shows that 27% of consumers had switched energy supplier in the last three years, higher than the proportion of consumers who had switched mobile phone provider (24%).<sup>45</sup>
- 3.3 The CMA's assessment of the "specific features" (barriers to engagement) of the market that give rise to the alleged AEC is not supported by the evidence**
- 3.3.1 **The PFs' assessment of the awareness and interest of ability of customers to switch energy supplier is incorrect and incomplete.** The PFs suggest that customers have "*limited awareness of and interest in their ability to switch*

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<sup>43</sup> PFs, para. 118.

<sup>44</sup> PFs, para. 8.74.

<sup>45</sup> GfK Survey, p. 15.

*energy supplier.*<sup>46</sup> The CMA bases this suggestion on its views that gas and electricity are “homogenous” products and that traditional meters and bills are “confusing and unhelpful.”<sup>47</sup> The CMA’s assessment is not, however, consistent with the available evidence, and results in unsound conclusions.

*Gas and electricity are not homogenous products*

- 3.3.2 The CMA suggests that gas and electricity are “*extreme examples*” of homogenous products, in that the energy that customers consume is “*entirely unaffected*” by the choice of retailer.<sup>48</sup> The CMA supports this view by citing evidence from its customer survey that price was the most important driver of choice for survey respondents.<sup>49</sup>
- 3.3.3 As described in detail above, the CMA’s analysis of its customer survey is highly selective. In this case, the CMA ignores the fact that, when prompted, more respondents (83%) indicated that good customer service was more important than a cheap tariff rate (78%) when choosing supplier.<sup>50</sup> In addition, a significant proportion of customers (25%) also indicated that the other services offered by suppliers (*e.g.*, boiler maintenance) were also important in choosing a supplier.<sup>51</sup>
- 3.3.4 The CMA’s finding also ignores significant real-life evidence that products are not homogenous. For example, consumer groups’ energy supplier tables typically provide information across a broad range of competitive parameters, such as customer service, value for money, bills (accuracy and clarity), complaints handling, and helping to save money.<sup>52</sup> Littlechild *et al.* note (and indicate that the CMA appears to have paid insufficient attention to) suppliers with “*fresh approaches*” in the energy markets, characterised by “*different product design*,” “*innovative marketing*,” and “*new forms of delivery*.”<sup>53</sup>

*The CMA’s assessment of traditional meters and bills ignores market developments that are in train and the impact of regulation*

- 3.3.5 The CMA’s provisional view is that traditional meters and bills “*are likely to have a harmful impact on engagement*.”<sup>54</sup> In this regard, the CMA has failed to give proper weight to the to the imminent roll-out of smart meters. Smart

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<sup>46</sup> PFs, para. 8.157.

<sup>47</sup> PFs, para. 8.157(a).

<sup>48</sup> PFs, para. 7.10.

<sup>49</sup> PFs, para. 7.11.

<sup>50</sup> Of the respondents, 28% rated a cheap tariff rate as essential and 50% as very important, while the equivalent figures for customer service were 32% and 51%. (*GfK Survey*, p. 35.)

<sup>51</sup> See *GfK Survey*, p. 35. Of the respondents, 8% rated “*range of other services available such as boiler maintenance*” as essential and 17% as very important. (*GfK Survey*, p. 35.)

<sup>52</sup> See *e.g.*, Which? Satisfaction Survey 2015 – available at <http://switch.which.co.uk/energy-suppliers/energy-companies-rated.html>.

<sup>53</sup> Littlechild PFs and NPR Response, para. 82.

<sup>54</sup> PFs, para. 8.92

meters will lead to instant access to energy consumption for customers, as well as more accurate billing.

- 3.3.6 Suppliers are required to install Smart Metering Equipment Technical Specifications (*SMETS*) compliant gas and electricity meters in their domestic customer properties, and smaller non-domestic customer premises, by the end of 2020. HM Government has recently committed to ensuring that the industry and consumer benefits of SMETS2 meters operated through the Data Communication Company (*DCC*) are realised as soon as possible (in conjunction with the DCC go-live in August 2016).<sup>55</sup>
- 3.3.7 In addition, as explained in more detail below (*see Section 4*), current restrictions in the RMR rules restrict suppliers' ability to communicate effectively with their customers in order to reduce the complexity of traditional meters and bills. Accordingly, to the extent that customer confusion can arise in practice, the most significant cause for this is the RMR rules.

*Other evidence shows that customers are aware of and interested in their ability to switch supplier*

- 3.3.8 Consumers are aware of their ability to switch. The customer survey shows that 76%, 81% and 89% of consumers knew they could switch tariff, payment method, and supplier respectively.<sup>56</sup> The customer survey also indicates that 68% of customers take an active interest in their energy use and expenditure.<sup>57</sup> Similarly, 66% of respondents had actively engaged with the market either by considering their options, shopping around or switching.<sup>58</sup>

**The PFs' assessment of actual and perceived barriers to accessing and assessing information is incorrect and incomplete**

- 3.3.9 The PFs suggest that customers face "*actual and perceived barriers to accessing and assessing information.*"<sup>59</sup> The CMA bases this assessment on its views that the information provided in bills and the structure of tariffs inhibit value-for-money assessments of available options and that certain customers lack confidence in, and access to, PCWs.<sup>60</sup>
- 3.3.10 As a starting matter, the CMA's view fails to reflect its own customer survey, in which only 17% of respondents found it difficult to locate information and only 28% of respondents found it difficult to understand or compare tariffs.<sup>61</sup>

<sup>55</sup> See HM Government, *Smart Metering Implementation Programme Government response to the Smart Metering Rollout Strategy consultation* (31 July 2015) – available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/450167/Smart\\_Meters\\_Rollout\\_Strategy\\_Government\\_response\\_FINAL.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/450167/Smart_Meters_Rollout_Strategy_Government_response_FINAL.pdf).

<sup>56</sup> GfK Survey, p. 39.

<sup>57</sup> GfK Survey, p. 11.

<sup>58</sup> GfK Survey, p. 18.

<sup>59</sup> PFs, para. 8.157(b).

<sup>60</sup> PFs, para. 8.157(b).

<sup>61</sup> GfK Survey, p. 52.

More broadly, 67% of respondents who shopped around in the last three years found the process either very or fairly easy.<sup>62</sup> Only 24% of respondents found the process either fairly or very difficult (and there is no suggestion that these difficulties proved to be insurmountable).<sup>63</sup> The CMA's assessment that there are barriers to accessing and assessing information in the energy market therefore appears to be based on a limited minority of the survey respondents.

3.3.11 With respect to the information provided in bills and the structure of tariffs, the CMA fails to consider the impact of the current restrictions in the RMR rules (*see* further Section 4 of this Response). As SSE has explained previously,<sup>64</sup> the introduction of RMR rules mandate high volumes of information to be provided to customers, often confusing them.

3.3.12 The PFs' suggestion that consumers lack confidence in and access to PCWs ignores the fact that PCWs are very widely-used today, and that their use is growing.<sup>65</sup> Nearly three in four (71%) survey respondents who had shopped around for energy in the last three years used PCWs as an information source.<sup>66</sup> Concerns around trust in PCWs are being addressed by Ofgem's PCW Confidence Code, which was strengthened in January 2015. The revised code requires accredited sites to meet tighter standards on how tariffs are displayed, and to list prominently which energy companies they have commission arrangements with and make clear that they earn commission on certain tariffs.

**The PFs' assessment of actual and perceived barriers to switching is incorrect and incomplete**

3.3.13 The CMA suggests that customers face "*actual and perceived barriers to switching*", in particular as a result of erroneous transfers and uncertified meters.<sup>67</sup>

3.3.14 The CMA's view fails to reflect its own customer survey, in which the vast majority of respondents (83%) who had switched supplier in the last three years had found it very or fairly easy.<sup>68</sup> Of the small number of respondents who had encountered difficulties in switching, approximately half had encountered problems with delays.<sup>69</sup> These problems have, however, largely been addressed by recent developments to improve the switching process. Further developments are in train such as measures to facilitate reliable faster switching and the roll-out of smart meters.

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<sup>62</sup> PFs, para. 8.100.

<sup>63</sup> GfK Survey, p. 50.

<sup>64</sup> See e.g., SSE's response to the Updated Issues Statement (the **RUIS**), para. 2.7.2.

<sup>65</sup> See Ofgem research cited in SSE's response to the SQ, S.118, para. 118.6.

<sup>66</sup> GfK Survey, p. 3.

<sup>67</sup> PFs, para. 8.125.

<sup>68</sup> PFs, Appendix 8.1, p. A8.1 – A8.64.

<sup>69</sup> GfK Survey, p. 71 – see those who faced delays in the length of the switching process (11%) and the previous supplier delaying the process (6%).



3.3.15 The CMA cites Ofgem data indicating that erroneous transfers only affected around 1% of completed domestic gas and electricity transfers between January and September 2014.<sup>70</sup> The PFs note the development of recent Ofgem measures intended to reduce erroneous transfers,<sup>71</sup> and recognise that smart meter data should reduce further the number of erroneous transfers.<sup>72</sup> On this basis, any concerns raised by erroneous transfers are clearly not material.

**The PFs' assessment of the technical constraints around pre-payment meters is incorrect and incomplete**

3.3.16 The CMA suggests that pre-payment meters (**PPMs**) place technical constraints on customers that “*reduce their ability and incentive to engage in the market and search for better deals.*”<sup>73</sup>

3.3.17 The evidence does not show that PPM customers face particular disadvantages to engaging in the market. The CMA recognises that “*prepayment customers are not more or less likely to have switched supplier in the last three years compared with all respondents.*”<sup>74</sup> SSE’s experience suggests, in fact, that PPM customers are more likely to switch supplier. SSE’s churn rate for PPM customers is higher than that for the SSE customer base as a whole (and nationally, PPM customers are less likely to be with the former public electricity supplier (**PES**) supplier for their area than is the case for a standard credit customer).

3.3.18 The CMA notes that there are “*fewer tariffs*” available to PPM customers.<sup>75</sup> This is due to technical constraints and the RMR tariff rules (*see further Section 4* of this Response).

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<sup>70</sup> PFs, para. 8.119.

<sup>71</sup> PFs, para. 8.122.

<sup>72</sup> PFs, para. 8.123.

<sup>73</sup> PFs, para. 157(d).

<sup>74</sup> PFs, Appendix 8.1, para. 10.

<sup>75</sup> PFs, para. 8.138.

### 3.4 The provisional finding that suppliers are pricing SVTs above the level justified by costs is not supported by the evidence

- 3.4.1 The PFs suggest that “*significant disparities*” exist in the tariffs offered by the six large energy firms and that these “*cannot be fully explained by differences in cost.*”<sup>76</sup> On this basis, the CMA reaches the view that suppliers are charging “*some customer segments*” (i.e., SVT customers) prices that are higher than can be justified by costs.<sup>77</sup>
- 3.4.2 This evidence shows, however, that SSE does not price discriminate by pricing SVTs above a level that can be justified by cost differences with NSTs. Differences in the pricing of SSE’s fixed-term and SVT tariffs are driven by regulatory or cost considerations. For example, RMR requirements focus discounting activity on fixed-term tariffs, and there can be significant variation in the wholesale costs associated with the two types of tariff as  $\propto$ .<sup>78</sup> None of these factors imply that there is less competition for SVT customers than for customers taking up fixed-term products.
- 3.4.3 **The CMA recognises that regulatory requirements have focussed discounting activity on fixed-term tariffs.**<sup>79</sup> As a result of the RMR reforms,<sup>80</sup> suppliers are effectively unable to offer discounted SVTs. In practice, therefore, much of the investment in customer acquisitions  $\propto$  has to be made through fixed tariffs. In such circumstances, it is to be expected that revenues per unit of energy and margins for fixed tariffs would be lower than those for SVTs.
- 3.4.4 **The CMA’s cost pass-through analysis provides no evidence that suppliers are pricing SVTs above a level justified by cost.** Given the restrictions inherent in the analysis, the CMA rightly attaches little weight to its cost pass-through analysis.<sup>81</sup> To the extent that that the CMA does suggest that its analysis indicates that suppliers are pricing at a level above that

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<sup>76</sup> PFs, para. 8.186.

<sup>77</sup> PFs, paras. 8.193 – 8.194.

<sup>78</sup> For further explanation *see RUIS*, para. 8.86.

<sup>79</sup> PFs, para. 7.134.

<sup>80</sup> The RMR reforms introduced a general prohibition on creating new “*dead*” tariffs (*see SLC 22D: Prohibition of Dead Tariffs*). Once an evergreen (or SVT) tariff has been removed from sale, all customers on that tariff must be migrated to the cheapest evergreen tariff for them. This means that if a discounted tariff were offered on an evergreen basis, as soon as that tariff was withdrawn from sale, all existing customers on that tariff would have to be migrated onto another (potentially higher-priced) tariff. This would, of course, risk a supplier suffering considerable reputational damage, and is therefore not a feasible commercial offering.

<sup>81</sup> *See PFs*, Appendix 7.2. The CMA recognises, in particular, that: the effective sample sizes are too small (para. 7); cost data is problematic particularly with regards to precise attribution of timing (para. 36); hedging policies are different between suppliers and change through time making the approach to the treatment of wholesale costs particularly difficult (para. 52); economic literature indicates that asymmetry can be present in highly competitive market conditions as well as in other circumstances (para. 59).

justified by costs, the analysis is undermined by a several material errors of fact and assessment. In particular:

- (a) *The CMA's emphasis on one year forward costs as the wholesale cost benchmark for SVTs is unsound.* For SVT tariffs, the expected wholesale cost, including already hedged costs, is an important competitive benchmark when setting SVT tariffs. Expected costs including hedged costs have been significantly higher in recent years than a purely forward looking one-year benchmark. Accordingly, by emphasising the one-year forward benchmark for analysis of SVT tariffs, the CMA overstates the significance of the fall in wholesale costs in recent years for this tariff type. This leads to an inaccurate assessment of the differing levels of cost pass-through for SVTs versus NSTs in recent years.
- (b) *The CMA's analysis continues to use policy costs that do not reflect suppliers' forward-looking expectations of costs.* As SSE has previously explained,<sup>82</sup> the policy costs used by the CMA are not genuinely forward-looking. Having collected real-life data from suppliers on their expected costs, the CMA chooses not to use these on the basis that the differences between these costs and the SMI costs it uses are “not material.”<sup>83</sup> However, the CMA's own analysis shows there are major differences between the average supplier expected costs and the SMI figures.<sup>84</sup> In particular, between late-2012 and late-2013, suppliers' average expected costs were around £30-40 higher per customer than those used by the CMA (amounting to approximately 3-4% of the representative bill). The CMA's own analysis also shows suppliers' expected costs rising much faster than the SMI measure between early-2011 and late-2013.<sup>85</sup> Again this means the CMA's measure of expected costs is unreliable and misrepresents the pattern of cost pass-through.
- (c) *The CMA continues to exclude indirect costs from its analysis.* The evidence shows that a large proportion of indirect costs vary with customer numbers in the short term (particularly metering, as the CMA notes, and bad debts). These costs are therefore relevant to tariff-setting. The CMA's assertion that there have not been material variations in indirect costs in recent years is factually incorrect. SSE has experienced material increases in indirect costs in the last few years, as set out in numerous submissions to CMA,<sup>86</sup> and it would

<sup>82</sup> See e.g., SSE's response to the CMA's Working Paper, *Cost pass-through* (the **Cost pass-through Working Paper Response**), para. 5.

<sup>83</sup> PFs, Appendix 7.2, para. 38.

<sup>84</sup> PFs, Appendix 7.2, Figure 2.

<sup>85</sup> PFs, Appendix 7.2, Figure 9.

<sup>86</sup> See e.g., SSE's response to the SQ, S.31, para. 31.8 and *Cost pass-through Working Paper Response*, paras. 10 – 12 and Figure 1.

expect competitors to have experienced similar cost pressures. Therefore, by excluding indirect costs completely from its analysis, the CMA's analysis materially understates increases in marginal costs and presents a misleading impression of cost pass-through.

3.4.5 Combined, these flaws mean that costs have been rising much faster since 2011 than the CMA one year benchmark would indicate. Overall average gross margins have been relatively stable between 2011 and 2014, as noted by the CMA and shown in Figure 7 of Appendix 7.2 to the PFs giving no evidence of weakening competition for SVTs and NSTs considered together. There is also no discernible difference in trend between SVTs and NSTs with regard to the average revenues earned between 2011 and 2014 as shown in Figure 7 of Appendix 7.2.

3.4.6 Once these flaws are corrected for, the analysis clearly shows that tariffs have closely tracked direct costs over the Relevant Period, and therefore provides no evidence that suppliers are pricing SVTs above a level justified by cost.

### **3.5 The CMA's profitability analysis and competitive benchmarking in retail energy supply is not supported by the evidence and is undermined by serious errors of fact and assessment**

3.5.1 In principle, ROCE is not an appropriate measure of retail supply profitability, given the asset-light nature of the business, and that the estimations and assumptions required to undertake the analysis are liable to lead to extreme conclusions that are detached from the market reality, as has happened in this case. In practice, the ROCE analysis contains material errors of fact, applies extreme assumptions, and assumes characteristics of the market that did not apply over the Relevant Period.

3.5.2 The CMA's analysis of "competitive" prices is not founded on a benchmark consistent with the CMA's own guidance, and is based on a wholly implausible cost model.

3.5.3 The fact that the separate pieces of analysis undertaken by the CMA are directionally consistent does not provide confidence in the validity of the results (as the PFs seem to suggest). The analyses are not independent of each other, and rely on common erroneous assumptions which compound the errors made.

3.5.4 These observations are explained in more detail in the remainder of this Section. More detailed analysis and evidence that supports these observations is provided in **Annex 1** (and in the confidential Disclosure Room submission of SSE's Authorised Advisers).

#### *The ROCE analysis contains material errors of fact*

3.5.5 The ROCE analysis contains errors of fact, which have a material bearing on the out-turn measure of profitability for SSE. These include the incorrect treatment of ROCs and imbalance costs, an underestimate of working capital requirements; and, an undue reliance on purported trading intermediary

arrangements that are not consistent with the CMA's interpretation of and weight placed on them and, in any event, were not available during the Relevant Period. Despite SSE's adjustments being conservative, SSE's analysis suggests that the average ROCE (at 16% for the six large energy firms) is very close to the CMA's WACC. SSE is at that level, as is another firm; a third firm is loss-making. In view of this analysis, it is clear that the CMA's analysis provides no robust and reliable evidence to suggest that the ROCE across the six large energy firms is at a level that would be consistent with excessive profits.

- 3.5.6 **Incorrect treatment of ROCs.** The CMA recognises that it is, in principle, appropriate to capitalise the asset value of ROCs and has done so for all other suppliers. The CMA has, however, not yet done so for SSE because it has apparently been unable to reconcile the value of the ROCs asset for SSE and the provision that SSE has made. The information provided in Annex 1 (which explains the basis for SSE's ROC provision in 2013 of £[X]) should resolve the CMA's concerns regarding the magnitude of SSE's ROCs intangible assets, meaning that they should now be incorporated into SSE's capital employed.
- 3.5.7 **Incorrect treatment of imbalance costs.** SSE has estimated that its annual imbalance costs for its retail business have been on average £[X] per year for the last three years. These costs have been incorrectly removed in the CMA's analysis as a consequence of the removal of SSE's risk premium that it applies to its wholesale energy costs. SSE's view is that these costs are likely to be competitive when compared to other suppliers' balancing costs. Therefore, these cannot be excluded on the basis of them being excessive, particularly given that such costs have effectively been included for the other large energy firms via their wholesale costs estimates.
- 3.5.8 Correcting for these errors in relation to ROCs and imbalance costs collectively reduces the average ROCE measure for SSE by [X]% points over the Relevant Period.

*Errors of fact and interpretation relating to the capital requirements of a standalone retailer of scale*

- 3.5.9 The ROCE analysis fundamentally understates the level of risk associated with energy retailing and fails to recognise the costs of providing for this risk. Accordingly, by relying on reported capital employed, the ROCE analysis errs in not using a realistic level of capital employed. Risks facing retailers, and the cost of managing these, were particularly pronounced during the period analysed by the CMA (2007 to 2013). In this period, there was high volatility in wholesale energy markets, increasing working capital and collateral requirements, while there was also major volatility in financial markets, increasing the costs of managing retail business risks.
- 3.5.10 **The CMA underestimates working capital.** There is evidence of extreme volatility in the CMA's estimates of capital employed over time for each supplier, the main driver of which appears to be working capital. This raises

concerns that the capital employed figures may partly reflect accounting anomalies and not genuine economic requirements for capital employed. This also highlights that suppliers must have capital to ensure they can meet peaks in capital requirements which can emerge quickly. Applying peak working capital, a more appropriate measure of the economic requirement for capital is both more stable and realistic. With this adjustment, the corresponding average ROCE for the six large energy companies is 19%.

**3.5.11 The CMA's analysis of arrangements with third party intermediaries to manage business risk is wholly unsound.** The CMA has not provided any evidence to support many of the key elements of the arrangements referred to in the PFs (notwithstanding several requests from SSE to do so). The information that has been made available to SSE and its external advisers has therefore not been sufficient to meet the standards required of the CMA to set out the “gist” of its case. Moreover, although considerable reliance has been placed on evidence provided by Shell, it appears that Shell has not been heard before the Panel, so this critical evidence has not been tested by the decision-makers in the case. Accordingly, notwithstanding the observations made below, SSE reserves its position to make further representations in relation to Shell's evidence, the CMA's interpretation of it, and any other such arrangements on which the CMA seeks to rely.

**3.5.12 The CMA's analysis fails to take account of all relevant costs.** Based on the evidence that has been made available, it is clear that the CMA's analysis of trading intermediary arrangements fails to take sufficient account of all of the costs that an independent supplier of scale would face in managing risk. In particular:

- (a) *The scope of the intermediary services provided by Shell is unclear.* Little information is provided on the precise nature of the service provided by Shell acting as a trading intermediary. Based on the basic description of the arrangement and the indicative size of the trading fee, it seems likely that Shell is simply allowing suppliers to trade on an uncollateralised basis whilst the supplier continues to face all of the trading and other business risks typically faced acting in that capacity. In such circumstances, substantial wholesale market risk would remain with the supplier.
- (b) *The arrangements do not appear to address sufficiently all relevant risks.* Assuming this is correct, the size of the credit facility that accompanies the arrangement will be critical to understanding whether the service provided by Shell would be robust to volatile market conditions or whether, alternatively, an independent supplier could be expected to make provision for additional costs to manage situations when the market moves against them. Suppliers will face volumetric risks (it is impossible, in practice, to hedge in a way that will reduce all volumetric risks), as well as potentially significant exposures created by purchasing energy in forward markets that open up if the wholesale market then declines. The CMA's suggestion that credit facilities

provided by intermediaries may help suppliers manage these business risks is not credible on the evidence. It is also not credible (and therefore not reasonable to assume) that the trading fee assumed by the CMA would be sufficient to cover these risks.

- (c) *The CMA has not valued the strength of the balance sheet that the intermediary may choose to deploy to support an energy supplier in difficulty.* The CMA states that Shell may, at its discretion, provide support to an energy retailer in the event that risks not covered by the trading fee. Yet the balance sheet strength required to do this – despite being wholly analogous to what vertically integrated large energy suppliers draw on in similar situations – has not been valued by the CMA. Should Shell decline to support an energy supplier where these risks materialise then the supplier would be faced with severe financial difficulty, and the experience of the last 20 years suggests that many suppliers fail when those extreme events materialise. On this basis, the CMA has seriously under-estimated the true notional capital required to support a stand-alone energy supplier of scale on a sustainable basis.
- (d) *Collateral required for trading in near-term markets does not appear to be included.* The CMA states that the trading arrangements do not cover collateral required from spot trading short-term markets. The CMA does not consider the cost that this imposes on a standalone retailer of scale, in terms of the need to make capital available to meet mark-to-market exposures. As SSE has previously informed the CMA, this capital equates to £30 million per annum in the forms of letters of credit.
- (e) *All regulatory collateral requirements appear to be excluded.* As SSE has previously explained, its total regulatory collateral requirements are around £30.<sup>87</sup> Even if the CMA were to discount the amount for which SSE relies on unsecured lines of credit, this would leave an amount of over £30 for which SSE must provide a secured form of collateral – either a letter of credit (which attracts a fee) or parent company guarantee. It is therefore inappropriate to exclude all regulatory collateral on the basis that it can be covered by unsecured lines of credit, as that flies in the face of the available evidence, including the evidence from Shell. This is inconsistent and is not addressed or explained.
- (f) *The impact of the charge on assets has not been properly taken into account.* The trading arrangements appear to give Shell a charge over assets owned by the independent supplier. The CMA considers that this charge over assets will not impose a cost on the independent supplier because it is assumed that the supplier would be entirely equity funded. This is, however, an extreme and unreasonable

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<sup>87</sup> See Frontier Economics submission to the CMA, *Estimating the capital employed for a stand-alone GB energy retailing company* (30 January 2015).

assumption (as an independent supplier operating at scale may well wish to take on some debt). The charge on assets will also increase the risks that an investor takes on because, in the case of default, the investor would recover a smaller proportion of its investment than would be the case in the absence of the charge on the supplier's asset. This increase in investment risk will either raise the WACC for that supplier, for a given level of capital employed, or require additional capital to be made available.

- 3.5.13 The CMA disputes that a supplier would have to make additional provisions for all eventualities (largely based on the fact that no cash or cash equivalent reserves are held on the balance sheet of the two independent suppliers that use intermediaries). However, this is not a robust assumption, as these companies may well have access to capital off balance sheet (which should, consistent with the applicable guidance,<sup>88</sup> be taken into account).
- 3.5.14 Irrespective of the approach adopted by the two mid-tier suppliers, energy retailers face genuine risks and costs that cannot be captured in the trading intermediary arrangements or credit facilities suggested by the CMA, but which must be taken account of in the capital base of a standalone retail supplier of scale. It is not clear that the CMA has satisfied itself that the small sample of companies it has chosen for this exercise have robust business models that are sustainable in the face of significant market volatility.
- 3.5.15 **The CMA's analysis wrongly concludes that such arrangements would be scalable.** In making this claim the CMA has relied heavily on the assumption that an intermediary taking different positions in generation and retail supply would be able to diversify risk, such that it can operate at greater scale. However, this is not a sound assumption:
- (a) The nature of the arrangements in place – such as it is possible to determine from the limited information that has been provided – does not appear to enable Shell to offset risks by finding opposing positions in relation to generation and retail supply. Shell would be able to take a balanced position (in that it buys energy from generators in quantities roughly equal to that which it will need to sell), but would still be exposed to negative shocks affecting the ability of the party on one side of the transactions to pay.
  - (b) There is also some uncertainty in Shell's evidence as to whether it would be possible to enter into arrangements with generation companies in a way that would balance its arrangements with suppliers. Generators and retail suppliers face different types of risk that are not well correlated with each other and consequently cannot perfectly offset each other. As a consequence, it would not be possible for an intermediary to grow in scale through diversification, which is the sole route that the CMA envisages.

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<sup>88</sup> Oxera, *Assessing profitability in competition analysis*, Economic discussion paper 6 (July 2003), prepared for the OFT, paras. 13.53 – 13.55.



- 3.5.16 **The CMA's analysis fails to consider whether such trading arrangements would have been available during the Relevant Period.** The PFs make no comment about whether the trading arrangements they describe would have been in place, and accessible by independent retail suppliers operating at scale, during the Relevant Period. Had they been, it is inconceivable that SSE would not have been aware of them. This is an important question, because the CMA's test for whether profits are excessive is to consider whether a new entrant could have come into the market and made a profit during the Relevant Period.
- 3.5.17 In fact, the evidence suggests that these arrangements would not have been available for a supplier of scale at the cost envisaged in the PFs over the Relevant Period. These arrangements appear to be relatively new to the market and, as far as SSE is aware, only a single firm (Shell) offers such services. Moreover, they are not available at scale.
- 3.5.18 The CMA's reasoning also drives the erroneous conclusion that an arrangement with an intermediary would have been more cost-effective for an independent supplier during the Relevant Period than holding notional capital (as several suppliers have argued would be necessary). This conclusion simply follows from the fact that the PFs have assumed a level of risk in energy retailing in that period that is too low and judged the efficacy of the trading arrangement against that benchmark. The comparison therefore tells us nothing about the relative cost-effectiveness of intermediary arrangements and holding notional capital when compared on a like-for-like basis. The ROCE analysis of the Relevant Period is therefore entirely unsatisfactory in simply assuming away the risks in energy retailing that sent several suppliers into bankruptcy in the mid-2000s.
- 3.5.19 **Sensitivity of the resulting ROCE correcting for errors and using more plausible assumptions.** Accordingly, as described above (and in detail in **Annex 1**), the CMA has made a number of errors in estimating the ROCE. The table below shows the impact of adjusting for these errors (both individually and in aggregate).
- (a) *First*, the table shows the impact of adjusting for the errors in the CMA's calculation of the specific ROCE for SSE (*i.e.*, the errors in relation to the ROC liability and imbalance costs).
  - (b) *Second*, it shows the individual impact of adjusting working capital estimates using peak annual figures, which – for the reasons explained in **Annex 1** – is a more reasonable approach to estimating working capital requirements than the CMA has used (although arguably still conservative).

- (c) *Third*, it shows the impact of including £150 million of capital to cover secured regulatory and short-term trading collateral, neither of which would be covered by an intermediary trading fee arrangement.<sup>89</sup>

3.5.20 As the table shows, these changes alone substantially reduce the estimated ROCE for SSE to [X]% and the estimated average ROCE of the six large energy firms to 16%.

#### **ROCE adjustments for error**

Adjustment for error	ROCE (SSE)	ROCE (six large energy firm average)
<b>CMA ROCE estimate</b>	[X]	<b>28%</b>
1. CMA ROCE correcting for SSE ROCs and imbalance costs	[X]	26%
2. Adjusting working capital estimates using peak annual figures	[X]	18%
3. Including £150 million, of capital to cover secured regulatory and short-term trading collateral	[X]	23%
4. Removing Supplier A and F from average	-	22%
<b>Combination of effects 1, 2 and 3</b>	[X]	<b>16%</b>
<b>Combination of effects 1, 2, 3 and 4</b>	-	<b>12%</b>

3.5.21 In addition:

- (a) Removing the two firms with the highest and lowest ROCE from the analysis further reduces the ROCE estimate to 12%. This indicates that the CMA's market-wide results are being strongly driven by outlier firms rather than reflecting a consistent picture across the market; and
- (b) Even after these adjustments, the figures remain artificially inflated by the CMA's incorrect assumptions around the risks that could be covered by intermediary trading arrangements, the availability of these arrangements during the Relevant Period, the scalability of these arrangements and the fee that a standalone supplier of scale would need to pay to access these arrangements. SSE's Authorised Advisers have conducted further analysis to gauge the sensitivity of the ROCE estimates to the assumed fee level, which points to a further wide margin of error around the CMA's estimates. (Further evidence substantiating this finding is provided in the confidential Disclosure Room submission of SSE's Authorised Advisers.)

3.5.22 Despite SSE's adjustments being conservative, SSE's analysis suggests that the average ROCE is very close to the CMA's WACC. SSE is at that level, as is another firm; a third firm is loss-making. In view of this analysis, it is clear that the CMA's analysis provides no robust and reliable evidence to suggest

<sup>89</sup> For the other six large energy firms SSE has pro-rated the SSE estimate of £150m according to the relative wholesale energy cost.

that the ROCE across the six large energy firms is at a level that would be consistent with excessive profits. The fact that the results vary significantly between firms ought to also have been an indicator that the CMA should have looked more deeply into those firms which apparently drive these outcomes. Otherwise a misdiagnosis of the AECs and any consequent remedies would be a real likelihood, as is apparent in the present case.

### **Margin benchmarking is based on inappropriate comparisons**

3.5.23 The PFs, in part, attempt to justify the results of the ROCE calculation by observing that the “*competitive margin*” implied by the analysis is in line with two comparators: (1) gross margins of mid-tier suppliers; and (2) I&C customers. (The ROCE derived margin is, in any case, at the lower end of the range implied by comparators.)

3.5.24 The PFs fail, however, to take into account specific characteristics of these comparators that invalidate their selection as a direct comparison:

(a) *Mid-tier suppliers do not provide a relevant direct comparison.* The gross margin of the mid-tier suppliers is too low to be used as a comparable benchmark to inform margins that should be earned by the six large energy companies:

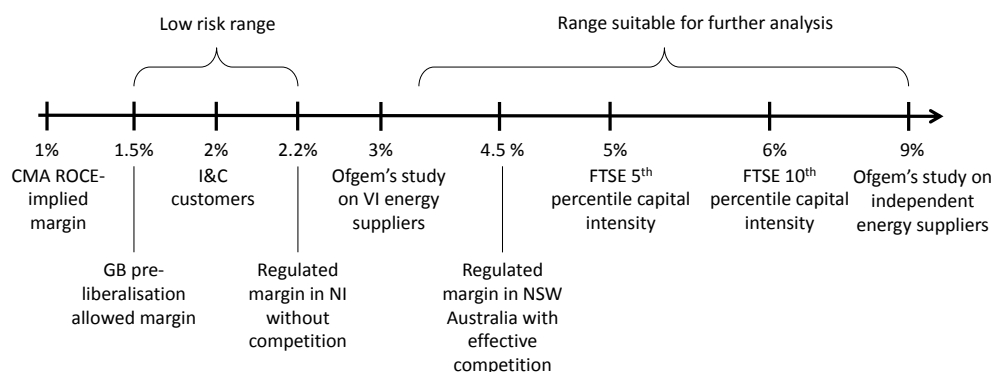
- (i) Customers of the mid-tier suppliers tend to be cheaper to serve because a higher proportion are on direct debit, therefore necessitating a lower gross margin to cover different levels of overhead costs;
- (ii) The pricing of the mid-tier suppliers is not at a long-term sustainable level because of the stage of their business cycle. Their gross margin will therefore be lower than that needed to support an established business and provide an adequate return on capital employed. This point has been made by all of the six large energy firms and also by one of the mid-tier suppliers. However, this point is dismissed without reasonable justification in the PFs.
- (iii) The weighted average margin across (*i.e.*, after deducting an estimated capital charge from EBIT) for each of the mid-tier suppliers over the period 2009-2013 was -0.2%. This provides further evidence that the EBIT margins of these suppliers as a group were not sufficient to cover the costs of capital (or interest and dividend costs) over the period.

(b) *The I&C sector does not provide a relevant direct comparison.* The PFs appear to accept that I&C customers are lower risk, given the more limited volatility in their demand relative to domestic customers and, in particular, the fact that contracts tend to be structured in a way that allows suppliers to pass through cost increases. However, the PFs apply a flawed logic to arrive at the position that a business serving domestic and SME customers (that is higher risk relative to I&C

customers) should attract a lower margin, in particular because the CMA wrongly assumes that volumetric risk associated with serving domestic customers can be eliminated as a result of hedging.

- 3.5.25 The PFs also dismiss the relevance of certain other potential benchmarks without proper justification. The PFs imply that caution needs to be taken in comparing the margins earned across sectors that do not have the same cost structure, levels of capital employed and risk characteristics, since there will be marked differences in the competitive margin unless these characteristics are aligned.
- 3.5.26 In fact, the only characteristic that needs to be aligned (at least with respect to asset-light sectors) is the risk profile of the sector. ROCE results for firms operating in the same sector facing the same level of risk will, however, be driven to a very large extent by the choice of how much capital is invested (in spite of a similar level of EBIT). Margins are therefore the most stable measure of the required return in an asset-light business, due to the greater degree of choice surrounding the level of capital employed. This logic underpins the focus of the financial markets on EBIT margins.
- 3.5.27 On this basis, there is no reason for the CMA summarily to dismiss the other benchmark margins indicated by SSE. More generally, the sensitivity of ROCE estimates to assumptions made about capital employed, strongly indicates that the weight given to the ROCE analysis in the CMA's profits analysis is unsound.
- 3.5.28 The detailed evidence that SSE has submitted on the inferences that can be drawn from comparisons with EBIT margins in other sectors, the results of which are replicated below, is therefore a particularly relevant consideration.
- 3.5.29 There is no “*perfect*” single point of comparison for the retail profits of GB energy retailers. Nevertheless, the assessment of an appropriate range of potential EBIT margin benchmarks, taking into account the necessary adjustments to reflect different levels of cost and/or risk, can be informative. Analysis of these comparators makes it clear that suppliers must be able to make an EBIT margin of *more than* 3% on their domestic and SME businesses over the long run.

### **Framework for analysis of potential EBIT margin benchmarks**



### **Average retail prices are consistent with those that would result in a competitive market**

3.5.30 **The CMA's efficient benchmark analysis is unsound.** In addition to reporting out-turn profitability levels for the six large suppliers, the CMA also assesses the economic profit made by the six large energy firms taking into account the costs that would have been incurred by a hypothetically efficient supplier over the Relevant Period. This analysis leads the CMA to claim that the six large energy suppliers are “*overcharging*” domestic and SME customers relative to the price that an efficient supplier could offer.

3.5.31 The CMA's claim that the six large energy firms are overcharging customers can be broken down into three components:

- (a) **Claim 1:** the capital charges of these firms are too high relative to the “*competitive*” benchmark level;
- (b) **Claim 2:** viewed collectively, the six large energy firms have inefficiently high wholesale energy and other direct costs; and
- (c) **Claim 3:** viewed collectively, the six large energy firms have inefficiently high indirect costs.

3.5.32 The CMA makes adjustments to the capital charges and costs of the six large energy firms to “*correct*” for each of these claimed inefficiencies and derive a set of efficient benchmark prices. However, each of these three sets of adjustments ignores material considerations relevant to the practical realities of operating as an energy retailer, resulting in a number of wholly unsound assumptions being made. This therefore does not provide a robust and reliable basis to support the conclusions suggested in the PFs. In particular:

- (a) In relation to Claim 1, the proposed calculation of an “*efficient*” level of working capital for inclusion in the capital base is wholly unsound, since it assumes that an efficient firm should be able to sustain extremely large negative working capital balances. Furthermore, in calculating this capital base, the CMA has made the same errors of fact and assumption as in the ROCE analysis around the level of risk in energy retailing and the costs of providing for this risk;
- (b) In relation to Claim 2, the CMA's proposed adjustments to wholesale energy costs are again founded on wholly unrealistic assumptions. The CMA compares the wholesale pricing strategies of the six large energy firms to those of an entirely hypothetical “*efficient*” supplier that is assumed to be able to move from one hedging position to another from each period, so that it stays on the “*lower quartile*” level. This is at odds with the reality of commodity trading, as forward contracts cannot be novated without cost, particularly when out of the money. This approach also fails to consider the knock-on effect that this would have on the viability of long-term supply contracts and therefore, in turn, on the economics of generation; less plant would be available and wholesale prices would be higher. (For example, SSE has external

legacy PPA contracts with Seabank and Marchwood which involve real physical cash flows; these plants provide power for over one million homes. Without the PPAs they would never have been built and contributed to the GB energy market.) Furthermore, the CMA has made proposed adjustments to “*other direct cost*” items reported by some firms that are not adequately explained or justified. Moreover, in order to justify adjustments to actual wholesale energy costs on this scale, there would need to be clear evidence that some of the firms had lower expected costs than those other firms at the time the firms purchased the energy. The PFs provide no compelling evidence that any of the six large energy firms’ wholesale energy purchasing strategies were *ex ante* inefficient; and

- (c) In relation to Claim 3, the proposed adjustments to indirect costs are founded on material errors of fact and assessment. The CMA appears to believe that there are material indirect cost efficiency gains available to the six large energy suppliers, but the available evidence does not support this.

3.5.33 When a more reasonable set of assumptions is applied, it is clear that there is no reliable evidential support for the proposition that the prices charged by the six large energy firms were above the competitive level over the Relevant Period.

3.5.34 **Sensitivity of the resulting efficient benchmark analysis correcting for errors and using more plausible assumptions.** Accordingly, as described above (and in detail in **Annex 1**), the CMA has made a number of errors in estimating its efficiency benchmark. As the chart below shows, when these errors are addressed, the “*overcharge*” estimated for domestic customers disappears completely once these changes are taken into account. In particular:

- (a) Addressing the CMA’s errors of fact and assessment in relation to capital employed reduces the estimated overcharge from 4.6% to 2.2%;<sup>90</sup>
- (b) Addressing the CMA’s errors of fact and assessment in relation to the wholesale energy and other direct cost benchmarks further reduces the estimated overcharge from 2.2% to 0.2%;<sup>91</sup> and

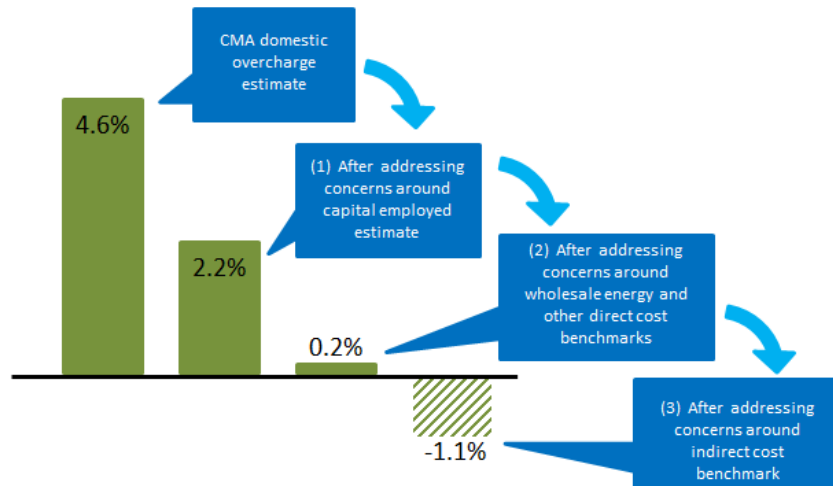
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<sup>90</sup> For the estimates of capital employed used to calculate the capital charge, SSE has: (1) replaced the working capital assumptions that it has used for the purpose of its efficiency benchmarking analysis with estimates of working capital that SSE has argued are appropriate for the CMA’s ROCE analysis; (2) increased the capital employed to take proper account of regulatory collateral / near-term trading collateral; and (3) doubled the intermediary trading fee.

<sup>91</sup> For the estimates of direct costs SSE has have: (1) used the wholesale energy costs actually reported by the six large energy firms rather than the lower quartile/average benchmarks ; and (2) used the other direct costs actually reported by the six large energy firms rather than allocating a 0.5% other direct costs allowance to all firms.

- (c) Addressing the CMA's errors of fact and assessment in relation to the indirect cost benchmark eliminates the remaining overcharge altogether.<sup>92</sup>

### **Cumulative impact of sensitivities on CMA's domestic overcharge estimates**



3.5.35 The results of the CMA's overcharge analysis are highly sensitive to these errors – once these sensitivities are taken into account it becomes clear that the CMA's analysis provides no reliable evidence of any overcharge over the period in question.

### **3.6 Conclusions on alleged AEC in relation to an “overarching feature” of weak customer response**

3.6.1 To establish an “overarching” market feature of weak customer engagement in the domestic retail market, the CMA must assess the functioning of the market as a whole.

3.6.2 Since the market is based on the actions of key players, the CMA needs to have regard to the extent to which the behaviour of individual suppliers mirrors or deviates from its market-wide provisional findings as a cross-check on whether those findings are likely to be correct. Many of the CMA's general observations are simply not accurate with respect to SSE, and this should have caused the CMA to consider more closely whether its assessment of market-wide AECs was likely to be well-founded. In particular:

- (a) *SSE's customers are engaged.* Almost 90% of SSE's existing 4.6 million electricity customers have switched internally, switched externally, or signed up to additional non-electricity services at least once in the last decade.<sup>93</sup> Last year, 500,000 customers switched

<sup>92</sup> For the estimates of indirect costs, SSE has have used the amounts actually reported by the six large energy firms, rather than the lower quartile/average benchmarks

<sup>93</sup> This is consistent with RMR's baseline survey which found that 60% of customers had switched supplier at some point whilst 24% had switched tariff within a supplier.

internally within SSE, while SSE received a total of [X] inbound contacts from domestic energy customers.<sup>94</sup> Since 2009, SSE alone has on average gained 1,000,000 customers but lost 1,200,000 customers every year.

- (b) *SSE's high quality customer service forms a key part of its competitive offering.* As the CMA's survey shows, 83% of customers put a high value on customer service. Customer service is a key element of SSE's product offering and one which SSE pursues proactively.<sup>95</sup> SSE's commitment to high quality customer service has been recognised externally, both within the energy market and across all sectors.<sup>96</sup> In addition, the Energy Ombudsman has praised SSE's complaints handling.<sup>97</sup>
- (c) *SSE's customers are not divided between separate groups of customers for SVTs and fixed-term tariffs.* Contrary to the CMA's view, SSE's SVT and NST customers do not fall into different segments.<sup>98</sup> In SSE's experience, customers are fluid and move between different tariffs *i.e.*, customers move from fixed tariffs to SVTs and *vice versa*, and between SVTs. Over [X]% of the electricity and gas customers that SSE acquired between 2010 and 2013 joined on SVTs.
- (d) *SSE is a highly efficient supplier.* SSE is a highly efficient operator and its focus on reducing overhead costs is a key component of the EBIT margins achieved.
- (e) *SSE's profits and prices are not excessive by any relevant benchmark.* As discussed above, SSE's margins are reasonable by any competitive benchmark and are at the lower end of the scale for large suppliers (*see Section 3.5*). Indeed there are significant differences in profitability between firms, the implications of which the PFs entirely fail to address.

3.6.3 For the reasons explained in this Section, therefore, SSE considers that the PFs do not properly explain the dynamics of the retail market and this leads to inappropriate and unevicenced conclusions as to the existence and nature of the AEC.

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<sup>94</sup> See RUIS, para. 8.2.5(b).

<sup>95</sup> See RUIS, paras. 8.4.1-8.4.7.

<sup>96</sup> See SSE's response to the Issues Statement (the **RIS**), para. 6.3.22.

<sup>97</sup> Summary of Hearing with Energy Ombudsman (16 February 2015), p. 3.

<sup>98</sup> PFs, para. 3.32.



**4. Removing the “*simpler choices*” component of the RMR rules will enable suppliers to compete and innovate more effectively and address any AEC in relation to domestic retail markets**

**4.1 Introduction and overview**

4.1.1 The PFs correctly recognise that the “*simpler choices*”<sup>99</sup> element of the RMR rules has restricted suppliers’ ability to innovate and offer tariffs tailored to customers’ personal circumstances. As explained in previous submissions, this finding is consistent with SSE’s experience in the marketplace.<sup>100</sup> SSE therefore welcomes the proposed removal of these aspects of the RMR, which will enable suppliers to innovate more effectively and stimulate competition.

4.1.2 The PFs fail to address, however, the other unhelpful aspects of the RMR rules, as well as certain non-RMR regulatory interventions. SSE considers that these measures have also constrained suppliers’ ability to engage customers since their introduction and would welcome their removal.

**4.2 The removal of the “*simpler choices*” component of the RMR rules will enable suppliers to compete and innovate more effectively**

*Impact on competition between suppliers*

4.2.1 The “*simpler choices*” element of the RMR rules has significantly impeded suppliers’ ability to attract, retain and reward customers and significantly limited the opportunities to innovate and create packages of services which differentiate themselves from their competitors.

4.2.2 As SSE has previously explained,<sup>101</sup> these rules create unhelpful restrictions, (in particular) in relation to:

- (a) Introductory offers (*e.g.*, sign-up rewards) for new customers taking up a tariff, as new and existing customers need to be able to take advantage of the same arrangements;
- (b) Bundled offers (where the rules are extremely complex and prescribe not only how offers are to be presented to customers but also limit a supplier’s ability to offer a one-off reward);
- (c) Tariff characteristics such as prompt payment discounts, tracker tariffs and tariff structures such as tiered unit rates, which have previously proven very popular with customers; and

<sup>99</sup> The “*simpler choices*” element of RMR encompasses: (1) unit rate and standing charge requirements (ban on tiered rates); (2) the tariff cap; (3) discount restrictions; and (4) bundling restrictions. The relevant SLCs are *SLC 22A: Unit Rate and Standing Charge requirements* and *SLC22B: Restrictions on Tariff numbers and Tariff simplification*.

<sup>100</sup> See *RIS*, *RUIS*, SSE’s response to the RMR ‘four tariff rule’ information request, the PCW information request, SSE’s response to the follow up questions on PCWs and answers to the following questions in the *SQ*: S.32, S.42, S.44, S.81, S.83, S.103 and S.106 – 108.

<sup>101</sup> See *RUIS*, para. 8.10.8.

- (d) Discounted evergreen tariffs (where a ban on creating new “*dead tariffs*” means that once an evergreen tariff is removed from sale, all customers who have opted for that tariff must be migrated to the relevant cheapest live evergreen tariff), which act as a constraint on competition for customers who prefer an SVT product.<sup>102</sup>
- 4.2.3 The PFs suggest that the impact of the RMR rules on the “*intensity of price competition between suppliers*” is “*less clear,*” on the basis that “*price competition now takes place in the fixed-term, fixed-rate space.*”<sup>103</sup> However, as noted above, suppliers are effectively unable to offer discounted SVTs because of the restrictions imposed by RMR rules. The RMR rules therefore act as a constraint on suppliers’ competitive offerings for customers who may prefer an SVT product.
- 4.2.4 The primary focus of competition may have shifted from SVTs to NSTs (though competition in the SVT area remains), but SSE has not experienced any “softening” in price competition since the introduction of the RMR rules. Suppliers continued to compete fiercely, even if certain tariff models have been sidelined or closed down.

*Impact on competition between PCWs*

- 4.2.5 The PFs also suggest that RMR appears to be harmful to price competition between PCWs.<sup>104</sup> SSE agrees with this assessment. As PCWs are effectively prevented from offering discounts on suppliers’ tariffs,<sup>105</sup> there is little ability or incentive for PCWs to compete by offering higher discounts to consumers (and to compete on commission rates). There is similarly no scope in practice for PCWs to offer exclusive tariffs, again limiting the scope for competition on commission rates. The removal of the “*simpler choices*” component of RMR should therefore help to increase competition between PCWs and, in turn, improve the range of offers available in the marketplace for consumers.
- 4.3 The removal of the “*simpler choices*” component of the RMR rules will address the concerns wrongly attributed to “*weak customer response*” in the PFs**
- 4.3.1 As the PFs suggest, the removal of the “*simpler choices*” element of the RMR rules will improve the ability of suppliers to be able to attract, reward and retain customers, and create additional opportunities to innovate and create packages of services that will differentiate themselves from their competitors.

<sup>102</sup> See SLC22D: *Prohibition of Dead Tariffs*.

<sup>103</sup> PFs, para. 8.245.

<sup>104</sup> PFs, para. 8.246 – 8.247.

<sup>105</sup> The PFs suggest that Ofgem now permits TPIs to offer cashback in certain circumstances. Some uncertainty remains, however, in relation to application of these rules (as Ofgem has indicated that this is only an “*initial view*” and that it is simply “*minded to*” take this position). See Ofgem, *Open letter on Retail Market Review: application of rules in the TPI sector* (19 December 2013) – available at <https://www.ofgem.gov.uk/ofgem-publications/85343/cashbackandbundledproducts-openletter.pdf>.

In this regard, the PFs fail to recognise the significance that the unintended consequences of the RMR rules have had on the AECs identified in the PFs (instead wrongly attributing these to the “*overarching*” feature of weak customer response).

- 4.3.2 In particular, energy customers do not have any inherent “*limited awareness of and interest in their ability to switch energy supplier*” because of the “*fundamental characteristics*” of the product.<sup>106</sup> Instead, to the extent that consumers are not engaging in the market, this is more likely to be a function of the fact that suppliers are not able to offer them products that are tailored to their needs. The removal of the RMR rules, and the potential re-introduction of arrangements such as introductory offers, prompt payment discounts, and tracker tariffs, as well as a more practical approach to bundled tariffs, should therefore address the concerns expressed around consumer awareness and interest in switching.

#### **4.4 Consumer outcomes would also be improved by the removal of other aspects of the RMR rules**

- 4.4.1 The PFs recognise that the “*simpler choices*” component of the RMR rules has negatively impacted the market. However, the PFs fail to consider the negative effects of other elements of the RMR rules.
- 4.4.2 As SSE has previously explained, the “*clearer information*” element of the RMR rules, particularly the rules governing bills and annual statements, price increase notifications and end of fixed-term letters,<sup>107</sup> are overly-prescriptive, hinder consumer engagement, and contribute to a negative perception of suppliers (which, in turn, discourages consumers from engaging).
- 4.4.3 Similarly, some of the “*fairer treatment*” RMR rules are impeding customer engagement. Licence conditions and amendments introduced to protect consumers mean that simple changes and variations to customers’ contracts are now subject to counterintuitive and non-customer friendly rules. For example, Mutual Variation Licence Condition (*SLC23A*) means that it is difficult for suppliers to execute certain simple changes on a customer’s account,<sup>108</sup> which can be frustrating for customers. This level of regulation is neither necessary nor warranted given existing consumer protection regulations, including the direct debit guarantee.

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<sup>106</sup> PFs, para. 8.157(a).

<sup>107</sup> See *RUIS*, para. 8.10.6, *RIS*, Annex 6.2, and SSE’s response to the *SQ*, S.103. The SLCs affected are: *SLC31A: Bills, statement of account and Annual Statements* and associated schedules; *SLC23: Notification of Supply Contract terms* and associated schedules; and *SLC22C: Fixed Term Supply Contracts*.

<sup>108</sup> *RIS*, Annex 6.2, para. 21.

- 4.4.4 In addition, the “*fairer treatment*” rules prohibit suppliers from increasing prices on a fixed-term tariff.<sup>109</sup> Previously popular fixed discount “tracker tariffs” are no longer permitted. The removal of this element would increase suppliers’ ability to innovate and help foster further consumer engagement with the market. This would address many of the concerns around barriers to “*accessing and assessing information*” in the domestic retail market that the CMA wrongly attributes to “*weak customer response*”.<sup>110</sup>

#### **4.5 The revision of other regulations could also further improve consumer outcomes**

- 4.5.1 In addition to the restrictions stemming from RMR, other regulatory interventions have also had a detrimental impact on customer engagement.
- 4.5.2 In particular, the reach of the sales regulations, coupled with the understandably cautious view that suppliers take because of Ofgem’s stated approach to enforcement, makes certain types of sales interaction with customers virtually impossible. For example:
- (a) *TPIs*: the definition of “*representative*” means that suppliers are reticent about using third parties to facilitate the sales process (as has been suggested in the context of industry campaigns such as the “*Big Switch*”);
  - (b) *Face-to-face sales*: some customers, particularly those without the internet, prefer a face-to-face approach.<sup>111</sup> However, since the cessation of doorstep selling, current restrictions have rendered this strategy commercially unfeasible in GB;<sup>112</sup> and
  - (c) *Sales calls*: burdensome regulation leads to SSE’s sales calls lasting approximately 20 minutes and providing customers with, arguably, more information that can reasonably be assimilated in a phone call.<sup>113</sup>

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<sup>109</sup> SLC 22C.11: *Fixed Term Supply Contracts*. The RMR rules allow one form of automatically indexed tariff. However the index must be based on a reference price which the supplier does not control (and cannot therefore track the SVT). This arrangement is more complicated than previous tracker tariffs and no supplier has been able to devise a commercially viable and compliant tariff.

<sup>110</sup> PFs, para. 8.157(b).

<sup>111</sup> RUIS, para. 8.10.9.

<sup>112</sup> SLC25 places extra obligations upon suppliers when conducting face-to-face sales including but not limited to: any offer to the customer must be provided in writing; if selling to a customer with a PPM then a written comparison must be given showing the difference in price between their current tariff and the offered tariff; and within 14 days of any face-to-face sale the supplier must contact the customer to ensure they understand the terms of their contract, understand any comparison given and are content with how the sale was carried out and with the fact that they have entered into a contract (“*sales verification*”). As a result, the face-to-face sales process is burdensome and not customer friendly.

<sup>113</sup> SSE quoted a sales call length of 30 minutes in the RUIS, para. 6.3.25, however since then SSE has worked hard to reduce the length of its calls.

- 4.5.3 There are also a number of other conditions (predating RMR) which lead to excessive information on bills. Currently mandatory billing information includes: information on the distributor's enquiry service; the customer's supply number; information about dispute settlement; fuel mix disclosure; information on Citizens Advice Bureaus; and information on energy efficiency advice.<sup>114</sup> This volume of information is excessive and can therefore impede consumer engagement.
- 4.5.4 SSE considers that these restrictive regulations should be lifted. Consumer protection arrangements and the Standards of Conduct licence condition (SLC 25C) are sufficient to ensure that customers are adequately protected when they sign up to an energy contract.

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<sup>114</sup> See SLC20: Enquiry service, Supply Number and dispute settlement; SLC 21: Fuel mix disclosure arrangements; and SLC 31: General information for domestic customers.

**5. The PFs’ analysis of specific demographic groups that are “less likely” to be engaged in domestic retail energy markets does not provide a reliable basis for robust conclusions to be drawn and risks over-stating the extent of disengagement of vulnerable-type customers**

**5.1 Introduction and overview**

5.1.1 The CMA suggests that its survey indicates that certain customer groups, incorporating “*those who have low incomes, have low qualifications, are living in rented accommodation – particularly social rented housing – or who are above 65*” are “*less likely to be engaged in the domestic energy markets [...]*.”<sup>115</sup> (The CMA also suggests that similar concerns exist in relation to customers with a disability and customers on the PSR.)<sup>116</sup>

5.1.2 SSE is keen to support the CMA in its efforts to consider how best to assist vulnerable-type customers. As explained in previous submissions to the CMA,<sup>117</sup> in addition to contributing to the industry-wide initiatives, SSE operates its own specifically-targeted initiatives to ensure that vulnerable customers are assisted over and above statutory requirements.

5.1.3 In SSE’s experience, however, there are few “*hard and fast*” trends within these customer groups, with significant differences in behaviour observed within each group. The CMA’s intentions, while laudable, therefore fail to achieve their stated purpose. As explained in further detail below, the PFs provide an over-broad and highly imprecise identification of potentially vulnerable-type customers and fail to consider properly the nature of the barriers to engagement that such customers might face. This assessment would therefore not be capable of supporting a wide-ranging remedies of the type apparently under consideration in the CMA’s Notice of Possible Remedies.

**5.2 The CMA’s analysis of its customer survey fails to identify the most significant drivers of customer engagement**

5.2.1 As noted above, the CMA identifies six groups of customers that it considers to be particularly likely to be disengaged and inactive: (1) customers with household incomes under £18,000 a year; (2) customers living in rented social housing; (3) customers with no qualifications; (4) customers aged 65 and over; (5) customers who have a disability; and (6) customers on the PSR.<sup>118</sup>

5.2.2 The CMA’s broad groupings capture a significant cross-spectrum of customers. Indeed, more than half the respondents to the CMA’s survey (55%) fell into one or more of the six vulnerable-type groups identified by the CMA.

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<sup>115</sup> PFs, para. 8.26.

<sup>116</sup> PFs, paras. 8.10 and 8.14.

<sup>117</sup> See, in particular, RUIS, paras. 8.6.4 – 8.6.11; SSE’s response to the SQ, S.105, paras. 105.12 – 105.15.

<sup>118</sup> PFs, Appendix 8.1, para. 64.

- 5.2.3 As the CMA's initial screening suggests, the six potentially vulnerable groups identified by the CMA do correlate with lower levels of engagement. Customers who meet one or more of the CMA's criteria for vulnerability are 16-47% less likely to have switched energy supplier (depending on the measure of engagement used).
- 5.2.4 The CMA's analysis does not, however, support a conclusion that possessing any one of these characteristics will, in itself, make a customer less likely to switch supplier. Indeed, further analysis shows that:
- (a) The six vulnerable-type demographic characteristics identified by the CMA are correlated with one another. The CMA's analysis therefore does not attempt to disentangle the effect of each of these individual characteristics from one another, and so is unable to isolate the impact of each of them on engagement.
  - (b) The six vulnerable-type demographic characteristics identified by the CMA are correlated with other factors that appear to have a more significant influence on switching behaviour. This means that the socio-economic and demographic characteristics identified by the CMA are unlikely to be the real drivers of customer engagement, but merely correlated with the underlying causes of customer engagement. The customer survey results indicate that there are three correlated factors that may be relevant:
    - (i) *Internet access.* The CMA has suggested that the internet has significantly reduced search and comparison costs in recent years, but there appear to be specific barriers to engagement for those who either do not have access to the internet or do not feel confident using it.<sup>119</sup> Further analysis shows that 30% of customers who meet one or more of the six vulnerable-type demographic criteria identified by the CMA do not have internet access, compared to only 3% who do.
    - (ii) *Contact by suppliers.* Further analysis suggests that lower income groups are less likely to have been directly contacted by other suppliers suggesting that they switch tariffs, or by their own supplier about switching tariffs. This may be relevant to the extent that supplier contact facilitates switching and/ or prompts customers to consider switching.
    - (iii) *Receipt of the Warm Home Discount (WHD).* Further analysis shows that 11% of survey respondents who met one or more of the CMA's six vulnerable-type demographic characteristics are WHD recipients compared to 1% of those who are not.
- 5.2.5 The CMA's analysis is unable to reliably disentangle the relevant drivers of switching and/or engagement from the factors that merely happen to be

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<sup>119</sup> PFs, para 8.94

correlated with those drivers. To investigate the underlying drivers of engagement, it is instead necessary to take all of these factors into account, and systematically assess which of them drives engagement.

- 5.2.6 To do this, SSE's advisors carried out an econometric analysis of the relationship between actual switching behaviour, the socio-economic and demographic characteristics listed by the CMA, and the three factors identified above as being correlated with these customer characteristics (internet access, contact by suppliers, and WHD). The details of this analysis (including robustness checks) and the full results are set out in full in **Annex 2**.<sup>120</sup>
- 5.2.7 The results of this analysis indicate that there are four statistically significant drivers of customer switching:
- (a) *Internet access.* The regression analysis suggests that internet access is the biggest driver of engagement. All else being equal, customers with no internet access are 12-15 percentage points less likely to have ever switched supplier, and 6-12 percentage points less likely to have switched recently. Customers without internet access are also less likely to be confident in their ability to switch and less likely to switch in the next three years.
  - (b) *Contact from suppliers.* The regression analysis suggests that contact from other suppliers increases the possibility of switching supplier and/or tariff by 10-15 percentage points, and of switching in the last three years by 6 percentage points. Contact from a customer's own supplier further increases the probability of ever switching supplier or tariff and it increases the probability of customers feeling confident about making the right decision or finding the right deal.
  - (c) *Receipt of the WHD.* The regression analysis suggests that recipients of a WHD are on average 7-10 percentage points less likely to have switched. WHD recipients are also less likely to consider themselves likely to switch suppliers in the next three years. Nevertheless, the evidence does not suggest that WHD customers are more likely to be intrinsically disengaged from the market. The regression analysis indicates that WHD customers are no less likely to feel confident about making the right decision, and 7 percentage points more confident about finding the right deal. This suggests that the low propensity of these customers to switch is most likely because they are already on favourable tariffs.
  - (d) *Tenure type.* The regression analysis suggests that household tenure influences the propensity to switch, with customers who rent being less likely to switch than those that have a mortgage. However, the evidence does not suggest that social housing renters are less likely to

<sup>120</sup> Excerpt from the *Report of SSE plc's Authorised Advisors from the second Energy Market Investigation Disclosure Room* on vulnerable customers (the ***Vulnerable Customer Statistical Analysis***).



switch than private renters or that they feel less confident about their ability to switch or find the right deal.

- 5.2.8 By contrast, the other socio-economic and demographic characteristics, (such as age, income, qualifications, PSR and CDSP indicators) do not have a statistically significant effect after controlling for these factors.
- 5.2.9 These results are therefore consistent with SSE's experience that there are few "*hard and fast*" trends within these customer groups. Demographic criteria (e.g., analysing customer groups by reference to age) are of limited relevance in assessing engagement.
- 5.2.10 The characteristics that are most significant for customers who have chosen not to switch are not consistent with an inherent lack of engagement in energy markets:
- (a) The most statistically significant factor – a lack of internet access – reflects broader socio-economic factors that are not specific to the energy market.
  - (b) The second most statistically significant factor – contact from suppliers – is likely to have been heavily impacted by concerns around cold-calling (SSE took the decision in April 2013 to permanently cease out-bound cold-calling). As SSE has previously explained, the availability of a greater variety of routes to market (including cold-calling) is one of the reasons why external switching levels were substantially higher in the past (e.g., at around 20% in 2008).<sup>121</sup>
  - (c) Receipt of the WHD is not a function of disengagement, but rather reflects the fact that these customers are typically on favourable tariffs. As customers clearly value the WHD (which amounted to £140 per customer for 2014-2015), and a customer might lose WHD upon switching to another supplier, it is unsurprising that customers in receipt of the WHD may choose not to switch.
  - (d) The results for tenure type suggest that differences in switching rates may stem from the nature of rental contracts and/or differences in preferences of those that rent, rather than differences in customer confidence or willingness to engage in the market.

### **5.3 The CMA has failed to conduct any other kind of meaningful analysis into barriers to engagement for potentially vulnerable customers**

- 5.3.1 The CMA's analysis not only fails to identify the most significant drivers of customer engagement, but also neglects to provide any meaningful analysis into the barriers to engagement they might face.
- 5.3.2 In particular:

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<sup>121</sup> See *RUIS*, para. 8.2.3.

- (a) The findings set out in the PFs appear to be based solely on the CMA's customer survey and therefore fail to adequately consider the full market context. As Professor Littlechild *et al.* have noted, there are myriad market features touching on potentially vulnerable customers that the CMA appears not to have considered: "*it is not clear that the CMA has given sufficient regard to the existing provisions for support, and to the ever-increasing number and range of developments associated with suppliers, PCWs, TPIs, local, regional and national governments, that seek to improve the situation of vulnerable customers in the modern competitive energy market.*"<sup>122</sup>
- (b) The CMA has not used standard techniques available to it, such as behavioural economics analysis, which have been employed in other Market Investigations.<sup>123</sup>
- (c) As with its approach in relation to switching rates and gains from switching, the CMA has also failed to conduct any kind of relevant benchmarking exercise, in particular to establish to what extent potential barriers to engagement may be energy-specific. For example, a lack of internet access (which, as explained above, is a significant characteristic for non-switchers) is clearly not an energy-specific barrier to engagement.

#### **5.4 The CMA fails to consider that customers within the potentially-vulnerable groups identified may rationally choose not to switch suppliers despite the potential savings available**

- 5.4.1 The CMA suggests that the fact that a higher proportion of households on lower incomes are leaving "*money on the table*," where energy constitutes a "*high proportion of the total expenditure for the poorest households*," means that the customer inactivity observed by the CMA cannot not be explained by a lack of interest in saving money through switching.<sup>124</sup>
- 5.4.2 This is not correct. The results of the customer survey also show that low-income consumers are significantly more likely to value reputation/brand and

<sup>122</sup> Littlechild PFs and NPR Response, para. 83. Littlechild *et al.* also note that the CMA should consider that impact that the end of doorstep selling has had on vulnerable customers (*see Littlechild PFs and NPR Response*, para. 109).

<sup>123</sup> The CMA's approach in this regard therefore contrasts directly with the approach that it has adopted in its retail banking market investigation, in which the CMA is explicitly considering "*whether there are any behavioural biases which might limit customers' ability to accurately assess alternative offers, and how this interacts with banks' decisions on price and product structures.*" (*See the CMA's updated issues statement in the retail banking market investigation (21 May 2015) para. 66*). In particular, the CMA is undertaking a behavioural economics-type analysis using data from its quantitative survey of personal current account customers and the transactional data it has received from banks to assess differences between customers' perceptions of their account usage and charges and their actual behaviour. (*See CMA, Proposed approach for comparing actual and perceived behaviour of personal current account customers (10 March 2015)*).

<sup>124</sup> PFs, paras. 8.28 – 8.29.

the range of other services offered, and no more likely to value price, than customers with higher levels of income.

**Percentage of customers who consider decision-making drivers to be “essential”  
by income level**

	Cheap tariff essential	Customer service essential	Reputation/brand essential	Range of other services essential
<£18,000	29%	34%	12%	15%
£18,000 and above	28%	31%	6%	4%

*Source: SSE analysis of CMA customer survey*

5.4.3 Accordingly, the CMA’s assumption that low-income customers place more emphasis on cheap tariffs, which forms a key pillar of its theory of harm in the domestic segment, is not correct. Instead, the customer survey shows that the switching behaviour of low-income customers is consistent with the greater weight they place on non-price factors, which are less liable to change over time.

5.4.4 Indeed, as described above, low-income customers on average face significantly lower potential gains from switching and do not require lower gains to consider switching.<sup>125</sup>

**5.5 Overall, the PFs’ assessment of barriers to engagement and outcomes for these customers is unsound and cannot support a wide-ranging remedy**

5.5.1 SSE is keen to support the CMA in its efforts to consider how best to assist vulnerable-type customers. The CMA has, however, relied upon a paucity of evidence upon which to base its conclusions and has, in many cases, incorrectly interpreted the results of its analysis. The CMA has failed to address highly relevant available evidence – *e.g.*, from its customer survey and gains from switching analysis – for the potential groups of concern identified by its initial screening. The CMA has also failed to pursue obvious lines of inquiry and use standard techniques available to it, which have been employed in other Market Investigations. Accordingly, as explained above, the CMA’s analysis results in an over-broad and highly imprecise identification of potentially vulnerable customers. This would not provide an adequate evidential basis for a wide-ranging remedies of the type that appear to be under consideration in the CMA’s Notice of Possible Remedies.

<sup>125</sup> See para. 3.2.20 of this Response.

## **6. Revising the current system for gas settlement would reduce distortions and incentivise innovation and efficiency**

### **6.1 Introduction and overview**

6.1.1 The PFs correctly recognise that the current system of gas settlement can lead to the inefficient allocation of costs and reduce efficiency. SSE considers, in particular, that the most significant distortions arise from the allocation of disproportionate levels of unallocated gas on domestic shippers as compared to large gas customers (rather than distorting competition between domestic gas suppliers).

6.1.2 However, Project Nexus (and other developments in course), once implemented in October 2016, should effectively address the current inefficiencies in the gas settlement system.

### **6.2 The current system for gas settlement provides scope for distortions that impose excessive costs on domestic shippers/suppliers and can reduce incentives for innovation and efficiency**

*Supplier distortions are primarily due to changes in customer numbers and will be largely addressed by Project Nexus*

6.2.1 The PFs suggest that the current system of gas settlement is a feature of the market which gives rise to an AEC through the inefficient allocation of costs to parties and the scope it creates for gaming.<sup>126</sup>

6.2.2 In SSE's experience, the "lag" in accurate AQ readings does not specifically disadvantage suppliers that have been effective in helping their customers reduce their gas consumption. Any additional disadvantage experienced by such suppliers is small in comparison to the potential size of errors relating to total customer losses or gains in the last year.

6.2.3 SSE welcomes Ofgem's ongoing work to closely monitor the AQ process through a combination of information requests and consideration of the annual Mod081 reports.<sup>127</sup> These reports are available to other industry participants (on an anonymised basis), to facilitate ongoing scrutiny of shippers' AQ submissions. SSE submits all valid meter readings to Xoserve and does not attempt to restrict the selection of meter points for AQ amendment.

6.2.4 The settlement regime that will be implemented under Project Nexus will greatly reduce the influence of the AQ process. SSE welcomes the changes proposed under Project Nexus, which will significantly improve the allocation process, and will effectively address the vast majority of the concerns raised in the PFs.

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<sup>126</sup> PFs, para. 8.272.

<sup>127</sup> See SSE's response to the CMA Working Paper, *Gas and Electricity Settlement and Metering* (the *Gas and Electricity Settlement Working Paper Response*), para. 9.

- 6.2.5 Project Nexus remains scheduled to be implemented in relatively short order (in October 2016). It is therefore not the case that the “*slow pace*” of implementation or “*lack of a deadline*” for the introduction of Project Nexus would give rise to an AEC.

*Distortions between domestic and large gas customers relating to the allocation of “unidentified gas” will be largely, but not completely, addressed by Project Nexus*

- 6.2.6 As SSE has explained previously,<sup>128</sup> domestic suppliers are unable to bill all of the gas allocated to them by national systems because of the “*unallocated gas*” (i.e., the difference between allocated and metered volumes). The costs of unallocated gas are currently predominantly met by domestic shippers as a consequence of the industry process known as Reconciliation by Difference (**RbD**).
- 6.2.7 There is a bias against domestic shippers in the way RbD allocates imbalance, which results in domestic shippers being overcharged by Xoserve (the company which independently maintains the national systems on behalf of the Gas Distribution Networks (**GDNs**)), compared to large gas customers (whose supply points are settled individually based on actual consumption). As RbD/unallocated gas represents a cost that suppliers must recover in their prices, these costs are ultimately borne (disproportionately) by domestic consumers.
- 6.2.8 The introduction of a revised settlement regime under Project Nexus in October 2016 will address some of these concerns. The Allocation of Unidentified Gas Expert (**AUGE**) process will also improve, but will not fully address, the issue of the unfair allocation of imbalance volumes (and hence costs will continue to fall disproportionately on domestic consumers). SSE continues to consider that further work is necessary to address the market distortions caused by the treatment of unallocated gas in a robust way. For example, there may be scope for improvements in the system which could be delivered through a review of the system operator incentives (covering, for example, improved metering or a greater incentive to identify and resolve persistent leaks), although this would need to be subject to a thorough cost-benefit analysis.

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<sup>128</sup> See e.g., RUIS, para. 8.2.12 and SSE’s response to the SQ, S.12, para. 12.21.

**7. Moving to HH settlement for domestic customers should, in due course, enable suppliers to compete and innovate more effectively**

**7.1 Introduction and overview**

7.1.1 The PFs correctly recognise that the use of HH consumption data should, as smart meters are rolled out, incentivise suppliers to introduce new and innovative tariffs. There is no case, however, on the evidence that the absence of any “*concrete proposal*” for the introduction of HH settlement is resulting in an AEC, given the relatively early stage of smart meter roll-out.

**7.2 It would be premature to develop a concrete plan for a move to HH settlement within the current market context**

7.2.1 The CMA raises concern about the lack of concrete plans for a move to HH settlement and the fact that no modification process on this has begun.<sup>129</sup> The CMA is concerned, in particular, that the required code modification process could “*take a long time*” and that a lack of clarity over the regulatory regime could inhibit cost-effective elective HH settlement.<sup>130</sup>

7.2.2 SSE welcomes that the CMA has recognised that the timing of a shift to HH settlement for all domestic customers should be determined by an assessment of the overall costs and benefits (which will partly be a function of the number of domestic customers that have smart meters).<sup>131</sup> However, until the smart meter roll-out is sufficiently advanced, the material costs of HH settlement would vastly outweigh the benefits realised by those with smart meters.

7.2.3 The PFs understate the progress that has already been made towards accommodating HH settlement in profile classes 1-4.<sup>132</sup> Furthermore, the experience of introducing HH settlement for profile classes 5-8 should help to expedite the process of assessing and implementing the necessary code modifications and ensure a more efficient process overall for the remaining classes.<sup>133</sup>

7.2.4 SSE firmly considers that current industry governance arrangements are sufficient to ensure that modification proposals are suitably reviewed and assessed prior to implementation. Beyond these arrangements, moving to HH settlement is part of Ofgem’s “*smarter markets*” roadmap and an overarching strategic body would be well placed to help prioritise its implementation.

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<sup>129</sup> PFs, para. 8.285.

<sup>130</sup> PFs, para. 8.284.

<sup>131</sup> PFs, para. 8.283

<sup>132</sup> Modifications to industry codes to deliver HH settlement for profile classes 5-8 have resulted in changes to the Distribution Connection and Use of System Agreement (*DCUSA*) under DCP179, which makes it possible for HH tariffs to be created in the Common Distribution Charging Methodology specifically for customers in profile classes 1-8. See Ofgem, *Balancing and Settlement Code (BSC) P300: Introduction of new Measurement Classes to support Half Hourly DCUSA Tariff Changes (DCP179)* (15 October 2014).

<sup>133</sup> This is explained further in the *Gas and Electricity Settlement Working Paper Response*.

**8. The provisional finding that an “overarching feature” of weak customer response in the microbusinesses sector gives rise to an AEC is not supported by the evidence**

**8.1 Introduction and overview**

8.1.1 The CMA bases its case that weak customer response in the microbusiness sector gives rise to an AEC on three findings:

- (a) *First*, the CMA considers a “*range of evidence*” for the microbusiness customer sector to assess whether the level of engagement is sufficient.<sup>134</sup> (See Section 8.2.)
- (b) *Second*, the CMA considers whether there is evidence that microbusiness customers are achieving “*poor outcomes*” in their energy supply.<sup>135</sup> To this end, the CMA examines, in particular, whether prices and profits in the microbusiness segment are at higher levels than might be justified by cost. (See Section 8.3.)
- (c) *Third*, as in the domestic sector, the CMA examines the “*specific features*” of the market (*i.e.*, barriers to engagement that the CMA considers that microbusiness customers are likely to face) that it considers give rise to the alleged AEC.<sup>136</sup> (See Section 8.4.)

8.1.2 As explained in the remainder of this Section, the CMA’s case is undermined by a series of key errors of fact and assessment. The PFs combine a series of analyses underpinned by extreme assumptions to arrive at conclusions that are divorced from the realities of the market. Many of the findings on which the CMA relies are simply not supported by the evidence. In particular, in conducting its analysis of microbusiness customer engagement, the CMA has relied on outdated information that is not fit-for-purpose and not taken full account of recent and imminent developments relevant to microbusiness customer engagement.

8.1.3 In SSE’s view, the microbusiness segment is dynamic and innovative, with all relevant indicators showing that competition is already strong (and increasing). There are currently 33 active electricity suppliers and 35 active gas suppliers,<sup>137</sup> and competition is intensifying as existing players deepen and broaden their competitive offerings and new firms enter the segment. A recent Cornwall Energy report found that the non-domestic business electricity and gas markets “*are the most competitive they have ever been.*”<sup>138</sup>

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<sup>134</sup> PFs, paras. 9.35 - 9.46.

<sup>135</sup> PFs, paras. 9.75 - 9.109.

<sup>136</sup> PFs, paras. 9.47 - 9.65.

<sup>137</sup> CMA Working Paper, *Microbusinesses*, para. 27.

<sup>138</sup> Cornwall Energy, *Competition in the British business energy supply markets* (April 2014), p. 4.

8.1.4 SSE therefore does not recognise the picture of the market that has been painted by the CMA. In short, there is no overarching feature of “*weak customer response*” that gives rise to an alleged AEC.

## **8.2 The evidence suggests that levels of engagement in the microbusiness sector are significant**

8.2.1 The CMA considers a “*range of evidence on engagement*” and reaches the (relatively limited) finding that “*the level of engagement for some microbusinesses appears to be low.*”<sup>139</sup> The CMA later appears to mischaracterise this finding to arrive at a far broader conclusion that certain features of the microbusiness segment impede the ability of customers to engage in the market “*effectively and successfully.*”<sup>140</sup>

8.2.2 **Switching rates are high (and increasing).** The CMA appears to place considerable weight on 2013 Ofgem survey data that suggested that a “*sizeable minority*” of microbusiness customers (39% of businesses with one to four employees and 28% of businesses with five to nine employees) had not switched supplier in the last five years.<sup>141</sup>

8.2.3 The microbusiness sector has, however, evolved considerably within the last five years (as described elsewhere in this Section) and the (more relevant) recent data indicate that switching rates are currently materially higher. In 2014, 20% of businesses with one to four employees and 24% of businesses with five to nine employees had switched supplier in the past year.<sup>142</sup> Indeed, even these data likely understate the current extent of switching in the microbusiness segment given the prevalence of fixed-term contracts with a term of 18 months or longer, which preclude switching before their termination date.<sup>143</sup> For example, in 2014, over 40% of microbusiness customers that had not switched suppliers within the past twelve months, stated that they had not done so because they were tied to existing contracts.<sup>144</sup>

8.2.4 Moreover, a comparison of switching rates against possible benchmarks show that annual switching rates for microbusinesses/SMEs in energy compare

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<sup>139</sup> PFs, para. 9.35.

<sup>140</sup> PFs, para. 9.11.

<sup>141</sup> PFs, para. 9.33.

<sup>142</sup> PFs, para. 9.38(a).

<sup>143</sup> Since 2013, “*the propensity to have a fixed-term contract has increased significantly*” for SMEs (including microbusiness customers) with over 61% of the segment on fixed-term contracts. (See BMG research for Ofgem, *Micro and Small Business Engagement in Energy Markets* (March 2015) (the **BMG Survey**), p. 31.) These fixed-term electricity and gas contracts have a term of 18 months or more and microbusiness customers may not switch before their termination date. (See *BMG Survey*, pp. 20 and 31.) The CMA acknowledges that “*a customer on a fixed-term contract would be unable to switch every year.*” (See PFs, Appendix 9.1, para. 56(a).)

<sup>144</sup> *BMG Survey*, p. 43.



favourably to those in other markets, including insurance, SME fixed landline, internet and mobile phones.<sup>145</sup>

- 8.2.5 **Market shares in former PES regions are relatively modest (and rapidly decreasing).**<sup>146</sup> The former PES suppliers' market shares in their 'in-area' regions are already relatively modest (amounting to 34% on average in July 2014).<sup>147</sup> These shares continue to decrease rapidly (*e.g.*, the average SME share of the former PES supplier in each region fell from 55% in July 2006 to 34% in July 2014, a decrease of some 40% over the period).
- 8.2.6 **Microbusiness customers can engage with their suppliers through actions other than switching suppliers.** As the PFs recognise,<sup>148</sup> microbusiness customers can engage in the market – in particular by “*contract searching*” – without necessarily changing supplier. The CMA notes that half of businesses with one to nine employees had looked into switching supplier or changing their contract within the last year.<sup>149</sup> (As explained above, this statistic likely understates the extent of engagement given the large proportion of customers on fixed-term contracts who would effectively have been unable to switch during this period.) Similarly, microbusiness customers also engage with the market by changing tariffs or payment details, or otherwise contacting their supplier. For example, 45% of microbusiness customers have contacted their supplier in the last year, primarily to query or obtain information, including switching information.<sup>150</sup> For its part, SSE had approximately [X] contacts with its customers last year (across its existing base of just under [X] customers).
- 8.2.7 **Suppliers are working hard to engage further with customers.** Suppliers are using a variety of methods to improve engagement in the microbusiness sector further. SSE has, for example, introduced a pioneering switching programme for microbusiness customers with a poor credit rating who might traditionally have struggled to switch supplier. SSE is also developing its non-domestic customer service by <sup>151</sup>X<sup>152</sup>. All of these measures are aimed at increasing microbusiness customer engagement.

<sup>145</sup> PFs, para. 9.38. The switching levels for the past two years have been broadly consistent across these utilities: fixed landline (19%), fixed internet (20%) and mobile phones (21%) (Jigsaw Research for Ofcom, *SME experience of communications services – a research report* (16 October 2014), p. 70).

<sup>146</sup> PFs, paras. 9.42 - 3.

<sup>147</sup> PFs, Appendix 9.1, para. 25.

<sup>148</sup> The proportion of microbusiness customers who looked into changing supplier was higher than the proportion who switched (PFs, Appendix 9.1, para. 62 and *BMG Survey*, pp. 21 – 22).

<sup>149</sup> PFs, para. 9.41.

<sup>150</sup> 45% of microbusiness customers have contacted their suppliers in the last year, primarily to query or obtain information, including switching information (*BMG Survey*, p. 59).

<sup>151</sup> See *RUIS*, para. 8.13.2.

<sup>152</sup> See *RUIS*, para. 8.13.2.

- 8.2.8 ***The evidence shows that microbusinesses are aware of their ability to switch and well-practised in doing so.*** Switching rates in the microbusiness segment are high and increasing. Microbusiness customers show a high level of familiarity with their contracts and tariffs, including when they are able to start negotiating and/or give notice.<sup>153</sup> None of these observations, which are largely ignored in the PFs, support the CMA's unsubstantiated provisional finding that microbusiness customers are disengaged. Instead they show that microbusiness customers have a strong interest in their ability to switch and are fully engaged with the market.
- 8.2.9 ***Market developments already in train will further improve engagement.*** Several market developments already in train will have (or are already having) a positive impact on customer engagement in the microbusiness sector. In particular, the microbusiness-specific reforms introduced by Ofgem in 2014/2015 have increased awareness amongst microbusiness customers of their contract deals and provided prompts for engagement.<sup>154</sup> Ofgem is also developing a code of conduct for non-domestic third party intermediaries (*TPIs*). Ofgem's preferred approach is to underpin this code with a licence condition that mandates that suppliers only work with code-accredited TPIs.<sup>155</sup> (SSE supports this measure in principle, provided that obligations for code-adherence are placed directly on TPIs, as suppliers have no control over the conduct of these organisations.) Although Ofgem has deferred its consultation on the code, pending the outcome of the CMA's investigation, it has set out a set of principles that it expects TPIs to adhere to. These principles include the basic standards of honesty, respect, accuracy, transparency, customer focus and professionalism.<sup>156</sup> Broader industry developments, such as the roll-out of smart meters and improvements to the switching process, can also be expected to improve microbusiness customer engagement.

<sup>153</sup> For instance, nearly 50% of SMEs and microbusiness customers have read or glanced through their energy contacts in the past year. This is a significant increase on the year before (*BMG Survey*, pp. 25 and 31). Over 65% of SMEs and microbusiness customers either know exactly or approximately when their contract ends (*BMG Survey*, p. 25). This figure rises to over 80% for those who have shopped around within the past twelve months (*BMG Survey*, p. 25).

<sup>154</sup> Ofgem measures introduced in March 2014 included the requirement for suppliers to put the last date to give notice of termination and the contract end date on bills. The April measures included: allowing microbusiness customers to give notice to terminate a contract no more than 30 days before a contract ends; providing current prices and annual consumption details on renewal letters for microbusiness fixed-term contracts, and acknowledging a termination notice from a microbusiness customer within five working days of receipt, or as soon as reasonably practical after. (For April 2015 measures, see Ofgem, *Decision on automatic rollovers and contract renewals for micro-business consumers* (28 November 2014).)

<sup>155</sup> See Ofgem, *Open letter on next steps to the non-domestic TPI code of practice project* (7 August 2014) – available at <https://www.ofgem.gov.uk/publications-and-updates/next-steps-non-domestic-tpi-code-practice-project>.

<sup>156</sup> See Ofgem, *Open letter on next steps on our project for a code of practice for the non-domestic third party intermediary (TPI) sector* (5 March 2015) – available at <https://www.ofgem.gov.uk/ofgem-publications/93764/openlettertpiprinciplesmarch2015forweb-pdf>.

8.2.10 ***The CMA’s conclusion overlook high levels of customer satisfaction.*** The PFs appear to suggest that a microbusiness customer who has failed to switch (or, at the very least, to “*contract search*”) is likely to be disengaged.<sup>157</sup> This is, of course, a simplistic approach that fails to reflect the other possible means of engagement described above. It also ignores that microbusiness customers may choose not to switch because they are satisfied with their existing supplier. The PFs acknowledge that customers who stay with a supplier could be “*satisfied with the tariff offering and service provided.*”<sup>158</sup> Indeed, 60% of microbusiness customers had not switched supplier within the past year because they were “*broadly satisfied with their existing supplier.*”<sup>159</sup> It is not possible to simply assume that customers who have chosen not to switch suppliers must be disengaged.

### 8.3 **The suggestion that customers are achieving “*poor outcomes*” in their energy supply is not consistent with the evidence**

8.3.1 The PFs arrive at the provisional conclusion that “*a substantial number of microbusiness are achieving poor outcomes in their energy supply.*”<sup>160</sup> The CMA suggests that this is because a proportion of the microbusiness customer base is on one of the so-called “default” tariffs. The CMA further suggests that “*average revenues are substantially higher on the default tariff types that less engaged customers end up on,*” and that such differences in revenues cannot be justified by cost.<sup>161</sup>

8.3.2 It cannot simply be assumed that microbusiness customers on default tariffs are disengaged from the market. Indeed, this is recognised in the PFs, which acknowledge that microbusiness customers on default tariffs are “*not necessarily less engaged*” than other microbusiness customers.<sup>162</sup> Ofgem survey data confirm that the vast majority (91%) of microbusiness customers were aware when their contract had been extended or rolled-over.<sup>163</sup> Customers are required to receive renewal letters informing them that they are moving onto a default tariff.<sup>164</sup> SSE makes significant efforts to engage with customers and encourage those on Variable Business Rates (**VBR**) and deemed arrangements to switch back to fixed contractual arrangements. SSE

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<sup>157</sup> PFs, para. 9.41.

<sup>158</sup> PFs, para. 9.34.

<sup>159</sup> *BMG Survey*, p. 43. This figure is made up of those who have not switched for the three groups: 0 employees, 1-4 employees and 5-9 employees. This figure is not weighted.

<sup>160</sup> PFs, para. 9.110.

<sup>161</sup> PFs, para. 9.110.

<sup>162</sup> PFs, Appendix 9.1, para. 47.

<sup>163</sup> *BMG Survey*, p. 21.

<sup>164</sup> Under SLC7A, suppliers are required to set out the following in the renewal letters: the customers’ annual consumption and details of contract prices and terms if the contract is automatically renewed, or if the customer takes no action at the end of the existing contract term. SSE sends out its renewal letters two to three months before a microbusiness customer’s contract end date.

starts to contact customers with renewal terms around two to six months before contract expiry and continues to engage up to and beyond the expiry date.<sup>165</sup> SSE then proactively contacts microbusiness customers on its VBR and deemed rates two weeks after they have moved to these rates, and then at least every six months thereafter, to advise them on the potential benefits of moving onto a contract.<sup>166</sup>

- 8.3.3 ***The majority of SSE’s microbusiness customers are on acquisition and retention tariffs.*** The CMA’s analysis of tariff types attaches undue weight to a relatively small number of customers on default tariffs (and is incapable of supporting the CMA’s conclusion that these tariffs are “*highly prevalent*”).
- 8.3.4 SSE voluntarily abolished auto-rollover contracts in April 2014. Customers who would previously have been rollover customers instead now move onto VBRs. It is anticipated that such customers do so on a temporary basis, before they move to another supplier or onto a negotiated fixed-term contract.
- 8.3.5 More broadly, the prevalence of default tariffs does not appear to be widespread. The PFs acknowledge that deemed and out-of-contract (*OOC*) tariffs together represented only 6% of electricity and 7% of gas supplied to microbusinesses.<sup>167</sup> Similarly, very few customers appear to be on auto-rollover tariffs.<sup>168</sup> The proportions of customers on these contracts cannot, therefore, form the basis for segment-wide conclusions.
- 8.3.6 ***SSE’s profits in the microbusiness segment are not excessive by any relevant benchmark.*** The PFs suggest that EBIT margins are “*generally higher*” in the SME markets than other markets and that these differences are “*beyond what appears to be justified by risk.*”<sup>169</sup>
- 8.3.7 This is not the case for SSE. In fact, SSE’s electricity SME margins have fluctuated year-on-year. At an average of [X]%, SSE’s margins were considerably lower than the industry average of 7.9% for the segment observed by the CMA (with the difference between SSE’s electricity and domestic margins being only [X]%). The CMA has therefore not correctly identified a market-wide concern but one that only applies, at most, to the activities of certain industry participants.
- 8.3.8 ***SSE’s prices for microbusiness customers are not excessive.*** The CMA suggests that average prices for SMEs are about 14% higher than the CMA’s

<sup>165</sup> The CMA’s definitions of “*deemed*” and “*OOC*” tariffs do not correlate with SSE’s definitions. A customer will be placed on a deemed contract with SSE in two instances – when: (1) they move to a new property and start to consume energy without a contract; and (2) they terminate their contract but have not yet switched to a new supplier. For SSE’s customers, OOC rates apply when a customer has reached the end of their fixed-term contract and takes no action.

<sup>166</sup> See *RUIS*, para. 8.13.10.

<sup>167</sup> *PFs*, para. 9.85.

<sup>168</sup> *PFs*, para 9.80, fn. 545.

<sup>169</sup> *PFs*, para. 9.110.

competitive benchmark.<sup>170</sup> The methodological problems with the CMA's pricing analysis are explained in detail above in Section 3.5. As demonstrated, addressing these problems completely removes the CMA's claimed customer "overcharge" across domestic and SME customers collectively.

**8.4 The CMA's analysis of the "specific features" of the microbusiness market that it considers give rise to the alleged AEC is not supported by the evidence**

8.4.1 The CMA suggests that certain "specific features" of the market "act in combination to deter microbusiness customers from engaging in the SME retail gas and electricity markets, to impede their ability to do so effectively and successfully, and to discourage them from considering and/or selecting a new supplier that offers a lower price for effectively the same product."<sup>171</sup>

8.4.2 The CMA's analysis of these features of the market is not, however, supported by the evidence. In particular, the CMA materially overstates the impact that these market features have in practice on the ability of microbusiness customers to participate in the market.

8.4.3 **The PFs' assessment of the awareness and interest of ability of microbusiness customers to switch energy supplier is incorrect and incomplete.** The PFs (replicating the CMA's approach in its analysis of the domestic sector) suggest that microbusiness customers have "limited awareness of and interest in their ability to switch energy supplier."<sup>172</sup> As in the domestic sector, the CMA bases this suggestion on its views that gas and electricity are "homogenous" products and that traditional meters and bills are "confusing and unhelpful."<sup>173</sup>

(a) As explained above,<sup>174</sup> gas and electricity are not homogenous products and there are several drivers of choice for customers. As in the domestic sector, microbusiness suppliers compete across a broad range of competitive parameters. For example, the promise of better service is a strong driver for switching supplier for microbusiness customers, as is greater assistance with energy reduction initiatives.<sup>175</sup>

(b) The CMA presents no evidence to suggest that traditional meters or bills give rise to any material barrier to engagement (and the extensive evidence of engagement described above indicates that this is not the case). To the extent that any difficulties could be raised by traditional meters or bills, these will, of course, largely be addressed by the imminent roll-out of smart meters (which the CMA does not appear to

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<sup>170</sup> PFs, para. 10.65.

<sup>171</sup> PFs, para. 9.111.

<sup>172</sup> PFs, para. 9.112.

<sup>173</sup> PFs, para. 9.112(a).

<sup>174</sup> See paras. 3.3.2 – 3.3.4 of this Response.

<sup>175</sup> BMG Survey, p. 40.

have considered here). In addition, as explained above (*see* [Section 4](#)), current regulations restrict suppliers' ability to communicate effectively with microbusiness customers to reduce the perceived complexity of traditional meters and bills. Accordingly, to the extent that microbusiness customer confusion does arise, a significant cause of this would be unnecessary regulation.

- (c) There is a large volume of evidence demonstrating microbusiness customers' interest in and ability to switch supplier. As described above, switching rates in the microbusiness segment are high and increasing. In addition, microbusiness customers show a high level of familiarity with their contracts and tariffs, including when they are able to start negotiating and/or give notice. For example, nearly 50% of SMEs and microbusiness customers have reviewed their energy contracts in the past year.<sup>176</sup> Over 65% of SMEs and microbusiness customers either know exactly or approximately when their contract ends.<sup>177</sup> This figure rises to over 80% for those who have shopped around within the past twelve months.<sup>178</sup> When shopping around, the majority of microbusiness customers obtained two or more quotes for an alternative supplier.<sup>179</sup> Such evidence shows that microbusiness customers generally have a strong awareness of and interest in their ability to switch supplier.

#### 8.4.4 **Actual or perceived barriers to accessing and assessing information in the microbusiness segment do not have a material impact on engagement.**

The PFs suggest that microbusiness customers face “*actual and perceived barriers to accessing and assessing information.*”<sup>180</sup> The CMA suggests that such barriers arise, in particular from a general lack of price transparency, a lack of trust in TPIs, a lack of transparency about how TPIs charge customers, and the currently limited presence of PCWs within the microbusiness segment.<sup>181</sup>

- 8.4.5 As a starting matter, SSE is not aware of customer concerns around the availability of price information. In addition, Ofgem survey data indicate that 75% of non-domestic customers who had switched supplier considered that the process of choosing a new supplier was “*easy.*”<sup>182</sup> SSE's price information is readily accessible on its website (in the case of VBRs and deemed rates), from SSE's customer service team, or from TPIs. SSE also provides

<sup>176</sup> This is a significant increase on the year before (*BMG Survey*, pp. 25 and 31).

<sup>177</sup> *BMG Survey*, p. 25.

<sup>178</sup> *BMG Survey*, p. 25.

<sup>179</sup> *BMG Survey*, p. 39.

<sup>180</sup> *PFs*, para. 9.112(b).

<sup>181</sup> *PFs*, para. 9.112(b).

<sup>182</sup> The Research Perspective and Element Energy, *Quantitative research into non-domestic consumer engagement in, and experience of, the energy market* (report for Ofgem) (December 2013) (the **2013 Survey**), p. 32 and p. 50.

customers with alternative means of accessing prices and tariff structures through its online portal.<sup>183</sup>

- 8.4.6 The suggested lack of trust in TPIs, or concerns around how they charge customers, similarly seems to have little impact on customer engagement. The PFs acknowledge that TPIs represent only one of many routes to market. For example, Ofgem survey data from 2013 indicate that only 11% of microbusiness customers had chosen their current energy contract with the help of a broker.<sup>184</sup> As the CMA acknowledges, microbusiness customers are “*more likely than larger customers to use information directly from suppliers.*”<sup>185</sup> To the extent that a lack of trust in TPIs, or concerns around how they charge customers, could impede customer engagement, a number of developments in train, such as the pending Code of Conduct for non-domestic TPIs (as described above), should largely address these concerns.
- 8.4.7 Many microbusinesses prefer to approach suppliers directly to negotiate tariffs, rather than through TPIs. The levels of switching (and other forms of engagement) observed in the segment, and the ease with which microbusinesses obtain quotes, together suggest that the relative absence of PCWs has not hindered engagement. Moreover, there appear to be no features of the market that would prevent the entry of PCWs. Indeed, the CMA notes that there is already “*a viable business model for a non-domestic energy PCW.*”<sup>186</sup>
- 8.4.8 **Auto-rollover tariffs have been discontinued by a large number of suppliers (including SSE) and should not have a material impact on microbusiness customers’ ability to engage, particularly with regards to gas.** The PFs suggest that auto-rollover tariffs can also be a barrier to engagement for some customers.<sup>187</sup> This is, however, no longer a relevant issue (at least for SSE). The six large energy firms and Opus stopped offering auto-rollover tariffs in 2013/2014. Since then, the number of auto-rollover tariffs has decreased markedly and should now account for only a minimal proportion of the market. SSE would support the permanent removal of these tariffs from the market to increase customer engagement.

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<sup>183</sup> Through the Business Energy Centre, prices can be obtained and accepted for electricity or gas or both, for single site, NHH electricity or non-daily metered gas supply points. Customers are asked for details of the supply (such as supply number, consumption etc) and, based upon the submission, customers are presented with a choice of tariff structures. Once the customer has selected the required structure, they are offered four contract durations and associated prices. The customer can then proceed to accept the offer and a confirmation email will be sent to them containing additional details. All acceptances are credit checked before finally being accepted by SSE.

<sup>184</sup> 2013 Survey, p. 31.

<sup>185</sup> PFs, Appendix 9.1, para. 97.

<sup>186</sup> PFs, para. 9.64.

<sup>187</sup> PFs, para. 9.112(c).

## **8.5 Conclusion**

- 8.5.1 As described in detail above, the most recent and relevant evidence illustrates that the microbusiness sector is dynamic and innovative, and that competition and engagement are strong (and increasing).
- 8.5.2 The PFs' analysis of the microbusiness sector fails to reflect these competitive dynamics, or the developments already in train in the sector that are likely to have a positive impact on engagement. The CMA's provisional finding is therefore based on a series of key errors of fact and assessment, extreme analyses that rely on outdated information, and unsubstantiated assumptions.
- 8.5.3 The evidence therefore does not suggest that there is an "*overarching feature*" of weak customer response in the microbusiness sector that could give rise to the alleged AEC.



## **9. The provisional finding that the absence of locational pricing for transmission losses gives rise to an AEC is not supported by the evidence**

### **9.1 Introduction and overview**

9.1.1 The CMA's case is based on a highly theoretical argument that fails to properly consider how locational pricing for losses would negatively impact customers. No proper cost-benefit analysis has been carried out, with undue reliance placed on evidence that is out-of-date or highly questionable. The PFs fail, for example, to consider that dispatch decisions are driven by a wide range of factors and therefore would be largely unaffected by the introduction of locational pricing. The CMA's analysis also gives insufficient weight to (or ignores completely) a number of material costs which would potentially be incurred by the introduction of locational pricing and which would raise additional complexity and cost for market participants.

### **9.2 The PFs' analysis of the "*short-run*" and "*long-run*" benefits of locational prices for transmission losses is unsound**

9.2.1 The PFs suggest that the introduction of locational prices for transmission losses would eliminate "*cross-subsidisation*" and have both "*short-run*" and "*long-run*" benefits.<sup>188</sup> In both cases, the claimed benefits are highly theoretical and uncertain in practice.

9.2.2 In the "*short-run*," the CMA suggests that the current absence of locational prices for transmission losses may lead to inefficient dispatch decisions.<sup>189</sup> This is a highly simplistic assessment that fails to take into account a number of relevant factors. The dispatch of thermal assets, for example, is affected by a range of cost factors, as well as by system stability considerations. (Indeed, system stability considerations are increasingly important in practice given the connection of new intermittent capacity.) The "*signals*" created by locational transmission losses would not have the impact on scheduling decisions that the CMA suggests.

9.2.3 In the "*long-run*," there are already strong locational signals in the market, which are sufficient to encourage the efficient location of plant. Locational price signals can in any case also be very uncertain and unreliable over the longer-term. This is particularly the case given the likelihood, and potential impact, of other generators building in the same zone over the *circa* 40 year life of a generation asset. For example, a party looking to build a power station in Southern England would be unable to rely on the perceived benefit of its locational decision over the longer-term, as that benefit could disappear as soon as the station is commissioned (and the relevant seasonal zonal loss factors are recalculated).

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<sup>188</sup> PFs, para. 5.45.

<sup>189</sup> PFs, para. 5.45(a).

### 9.3 The CMA's modelling of the potential economic benefit of introducing a system of locational transmission losses is unsound and suggests that any potential economic benefits are low and uncertain

9.3.1 The PFs' cost-benefit analysis is effectively based on analyses prepared for Elexon and Ofgem around 2009 in relation to P229, which was rejected in September 2011. The CMA notes that these analyses report a ten-year net present value (*NPV*) benefit from the introduction of locational pricing of transmission losses of between £160 million and £275 million.<sup>190</sup>

9.3.2 These purported benefits are, however, significantly overstated:

- (a) The purported maximum benefit of £27.5 million per annum could, in SSE's view, be accounted for by a rounding error in the modelling used (the model takes account of the overall electricity market effects). In any event, the alleged benefits are low and uncertain at 10p/MWh.
- (b) These assumptions are based on an average annual reduction in losses of 211 GWh (equivalent to about 5% of losses),<sup>191</sup> which is highly uncertain given the very marginal impact on dispatch decisions described above.
- (c) The PFs indicate that a substantial proportion of the savings cited "*relate to environmental benefits from sulphur dioxide and nitrogen oxide reductions, arising from the fact that less coal and gas would need to be consumed in order to satisfy demand under a locational loss-charging scheme.*"<sup>192</sup> A significant proportion of the modelled benefit may therefore be accounted for by restrictions in output and by the planned closure of plant that does not meet the standards required under the Industrial Emissions Directive (which would, of course, not be dependent on the introduction of locational pricing for transmission losses).

### 9.4 The introduction of locational pricing for losses is out-of-step with EU developments and risks distorting competition (disadvantaging GB generators)

9.4.1 The introduction of locational pricing of losses could distort competition by imposing disproportionate costs on GB generators, placing them at a material competitive disadvantage to interconnected European generators. There are only a handful of locational transmission charging regimes in Europe, of which GB is one.<sup>193</sup> None of the Northern European states directly interconnected with GB have locational transmission charging regimes. Due

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<sup>190</sup> PFs, para. 5.47.

<sup>191</sup> PFs, para. 5.47.

<sup>192</sup> PFs, para. 5.47, fn. 130.

<sup>193</sup> See ENTSO-E, *ENTSO-E Overview of transmission tariffs in Europe: Synthesis 2014*, (June 2014), Table 3.1. The GB market is unique in adopting negative charges for generation in areas of high demand, which serves to greatly exaggerate the price signal for investment.

consideration needs to be given to EU policy and market coupling, as existing competitive distortions would be compounded by the locational pricing of transmission losses in GB. Therefore, any proposal to roll out locational pricing of losses should be considered in the context of the current market distortions caused by interconnectors being exempt from transmission charges. Since there are no plans to review the interconnector exemption, the introduction of locational transmission losses would exacerbate the existing market distortion, leading to less efficient plant running in Europe, displacing more efficient plant with higher transmission charges in GB.

## **9.5 The PFs’ analysis understates the impact of transitional costs and additional market uncertainty and complexity**

9.5.1 The cost-benefit analyses cited by the CMA assume that the transitional costs of the implementation are “negligible,”<sup>194</sup> while the CMA considers that implementation costs are “likely to be low.”<sup>195</sup> The CMA reaches this position on the basis that systems are already in place for losses to be included in prices, and that minimal changes would be required to National Grid’s settlement system.<sup>196</sup> This is an incorrect and incomplete assessment of the transitional costs of introducing such a system.

9.5.2 The transmission charging regime (including TNUoS) has only just been settled following the recent decision to reject RWE’s appeal of Project TransmiT after a lengthy process. However, due to the exaggerated nature of the existing price signal in TNUoS, the introduction of locational pricing of losses would require a full review of the existing transmission charging arrangements to arrive at a balanced and cost-reflective charging mechanism. The need to reconsider existing transmission charging arrangements prior to the introduction of locational pricing for transmission losses would also introduce significant and unwelcome uncertainty and complexity into the market.

## **9.6 The PFs’ analysis of a move to locational pricing for losses fails to consider a number of other relevant considerations**

9.6.1 The CMA’s highly theoretical cost-benefit analyses of a move to locational pricing for losses also fail to consider the relevant market context properly. In particular, the PFs fail to consider important technical and policy factors.

9.6.2 **The PFs ignore the impact that locational pricing for transmission losses would have on the provision of ancillary services.** As SSE has explained previously,<sup>197</sup> important technical considerations call into question the purported benefits of a move to locational pricing of losses. Any assessment

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<sup>194</sup> PFs, Appendix 5.2, para. 24.

<sup>195</sup> PFs, para. 5.51.

<sup>196</sup> PFs, Appendix 5.2, para. 24.

<sup>197</sup> SSE’s response to the CMA’s Working Paper. *Locational pricing in the energy market in Great Britain* (the **Locational Pricing Working Paper Response**), para. 5.

of the potential benefits of locational pricing must take full account of all consequential effects.

- 9.6.3 The PFs fail to take these considerations into account adequately. The CMA recognises that a move to locational pricing for losses would have “*some effect on the way in which ancillary services are provided*,”<sup>198</sup> and that a move to locational pricing for losses would likely increase the costs of providing voltage support in Scotland.<sup>199</sup> However, the PFs simply conclude (without any evidence in support) that even the increased cost of these ancillary services “*would not depart from the economic case for cost-reflective pricing*.”<sup>200</sup>
- 9.6.4 The PFs do not address the requirement for flexible generation (the provision of reactive power) to maintain system stability. There will always be a requirement for dispatchable assets to provide this service on a locational basis. In this regard, the prevailing price signal is relevant only in terms of the cost to provide such a service.
- 9.6.5 **The PFs ignore the impact that locational pricing for transmission losses would have on renewables generation.** As SSE has explained previously,<sup>201</sup> pricing signals produced by locational pricing for losses would work in the opposite direction to HM Government’s policy on carbon reduction. .

## 9.7 Conclusion

- 9.7.1 The analysis and modelling of benefits for the locational pricing for transmission losses is unsound. The purported benefits are, at best, relatively low and uncertain. Many of the claimed benefits will accrue as a result of existing market developments rather than as a result of locational pricing for transmission losses. The introduction of locational pricing for transmission losses would have a negative effect on market certainty and complexity, as well as its cost impact on broader policy objectives. Furthermore, it is out-of-step with EU policy on market coupling and runs the risk of creating material distortion to competition between European generators (to the disadvantage of GB generators).

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<sup>198</sup> PFs, para. 5.57.

<sup>199</sup> PFs, Appendix 5.2, para. 44.

<sup>200</sup> PFs, Appendix 5.2, para. 44.

<sup>201</sup> See *Locational Pricing Working Paper Response*, paras. 12 – 14.

## **10. The provisional finding that the mechanisms for allocating CfDs give rise to an AEC is not supported by the evidence**

### **10.1 Introduction and overview**

10.1.1 The PFs' assessment of the (*FIDeR*) process is unsound and fails, in particular, to consider adequately the transitional nature of that regime (which was, in SSE's experience, competitive in any case, with contracts awarded under objective criteria set by reference to their viability and deliverability). The CMA also provides no direct evidence credibly to support its assessment of the "*detriment*" that it considers arose.

10.1.2 Future CfDs should, of course, be awarded through a clear and objective process. In this regard, SSE considers that the division of the CfD budget into pots incentivises the development of new technologies and promotes a broad and competitive mix of technologies in the longer-term.

### **10.2 The PFs' analysis of purported efficiency gains in relation to the FIDeR is unsound**

10.2.1 The CMA suggests that DECC's decision to award CfD contracts under FIDeR for renewable generation projects through a "*non-competitive process*" may have led to consumer detriment as the strike prices awarded "*appear to have been set at a level that does not reflect the underlying costs of those projects.*"<sup>202</sup>

10.2.2 Firstly, SSE does not recognise this characterisation of the process. In SSE's experience, the FIDeR process was competitive. Investment contracts were awarded by means of a competitive process with the criteria for success set by DECC with reference to the viability and deliverability of the project.

10.2.3 Secondly, the CMA assesses the scale of the "*detriment*" that it considers may have arisen by comparing (1) the strike prices awarded to the five offshore wind projects under FIDeR with (2) the strike prices awarded to projects successful in the first CfD auction. On this basis, the CMA suggests that the "*total cost of supporting these FIDeR projects is approximately £253-310 million per year higher than it likely would have been had the FIDeR projects been awarded CfDs at the auction clearing price.*"<sup>203</sup>

10.2.4 Such comparisons are, as the CMA recognises merely "*indicative*" and are not necessarily "*like-for-like.*"<sup>204</sup> There were only two offshore wind projects that were successful in the first CfD auction to which the projects under FIDeR could be compared. This is an insufficiently reliable and robust benchmark against which to measure any detriment that could have arisen and the CMA's conclusions in this regard are speculative at best.

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<sup>202</sup> PFs, paras. 5.191 and 5.197.

<sup>203</sup> PFs, para. 5.201.

<sup>204</sup> PFs, para. 5.202.

### **10.3 Any assessment of FIDeR should take into account the transitional nature of that scheme and its role in ensuring market stability and investment**

- 10.3.1 Any assessment of the FIDeR scheme should also adequately consider the transitional nature of that regime.
- 10.3.2 The contracts awarded under FIDeR were designed to offer better value for money than the Renewables Obligation (**RO**) system (rather than extending the RO system until the CfDs scheme was fully operational).
- 10.3.3 The move from automatic entitlement for RO support for eligible projects to bidding for contracts from a set budget under CfDs was a significant change. FIDeR was a one-off process intended to facilitate the transition to the CfD regime for projects at an advanced stage of development. As the CMA reports in the PFs, DECC recognised that it was critical to put in place transitional arrangements to “*prevent an investment hiatus.*”<sup>205</sup>
- 10.3.4 When DECC launched the FIDeR scheme in March 2013, the timing of the first CfD auction was uncertain. Within this context, FIDeR enabled and encouraged developers of low carbon electricity plants to take investment decisions as soon as possible. In fact, DECC signed the FIDeR contracts in May 2014. Given the years it takes to develop projects like off-shore wind farms, persisting uncertainty over support for investment could have caused significant instability in the market. Any proper cost-benefit analysis of the must therefore take FIDeR’s transitional nature into account.

### **10.4 Future CfDs should be awarded through a clear and objective process**

- 10.4.1 The CMA suggests that its concerns around the FIDeR process provoke concerns about the power retained by DECC to direct the CfD counterparty outside the competitive process (under the Energy Act 2013).<sup>206</sup> SSE is keen that CfDs should be awarded through a clear and objective process. SSE would therefore welcome further transparency in relation to DECC’s decision-making around the allocation of CfDs outside the competitive process.

### **10.5 The division of the CfD budget into pots incentivises the development of new technologies and promotes a broad and competitive mix of technologies in the longer-term**

- 10.5.1 The division of the CfD budget into three pots reflects government policy. This is intended to enable DECC to influence the GB generation mix by allowing less well-developed technologies to gain a foothold in the market.
- 10.5.2 SSE supports the additional incentives for newer, more expensive technologies (which would otherwise likely be unable to compete with onshore wind plant) and considers that this split is required to secure the investment necessary to support a broad renewables generation base. The drastic reduction in the cost of renewable generation generally in recent years provides clear and

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<sup>205</sup> PFs, para. 5.208

<sup>206</sup> PFs, para. 5.209.

convincing evidence of the effectiveness of this approach. The CMA's analysis also appears to suggest that the division of the CfD budget into separate technology pots did not result in any material detriment.<sup>207</sup>

10.5.3 SSE therefore considers that such an approach does not give rise to an AEC but rather helps to foster a broad and competitive mix of technologies in the longer-term.

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<sup>207</sup> *PFs*, para. 5.227.

**11. The provisional finding that the lack of a regulatory requirement for clear and relevant financial reporting is a feature of the market that gives rise to an AEC is not supported by the evidence**

**11.1 Introduction and overview**

11.1.1 The suggestion that energy firms are unable to readily provide “*all of the market-orientated financial information*” required by regulators and policy-makers is not supported by the evidence.<sup>208</sup> To the extent that policy and regulatory activity has negatively impacted the market, it is clear a lack of certain firm-specific financial information has not been the root cause of this problem. Indeed, to the extent that any AEC could exist in relation to a “*lack of transparency and robustness in regulatory decision-making*,” the evidence clearly indicates that this is more properly attributed to other features of the market (see Section 12).

**11.2 SSE is committed to ensuring the highest standards of financial reporting**

11.2.1 As a UK publicly-listed company, SSE is bound by the highest standards of financial reporting. In addition, SSE is committed to enhancing the transparency of the measurement and reporting of the performance of its businesses (over and above its statutory obligations) where this is proportionate and would help achieve good outcomes for consumers.

11.2.2 For example, in March 2015, SSE implemented revised transfer pricing arrangements intended to be more “*market-orientated*.” This change, (described in more detail in SSE’s Consolidated Segmental Statements (CSS) for year ended 31 March 2015), was facilitated by SSE’s investment in a new energy trading risk management system. As explained in SSE’s CSS, the change is “*designed to enhance the transparency of the measurement and reporting of the performance of these businesses*.”<sup>209</sup> The change will sit alongside SSE’s move to separate companies for supply, trading, and generation with separately audited accounts from April 2015 to ensure that financial arrangements between SSE companies continue to be clear and transparent.

**11.3 The suggestion that energy firms are unable to readily provide “*all of the market-orientated financial information*” required by regulators and policy-makers is not supported by the evidence**

11.3.1 SSE was therefore surprised that, in the CMA’s experience, most of the six large energy firms’ reporting systems are “*unable readily to provide all the market-orientated financial information that regulators and policymakers require [...]*.”<sup>210</sup> The PFs further suggest that the “*main issue*” is the “*lack of clear, relevant and consistent information demarcation of activities between*

<sup>208</sup> PFs, para. 11.32.

<sup>209</sup> SSE, *Consolidated Segmental Statement (CSS) for the year ended 31 March 2015*, p. 6 – available at <http://sse.com/media/330020/CSS-2014-15.PDF>

<sup>210</sup> PFs, para. 11.32.



*generation, trading and retail supply.*<sup>211</sup> On this basis, the PFs conclude that the lack of a regulatory requirement for “*clear and relevant financial reporting*” contributes to a lack of financial transparency in the information available to Ofgem, increasing the risk of poor policy decisions that subsequently have an adverse impact on competition.<sup>212</sup>

11.3.2 The CMA offers no relevant evidence to support these propositions. Indeed, the available evidence, consistent with SSE’s experience, indicates that the current reporting system – *i.e.*, the CSS– is wholly fit-for-purpose. In particular:

- (a) The 2011 review of the CSS conducted by BDO found that the firms’ transfer pricing methodologies were broadly “*fit for purpose and transparent,*” would likely meet the measure of best practice described in the OECD’s transfer pricing guidelines, and sufficiently accounted for the different ways in which respective firms allocated key functions to different parts of their businesses.<sup>213</sup> Specifically, BDO considered that it had seen “*no evidence*” that profits were being “*unduly excluded from the CSS due to reporting policies or procedures for any of the companies reviewed.*”<sup>214</sup> Further, BDO did “*not believe*” that the CSS “*demonstrate that any of the companies are engaged in activities to purposefully mislead or cloud the view of the profits generated by different segments....*”<sup>215</sup>
- (b) The Summer 2014 review of CSS conducted by BDO confirmed the methods used by each of six large energy firms are appropriate, in line with global accounting standards, and properly reflect profits for the different parts of the business represented in the statements. Crucially, it found that the firms are “*clear in their intention to meet the arm’s length standard,*” and that there appears to be no material tax, commercial or managerial incentive to shift profit from reported to unreported segments through transfer pricing.<sup>216</sup>
- (c) Ofgem has consistently indicated that it is confident that the profits declared by the energy firms were the ones that they actually made from their activities in generation and supply.<sup>217</sup> In its most recent report on the subject, Ofgem stated that, because of reforms, the CSS for 2013 “*provide greater transparency than in the past, and we are*

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<sup>211</sup> PFs, para. 11.33.

<sup>212</sup> PFs, paras. 11.82 and 11.86.

<sup>213</sup> PFs, Appendix 11.1, paras. 13 – 14.

<sup>214</sup> BDO, *Ofgem Segmental Statements Review* (January 2012) (*Segmental Statements Review 2012*), p. 56.

<sup>215</sup> *Segmental Statements Review 2012*, p. 56.

<sup>216</sup> BDO, *Review of Big Six Transfer Pricing Policies* (October 2014), p. 5.

<sup>217</sup> PFs, Appendix 11.1, para. 14.

*even more confident that they present an accurate picture of generation and supply profitability.”*<sup>218</sup>

- 11.3.3 The CMA does not provide any direct evidence of difficulties incurred by Ofgem as a result of the suggested lack of clear, relevant and consistent demarcation of activities between generation, trading and retail supply. (Indeed, as noted above, the only direct evidence cited suggests the opposite.) The PFs refer to profitability work undertaken by Ofgem that was not ultimately published, but no meaningful analysis is provided which relates that situation to the alleged AEC.
- 11.3.4 Otherwise, the PFs simply list a number of adjustments that the CMA has been required to make to the information provided by energy suppliers in conducting its profitability analysis,<sup>219</sup> (although the CMA presumably considers that none of the adjustments required has precluded it from producing a profitability analysis of the required standard). The CMA fails, however, to recognise the wholly different nature of the information that might be required within the context of a one-off market investigation compared to that required within the framework of ordinary course market regulation.

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<sup>218</sup> Ofgem, *The revenues, costs and profits of the large energy companies in 2013* (October 2014), p. 2.

<sup>219</sup> PFs, Appendix 11.1, paras. 23 – 51.

## **12. Improving the robustness and transparency of regulatory decision-making would help to avoid future regulatory distortions and promote pro-competitive outcomes for consumers**

### **12.1 Introduction and overview**

12.1.1 As explained above, well-intended, but flawed, regulatory initiatives introduced since 2009 have had a negative impact on competition and consumer outcomes. Evidence shows that regulators and policy-makers do not lack sufficient market-related financial information to fulfil their policy and regulatory remits (*see* [Section 11](#)). Instead, other features of the regulatory process have contributed to the policy and regulatory decision-making concerns the PFs identify.

### **12.2 Lack of effective communication of the forecast and actual impacts of energy policies**

12.2.1 It is critical that the potential impact of all regulatory interventions in the market are adequately assessed prior to implementation. This assessment should include costs and benefits incurred as a result of the adoption of particular measures, and should continue post-implementation. The regulator should communicate its findings to other stakeholders.

### **12.3 Statutory duties and objectives of Ofgem**

12.3.1 Since 2010 the regulatory framework has become more complex, driven by the Energy Act 2010 and EU legislation. Ofgem now has a number of objectives which extend beyond its competition remit to contend with:

- (a) Duties under EU legislation including (but not limited to) responsibility for: REMIT; the third party access regime; transmission unbundling and certification; and the development and implementation of the European Network Codes (*ENCs*); and
- (b) Administrative responsibility for a number of government schemes including numerous consumer and environmental schemes and programmes, such as WHD, the RO, Feed-in Tariffs, Energy Company Obligation and the Government Electricity Rebate.

12.3.2 However, whenever Ofgem has discretion over policy direction, it should focus primarily on the promotion of competition as its main objective. This approach will avoid the implementation of measures which have an adverse effect on competition (as was the case with RMR when consumer protection was prioritised).

### **12.4 Absence of a formal mechanism for DECC and Ofgem to reconcile policy outcomes**

12.4.1 Introducing a formal mechanism for DECC-Ofgem policy reconciliation would increase transparency and improve the quality of public debate and policy decision-making, without imposing unnecessary and disproportionate reporting and other obligations on energy firms.

### **13. The system of governance of industry codes offers scope for improvement**

#### **13.1 Introduction and overview**

13.1.1 The PFs identify features of the market relating to industry code governance which limit innovation and the ability of the energy markets to keep pace with regulatory developments and wider policy objectives. SSE agrees that improvements to the operation of the codes system are necessary to ensure developments can be delivered in a timely and efficient manner. In particular, SSE would welcome a mechanism to address the CMA's concern that: "[t]he current code modification arrangements do not contain an effective mechanism to ensure efficient prioritisation."<sup>220</sup>

#### **13.2 The number and complexity of codes are ripe for streamlining**

13.2.1 The CMA concludes that "*to some extent, the complexity of the code structure reflects the complexity of the industry...*"<sup>221</sup> To a certain degree, complexity is inevitable. However, in recent years, an additional layer has developed due to the piecemeal nature of code modifications. The codes' complexity is likely to increase further with imminent developments, including the implementation of the binding ENC's. As the PFs state, the ENC's "*might exacerbate the risks of delays in implementing change that would have positive effects for innovation and consumers.*"<sup>222</sup> This moment thus presents a timely opportunity to modify and streamline the GB energy codes.

13.2.2 The codes could be simplified in two ways, by:

- (a) Rationalising requirements and clearly delineating responsibilities: this step would not compromise the technical precision of the codes, but would reduce the expertise and resource needed to understand and comply with them. The streamlining would increase efficiency for all market participants and result in cost savings for consumers; and
- (b) Consolidating the codes: Code consolidation would impact competition positively. Consolidation would expedite and facilitate future compliance with EU law, while reducing the existing overlap and duplication of similar elements between industry codes. The ideal approach would be to place the existing GB upstream industry codes into the three electricity groupings used for the ENC's: (1) connection; (2) operational; and (3) market codes, with a further upstream code for gas. For retail operations, there could be two dual-fuel codes: one covering interactions between service providers and another covering supplier to customer interactions.<sup>223</sup>

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<sup>220</sup> PFs, para. 11.159.

<sup>221</sup> PFs, para. 11.106.

<sup>222</sup> PFs, para. 11.148.

<sup>223</sup> See SSE's response to Ofgem's further review of code governance and SSE's response to the CMA's Working Paper, *Codes*, para. 16.

### 13.3 The system of code governance and modification fails to deliver timely change.

#### *Party interests and timing*

13.3.1 The PFs suggest that despite recent Ofgem reforms, there are still circumstances in which the current model “*does not allow code modifications to be developed and/or implemented efficiently.*” The CMA suggests that this is particularly the case where a proposed change has “*significant and unevenly distributed impacts on market participants.*”<sup>224</sup>

13.3.2 To illustrate its point, the CMA has reviewed case studies of six modification proposals.<sup>225</sup> Although a useful exercise in highlighting the possible causes of delay to modifications, the case studies do not provide any direct evidence to support the CMA’s suggested correlation between suppliers’ interests and the length of the process.<sup>226</sup> Instead, the CMA relies on unsubstantiated assumptions about suppliers’ attitudes to reach its conclusions.

13.3.3 In SSE’s experience, the self-regulation model has not affected the timeliness of modification processes because of conflicting interests or limited incentives; the commercial interests of smaller companies are aligned with those of larger ones in the vast majority of cases. In addition, most of the major codes have open governance systems. These systems allow all parties and a number of non-parties to raise modifications. SSE considers that all the codes would benefit from these open governance arrangements.<sup>227</sup>

13.3.4 Ultimately, a degree of delay is inevitable when deliberating over complex modifications.<sup>228</sup> However, these delays are not attributable to any unwillingness on the part of suppliers to progress changes.

#### *The role of the regulator*

13.3.5 In SSE’s experience, much of the delay in the delivery of code modifications arises once they have been passed to Ofgem for approval. Proposals can be fast-tracked by Ofgem if considered urgent. However, fast-tracking is subject to the proposal meeting certain “*strict*” criteria.<sup>229</sup> Only a small fraction of modification proposals have been progressed this way. It is notable that the

<sup>224</sup> PFs, para. 11.157.

<sup>225</sup> PFs, paras. 11.111 – 11.122 and Appendix 11.2.

<sup>226</sup> See the case studies for P272 (HH metering and settlement for SMEs in electricity) and Project Nexus (Metering and settlement in gas, including modifications to facilitate the developments of tariffs relying on smart meters); and PFs, para. 11.114.

<sup>227</sup> As established by Ofgem via the two previous Code Governance Reviews, which already apply to the Balancing and Settlement Code, DCUSA and the Connections Use of System Code.

<sup>228</sup> In addition, the PFs fail to give sufficient weight to other factors, for example, that “*part of the delay [in Project Nexus] can be attributed to the uncertainty relating to the roll out of smart-meters.*” (PFs, Appendix 11.2.)

<sup>229</sup> See Ofgem, *Guidance on Code Modification Urgency Criteria* (May 2011); and PFs, Appendix 11.2, para. 128.

case study relating to 17-day switching, which illustrated the possibility of “*relatively smooth and quick change*,” was an example where Ofgem intervened using its powers to implement licence condition modifications.<sup>230</sup>

13.3.6 Ofgem is not currently able to push through more complex changes with licence modifications and has limited powers to manage the code modification timetable. SSE supports changes that could expedite the code modification process. However, any changes must retain an appropriate level of scrutiny from technical experts to ensure that potentially adverse unintended consequences are avoided.

13.3.7 SSE welcomes the CMA’s view that the current representation of industry participants on code panels “*achieves a fair balance*.”<sup>231</sup> The CMA does, however, express concerns in relation to the ability and incentives of code administrators to “*effectively and independently assist code parties...and therefore to achieve the governance objectives in the CACoP*.”<sup>232</sup> SSE considers that Ofgem’s reforms have already largely addressed these issues. For example, Code Administrators are now required to act as “*critical friend*” for small market participants and under-represented parties to facilitate their participation in the process.

#### **13.4 An overarching prioritisation body could deliver real efficiency benefits**

13.4.1 The CMA expresses concern that existing measures: “*do not provide a formal overarching change mechanism which would allow change to be carried out through a single process administered by one entity*.”<sup>233</sup> SSE, like the CMA, would welcome measures that ensure efficient prioritisation of changes (particularly those covering areas of new technology, UK policy and cross-code modifications) so consumers receive the intended benefits promptly. Establishing an overarching, strategic body that sits above all of the industry codes, as Ofgem suggests,<sup>234</sup> would achieve this aim and ensure a greater degree of cross-industry and cross-code coordination in implementing strategic industry reforms.

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<sup>230</sup> PFs, para 11.117.

<sup>231</sup> PFs, para. 11.125.

<sup>232</sup> PFs, para. 11.129.

<sup>233</sup> PFs, para. 11.154.

<sup>234</sup> See Ofgem’s suggestion to the CMA, as reported in PFs, para. 11.132.

## **14. The analysis of customer detriment provided in the PFs is seriously deficient**

### **14.1 Introduction and overview**

14.1.1 The PFs' analysis of the degree and nature of consumer detriment relating to the alleged AECs is seriously deficient. The alleged level of consumer detriment is not supported by the evidence and is materially overstated.

### **14.2 The CMA's assessment of consumer detriment in the retail sector relies exclusively on its flawed profitability and price analysis**

14.2.1 In the retail sector, the CMA relies principally on its analysis of profitability and competitive benchmarking to establish consumer detriment. However, as explained in detail above,<sup>235</sup> this analysis is fundamentally flawed. A fit-for-purpose analysis (addressing the flaws in the CMA's approach) would show that SSE's profits are not excessive by any relevant benchmark and that average consumer prices are consistent with the levels that would be expected in a well-functioning market.

14.2.2 As the CMA's analysis wrongly concludes that profits are excessive and consumer prices are above competitive levels, the degree and nature of consumer detriment suggested by the CMA is also materially overstated. The CMA would be required to take this into account in assessing the proportionality of any measures proposed to address the AECs.

14.2.3 In any event, there are (as the CMA recognises) significant differences in profitability between firms. SSE's retail profits are modest, another major retailer is loss-making, and the CMA's purportedly industry-wide findings are heavily driven by the results of a single firm (to which the CMA should have regard in assessing the proportionality of any measures of general application).

### **14.3 The CMA's assessment of consumer detriment in relation to the lack of transmission losses for locational pricing is unsound**

14.3.1 The CMA's assessment of potential detriment in relation to the lack of transmission losses for locational pricing is highly theoretical and uncertain in practice.

14.3.2 The potential economic benefits are materially overstated (and rely on out-of-date analysis). The PFs also ignore significant transitional costs and negative knock-on effects on consumers (because of likely increases in the costs of funding ancillary services, such as voltage support, and supporting HM Government's policy on carbon reduction). The cost-benefit analysis is effectively based on analyses prepared for Elexon and Ofgem around 2009 in relation to P229, which was rejected in September 2011.

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<sup>235</sup> See, in particular, [Section 3.5](#) of and [Annex 1](#) to this Response.

#### **14.4 The CMA’s assessment of consumer detriment in relation to the FIDeR process is unsound**

- 14.4.1 The CMA’s assessment of potential detriment in relation to the FIDeR process is highly speculative and, as a result, materially overstated. As explained in detail above,<sup>236</sup> the CMA’s analysis does not provide a reliable and robust benchmark against which the efficiency of the strike prices can be assessed (indeed, the CMA acknowledges that the potential efficiency losses that it identifies are merely “*indicative*”).<sup>237</sup>
- 14.4.2 The CMA’s assessment also fails to take the transitional nature of the FIDeR scheme into account and the role that it played in ensuring market stability and investment. Indeed, as recognised in the PFs, transitional arrangements were necessary to “*prevent an investment hiatus.*”<sup>238</sup> Any proper cost-benefit analysis of the FIDeR must also take this consideration into account.

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<sup>236</sup> See, in particular, Section 10 of this Response

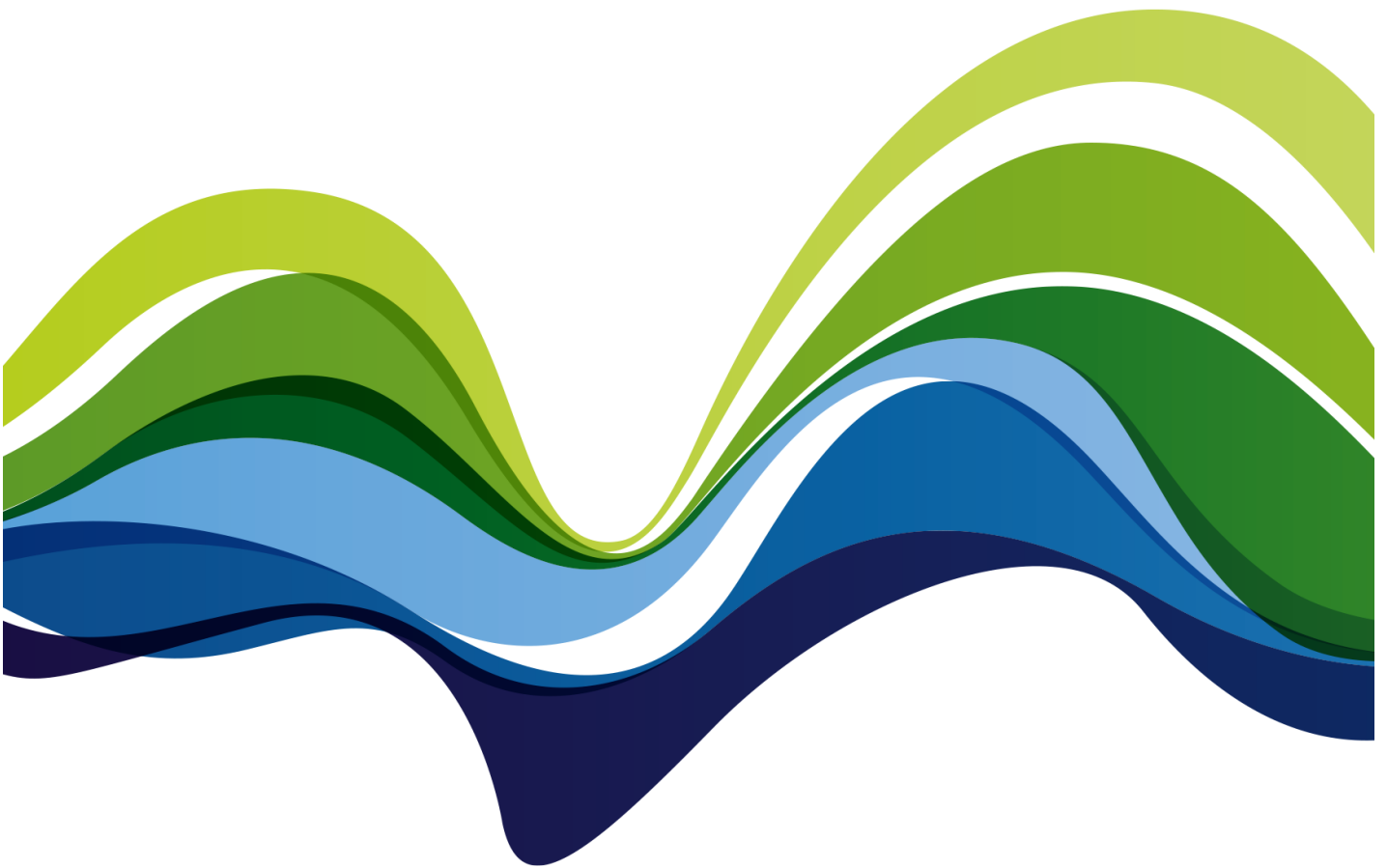
<sup>237</sup> PFs, para. 5.202.

<sup>238</sup> PFs, para. 5.208.



# SSE: Response to Notice of Possible Remedies

5 August 2015



## **TABLE OF CONTENTS**

1.	Introduction.....	3
2.	Executive Summary .....	8
3.1	Overarching considerations regarding the implementation of remedies .....	15
3.2	Remedy 1 .....	16
3.3	Remedy 2a .....	19
3.4	Remedy 2b .....	19
3.5	Remedy 3 .....	21
3.6	Remedy 4a .....	26
3.7	Remedy 4b .....	34
3.8	Remedy 5 .....	35
3.9	Remedy 6 .....	44
3.10	Overarching comment on microbusiness.....	50
3.11	Remedy 7a .....	52
3.12	Remedy 7b .....	55
3.13	Remedy 8 .....	59
3.14	Remedy 9 .....	62
3.15	Remedy 10 .....	72
3.16	Remedy 11 .....	77
3.17	Remedy 12a .....	90
3.18	Remedy 12b .....	92
3.19	Remedy 13 .....	94
3.20	Remedy 14 .....	98
3.21	Remedy 15 .....	103
3.22	Remedy 16 .....	104
3.23	Remedy 17 .....	105
3.24	Remedy 18a .....	106
3.25	Remedy 18b .....	108
3.26	Remedy 18c .....	110
4.	Comment on remedies which the CMA is minded not to consider .....	111

## SSE: RESPONSE TO NOTICE OF POSSIBLE REMEDIES

### 1. Introduction

1.1.1 This paper provides the response (the *Response*) of SSE plc (*SSE*) to the Notice of Possible Remedies (*NPR*) issued on 7 July 2015 by the Competition and Markets Authority (*CMA*).

1.1.2 SSE welcomes those remedies which address issues in the market which SSE has previously highlighted to the CMA. Whilst SSE recognises that much depends on the detail of how the remedies would be implemented, and on the overall impact of the remedies combined, SSE supports the CMA's principles-based approach to the retail remedies; providing the framework for effective competition, facilitating widespread customer engagement and providing appropriate safeguards to help disengaged or vulnerable customers.

#### (a) *Framework for effective competition*

SSE considers the retail market is generally well-functioning (and do not recognise some of the features the CMA has identified in its Provisional Findings (the *PFs*) but nevertheless continue to support measures which further improve engagement. In some instances, such measures require a re-assessment of previous regulatory interventions. For example, the proposed removal of the “*simpler choices*” component of the domestic Retail Market Review (*RMR*) rules (*Remedy 3*) is very welcome and addresses serious concerns raised by SSE and others. If properly implemented, the remedy would also be far more effective at addressing some of the other concerns the CMA has identified in its PFs and which it has proposed addressing with alternative remedies, which would likely have unwelcome side-effects. For example, the suggested early roll-out of smart meters for prepayment (*PPM*) customers would prevent these customers switching between suppliers (as the functionality does not exist with the current model) and would adversely impact the development of a Smart Metering Equipment Technical Specifications (*SMETS*) 2 solution.

A number of the other remedies proposed by the CMA also provide an opportunity to improve the current framework for competition including introducing steps to ensure effective and efficient switching (proposed under *Remedy 4a*), and clarifying and simplifying the role of the regulator (*Remedy 16*).

Over the coming months, SSE will work with the CMA to ensure any individual remedies deliver the expected customer benefits and that due consideration is given to the interaction with other remedies and potential unintended consequences.

In SSE's view, the efficacy of these remedies collectively would be significantly compromised by: the unintended consequences of the transitional safeguard tariff of *Remedy 11*; their interaction with

measures to provide information and prompts to customers to engage with the market (*Remedies 9 and 10*).

(b) *Engagement*

As SSE has set out in its response to the PFs, its experience in the retail market shows that customers in the GB energy market are far more engaged than the CMA suggests. Despite this, SSE is generally supportive of any steps that would further improve engagement.

SSE disagrees with the CMA's premise that all customers on "default" tariffs are disengaged. Nevertheless, in principle, SSE supports additional measures to prompt these customers to further engage in the market (*Remedy 10*). The detail of how this would work in practice would need to be carefully considered (including the use of trials where possible) to ensure there are no unintended adverse consequences stemming from the proposed remedies aimed at improving engagement, e.g., excessive information requirements on bills (these actually make meaningful engagement harder).

(c) *Safeguards for disengaged customers*

In tandem with the work of many consumer groups, SSE and the other suppliers participate in a number of initiatives aimed at protecting vulnerable customers – the Priority Services Register and Warm Home Discount being two examples in the domestic market. With regard to the non-domestic market, SSE (and some other suppliers) voluntarily stopped auto-rollovers of microbusiness customers in April 2014 and SSE would support the general prohibition of auto-rollovers under *Remedy 8*.

Whilst SSE entirely agrees with the principle of helping disengaged and vulnerable customers, SSE considers this is best done through existing initiatives or implementing some of the proposed remedies discussed above which are specifically designed to improve engagement and/or promote a framework that allows for effective competition.

SSE remains concerned that the principal proposed remedy aimed at providing transitional protection for disengaged customers would in practice do far more harm than good.

*Remedy 11 – safeguard regulated tariff:*

- 1.1.3 The proposed remedy is neither proportionate nor well-targeted. SSE considers that such an onerous remedy as the proposed reintroduction of price controls could only be justified if it is designed to fix a very real and serious adverse effect on competition (*AEC*). The CMA has not identified such an AEC. SSE has set out in detail in its response to the PFs its concerns around flaws in the CMA's profitability analysis which has led to an erroneous perception of the market.

- 1.1.4 The reintroduction of any form of price control would be a significant intervention in the market with profound implications for competition (and for the role of the regulator and HM Government). There are also a number of significant practical issues with imposing a regulated tariff, particularly where it is aimed at a small, hard-to-define category of customers. It would be unfeasible to set a price control on a 1% margin with 70% uncontrollable costs. Errors would put suppliers into a loss-making pricing position and even the threat that it might occur would deter entry and expansion. There is also the risk of suppliers being deterred from competing for these customers leading to an adverse impact on the very customers the regulated tariff is designed to protect. The CMA has identified previous regulatory interventions as either constituting to an ongoing AEC, in the case of RMR tariff restrictions, or to have “*contributed to a softening of competition on the SVT*” in the case of SLC 25A.<sup>1</sup> The proposal to roll out a regulated tariff would similarly be a retrograde step and would cause more issues than it attempts to resolve.
- 1.1.5 By introducing a regulated tariff, the CMA seriously risks dis-incentivising customer engagement, further undermining customer trust in competition to deliver the best outcomes and severely impacting competition in the microbusiness market. The alleged harm it is designed to address could otherwise be achieved through the implementation of the other proposed remedies combined, such as the roll back of RMR for domestic customers, the prohibition of auto-rollover contracts for microbusinesses and appropriately targeted information to support customers’ choices of supplier and tariff. To the extent there are still issues for vulnerable customers after the implementation of these remedies, then it would be far more appropriate to address these issues via government intervention in the context of wider social policy.
- 1.1.6 In summary, the proposed reintroduction of price controls would be a significant intervention in the domestic and microbusiness market with profound implications for competition and is founded on flawed profitability analysis.

*Remedy 5 – prioritisation of smart roll-out to prepayment meter customers:*

- 1.1.7 SSE is supportive of measures that would lead to improved choices for prepayment customers. However, the proposed early roll-out of smart meters to prepayment meter customers is unfeasible and risks alienating a significant group of customers by installing meters before the SMETS 2 technology has been properly developed. An accelerated SMETS 1 roll-out would be counter-productive and end up being a barrier rather than an enabler to switching and engagement, instead causing further customer confusion and distrust.
- 1.1.8 Furthermore, the proposed removal of the RMR tariff restrictions (*Remedy 3*) would present suppliers with alternative means of offering discounts and other tariff types to PPM customers. Coupled with the proposed remedies to

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<sup>1</sup> See the CMA’s Summary of Provisional Findings (*PFs Summary*), para. 150.

improve information, simplify switching and to prompt customers to engage, these would be more effective, proportionate and timely ways to assist PPM customers.

- 1.1.9 The CMA's proposal to prioritise the roll-out of smart meters is therefore not required and would have a significant impact on the efficiency of the roll-out of programmes (with a high risk of higher costs for customers and delays to the programme as a consequence). Rather than alienating these customers through a premature (and inefficient) roll-out of smart meters, the CMA should focus on these alternative remedies as a more effective means of protecting PPM customers' needs.
- 1.1.10 As well as timing and cost issues around an early roll-out of smart meters, SSE is also concerned that caution is exercised around the roll-out of other remedies that SSE broadly supports, for example, the introduction of half-hourly (*HH*) settlement for domestic and small and medium enterprise (*SME*) (including microbusiness) customers before smart roll-out is sufficiently advanced (*Remedy 13*). SSE also remains concerned about any proposal to roll-out locational pricing for transmission losses (*Remedy 1*) as it would result in significant distributional impacts for minimum and uncertain gains in efficiency. This remedy would only provide a very weak dispatch signal due to the diversity of generation technology on the system and would also need to take proper account of European Union (*EU*) legislation. Even taking into consideration the modelling cited by the CMA (which is now out-of-date), this remedy would only equate to a reduction of around £0.10/MWh in the wholesale price of energy or an annual saving of less than 40p for the typical household or around £1 per year for a small microbusiness.<sup>2</sup>
- 1.1.11 SSE continues to believe that, overall, the GB energy markets are competitive and well-functioning and SSE has made a number of firm submissions to explain why many of the AECs suggested by the CMA do not (in practice) exist. Nevertheless, as the discussion turns to remedies, SSE looks forward to engaging with the CMA and other stakeholders on many of the potential remedies which, if appropriately targeted, are likely to bring about positive changes for the benefit of customers and competition.
- 1.1.12 When assessing the possible remedies the CMA must give due consideration to the likely speed of delivery and the potential to achieve the stated aim effectively and in a more timely, cost-effective and proportionate manner. These questions are of paramount importance where a remedy would require a major IT system change affecting either the customer interface or market process, as the industry continues to be faced with a very challenging implementation timetable to deliver strategic change (with Project Nexus and smart roll-out being the most significant of these). In other areas SSE has raised real concerns with the principle of what is proposed, for example, the introduction of a price cap would be a retrograde step which could

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<sup>2</sup> Based on total GB generation of 300 TWh per year, typical annual consumption of 3,200 kWh and consumption of 10,000 kWh for small microbusinesses.

dramatically reduce the potential effectiveness of the other remedies under consideration. It also poses a threat to competition as it exists in the market now and is not justified.

## 2. **Executive Summary**

### 2.1 **Comments on the proportionality and effectiveness of possible remedies**

2.1.1 **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.** This remedy would result in significant distributional impacts for minimal and uncertain gains in efficiency. The locational pricing of losses fails to take existing regulations and EU legislation into account and would provide: only a very weak dispatch signal due to the diversity of generation technology on the system; no significant increment on the existing locational signal for investment; and no significant impact on the patterns of consumption. Even taking into consideration the out-of-date modelling cited by the CMA, this remedy would only equate to a reduction of around £0.10/MWh in the wholesale price of energy or an annual saving of less than 40p for the typical household or around £1 per year for a small microbusiness.<sup>3</sup> There is no evidence that this proposed remedy would be effective in addressing the alleged AEC (which SSE does not consider exists).<sup>4</sup> Furthermore, the proposed remedy is disproportionate in comparison to the marginal potential benefits explained above.

2.1.2 **Remedy 2a – The Department of Energy and Climate Change (DECC) to consult on a clear and thorough impact assessment before awarding any Contract for Difference (CfD) outside the auction mechanism and Remedy 2b - DECC to consult on a clear and thorough impact assessment before allocating technologies or CfD budgets to the different pots.** There is no indication that an AEC exists in relation to the CfDs’ allocation mechanism.<sup>5</sup> However, SSE is in favour of a fair, transparent and dynamic energy market which rewards innovation. SSE thus supports the proposed measures so long as they do not result in a delay to further CfD auctions. It is possible that measures taken to address the potential Levy Control Framework (LCF) overspend forecasted for 2020-1 may mean that DECC policy in this area will overtake the CMA’s proposed remedies.<sup>6</sup>

2.1.3 **Remedy 3 – remove from domestic retail energy suppliers’ licences the “simpler choices” component of the RMR rules.** This remedy is very welcome as it addresses serious concerns raised by SSE and other stakeholders in the energy market.<sup>7</sup> For this proposed remedy to deliver the

<sup>3</sup> Based on total GB generation of 300TWh per year, typical annual consumption of 3,200 kWh and consumption of 10,000 kWh for small microbusinesses.

<sup>4</sup> See SSE’s response to the CMA’s Provisional Findings (PFR), Section 9.

<sup>5</sup> See PFR, Section 10.

<sup>6</sup> See DECC, *Controlling the cost of renewable energy* (22 July 2015) available at <https://www.gov.uk/government/news/controlling-the-cost-of-renewable-energy>. When asked for more specific information, DECC has confirmed via email the postponement of the CfD auction expected to take place in October 2015.

<sup>7</sup> See PFR, Section 4.



expected customer benefits it is critical that due consideration is given to its interaction with other remedies. The efficacy of this remedy in providing the framework for more effective competition could be significantly compromised by proposed conflicting measures and the unintended consequences of the transitional safeguard of Remedy 11. Equally important will be the interaction with measures to provide information and prompts to customers to engage with the market (Remedies 9 and 10).

- 2.1.4 **Remedy 4a – measures to address barriers to switching by domestic customers.** Notwithstanding its view that the AEC it is intended to address is unfounded,<sup>8</sup> SSE welcomes this proposed remedy as a means to engage consumers further. The proposed remedy would be particularly beneficial to customers if sources of errors in the switching process (including the quality of industry metering data) are addressed before any move to implement faster switching. SSE believes the emphasis should be on the value of error-free switching as this is more likely to address the alleged perceived barrier to switching.
- 2.1.5 **Remedy 4b – removal of exemption for Centrica on two-year inspection of gas meters.** SSE agrees with the principle of ensuring a level playing field between gas suppliers but disagrees with the CMA's proposed way of implementing this remedy as it would not deliver the best outcome for customers. To promote competition it would be preferable to ensure that all suppliers are able to benefit from technology driven efficiency gains. Instead of the derogation applying to a specific supplier it should therefore apply to a specific class of technology. This type of derogation would benefit all market participants, irrespective of size. SSE notes that Ofgem is currently consulting on the removal of the two-yearly meter inspection obligation as it applies to all suppliers.
- 2.1.6 **Remedy 5 – requirement that energy firms prioritise the roll-out of smart meters to domestic customers who currently have a PPM.** Notwithstanding that the CMA's provisional finding of the relevant AEC is unfounded,<sup>9</sup> SSE supports suitable measures that would lead to improved choices and engagement for PPM customers. However, the proposed remedy is unfeasible and disproportionate, and risks the unintended consequence of alienating a significant group of customers before the SMETS 2 technology has been properly developed. An accelerated SMETS 1 roll-out to these customers would be counter-productive. It would be a barrier rather than an enabler to switching, as well as causing potential disruption to the efficiency of the smart roll-out programme, resulting in higher costs for all customers. SSE considers that the removal of the RMR tariff restriction (*Remedy 3*) would present suppliers with alternative means of offering discounts and other tariff types to PPM customers.
- 2.1.7 SSE is strongly of the opinion that there are more appropriate means of delivering choice, improving engagement and assisting PPM customers prior

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<sup>8</sup> See PFR, Section 3.

<sup>9</sup> See PFR, Section 3.

to the planned roll-out of the enduring smart solution. For instance, the removal of RMR tariff restrictions in Remedy 3 and improved customer communications as proposed in Remedy 9 would also have a more immediate and positive and long-lasting beneficial impact on customers.

- 2.1.8 **Remedy 6 – Ofgem to provide an independent price comparison service for domestic (and microbusiness) customers.** SSE considers this proposed remedy is worth exploring to increase the engagement of consumers and microbusinesses, although SSE does not recognise the CMA’s provisional finding of the relevant AEC.<sup>10</sup> In exploring this option, the CMA needs to ensure that in practice, this remedy would be effective in meeting the stated aim of “*improving trust in PCWs*.”<sup>11</sup> The existing markets for price comparison websites (*PCWs*) in the domestic and microbusiness sectors differ from each other and as such, a remedy like this is likely to impact upon the markets differently. In the microbusiness sector, this remedy could have the unintended consequence of impeding the development of a commercial PCW market. In the domestic sector, this remedy would undermine competition and innovation, whilst lessening consumer confidence in PCWs. In both markets it must be clear how such an obligation would fit with Ofgem’s existing roles and responsibilities. In addition, there are more effective and proportionate remedies in attaining the CMA’s aim such as switching campaigns similar to HM Government’s “*Power to Switch*” earlier this year.
- 2.1.9 **Remedy 7a – introduction of a new requirement in the licences of retail energy suppliers to provide price lists for microbusiness customers on their own websites and to make this information available on PCWs.** SSE does not recognise the CMA’s provisional finding of an AEC in the microbusiness segment.<sup>12</sup> SSE already publishes its Variable Business Rates (*VBRs*) and deemed rates online. However, SSE welcomes this measure as a means of improving transparency and engagement with microbusiness customers. This proposed remedy would build upon features which already exist in the market. In order to be effective, however, it is important that the requirements placed on suppliers are reasonable and proportionate, so as to avoid unnecessarily restricting or burdening suppliers and leading to an increase in costs for customers.
- 2.1.10 **Remedy 7b – introduction of rules covering the information that third party intermediaries (*TPIs*) are required to provide to microbusiness customers.** As above, SSE does not recognise the CMA’s provisional finding of an AEC in the microbusiness segment.<sup>13</sup> Nonetheless, SSE welcomes this remedy as a method of improving transparency and trust in TPIs, provided that the obligation is placed directly on TPIs rather than incorporated into Supply Licences.

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<sup>10</sup> See *PFR*, Section 3.

<sup>11</sup> *NPR*, para. 67.

<sup>12</sup> See *PFR*, Section 8.

<sup>13</sup> See *PFR*, Section 8.

- 2.1.11 **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 contracts on to new contracts with a narrow window for switching supplier and/or tariff.** As above, SSE does not recognise the CMA’s provisional finding of an AEC in the microbusiness segment.<sup>14</sup> However, SSE voluntarily stopped providing automatic contract rollovers for microbusiness customers in April 2014 in response to feedback from HM Government, regulators and consumer groups (the other five large energy firms and Opus also ceased auto-rollovers around the same time). SSE therefore welcomes this proposal as it would increase the opportunities for customers to engage with the market.
- 2.1.12 **Remedy 9 – measures to provide either domestic customers and/or microbusiness customers with different or additional information to reduce actual or perceived barriers to accessing and assessing information.** SSE is committed to improving engagement in both the domestic and microbusiness segments, notwithstanding that the CMA has not established the necessary AECs to justify this remedy.<sup>15</sup> This proposed remedy would have different impacts in both the domestic and microbusiness segments. In the domestic segment, SSE considers that the information provided to customers has grown to the extent that customers are now deterred by excessive detail on routine communications. SSE would therefore support a reduction in the level of prescription in this area. Care should be taken to ensure that the same issue (that of excessive information) does not arise in the microbusiness segment. SSE considers the existing obligations for microbusinesses to be adequate and appropriate in this regard - the introduction of new requirements would thus be disproportionate. To avoid unintended consequences, the detail of how these measures would work in practice needs to be considered carefully (including the use of trials where possible, consistent with best regulatory practice). The CMA should also consider alternative remedies (including Remedy 3 and rolling back the “*clearer information*” element of RMR, as well as relaxing other legislation)<sup>16</sup> as more effective, less onerous means of achieving its aim.
- 2.1.13 **Remedy 10 – measures to prompt customers on default tariffs to engage in the market.** SSE does not consider that customers on “*default*” tariffs are less engaged than other customer groups, nor that an AEC has been adequately demonstrated in either the microbusiness or domestic segments.<sup>17</sup> Notwithstanding this, SSE is broadly supportive of prompts to customers to engage with the market. However, the CMA should carefully consider the nature of any such measures, how they will be implemented and the associated costs to ensure the outcome is delivered in an effective way. Customer trials would be particularly beneficial to test these prompts with

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<sup>14</sup> See *PFR*, Section 8.

<sup>15</sup> See *PFR*, Sections 3 and 8.

<sup>16</sup> See *PFR*, Section 4.

<sup>17</sup> See *PFR*, Sections 3 and 8.

customers to ensure the right outcome is achieved. This would be consistent with best regulatory practice and in keeping with behavioural economics approaches.

- 2.1.14 **Remedy 11 – a transitional “safeguard regulated tariff” for disengaged domestic and microbusiness customers.** SSE considers that such an onerous remedy as the proposed reintroduction of price controls could only be justified if it is designed to fix a very real and serious AEC, and this has not been identified by the CMA.<sup>18</sup> The reintroduction of any form of price control would be a significant intervention in the market with profound implications for competition. There are also a number of significant practical issues with imposing a regulated tariff, particularly where it is aimed at a small, hard-to-define category of customers (*see Section 3.16 of this Response*). In particular, SSE foresees substantial difficulties in setting (and resetting) the tariff at the appropriate level such that there is a very real risk that it could put suppliers into a loss-making pricing position and discourage entry and expansion by new entrants. There is also the risk of suppliers being deterred from competing for these customers leading to an adverse impact on the very customers the regulated tariff is designed to protect. The CMA has itself identified concerns around the impact of previous regulatory interventions as either constituting an ongoing AEC, in the case of RMR tariff restrictions, or as having “*contributed to a softening of competition on the SVT*” in the case of SLC25A.<sup>19</sup> This proposed remedy runs that same risk, of itself giving rise to an AEC.

This proposed remedy is unjustifiably complex, unreasonable and impractical. The CMA’s proposal risks unintended consequences and is unlikely to be effective in achieving the intended consumer benefits. Furthermore, it could undermine competition and discourage engagement. The outcomes for both domestic and microbusiness customers could be better (and more proportionately) achieved through the combination of other remedies proposed, such as: the roll back of RMR for domestic customers; the prohibition of auto-rollover contracts for microbusinesses; and appropriately targeted information to support domestic customers’ choices of supplier and tariff. To the extent there are still issues for vulnerable customers after the implementation of these remedies then it would be more appropriate to address these issues via government intervention *e.g.*, through state funded agencies set up to tackle fuel poverty.

- 2.1.15 **Remedy 12a – requirement to implement Project Nexus in a timely manner.** The PFs correctly recognise that the current system of gas settlement can lead to the inefficient allocation of costs and reduce efficiency.<sup>20</sup> SSE considers, in particular, that the most significant distortions arise from the allocation of disproportionate level of unidentified gas on domestic suppliers as compared to large gas customers (rather than distorting competition between suppliers). SSE is thus supportive of the

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<sup>18</sup> See *PFR*, Section 3.

<sup>19</sup> *PFs Summary*, para. 150.

<sup>20</sup> See *PFR*, Section 6.

“timely” implementation of Project Nexus, which (with other developments in progress) should effectively address the current inefficiencies in the market. Whilst it is disappointing that the October 2015 timescale will not be achieved, SSE fully expects Project Nexus to be implemented by October 2016. This remedy is therefore unlikely to be required.

- 2.1.16 **Remedy 12b – introduction of a new licence condition on gas shippers to make monthly submissions of Annual Quantity (AQ) updates mandatory.** SSE regards this remedy as unnecessary and disproportionate - the imminent implementation of Project Nexus will address the substantive issues relating to AQ updates.
- 2.1.17 **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.** For domestic customers, whilst well-intended this remedy is premature since until the smart meter roll-out is sufficiently advanced, the costs of HH settlement would outweigh the benefits realised by those with smart meters. This proposed remedy could also have unintended consequences, exposing consumers to the uncertainty of transmission network use of system (*TNUoS*) and Triad charges. Once a cost-benefit analysis has been undertaken after smart meter roll-out, a plan for the introduction of HH settlement can be put in place for domestic customers. For microbusinesses, the proposed remedy has been superseded by a plan already in place for SMEs.
- 2.1.18 **Remedy 14 – remedy to improve the current regulatory framework for financial reporting.** As a UK publicly-listed company, SSE is bound by the highest standards of financial reporting. SSE has always been committed to enhancing the transparency of the measurement and reporting of the performance of its businesses where this is proportionate and would help achieve good outcomes for consumers. However, this remedy is unjustified and disproportionate, given the absence of the alleged AEC,<sup>21</sup> and carries a significant risk of unintended consequences, including reduced innovation and diversity of business model to the detriment of customers. It is therefore important that the CMA ensures that the appropriate outcome is transparency of profits actually earned by companies, not *comparability* of profits based on a stylised assessment of notional standalone businesses.
- 2.1.19 **Remedy 15 – more effective assessment of trade-offs between policy objectives and communication of impact of policies on prices and bills.** SSE welcomes this proposed remedy as it is consistent with the principles of better regulation.<sup>22</sup> Suppliers sometimes struggle to explain the impact of rising policy costs to customers – more effective assessment and communication of expected impacts could mitigate this to the benefit of engagement and trust in the market.

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<sup>21</sup> See *PFR*, Section 11.

<sup>22</sup> See Department for Business, Industry and Skills, *Better Regulation Framework Manual*, (March 2015).

- 2.1.20 **Remedy 16 – revision of Ofgem’s statutory objectives and duties in order to increase its ability to promote effective competition.** SSE welcomes this remedy to clarify Ofgem’s position within a regulatory framework that has become increasingly complex since the Energy Act 2010. Much of the complexity is driven by EU legislation such that it may not be possible for Ofgem to revert to having a simpler focus on promoting effective competition. SSE would, nevertheless, welcome a remedy which established a stable regulatory framework and required Ofgem, wherever it has discretion over policy direction, to focus primarily on the promotion of effective competition within the energy markets.<sup>23</sup>
- 2.1.21 **Remedy 17 – introduction of a formal mechanism through which disagreements between DECC and Ofgem over policy decision-making can be addressed transparently.** SSE welcomes this remedy, which it considers would be effective in achieving the objectives sought. A formal mechanism would increase transparency and improve the quality of public debate and policy decision-making without imposing unnecessary and disproportionate reporting and other obligations on energy firms.
- 2.1.22 **Remedy 18a – recommendation to DECC to make code administration and/or implementation of code changes a licensable activity.** SSE welcomes measures which improve the standards applicable to code administration and implementation. Network owners’ licences already require code administrators to be subject to the Ofgem-controlled Code Administration Code of Practice (*CACoP*). The most proportionate and efficient means of achieving this remedy would be to recommend that Ofgem strengthens the *CACoP*.
- 2.1.23 **Remedy 18b – granting Ofgem more powers to project-manage and/or control timetable of the process of developing and/or implementing code changes.** SSE recognises the importance of oversight of strategic changes and would welcome a greater degree of cross-industry and cross-code coordination. However, where Ofgem proposes the content of a modification, its concurrent decision-making powers may pose a conflict. The most reasonable approach in this situation is to ensure that appeal rights are preserved so that parties have comfort that there is a route for implementation decisions to be appropriately and to be independently assessed.
- 2.1.24 **Remedy 18c – appointment of an independent code adjudicator to determine which code changes should be adopted in the case of dispute.** This measure offers a proportionate means of resolving any conflicts that may otherwise arise in situations where the modification proposer is also the approver.

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<sup>23</sup> See *PFR*, Section 12.

### **3. Detailed response to remedies on which the CMA is seeking views**

#### **3.1 Overarching considerations regarding the implementation of remedies**

- 3.1.1 This market has been, and continues to be, subject to significant change. The industry continues to work towards delivery of Project Nexus whilst simultaneously gearing up for accelerated roll-out of smart meters once the Data Communications Company (*DCC*) goes live next year. At the same time, significant changes are being implemented to settlement arrangements in electricity for Profile Classes five to eight. Measures which require a great deal of time and effort to implement – such as the Green Deal or aspects of the RMR remedies – can, however, sometimes prove to be short-lived. When such significant programmes of change are adopted they tend to suspend or displace activity that would otherwise be focused on improvements elsewhere.
- 3.1.2 SSE welcomes remedies which may improve customer trust in – and engagement with – the retail supply market, but notes that the CMA is considering a number of remedies which may require an element of IT development affecting the customer interface or market process. To avoid unintended consequences, the CMA should therefore ensure that remedies which might put at risk the successful delivery of significant strategic changes that are already in train (and which have already been determined to be of benefit to customers and competition) are not progressed unnecessarily.
- 3.1.3 Where a range of approaches are possible, SSE urges the CMA to avoid the introduction of unduly onerous or disproportionate requirements where alternative, more reasonable, approaches may be equally viable. In some cases it may be preferable to consider field trials or customer polling to test the efficacy of proposed measures and to consider whether there may be other effective means of increasing customer engagement that are less disruptive to suppliers' abilities to develop and improve their products and services to meet the needs of customers. These issues are discussed in more detail in the sections which follow.

**3.2 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**

*(a) What would be an appropriate method for ensuring that variable transmission losses are priced on the basis of location?*

*(b) How should the variable transmission losses be allocated between generators and suppliers?*

*(i) Is the 45-55 split appropriate or could efficiency be improved further by changing this allocation?*

*(c) What will be the distributional impacts of this remedy? Should the CMA take these into account in coming to a view on the proportionality of this remedy?*

*(d) Should the CMA implement this remedy directly, i.e., via an order, or should it make a recommendation to Ofgem to initiate a Balance and Settlement Code (BSC) modification instead? Are there any particular aspects of Ofgem’s objectives and duties to which the CMA should have regard if implementing this remedy by a licence change?*

3.2.1 The CMA has not made the case to support the introduction of locational pricing of transmission losses adequately. No AEC has been identified in the wholesale market and therefore this proposed remedy is wholly disproportionate to the potential advantages that have been identified.<sup>24</sup>

*Disregarded relevant factors*

3.2.2 The CMA has provided a fairly high-level analysis of locational pricing for transmission losses and has not fully considered the following important factors:

- (a) Whether the introduction of locational pricing for losses would necessitate a further review of existing TNUoS charging arrangements;
- (b) EU legislation regarding locational pricing for transmission and the varying levels of compliance across Member States;
- (c) Existing distortions to competition arising from interconnectors’ exemption to transmission charges;
- (d) Uncertainty regarding suppliers’ ability to adequately reflect zonal and seasonal transmission charges in customer tariffs; and
- (e) Increased complexity of demand forecasting due to numerous zonal adjustment factors – the ability to manage imbalance may disadvantage smaller suppliers and newer market entrants.

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<sup>24</sup> See PFR, Section 9.



- 3.2.3 SSE continues to believe that when the above factors are fully accounted for, it is far from certain whether this remedy would be effective in achieving the stated objective. It is therefore critical that the CMA conduct a thorough and robust cost-benefit analysis before deciding whether to proceed with this proposed remedy.

#### *Potential benefits*

- 3.2.4 The CMA estimates the potential benefit of locational pricing of transmission losses to be just under £30 million per year. Such savings would equate to a reduction of around £0.10/MWh in the wholesale price of energy or an annual saving of less than 40p for the typical household or around £1 per year for a small microbusiness customer.<sup>25</sup> SSE notes that this estimation is based on modelling which is now some years out of date<sup>26</sup> and considers that the cost benefit analysis should be updated in order to understand the distributional impact properly should this proposal be taken further.

#### *Feasibility*

- 3.2.5 The locational pricing of transmission losses is not feasible to achieve the delivery of either the short or long run benefits envisaged by the CMA. The strength of the dispatch signal attributable to locational transmission losses is greatly diluted by the diversity of generation types connected to the transmission system. In particular, nuclear, wind and hydro assets could all be expected to run based on availability, whilst the choice between coal and gas generation will largely be dictated by fuel costs and plant efficiency. SSE has previously commented that Peterhead, for example, has a contract with National Grid to provide voltage support to the transmission system in Scotland and can therefore be expected to run even when the plant is not in merit. The locational price signal due to locational losses will therefore only have an impact at the margins and will result in excessive costs for disproportionately low returns (even when a more up-to-date estimation of the potential benefit has been undertaken).
- 3.2.6 If locational transmission losses are adopted in GB then this will lead to conflicting signals to both generation and demand between the locational TNUoS regime, the quantum of which tends to be greater than transmission losses (according to the P229 modelling), and locational transmission losses such that there will be no practical locational signal in respect of transmission losses.
- 3.2.7 The current transmission charging regime means that, under EU law, interconnectors are not required to pay TNUoS or Balancing Services Use of

<sup>25</sup> Based on total GB generation of 300 TWh per year, typical annual domestic consumption of 3,200 kWh and consumption of 10,000 kWh for small microbusiness customers.

<sup>26</sup> Since the initial P229 modelling was undertaken: significant volumes of generation have closed or reduced their transmission entry capacity (*TEC*) holding(s); Electricity Market Reform (*EMR*) policy has been resolved and implemented; and a substantial growth of embedded generation has directly impacted the level of output required from transmission connected generation, with a consequential impact on total transmission losses.

System (*BSUoS*) charges. This creates a further complication which will be compounded if all currently planned projects are delivered as the current 4GW of interconnection capacity will grow to 12GW.<sup>27</sup> In particular, the variable (locational) transmission losses for a given generator in GB could be significantly affected by a subsequent decision to locate an interconnector in that generator's same transmission zone; whilst the interconnector owner would be immune from the locational pricing impact of this decision, the generator would not be. Equally, the disparity between the locational pricing signal faced by GB generators and that faced by interconnected generators (importing into GB) would create a significant distortion to the market and is at odds with the EU target model for market coupling.

- 3.2.8 Should the CMA wish to develop this remedy further, the most appropriate means to do so would be by means of a recommendation to Ofgem. Such a recommendation should address existing and future market distortion between GB and other EU Member States and reconcile the proposed locational pricing of transmission losses with the existing transmission charging arrangements in GB. Ofgem is best placed to assess these complex issues, with due regard to its objectives and duties and the relevant industry code objectives.

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<sup>27</sup> *PFs*, paras. 4.43 – 4.44.

**3.3 Remedy 2a – DECC to consult on a clear and thorough impact assessment before awarding any CfD outside the auction mechanism**

*(a) Would the remedy ensure that CfDs that are allocated outside the auction mechanism are awarded only when the benefits of doing so outweigh the costs?*

*(b) How much discretion should DECC retain in terms of the weight it places on each factor that it takes into account in coming to a decision on which projects to award CfDs outside the CfD auction mechanism? Should DECC be required to consult on and determine these factors and their relative importance in advance to enhance transparency? Should the weighting of each factor be constant across projects?*

*(c) In which, exceptional circumstances should DECC be able to allocate CfDs outside the auction process? For example, for reasons of industrial policy, where there are wider market failures, or where there may be insufficient competitors to hold an auction?*

3.3.1 SSE is in favour of a fair, transparent and dynamic energy market which rewards innovation. Whilst, there is no indication that the alleged AEC exists in relation to the CfDs' allocation mechanism,<sup>28</sup> this remedy offers an opportunity to review its effectiveness. However, it is possible that measures taken to address the potential LCF overspend forecasted for 2020/1 may mean that DECC policy in this area will overtake possible recommendations from the CMA.<sup>29</sup>

**3.4 Remedy 2b - DECC to consult on a clear and thorough impact assessment before allocating technologies or CfD budgets to the different pots.**

*(a) Would the remedy ensure that future decisions by DECC on the allocation of technologies and the CfD budget to the different pots are taken in a robust and transparent manner?*

*(b) Is the remedy likely to result in a positive change in how DECC makes decisions regarding the allocation of the CfD budget to the different pots?*

*(c) How regularly should DECC review the allocation of technologies between pots? What information should DECC publish when deciding to amend the allocation of technologies between pots? Should it also on a regular basis consult and/or publish reasons for not amending the allocation of technologies between pots?*

*(d) Should DECC be limited in the maximum proportion of the CfD budget that it can allocate to each of the different pots?*

<sup>28</sup> See PFR, Section 10.

<sup>29</sup> See DECC press release: *Controlling the cost of renewable energy*, (22 July 2015) available at <https://www.gov.uk/government/news/controlling-the-cost-of-renewable-energy>. When asked for more specific information, DECC has confirmed via email the postponement of the CfD auction expected to take place in October 2015.

- 3.4.1 SSE regards this remedy as appropriate to encourage transparency and certainty in the energy market, although it does not consider that the alleged AEC exists in relation to the CfD awarding mechanism. However, this proposed remedy should not result in a delay to future CfD auctions.<sup>30</sup> As with Remedy 2a, measures taken to address the potential LCF overspend forecasted for 2020-1 may mean that DECC policy in this area will overtake the proposed remedy.

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<sup>30</sup> See fn. 29 of this Response.

- 3.5 Remedy 3 – remove from domestic retail energy suppliers’ licences the “*simpler choices*” component of the RMR rules.** This proposal is very welcome as it will address many of the serious concerns raised by SSE<sup>31</sup> and others. If properly implemented the remedy would also be far more effective at addressing some of the other concerns the CMA has identified in its PFs and which the CMA has proposed to address by alternative remedies, often with material unintended adverse effects. For example, PPM customers would be far better served by suppliers being able, as a consequence of this remedy, to offer new and innovative products rather than relying on a misguided early roll-out of smart meters. The proposed remedy is therefore proportionate, reasonable, and readily implementable.
- 3.5.2 SSE considers that in order to be fully effective, this remedy should remove the “*simpler choices*” elements.<sup>32</sup> Removing or relaxing only parts of these restrictions is unlikely to be as effective in delivering choice, innovation and benefits for customers.<sup>33</sup>
- 3.5.3 In SSE’s view, the efficacy of this remedy in providing the framework for more effective competition would be significantly compromised by the unintended consequences of the transitional safeguard tariff of Remedy 11.
- 3.5.4 There are also further changes which may be required to other rules introduced as part of the RMR in order to ensure that this remedy can most effectively meet its stated objectives. The relaxation of the tariff rules can be expected to lead to a greater variety of tariff structures available to customers and potentially to a slight increase in the overall number of tariffs. Consideration must be given to appropriate changes to information provision, such as the Cheapest Tariff Messaging required on all routine customer communications, to ensure that information overload does not curtail improved customer engagement with the market as more innovative products are introduced.
- 3.5.5 SSE believes that the CMA should also examine whether the regulatory burden relating to face-to-face sales may impede the benefits to competition that would be brought about as a result of the proposed remedy.<sup>34</sup> This point is discussed further in Section 3.14 of this Response, in the context of information provision and barriers to switching.

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<sup>31</sup> See RIS, SSE’s response to the Updated Issues Statement (**RUIS**), SSE’s response to the RMR “*four tariff rule*” information request, the PCW information request, SSE’s response to the follow up questions on PCWs and SSE’s response to the SQ, S.32, S.42, S.44, S.81, S.83, S.103 and S.106 – 108.

<sup>32</sup> The “*simpler choices*” element of RMR encompasses: (1) unit rate and standing charge requirements (ban on tiered rates); (2) the tariff cap; (3) discount restrictions; and (4) bundling restrictions. The relevant SLCs are SLC 22A: *Unit Rate and Standing Charge requirements* and SLC22B: *Restrictions on Tariff numbers and Tariff simplification*.

<sup>33</sup> See PFR, Section 4.

<sup>34</sup> Notwithstanding the assertion in the NPR (fn. 12) that the CMA has “*not received any submissions raising concerns regarding the impact of Ofgem’s rules on doorstep selling [sic]*” which SSE believes to be a simple oversight by the CMA. References to concerns raised by SSE are provided in the discussion below in Section 3.14 of this Response.

- 3.5.6 Interaction between this remedy and measures which may be introduced to provide information and prompts to customers (under Remedies 9 and 10) will be critical to ensure that the loosening of tariff restrictions can be as effective as possible in providing a better framework for effective competition. SSE would favour some loosening of the existing rules around information provision on routine communications. In particular, detailed prescriptive requirements could be replaced with a more principles-based requirement that suppliers develop and provide nudges to customers to explore ways to engage in the market and save money. Allowing greater innovation in the means of delivering such prompts and the details they contain would allow suppliers to respond to customer feedback and can therefore be expected to evolve to a more effective form over time. Such prompts may be more effective, for example, if they can be placed on colourful leaflets alongside the primary communication, rather than complicating the layout and contributing to the clutter of information on bills, for example. This interaction is discussed further later in the Response.

***(a) Would this remedy be effective in increasing competition between domestic retail energy suppliers and/or between PCWs? What additional tariffs would energy suppliers be likely to offer that they currently do not due to the RMR restrictions?***

- 3.5.7 The RMR rules have resulted in a significantly reduced and restricted range of tariff offerings for customers. Many previously popular tariffs were either withdrawn or restructured in order to comply with the RMR requirements; such changes were not always to the benefit of customers. In this way, although the avenues by which suppliers can compete have been constrained, suppliers continue to compete fiercely. Opening up the permissible tariff options would allow suppliers to create more innovative tariffs and to compete on a wider basis by offering additional products or services alongside energy tariffs.
- 3.5.8 Recent regulatory intervention, including the RMR, has reduced the ability (but not the incentive) for suppliers to compete, innovate and differentiate themselves. SSE believes that it is in customers' best interests for suppliers to offer a variety of tariffs which meet the needs of a range of different customers (*e.g.*, products better tailored to customers' lifestyles). To this end, SSE is fully supportive of the removal of tariff restrictions placed upon suppliers. This is also an important change required to enable the development of smart tariffs.
- 3.5.9 SSE notes that other competitive markets use discounts, cashback offers, bundles and rewards to encourage customer engagement. Alongside restricting tariff numbers and structure, the RMR rules greatly reduced suppliers' and PCWs' ability to offer these to customers. SSE is fully supportive of removing restrictions on discounts, cashback, bundle products and rewards.
- 3.5.10 Removing the tariff restrictions would facilitate more effective competition between PCWs, either through cashback offers or by offering exclusive

tariffs. These offers and rewards could in themselves act as an effective means of promoting customer engagement with the energy market if they are already using a particular PCW to compare products in other markets. SSE considers that this would be beneficial to customers and competition.

- 3.5.11 The Response includes an **Annex to Remedy 3**, itemising the specific changes required to the Supply Licences in order to facilitate different tariff offerings. It is neither possible nor, in SSE's view, desirable to compile a comprehensive list of permissible tariff types as to do so necessarily restricts innovation; the Annex is therefore intended to highlight the degree to which small changes to the regulations can seriously impact on customer choice.

***(b) Removing the four-tariff rule is likely to increase the range of tariffs on offer and result in different tariffs being offered on different PCWs. Are there, therefore, any remedies that the CMA should consider alongside this remedy, to encourage domestic customers to use more than one PCW in order to facilitate effective competition between PCWs and domestic energy suppliers?***

- 3.5.12 SSE notes the positive impact on customer engagement which resulted from the DECC "Power to Switch" campaign – indeed this campaign was arguably the most cost-effective prompt to engage yet seen in the GB energy market and was supported across industry, including by consumer groups.<sup>35</sup> SSE considers that a similar campaign which highlights the importance of shopping around through a number of PCWs in order to get the best deal could be an efficient and customer friendly means of getting the message across. This is also the purpose of Smart Energy GB, the body established to communicate the benefits of smart meter roll-out to customers.
- 3.5.13 Customers are already assured by the consumer protection regulations and by the Standards of Conduct (SLC25C) that suppliers must always provide clear information regarding their cheapest tariff, or the best tariff for their needs. The advent of PCW specific tariffs would be no exception.
- 3.5.14 SSE believes that the best way of comparing tariff costs is by using the Personal Projection - an estimate of a customer's annual costs on a tariff based on their (actual or estimated) consumption. This means that customers are not required to understand the costs that make up tariffs (although they will be provided with these) in order to understand which one represents the best value to them. This means that the apparently more complicated tariffs (such as the former tiered rate tariffs or the time of use (ToU) tariffs expected to develop in order deliver the benefits of smart meters) do not put at risk effective customer engagement; the Personal Projection of annual costs based on consumption history reduces the choice between diverse tariff structures to the simple comparison of annual costs. It

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<sup>35</sup> This has parallels with the experience in New Zealand, where a national campaign was credited with the marked increase in customer switching activity witnessed in 2012. See Vaasaett, *World Energy Retail Market Rankings 2012* – available at <http://www.vaasaett.com/wp-content/uploads/2012/06/World-Energy-Retail-Market-Rankings-2012-FINAL-SHORT-VERSION.pdf>.

is important therefore that complex tariffs which have clear benefits for customers are not disregarded in favour of “simplicity”.

*(c) We note that if this remedy were to be imposed, Ofgem’s Confidence Code requirement for PCWs to provide coverage of the whole market appears likely to become impractical as the number of tariffs offered increases and PCWs agree different tariff levels and commissions with energy suppliers. Should this element of the Confidence Code be removed, therefore, as part of this remedy? If so, are alternative measures to increase confidence in PCWs required? For example, in order to maintain transparency and trust, should PCWs be required to provide information to customers on the suppliers with which they have agreements and those with which they do not?*

3.5.15 SSE understands that the whole of market view requirement is unique to the energy industry. It may be useful to examine whether customers have responded positively to the introduction of this requirement in order to inform whether it should continue.

3.5.16 An unintended consequence of the whole of market view requirement would be that suppliers would be listed on the PCWs whether or not they paid commission - this could lead to suppliers “free-riding” on this advertising. This would result in higher costs for PCWs and would inhibit their ability to compete effectively through the offer of cash incentives for customers to switch.

3.5.17 SSE considers that there are benefits in requiring PCWs to disclose information on commission arrangements or at least to declare that commission is payable. Ensuring that PCW ranking orders are not dictated by commission arrangements is in-line with providing greater transparency to customers and is consistent with the approach in other markets such as financial services. In doing so, however, care must be taken to ensure that customers do not misunderstand this information and think that they are required to pay the commission fee. SSE is keen that the switching process is as simple and straightforward as possible for customers.

*(d) Rather than removing all limits on tariff numbers and structures, would it be more effective and/or proportionate to increase the number of permitted tariffs/structures? If so, how many should be permitted and which tariff structures should be allowed? (i) For example, would requiring domestic energy suppliers to structure all tariffs as a single unit rate in pence per kWh, rather than as a combination of a standing charge and a unit rate, reduce complexity for customers, while avoiding restricting competition between PCWs? Alternatively, would such a restriction on tariff structures have a detrimental impact on innovation in the domestic retail energy markets?*

3.5.18 SSE supports the full removal of tariff restrictions. Merely relaxing the RMR restrictions would dilute the benefit of the improved framework for effective competition that this remedy could deliver. Attempting to define or enumerate the appropriate number of tariffs or tariff structures allowed in



the market presuppose that the CMA would be able to determine the “*right degree*” of innovation. SSE considers that this would unnecessarily restrict innovation and competition to the detriment of customer choice. The suppliers’ obligation to treat customers fairly (SLC25C) should ensure that there is no attempt to confuse or mislead customers.

- 3.5.19 Although a single unit rate proposal does potentially offer a degree of simplicity, this alternative remedy would not be as effective in addressing the concerns identified by the CMA. First, it raises the same issues as Remedy 3 is intended to address (in that it could curtail the ability of suppliers to offer certain tariffs). Second, to impose a whole of market single unit rate structure would immediately result in unintended consequences: it would create a cross-subsidy from high to low users; high users would see a significant rise in costs whilst low users would benefit from a price reduction to the point that many would become loss-making for suppliers.<sup>36</sup> The increased costs for many customers would be unfair and difficult to explain and would not be justified by the objective of the relative simplicity of tariff structure. As demonstrated by the impact of the RMR, “*simpler*” is not synonymous with “*better*”. Finally, a single unit rate structure would be unlikely to be sustainable when the intention is that more innovative ToU tariffs will be developed by suppliers in parallel with the delivery of mass market smart meter roll-out.
- 3.5.20 SSE considers that it may be counterproductive for customer engagement if tariff comparisons did not require that customers refer to their own energy usage. Energy efficiency measures to reduce consumption remain one of the most effective means of reducing bills. SSE considers that the information required (usage, current tariff, postcode) to make an effective comparison in today’s market is not at all burdensome and is all readily available to customers on bills, statements and other routine communications.

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<sup>36</sup> For example, removing the standing charge from SSE’s SVT would immediately provide low users with a discount of £100 per annum; this could be partly compensated by setting the single unit rate at a higher level than currently applies. Whatever level the unit rate is set at, the tariff would necessarily under-recover costs from low users or significantly over-recover costs from high users. For further examples of measures the CMA should consider, *see* [para. 3.14.25](#) of this Response.

### **3.6 Remedy 4a – measures to address barriers to switching by domestic customers.**

3.6.1 Notwithstanding its view that the AEC this proposed remedy is intended to address is unfounded,<sup>37</sup> SSE welcomes it as a means to engage consumers further.

*(a) Will the roll-out of smart meters address the feature of uncertified electricity meters? If not, what additional remedies should we consider to address this feature?*

3.6.2 The roll-out of smart meters will address this feature in that any traditional meter which is uncertified at present will be replaced with a smart meter. Smart meters will not be recertified in the way that the traditional Ofgem approved meters are. Instead, smart meters are Measuring Instrument Directive (*MID*) approved. MID-approved meters do not have prescribed certification lives; instead, suppliers and asset owners must demonstrate through in-service testing that their meters are in correct working order.<sup>38</sup>

*(b) Will the roll-out of smart meters address the barriers to switching faced by customers with Dynamic Teleswitched (DTS) meters? If not, what additional remedies should we consider to address this feature?*

3.6.3 The roll-out of smart meters has the potential to improve switching for DTS customers but it will be critically dependent on the eventual specification of a smart replacement for DTS.

3.6.4 In 2014, following research into customer experience of DTS meters, Ofgem requested that industry participants clarify their approaches to DTS customers in smart roll-out. Ofgem has also asked suppliers to identify any challenges which might prevent DTS customers from enjoying the full benefits of smart metering.<sup>39</sup>

3.6.5 SSE is one of the most active suppliers in this segment and works hard to offer this small customer base as much choice as possible. Accordingly, SSE creates DTS versions of all its tariffs; therefore, whilst these customers may face more limited choices if they wished to switch supplier, they are offered the full range of tariffs with SSE. Additionally, SSE will carry out meter exchanges free of charge if DTS customers wish to move to the nationally available Economy 7 or Economy 10 metering set ups.

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<sup>37</sup> See PFR, Section 3.

<sup>38</sup> See National Measurement Office and National Measurement and Regulation Office, *In-service testing for gas and electricity meters* (27 October 2014) – available at <https://www.gov.uk/in-service-testing-for-gas-and-electricity-meters>.

<sup>39</sup> See Ofgem, *Dynamically Teleswitched meters and tariffs – Research into consumer experience* (12 November 2014) – available at <https://www.ofgem.gov.uk/publications-and-updates/dynamically-teleswitched-meters-and-tariffs-%E2%80%93-research-consumer-experience>.

- 3.6.6 It should be noted that Ofgem has assessed the market for DTS customers<sup>40</sup> and found that, despite the limitations of bespoke metering arrangements, DTS customers are generally not paying higher prices for their energy.
- 3.6.7 Development of the smart solution for DTS is likely to increase the number of suppliers that support DTS set-ups and will therefore further increase competition and innovation in suppliers' services to these customers.
- 3.6.8 The way in which DTS switching messages are presently sent (via the BBC's 198 kHz long wave network) is due to be switched off in the next few years meaning that arrangements are currently being revised – this could also provide an opportunity for suppliers with no experience of “traditional” DTS to become involved and support DTS tariffs.
- 3.6.9 The deployment (once the technology is finalised) of SMETS 2 twin-element meters (interoperable between different suppliers' systems) will enable greater choice for DTS customers. For these reasons, SSE does not consider that further measures are required over and above smart roll-out to remedy this feature.

***(c) Should PCWs be given access to the ECOES database (meter point reference numbers) in order to allow them to facilitate the switching process for customers?***

***(i) To what extent would this reduce the rate of failed switches and/or erroneous transfers?***

***(ii) Are there any data protection issues we should consider in this respect?***

***(iii) Will access to this database still be relevant once smart meters have been introduced?***

- 3.6.10 As noted in the PFs, the industry average for erroneous transfers was 1% for January to September 2014.<sup>41</sup> Whilst this is low compared to other markets (e.g., telecoms where the rate is circa 7.3%),<sup>42</sup> SSE would welcome appropriate measures which make switching a more reliable and hassle-free experience for customers.
- 3.6.11 SSE sees a higher rate of [X] from PCWs than from any of its other direct customer acquisition channels. This change would allow PCWs to validate

<sup>40</sup> See Ofgem, *The state of the market for customers with dynamically teleswitched meters* (26 July 2013) – available at <https://www.ofgem.gov.uk/ofgem-publications/82288/state-market-customers-dynamically-teleswitched-meters.pdf>.

<sup>41</sup> PFs para. 8.119.

<sup>42</sup> See Ofcom, *Consumer Switching – A statement and consultation on the processes for switching fixed voice and broadband providers on the Openreach copper network* (8 August 2013) – available at [http://stakeholders.ofcom.org.uk/binaries/consultations/consumer-switching-review/summary/Consumer\\_Switching.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/consumer-switching-review/summary/Consumer_Switching.pdf). The consultation states that ETs 118,700 and estimated slams 84,500; together with comment at para. 3.3 that estimated number of switches per year on the Openreach copper network is 2.8m suggests ET rate of  $(118,700 + 84,500)/2,800,000 = 7.3\%$  (p. 255).

details such as customer address, supply number, meter serial number and meter type before passing the application to the supplier. This would ensure that customers receive an accurate comparison and will reduce the number of failed switches, resulting in a more positive switching experience for more customers.

- 3.6.12 It is important to note that any errors in industry data would still be present whether accessed by PCWs or suppliers. There is no audit trail when industry databases are updated so suppliers are reliant on other parties updating the databases correctly after a new connection or a meter exchange. SSE would therefore support changes which make industry data more robust.
- 3.6.13 Parties may be granted access to ECOES if approved by the Master Registration Agreement Executive Committee (*MEC*). The MEC would be able to advise on specific data protection concerns of allowing PCWs access. However, PCWs should only have access to data which they need.
- 3.6.14 SSE notes that the CMA only refers to ECOES (which covers electricity) but assumes that the same remedy would be applied to the Xoserve database SCOGES (which covers gas). Both of these databases will still be relevant once smart meters are introduced.

***(d) Should there be penalties for firms that fail to switch customers within the mandated period (currently 17 days, next-day from 2019)? How should these penalties be administered? At what level should the penalties be set? Should customers who suffer a delayed or erroneous switch receive the penalty as compensation?***

#### *Switching delays*

- 3.6.15 The current switching process is “*gaining supplier*” led. As a switch is the consequence of the customer making a proactive choice to move supplier SSE contends that gaining suppliers already have strong incentives to ensure that customers are able to switch as quickly as systems allow. In practice, once the 14 day cooling-off period has passed, a customer switch takes place in just three days (17 days in total) compared with 21 days before the changes to speed up switching were introduced.<sup>43</sup> If there is a delay to the mandated period, this will be due to other factors (such as metering information errors, lack of information or the “*losing supplier*” objecting to the switch due to debt) over which the gaining supplier will have limited, if any control.
- 3.6.16 In addition, as the CMA observes, the timing of switching is mandated by the Supply Licences and Ofgem monitors suppliers’ switching activities by requiring suppliers to provide information on a regular basis via their regulatory reporting returns. In cases where a repeated failure to comply with obligations is identified, Ofgem is already empowered to take

<sup>43</sup> SSE introduced faster switching on 5 November 2014. See <http://sse.com/newsandviews/allarticles/2014/11/remember,-remember-you-can-switch-faster-with-sse-from-5-november/>.

enforcement action against the relevant suppliers. A remedy introducing a penalty on the “gaining supplier” is therefore unnecessary and disproportionate (because the existing arrangements to ensure that customers have a smooth switching experience that are already in place are working effectively).

#### *Erroneous transfers*

- 3.6.17 It is important to distinguish between a customer switch that has been delayed and a customer switch that has taken place in error, and which the customer has not requested. In the case of the latter, there are existing compensation arrangements already in place for erroneous transfers through the voluntary Erroneous Transfer Customer Charter. This voluntary compensation scheme requires that any customer who has been erroneously transferred and who contacted the old or new supplier, receives £20 compensation where they were not sent a letter within 20 working days to confirm that that transfer had been erroneous and that they would be returned to their previous supplier.<sup>44</sup> The compensation is paid by whichever supplier the customer has contacted.
- 3.6.18 At the point that these compensation agreements were made, it was mooted that compensation payments could also be brought in where the existing supplier did not re-register the erroneously transferred customer in a timely manner. This suggestion was not implemented due to concerns that the receipt of certain industry flows required for registration are outside the supplier’s control. It should be noted that the compensation arrangements which do exist (described in the paragraph above) also rely on the other supplier responding to the initial dataflow on time. (However, as these are voluntary arrangements, suppliers do not need to be party to them if they have concerns on this, or any other, matter.)
- 3.6.19 It would be unnecessary and disproportionate to fine firms for instances where the supplier has acted on good faith and followed agreed processes. The existing arrangements to address erroneous transfers are working effectively (as is evidenced by the relatively low number of erroneous transfers).<sup>45</sup> In addition, in order to ensure that such fines were applied fairly, it would be necessary to establish clearly who was to blame for the delay or error (gaining supplier, losing supplier or, potentially, customer). The costs of doing so would be non-negligible and would certainly seem to outweigh the harm that the CMA seeks to address (given the low number of erroneous transfers). There would also be a clear need to establish who was to blame for the delay or error (gaining supplier, losing supplier or, potentially, customer).

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<sup>44</sup> SSE does not have a process in place for delivering this but is progressing a solution. Customers of SSE are entitled to receive compensation through its existing complaints procedure.

<sup>45</sup> Only 1% of all completed domestic gas and 1.4% of all completed domestic electricity switches were erroneous transfers in 2014 – see *PFs*, para. 8.119.

*Next-day switching considerations*

- 3.6.20 Current policy development work by industry (facilitated by Energy UK) has so far struggled to find a way for next-day switching to work for traditional “*non-smart*” meters (especially traditional PPMs which require the gaining supplier to send the customer a key or card which they use to top-up their meter). This leaves open the question over whether suppliers would be fined every time they switched a customer with a traditional meter if next-day switching was introduced. This could have the unintended adverse consequence of discouraging suppliers from encouraging these customers to switch (if there were risks that the gaining supplier could be exposed to fines).
- 3.6.21 As noted above, in addition to compensation that customers may receive, either under the Erroneous Transfer Customer Charter or through the normal course of suppliers’ customer service processes, the timing of supplier transfers is covered by the Supply Licences. It is unnecessary (and would therefore be unreasonable and disproportionate) to impose any further measures in this area.

***(e) When next-day switching is introduced, will a “cooling-off” period still be required? Could it be avoided by requiring that no exit fees are charged within two weeks of switching?***

*Hazards of even faster switching*

- 3.6.22 In SSE’s experience, the greatest cause of erroneous transfers is human error. By introducing more rigorous processes and taking more time to ensure an accurate result, SSE has achieved a significant reduction in erroneous transfers.<sup>46</sup> SSE therefore has concerns that the move to next-day switching<sup>47</sup> would mean that suppliers have insufficient time to make due checks; thus the rate of erroneous transfers is very likely to increase<sup>48</sup> despite suppliers’ best efforts, should the speed of switching be given greater emphasis than the quality of switching.

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<sup>46</sup> SSE’s erroneous transfer rate is [X]% for electricity gains and [X]% for gas gains, substantially lower than the industry average erroneous transfer rate of 1%.

<sup>47</sup> RUIS, para. 8.7.7.

<sup>48</sup> See SSE’s Response to CMA Working Paper, *Gas and electricity settlement and metering* (the *Gas and Electricity Settlement Working Paper Response*), paras. 24 and 25.

- 3.6.23 Ofgem’s own customer research showed that customers value reliability over speed.<sup>49</sup> SSE notes that this research was carried out prior to the introduction of 17 day switching. Ofgem has not yet published details of any monitoring of customer satisfaction with 17 day switching. Additionally, the CMA’s customer survey showed that people who worried that something would go wrong during the switching process were less likely to switch (61% compared to 80% of those who were not worried had switched in the last three years). If reliability is not the top priority then SSE runs a real risk of switching errors increasing and customers being put off engaging. SSE therefore advocates that stock should be taken of faster switching - and customer satisfaction with it - before proceeding with next-day switching.
- 3.6.24 Ofgem’s results are consistent with recent customer research carried out by the Financial Conduct Authority (**FCA**) in relation to current account switching. The FCA found that *“any reduction in the time taken is less important to consumers than it being easy and error free”* and *“consumer interest in a five day switch service hardly differed from interest in a seven day service, in terms of whether the consumer would be more likely to consider switching. Speed of switching was not spontaneously mentioned by consumers as a reason why they are not switching.”*<sup>50</sup> Indeed, the CMA’s update in July 2014 following the reduction of current account switching times found that *“the overall rate of switching including non-CASS (Current Account Switch Service) switching forms (for example, manual and gradual switching rates) remains at around 3% which is low.”*<sup>51</sup>
- 3.6.25 Notwithstanding the above, a cooling-off period will still be required in the context of next-day switching. The cooling-off period is required by EU legislation and customers cannot waive their right to a cooling-off period when purchasing gas or electricity contracts.
- 3.6.26 If next-day switching is introduced, customers will be switched within their cooling-off period, but only where they give permission for this to happen.

<sup>49</sup> See Ipsos MORI, *Ofgem Consumer First Panel – Research to inform Ofgem’s review of the change of supplier process* (9 August 2013) (the **Ofgem Customer Research**) – available at [https://www.ofgem.gov.uk/sites/default/files/docs/2013/12/final\\_cos\\_panel.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2013/12/final_cos_panel.pdf). “Ensuring reliability and accuracy during the CoS transfer was the most important issue for many. Spontaneously consumers were concerned that a quicker process would involve a “trade-off” against the reliability or accuracy of the process, and most felt that they would prioritise reliability and accuracy over speed” (Ofgem Customer Research, p. 6). “A key finding of the research is that many consumers found it difficult to explore their preferences around speed and reliability separately due to the widespread belief that a faster switch meant a higher risk of error. Additionally, the speed of the CoS process was not the main consideration influencing the decision to switch and it was of low salience to most people” (Ofgem Customer Research, p. 8).

<sup>50</sup> FCA, *Making current account switching easier – The effectiveness of the Current Account Switch Service (CASS) and evidence on account number portability* (March 2015), p. 6 – available at <https://www.fca.org.uk/static/documents/research/making-current-account-switching-easier.pdf>.

<sup>51</sup> See CMA, *Personal Current Accounts* (18 July 2014) – available at [https://assets.digital.cabinet-office.gov.uk/media/53c834c640f0b610aa000009/140717\\_PCA\\_Review\\_Full\\_Report.pdf](https://assets.digital.cabinet-office.gov.uk/media/53c834c640f0b610aa000009/140717_PCA_Review_Full_Report.pdf), p. 15.

Customers who are switched during the cooling-off period retain cooling-off rights as would any other customer. This presents a challenge when customers wish to cancel their new contract. The industry is currently working through several possible options for switch-back during the cooling-off period. Each of the options are far more complex and confusing for customers than if the switch had happened the next-day after the cooling-off period had finished. For this reason, SSE does not support switching during the cooling-off period.

3.6.27 In conclusion, the industry made significant improvements to the switching timescales through faster switching (17 day switching) by reducing the length of the process after cooling-off from 21 days to around three days. Around the same time Ofgem introduced new licence conditions (SLC14A.10 – 11) that require suppliers to take steps to reduce erroneous transfers. Both initiatives have the potential to improve the switching experience for customers greatly. By placing more emphasis on these initiatives (and any future data quality programmes) the industry could bring benefits to the customer switching experience but at a much lower cost and risk than implementing next-day switching. Monitoring progress and customer feedback could provide an excellent opportunity to test this before progressing further with next-day switching.

3.6.28 In light of the evolving market framework, applying a stricter regulatory framework around either faster switching (17 day switching) or the reduction of erroneous transfers is therefore not a reasonable or proportionate remedy.

***(f) Are specific measures required to facilitate switching for customers living in rented accommodation (either social or private)?***

3.6.29 Consumers in rented accommodation are entitled to switch (and to change their meter) like any other customer – renting is not a barrier to switching. The only exception to this is when there is an arrangement whereby the energy costs are included in the rent and the landlord is ultimately responsible for managing the energy account and has the contract with the energy supplier.

3.6.30 To encourage switching among renters, solutions could include: a recommendation to councils, landlords and estate agents that they provide information to customers in their welcome packs; Energy Performance Certificates (which are required in every rented property)<sup>52</sup> could be updated to advise customers of their rights; and consumer bodies (such as Citizens Advice Bureaus (*CABs*)) could be required to provide information on consumers' rights. It might also be worthwhile examining whether the arrangement whereby the energy costs are included in the rent (which results in tenants being unable to switch supplier or tariff) are anti-competitive and to the detriment of consumers.

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<sup>52</sup> In Scotland these must be displayed somewhere in the property and are often located in the meter cupboard which makes them an ideal means by which to prompt customers.



*Other remedies to address barriers to switching for domestic customers in light of the introduction of smart meters*

***(a) Does the “Midata” programme, as currently envisaged, provide sufficient access to customer data by PCWs to facilitate ongoing engagement in the market? Should PCWs – with customer permission – be able to access consumer data at a later date to provide an updated view on the potential savings available?***

3.6.31 DECC, the Department for Business, Innovation and Skills (**BIS**), PCWs and suppliers have all been involved in discussions on Midata. It is currently envisaged that the right data set for price comparisons will be included within Midata.

3.6.32 The first phase of Midata will allow customers to download their data. The second phase will allow customers to give PCWs one-off access to their data. SSE would support providing PCWs with continuous access to a customer’s data, provided that the following appropriate measures were applied:

- (a) Suitable data protection and security measures were in place;
- (b) Customers were required to give consent and be sure of what they were giving consent to;
- (c) Customers were able to revoke access; and
- (d) Appropriate mechanisms were in place so that customers can see who has access to their data.

3.6.33 SSE suggests that in order to encourage customers to use this service, consideration should be given to a trial or a customer awareness campaign or both.

***(b) Do customers need more or better information or guidance on how their new smart meters will work?***

3.6.34 No. In order for the smart meter roll-out to be a success, customers must be comfortable and confident using their meters. SSE believes that sufficient information is available to customers at the point of installation. The Smart Metering Implementation Code of Practice (**SMICoP**) sets the minimum standards that suppliers must meet before and during a smart meter installation. All of SSE’s business processes have been designed around SMICoP and, as noted in the response to Remedy 5, will take into account questions and concerns raised by customers at its Treating Customers Fairly (**TCF**) forum. Suppliers were required to set this up under Supply Licence Conditions (SLC41 and SLC42). Furthermore, Licence Conditions required suppliers to establish a communication body to carry out the role of consumer engagement. This body has been established and is called Smart Energy GB.

**3.7 Remedy 4b– removal of exemption for Centrica on two-year inspection of gas meters.**

*(a) Would this remedy be effective in removing the distortion to competition that currently exists as a result of Centrica’s derogation on the inspection of gas meters?*

*(b) Would it be preferable to remove Centrica’s derogation, or extend the derogation to other suppliers?*

*(c) If Centrica’s derogation were removed, should it be phased out over a period of time? If so, how long should Centrica be given in this respect?*

3.7.1 SSE agrees with the principle of ensuring a level playing field between gas suppliers but disagrees with the CMA’s proposed method of implementing this remedy as it would not deliver the best outcome for customers.

3.7.2 The objectives sought by the proposed remedy could be more readily obtained by ensuring that all suppliers are able to benefit from technology-driven efficiency gains. Accordingly, instead of the derogation applying to a specific supplier, it should be applied to a specific class of technology. This approach will benefit all market participants, irrespective of size (and ensure a level playing field). SSE notes that Ofgem is currently consulting on the removal of the two-yearly meter inspection obligation as it applies to all suppliers.<sup>53</sup>

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<sup>53</sup> See Ofgem, *Reforming suppliers’ meter inspection obligations* (23 July 2015) – available at <https://www.ofgem.gov.uk/publications-and-updates/reforming-suppliers-meter-inspection-obligations>.

### 3.8 Remedy 5 - requirement that energy firms prioritise the roll-out of smart meters to domestic customers who currently have a PPM

#### *Introduction and overview*

- 3.8.1 SSE disagrees with the assertion that there is an “*overarching feature of weak customer response arising in particular from those with prepayment meters*”.<sup>54</sup> PPM customers typically have fewer tariff options available to them, but the available evidence, including from the CMA’s customer survey, suggests that these customers are not disengaged. For instance, PPM switching levels are in line with those of customers with credit meters, with 24% of PPM customers reporting that they switched in the last three years.
- 3.8.2 Additionally, the CMA’s survey shows high satisfaction rates among PPM customers: 78% reported that they were satisfied with their supplier (compared with 74% for Direct Debit customers; 73% of those who pay on receipt of bill); and 67% stating that they would recommend their supplier (compared with 56% of those who pay by Direct Debit or on receipt of bill).<sup>55</sup> PPM customers are therefore engaged and satisfied with their suppliers.
- 3.8.3 The CMA has therefore not established that any AEC exists, let alone established the kind of material detriment that would be required to justify the imposition of such a disproportionate remedy.
- 3.8.4 Notwithstanding the above, SSE understands and is supportive of suitable measures that would lead to improved choices for PPM customers, but is very concerned about the feasibility of this remedy. SSE is also concerned by the risks it creates of compromising the successful delivery of a robust and enduring smart meter solution which works in the best interests of customers and competition. If additional issues remain for PPM customers, who have also been identified as being vulnerable, these are more appropriately addressed via targeted social policy measures.<sup>56</sup>
- 3.8.5 The GB smart meter programme has been supplier-led and has significant customer experience, cost, planning and internal systems implications. This proposed remedy would have a negative impact on each of these, and risks rolling out an existing technology which is not fit for purpose, diminishing consumer trust in the industry and creating a barrier to switching. Moreover, the costs attributed to delivering this proposed remedy in practice would be excessive.
- 3.8.6 SSE is strongly of the opinion that there are more appropriate means of delivering choice, improving engagement and assisting PPM customers prior to the planned roll-out of the enduring smart solution. For instance, the removal of RMR tariff restrictions in Remedy 3 and improved customer

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<sup>54</sup> PFs para. 8.138.

<sup>55</sup> GfK NOP, *Customer survey report* (20 February 2015) (the *GfK Survey*).

<sup>56</sup> See PFR, Section 5.

communications as proposed in Remedy 9 would have a more immediate and positive and long-lasting beneficial impact on customers.

- 3.8.7 The key factors in delivering a smart solution which works in the best interests of customers and competition is that the DCC<sup>57</sup> is delivered and that the SMETS 2<sup>58</sup> solution is defined. Prior to these being in place, it is widely accepted that smart meter roll-out cannot deliver its expected benefits.<sup>59</sup> The DCC is expected to go live in August 2016 and the initial testing of the SMETS 2 PPM solution is estimated to begin in Q1 of 2016. Both of these will have to go through a necessary period of testing and trialling to ensure stability and robustness prior to the mass roll-out. This is to ensure that the smart solution is fit for purpose and will not cause any customer detriment or hassle.
- 3.8.8 The introduction of smart metering presents the opportunity for all customers to become more engaged with the energy market and take greater control of their energy use. It is critical to the success of the project that an optimal solution is implemented and that it is a positive experience for customers. The Central Delivery Body (*CDB*), Smart Energy GB, has been tasked with engaging the public on smart meters,<sup>60</sup> alongside suppliers' own customer experience plans. There is already some public scepticism and concern about various aspects of smart meters.<sup>61</sup> To this end, it is crucial for the mass roll-out of smart meters to be executed in a considered, tested, reliable and efficient way which allows the CDB and suppliers to reassure customers through their engagement campaigns and ultimately, deliver the optimal solution. SSE's plans are informed by customer feedback, including those from its TCF forums.<sup>62</sup> In light of the practical constraints described above, there is, so far as SSE is aware, no feasible way in which the smart metering programme could realistically be accelerated without compromising on quality, stability and overall customer outcome.
- 3.8.9 As a flagship energy policy, costing an estimated £10.9 billion<sup>63</sup> (funded through customer bills), smart metering will justly face considerable

<sup>57</sup> Appointed by DECC, the DCC is responsible for linking smart meters in homes and small businesses with the systems of energy suppliers, network operators and energy service companies.

<sup>58</sup> SMETS 2 being the enduring and fully interoperable solution for smart metering (as opposed to SMETS 1 which has technical limitations and can only be an interim measure).

<sup>59</sup> See DECC, *Government response to the Smart Metering Rollout Strategy consultation* (31 July 2015) (the **Government Response on Smart Metering**) – available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/450167/Smart\\_Meters\\_Rollout\\_Strategy\\_Government\\_response\\_FINAL.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/450167/Smart_Meters_Rollout_Strategy_Government_response_FINAL.pdf).

<sup>60</sup> Activity so far has included an informative website (<http://www.smartenergygb.org/>) and a Youtube video campaign ([www.youtube.com/watch?v=eaSte4UGnZE](http://www.youtube.com/watch?v=eaSte4UGnZE)).

<sup>61</sup> Such as the “Stop Smart Meters! (UK)” campaign group – see <http://stopsmartmeters.org.uk/>.

<sup>62</sup> See: [X].

<sup>63</sup> See DECC, *Third annual report on the roll-out of smart meters* (December 2014) – available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/384190/smip\\_smart\\_metering\\_annual\\_report\\_2014.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/384190/smip_smart_metering_annual_report_2014.pdf).

scrutiny, especially if additional costs are incurred.<sup>64</sup> A recent report by the Energy and Climate Change Committee brought into question the cost benefit analysis of smart metering.<sup>65</sup> In the timescales required to respond to this remedy, SSE has been unable to calculate the cost to industry of accelerating smart meter roll-out but notes that even a 10% increase would be considerable: any increase would have to be justified by the CMA through a robust cost benefit analysis. SSE is in agreement with the Secretary of State for Energy and Climate Change, that in order to deliver smart meters efficiently, it is “*important that all suppliers maintain their focus on delivering the roll-out of smart meters by the end of 2020, to the benefit of all customers.*”<sup>66</sup>

- 3.8.10 The most effective and proportionate solution for PPM customers would be to ensure that the current market arrangements allow all customers to reap the benefits of competition, then allow SMETS 2 meters to be rolled out once the DCC is in place and SMETS 2 technology has been tested and trialled. This is the least intrusive, most cost-effective and efficient way of delivering long-lasting benefits to customers. This solution should also ensure that customers who never have a smart meter (some customers may opt-out, others may be unable to have a smart meter due to technical reasons)<sup>67</sup> are adequately protected.

***(a) Would this remedy be effective in allowing prepayment customers to engage fully in the market and benefit from a wider range of tariffs? Would it be effective in reducing the costs of supply to prepayment customers?***

- 3.8.11 This remedy would not be effective in allowing PPM customers to engage fully in the market, and would not reduce the costs of supplying PPM customers. (Indeed, this remedy could have the opposite effect.) A SMETS 2 PPM solution must be defined, the DCC must be delivered, RMR tariff restrictions must be removed and suppliers must have the freedom to deliver engaging communications before customers will benefit fully.
- 3.8.12 SSE has chosen not to embark upon a mass roll-out of the current technology (SMETS 1) because these meters have interoperability issues

<sup>64</sup> A DECC change, which was more substantial than anticipated by the DCC, to part of the SMETS specification required a timeline extension, more development work and further alterations to the test approach. The additional costs resulting from this revised plan were in the range of £60m to £90m. See DCC, *Resetting the DCC Delivery Programme* – available at [http://www.smartdcc.co.uk/media/205527/141117\\_dcc\\_plan\\_and\\_im\\_consultation.pdf](http://www.smartdcc.co.uk/media/205527/141117_dcc_plan_and_im_consultation.pdf).

<sup>65</sup> See House of Commons Energy and Climate Change Committee - Ninth Report (3 March 2015) – available at <http://www.publications.parliament.uk/pa/cm201415/cmselect/cmenergy/665/66502.htm>.

<sup>66</sup> See Amber Rudd MP (on behalf of DECC), *Response to CMA Provisional Findings in the Energy Market Investigation* (31 July 2015) – available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/450605/CMA\\_response.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/450605/CMA_response.pdf).

<sup>67</sup> Technical issues include that there is currently no solution for delivering smart meters in blocks of flats, and certain geographical areas do not receive the required wide area network coverage.

which mean that it is not feasible for SMETS 1 customers to switch easily and retain smart functionality. This could act as a barrier to switching since many customers will be put off at the thought of either losing their smart capability or having to undergo a meter exchange in order to retain smart functions. SMETS 1 meters are therefore far less beneficial than SMETS 2 meters for customers and competition. Industry approaches to SMETS 1 meters have varied from some suppliers choosing to opt-out almost entirely, to those who have rolled out many SMETS 1 meters. SSE's very limited roll-out of SMETS 1 meters has been purely on a trial-and-testing basis prior to the national roll-out of SMETS 2 meters. This has the objective of ensuring that SSE gets its plans in place.

- 3.8.13 The importance of focussing on SMETS 2 going forward has been discussed in the HM Government response to the Smart Metering Rollout Strategy consultation.<sup>68</sup>
- 3.8.14 Requiring suppliers to accelerate the development and roll-out of SMETS 2 PPMs will derail the current programme, cause long-term issues that could require further intervention and hinder the sustainability of smart. It is vital that this new technology is designed to meet the needs of customers most effectively, is tested and that systems are stabilised prior to mass roll-out. By reducing the time available to industry to do this, this remedy would reduce the reliability and quality of the output. Any issues with the technology or with the roll-out programme would have a real detrimental impact on customers and would negatively inform their view of smart meters, the other measures proposed by the CMA, their supplier and the energy industry as a whole. SSE wants customers' experiences of smart metering to restore their trust in the energy market further and encourage them to become more engaged: this will not happen if a sub-optimal solution is imposed upon industry and therefore customers.
- 3.8.15 Once the robust SMETS 2 solution is in place, smart meters will deliver a number of benefits to PPM customers: no limitations on the number of tariff options (subject to the removal of RMR restrictions which SSE supports); expanded payment method options, including "in home" options; remote switching to credit meter mode; and an in-home display will provide easily-accessible data. Supporting a range of new payment methods will come at a cost to suppliers, meaning that the overall costs to supply PPM customers may not reduce entirely. In the meantime, however, [X<].

***(b) Which version of this remedy would be more effective and/or proportionate?***

- 3.8.16 SSE does not agree that an accelerated rollout of smart meters to PPM customers (incorporating either version of this remedy) would be an effective or proportionate remedy. An accelerated roll-out runs the risk of either: tying PPM customers in to the restrictive SMETS 1 technology; negating any benefits of a mass, national roll-out; and disrupting the development and roll-out of SMETS 2 technology. The combination of the

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<sup>68</sup> See Government Response on Smart Metering

effects of other proposed remedies (such as the removal of tariff restrictions and the removal of prescriptive information requirements on customer communications) would instead help to deliver an immediate benefit for customers without risking the successful delivery of SMETS 2 meters.

3.8.17 Please see below for further specific comments on each remedy option.

(a) Version (a), the requirement for suppliers to stop installing “dumb” PPMs and ensure that any future installed PPMs are smart:

- (i) It would not be appropriate to implement this remedy whilst SMETS 1 is the only smart PPM solution.
- (ii) This solution focuses on new installations and does not seem to take into consideration existing PPM customers which would be a confusing message for customers.
- (iii) When SMETS 2 PPMs have been developed and tested as per existing plans, then SSE would support this remedy<sup>69</sup> (in addition to the general mass roll-out of SMETS 2 meters to all customers).

(b) Version (b), the requirement that suppliers install smart PPMs before they install any smart credit meters:

- (i) This version would not be appropriate whether rolling out SMETS 1 or SMETS 2 meters.
- (ii) This version has a negative impact on the cost and efficiency of smart meter roll-out as it prevents supplier-led street-by-street roll-out.
- (iii) Non-PPM customers would suffer unnecessary delays before receiving their smart meter.
- (iv) Customers who have one PPM and one credit meter would require two separate installations under this remedy – this would be confusing, disruptive and create a negative customer experience.<sup>70</sup>

***(c) Would any additional or alternative measures be required to ensure that this remedy comprehensively addressed the overarching feature of weak customer response arising in particular from those with prepayment meters?***

3.8.18 SSE is keen that PPM customers are provided with more choice and are able to further reap the benefits of competition. Looking only at the tariffs currently on offer to PPM customers presents a partial story of the true

<sup>69</sup> The New and Replacement Obligation (as discussed in section 5 of the *Government Response on Smart Metering*) is due to come into effect from mid-2018 and will require suppliers to take all reasonable steps to install a compliant smart meter where a meter reaches the end of its life.

<sup>70</sup> It would also be inefficient and more costly.

extent of competition and choice in the PPM market. In many cases suppliers will have closed fixed term contracts (*FTCs*), which are no longer for sale, but which still have customers supplied on them. These tariffs must run their course and have all customers migrated off them before a new tariff can use its slots.<sup>71</sup> PPM customers have access to two-rate (*i.e.*, Economy 7) and DTS (*i.e.*, Total Heating Total Control) tariffs, so are not at a disadvantage when compared with credit meter customers in this regard.

- 3.8.19 As noted above, neither rolling out SMETS 1 PPM meters nor prioritising and accelerating the delivery of SMETS 2 are effective or proportionate ways of achieving the CMA's aim. Rolling out SMETS 1 is only an interim solution and these meters are not interoperable. Regarding SMETS 2, the technology is not yet ready and must go through a testing and stabilisation period prior to mass roll-out, and this remedy would delay the roll-out to credit meter customers.
- 3.8.20 All customers (credit and PPM) will only benefit from smart meters if the current Supply Licence restrictions on tariff type and number are lifted. Without rolling back these rules, suppliers will be unable to offer a variety of innovative tariffs which meet customers' needs and make use of smart meter data.

#### Alternative measures

- 3.8.21 The focus should be on exploring the options available within the current system then, when the technology is ready and has been tested, implementing a cost-effective, stable and efficient roll-out of SMETS 2 meters to all customers.
- 3.8.22 Presently, due to RMR restrictions (namely the tariff cap and tariff simplification rules) and technical constraints, suppliers are limited considerably in what they can offer to PPM customers. Removing the RMR restrictions would allow suppliers to offer a range of options to all customers, including PPM customers, such as cashback, vouchers and free gifts.
- 3.8.23 SSE is very keen that PPM customers do not get a “*raw deal*” and as such has been exploring a number of options for increasing the offerings available to PPM customers, *e.g.*, [X]. SSE considers that this is a far more proportionate, customer-centric and efficient means of delivering choice to customers. However, the RMR tariff restrictions must be rolled back in for the benefits of this IT project to be fully available to customers.
- 3.8.24 Additionally, SSE is keen to make access to tariffs as easy as possible for all customers. SSE therefore does not charge for meter exchanges between

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<sup>71</sup> In the legacy PPM systems, the number of tariffs available across industry is restricted due to a limited number of tariff slots being available.



PPM and credit meters<sup>72</sup> (and vice versa), thus reducing the barriers to accessing all of its current tariffs. However, if the RMR tariff restrictions were removed then PPM customers would be able to access this wider range of tariffs without the disruption of requiring a meter exchange.

- 3.8.25 The Centre for Sustainable Energy's (*CSE*) 2015 annual accounts<sup>73</sup> noted that many customers value their PPM and feel that it is essential in allowing them to budget effectively. It is important that certain new benefits of smart meters which might not be accessible by some of the most vulnerable members of society (mobile app top-ups and viewing usage graphs on-line), do not overshadow the need for measures which will benefit all PPM customers. Measures to make switching simpler and more reliable coupled with the relaxation of tariff restrictions should help to encourage engagement and provide protection for all customers.
- 3.8.26 Finally, in the event that some PPM customers are vulnerable, and require additional support, this is better achieved via targeted social policy measures and customer-focused campaigns. For example, the Big Energy Saving Network provides face-to-face advice on energy bills to the most vulnerable customers.

***(d) What issues may arise as a result of prioritising the installation of smart meters in the homes of customers who currently have prepayment meters?***

- 3.8.27 A targeted and prioritised roll-out of PPM smart meters risks alienating PPM customers and causing them to lose out on the benefits of a mass national roll-out. Suppliers and the CDB have plans in place for communicating the benefits of smart and this has been planned for in the current timetables. Altering the timetable risks disrupting these activities and causing customer detriment. It is also more difficult to accompany a small, targeted, prioritised roll-out with wide-scale media campaigns or community engagement. PPM customers may feel that they are losing out by being treated differently and this might reinforce any perceived stigma attached to having a PPM. SSE is keen that all customers are treated fairly and equally and are able to benefit from the national roll-out and accompanying customer engagement activities.
- 3.8.28 The smart PPMs currently available are not the enduring solution: they are a barrier to switching which can increase distrust in the market and provide a poor customer experience. A forced, mass roll-out of SMETS 1 PPMs would cause unnecessary customer disruption, delay the development of SMETS 2 PPMs and have significant cost and efficiency implications. It would be very unfair for this group of customers to be tied in to a technology

<sup>72</sup> [X] Ofgem's June 2015 prepayment review report shows the variances between suppliers. See Ofgem, *Prepayment review* (23 June 2015) – available at [https://www.ofgem.gov.uk/sites/default/files/docs/2015/06/prepayment\\_report\\_june\\_2015\\_final\\_forpublication.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/06/prepayment_report_june_2015_final_forpublication.pdf).

<sup>73</sup> See Centre for Sustainable Energy, *Financial Statements* (31 March 2015) – available at <https://www.cse.org.uk/downloads/file/CSE-annual-accounts-2015.pdf>.

which is not fully fit for purpose and impedes them from fully engaging in the competitive market. Again, this would reinforce any perception that PPM is a “lesser” metering arrangement. To this end, SSE reiterates the importance of allowing the smart programme to work to the current timetable which will deliver SMETS 2 PPMs once the technology and the DCC have been tested and shown to be stable and reliable.

- 3.8.29 A key risk unique to PPM customers is that if their smart meter presents a fault it can leave the household without supply. This is not a risk with credit meter customers. For this reason, it is vitally important that SMETS 2 PPMs are thoroughly tested prior to roll-out and that suppliers are not compromised in their ability to respond to emergency calls to get a PPM customer back on supply.

*(e) Would it be more effective and/or proportionate to require energy suppliers to accelerate the roll-out of smart meters across the retail markets as a whole, in order to facilitate engagement more broadly, rather than focusing on customers on prepayment meters?*

- 3.8.30 It is vitally important that the roll-out of smart meters is as positive as possible for customers. Due to the risks of: delivering a sub-optimal solution; delaying the delivery of SMETS 2; alienating customers; and reducing the necessary trial and test period, SSE does not agree that it would be effective or proportionate to accelerate the roll-out of smart meters to either a specific consumer base or across the retail markets as a whole. As noted earlier in this response, SSE is strongly of the opinion that it is crucial for customers and competition that the roll-out of smart meters be done in a considered, tested, reliable and efficient way.
- 3.8.31 SSE’s plans are based on the current DCC go live date (August 2016) and roll-out could not feasibly be brought forward. Accelerating the programme would have an impact on many facets of roll-out including: training meter installers; development of back office systems; development and testing of SMETS 2 PPMs; development and testing of DTS SMETS 2 meters; development of a solution for smart meters in blocks of flats; the launch of the DCC; testing of DCC systems; and initial trials of SMETS 2 meters. It would not be appropriate to “cut corners” on any of these and the CMA would need to give due regard to whether the current plans could be further expedited without risking sub-optimal roll-out with unintended consequences.
- 3.8.32 In conclusion, SSE is strongly of the opinion that no version of this remedy (whether whole of market or PPM specific) that would operate in the best interests of customers or competition. An accelerated roll-out risks causing customer detriment, barriers to switching and a lack of success for the entire smart meter programme. SSE supports facilitating increased choice for PPM customers, but does not consider that this remedy will effectively achieve the objectives sought. Instead, the combined effect of a roll-back of RMR tariff restrictions, a roll-back of information regulations and a more reliable and robust switching process would be a far more effective and

proportionate way of providing PPM customers with more choice and the ability to easily take advantage of this choice.

- 3.9 Remedy 6 – Ofgem to provide an independent price comparison service for domestic (and microbusiness) customers** The CMA has proposed this remedy for both the domestic and microbusiness segment and SSE believes that this proposed remedy is worth exploring further to ensure that in practice, it would be effective in meeting the stated aim of “*improving trust in PCWs*”<sup>74</sup> However, the CMA should take into account that the existing markets for PCWs which cover the domestic and microbusiness segments are very different and as such, a remedy like this is likely to impact upon the segments differently. In the domestic sector, SSE considers that there already exists a vibrant PCW market with high use by customers at present – it is a key acquisition channel for all suppliers. In considering this remedy, care needs to be taken to ensure that customers’ confidence in existing PCWs is not undermined. In the microbusiness sector, customer engagement is already high without such a well-developed PCW market (although there are no structural barriers to the further development of the market). In both PCW markets it must be clear how such an obligation would fit with Ofgem’s existing roles and responsibilities.

***(a) Would this remedy be effective in increasing customers’ trust in PCWs and thereby encourage engagement in the markets and switching?***

- 3.9.2 Firstly, there are already high levels of engagement and switching in both the domestic and non-domestic energy markets and the CMA’s assessment of customer activity and engagement is not supported by the evidence (as detailed in the PFR).<sup>75</sup>
- 3.9.3 Notwithstanding this, the proposed measure would allow customers to check that prices they are being offered through PCWs are accurate against the Ofgem PCW site. This would increase trust in the offers being put forward. However, one unintended consequence is the possibility that the site could actually decrease trust in other PCWs through a perception that the Ofgem site is required because other PCWs misrepresent available tariffs; a perception which could have a significantly damaging impact on existing and developing PCWs. This uncertainty of outcome suggests that a trial period would be appropriate to test the feasibility and proportionality of this remedy.
- 3.9.4 With regard to the application of this remedy to microbusinesses, SSE has been involved in discussions with a number of parties over the years about the potential for a non-domestic PCW of this sort. In all of these discussions it has become clear that the difficulty lies more in the marketing of such a site than in the mechanics. The existence of such a site would not in itself encourage engagement; customers would have to be attracted to the site through some marketing exercise before it will have any impact on engagement and switching. As the CMA has recognised in its PFs, the marketing of such a site to non-domestic customers is costly and has been weighed by many parties as too high to make such a site sustainable.

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<sup>74</sup> NPR, para. 67.

<sup>75</sup> See PFR, Section 3.

***(b) Should this service be online-only, or should it also operate over the telephone for those customers without access to the internet?***

- 3.9.5 As shown by the CMA's customer survey, internet access is a key characteristic in determining a customer's propensity to switch (13% of respondents without internet access have switched in the last three years versus 30% of those with internet access). It would be appropriate therefore for this service to have a telephone option so that customers without internet access (or who are not confident in using the internet or using PCWs) are not excluded from any potential benefits that this service may provide.
- 3.9.6 However, any outbound telephony is unlikely to be appreciated by customers. This is why SSE stopped cold calling for domestic customers. Feedback from microbusiness customers is similarly negative about receiving calls from TPIs which are already seen as a nuisance.<sup>76</sup> However, microbusiness customers are used to using a telephony-based service as this is the standard model for their engagement with suppliers and many TPIs. Given the additional complexity of non-domestic tariffs, and depending on the design and usability of the PCW, a telephony element may be essential for this market.

***(c) Is there a risk that such an independent service could undermine the development of other PCWs in the energy sector? How could this risk be mitigated?***

- 3.9.7 SSE considers that there is a real risk that such an independent service could undermine the development of other PCWs in the market. The risk of this would be greatest if customers could switch through the independent service, because if there was nothing to differentiate the independent site from the commercial sites (such as the ability to switch), then customers may simply use the independent site. This risk is still present if the service is information only, as customers may use the independent site for comparison purposes and then contact suppliers directly to switch, just as many do with commercial PCWs at the moment. If this remedy is to be implemented, it must be ensured that commercial PCWs retain a unique selling point in order that they continue to be viable.
- 3.9.8 In order to reduce this effect, the other PCWs in the market will need to be able to offer benefits not available to customers searching through the Ofgem site, for example: special tariff rates, discounts, cashback or bundled products. This would require the rolling back of the RMR "*simpler choices*" rules. If a far reduced number of customers switch through commercial

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<sup>76</sup> A qualitative survey of micro and small businesses' experiences and perceptions of energy broker services undertaken in 2014 for Ofgem found that "*evidence of dissatisfaction with cold-calling by brokers in the answers provided to the survey and when [BMG] initially contacted respondents. During the process of recruiting businesses to take part in the survey a large number refused because they thought they were being cold called by a broker.*" (BMG Survey, p. 43). It also found that "*many businesses – including those that had actually used broker services – expressed their frustration with the high volume of cold calls they receive from energy brokers. Most said that they were called several times a week, with one company receiving three calls a day five times a week.*" (BMG Survey, p. 17).

PCWs it may no longer be commercially viable for them to operate and they may choose to stop offering energy comparisons, resulting in less competition between PCWs.

- 3.9.9 In each of these examples it would still be possible for the Ofgem site to display the tariff rates included in these offers, in order to maintain whole-of-market coverage, but customers would only be able to access the offers and special rates by switching through the commercial comparison site.

***(d) Should the Ofgem website quote the energy suppliers' list prices only? Or should it seek to provide full details of all quotes available on the market (including on other PCWs), i.e., function as a meta-PCW?***

- 3.9.10 As noted above, the ability of the Ofgem PCW to quote all prices in the market (including those unique to other PCWs) would reduce the value of those other PCWs to customers and could damage the PCW energy market. However, customers may expect the Ofgem PCW to quote all prices on the market and if it does not, this could lead to reduced trust and confusion from customers rather than increased trust and clarity. It is pertinent therefore that the site is transparent about exactly what it does and does not show. In addition, and more generally, if suppliers' offers are not calculated in the same way (*i.e.*, PCWs use different methods) this also risks customer confusion.
- 3.9.11 The best approach on this issue depends on the main purpose of the Ofgem PCW. If the purpose is to: support customers who the CMA considers are not engaged, to ensure that these customers have access to an independent price comparison service to help them get a better deal, then just quoting the list prices of the suppliers is sufficient. However, if the purpose of an Ofgem-run PCW is as a checking mechanism against all other PCWs and all other prices in order to increase trust in PCWs, then whole-of-market coverage will be required. If the CMA chooses to implement this remedy, it would be useful to trial each version and see which one customers respond better to.<sup>77</sup>
- 3.9.12 For the microbusiness market, it may not be possible for the Ofgem PCW to technically list all prices available since prices can be individually negotiated. However, the site could list all prices included in the price matrices that suppliers provide to TPIs (fixed) as well as all deemed and out of contract rates. This could increase transparency in the market by making these rates from all suppliers more readily accessible in one location, more like the domestic model, rather than businesses having to search between the sites of different suppliers.

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<sup>77</sup> The trial could provide a PCW covering one distribution area (*i.e.*, avoiding the costs of including all regional price variations) and could be coupled with a regional advertising campaign to raise awareness. Customers using the trial service could be prompted to identify the marketing channel through which they became aware of the PCW. Customer feedback and satisfaction could be monitored. Data so collected could then be used to properly inform the final decision on whether the service should be rolled out nationwide.

***(e) How could we ensure that an Ofgem price comparison service was robust in terms of offering all tariffs available on the market? Should there be an obligation on retail energy suppliers and/or PCWs to provide information to Ofgem on their tariffs?***

- 3.9.13 SSE would be happy to provide Ofgem with information on prices through a similar mechanism to the provision of price information to other comparison sites with which it has commercial relationships, on the basis that Ofgem already has the ability to request this information from any supplier under the current regulatory framework. Of course, it would be important to ensure that any obligation on suppliers or PCWs is proportionate. Requirements on the format of information provided should be designed to align with existing business processes wherever possible, this approach would reduce the resource requirements, associated costs and implementation timescales.
- 3.9.14 For microbusinesses, SSE's business energy sales team currently issues price matrices to TPIs on a regular basis to allow them to calculate the best deals for their customers. SSE would be happy to include Ofgem on the distribution list for these prices matrices which should include all SSE prices required to be listed on such a site.<sup>78</sup>

***(f) Should any price comparison service operated by Ofgem be transactional, i.e., be able to carry out switches for consumers, or should it provide information only?***

- 3.9.15 As noted in SSE's response to question (c) above, a transactional independent comparison service poses the greatest risk to commercial PCWs. Ultimately, it depends on what outcome the establishment of an Ofgem operated price comparison service is intended to achieve. As discussed above (*see* para. 3.9.11) there could be merit in trialling each version in the first instance with customers, to see which one customers respond better to.
- 3.9.16 Suppliers would have to set up new processes to facilitate switches for microbusiness customers via an online comparison site (irrespective of whether it was operated by Ofgem or any other party), to ensure that there was no reduction in the speed and quality of the switching process. If this remedy were to be pursued further, and regardless of whether the site were information only or transactional, in order for it to be successful customer awareness of the site would need to be generated, otherwise it might not achieve the stated objective.

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<sup>78</sup> See discussion of Remedy 7a at [para. 3.11](#) of this Response for further considerations regarding the provision of price data to TPIs and PCWs.

***(g) What would be the likely costs to Ofgem of offering this type of price comparison service? Would Ofgem need additional funding and/or statutory powers in order to provide this type of service? If so, where should this funding come from?***

- 3.9.17 The costs of offering this service could be substantial. If Ofgem were to adopt a licensing model with an existing PCW service provider then it may not need to develop a new system of its own. However the costs would likely still be high. The level of costs would also depend on the functionality of the site, as the costs would be higher if the site were transactional as this would require a more complex system. PCWs would be better placed to advise on the likely costs involved.
- 3.9.18 Even if the site were to be transactional, SSE's expectation is that Ofgem would not be operating the site under a commercial model. Therefore additional funding of these costs would need to be sourced by Ofgem. SSE's initial view is that the operation of such a site would need to form part of Ofgem's statutory duties and therefore, ultimately, the costs of operation would be recovered from all suppliers on the same basis as the rest of Ofgem's activities. If the site was not used by customers and was of limited success (in increasing engagement), then the cost benefit would be very poor.
- 3.9.19 If the site (and any associated telephony activity) was used by customers who are already actively switching, but the cost is recovered from all customers, then this could introduce another regressive policy element in bills and could be to the detriment of customers who were actively choosing to stay with their current supplier.
- 3.9.20 As noted above, SSE suggests that a trial period would be appropriate, so as to ascertain whether the costs potentially involved in establishing the site would outweigh the benefits to customers.

***(h) How should customers be made aware of the existence of this service? Should information be provided by energy suppliers on bills/during telephone calls? Should PCWs be required to provide links to the Ofgem website during the search process to allow customers to cross-check prices?***

- 3.9.21 If this remedy were to be pursued, it would need to be assessed in the round. As noted in the response to Remedy 9, SSE is generally supportive of providing proportionate and targeted prompts to customers which take account of their preferences. Customer feedback to suppliers indicates that they would prefer to see the complexity of their bills reduced. SSE contends that there are more effective methods of prompting customers to engage than signposting them to an Ofgem PCW on their energy bill. It would therefore be disproportionate and even off-putting for customers to have information about the service included on their bills. Moreover, while it would be possible for suppliers to make reference to the Ofgem site during calls with customers (both domestic and microbusiness) this would benefit from being trialled with customers to see whether it has the desired effect.



- 3.9.22 The appropriateness of imposing a requirement for commercial PCWs to link to an independent site is questionable. This is not required in other markets and may risk undermining the commercial PCW by suggesting to customers that the commercial PCW cannot be trusted.

*(i) Is there any additional information that Ofgem should provide on its website relating to energy suppliers and/or tariffs to facilitate the customer search and switching process?*

Ofgem presently provides accessible information to domestic<sup>79</sup> and microbusiness customers<sup>80</sup> on its website. This information, in conjunction with the information and advice available from other sources (suppliers, PCWs, consumer bodies), is adequate in providing customers with information about their options and rights. As noted in the PFR,<sup>81</sup> large proportions of customers are aware that they can change supplier (89%), payment method (81%) or tariff (76%). Only 17% of respondents to the CMA's survey found it difficult to locate information and only 28% of respondents found it difficult to understand or compare tariffs. For microbusinesses, switching rates are high and increasing, and these customers display a sophisticated aptitude at using that ability from beginning (contract familiarity) to end (quote gathering and final switching process).

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<sup>79</sup> See Ofgem's domestic Go Energy Shopping website – available at <http://www.goenergys shopping.co.uk/en-gb>.

<sup>80</sup> See Ofgem's FAQ page for microbusiness – available at <https://www.ofgem.gov.uk/simpler-clearer-fairer/information-business-consumers/micro-business-consumers-your-questions-answered>.

<sup>81</sup> PFR, para. 3.2.3.

### 3.10 Overarching comment on microbusiness – concerns around the definition of microbusinesses and implementation costs

- 3.10.1 SSE welcomes the inquiry into how microbusinesses are affected by the way the market operates and the opportunity this presents to identify ways to improve the position of microbusiness customers, as well as to facilitate competition and innovation by suppliers. SSE agrees with the principle of giving additional support to smaller business customers and welcomes many of the measures proposed by the CMA. SSE's response to each of the microbusiness-specific remedies is set out below but it is first important to discuss SSE's concerns around how microbusinesses are defined to ensure the remedies are well-targeted and proportionate. These concerns are shared by the majority of customers and interested bodies. SSE would like to see a simplification of the definition that removes the criteria around employee numbers and turnover and instead focuses on energy consumption.
- 3.10.2 As the CMA has recognised in its PFs, it is difficult for suppliers to identify microbusinesses under the current definition due to their limited access to information on microbusinesses' employee numbers and turnover and the fact that these factors can change regularly. This is one of the main reasons why many suppliers have adopted an approach of applying regulatory requirements for microbusinesses to all SMEs, as separately identifying microbusinesses from SMEs on the basis of these factors is not robust. Applying a purely consumption-based definition would facilitate the targeted implementation of remedies by SSE (and other suppliers) as suppliers would be better able to identify the customer to whom the remedy should apply on a consistent basis.
- 3.10.3 Additionally, the current threshold for consumption is too high. When Ofgem made the decision to increase the consumption level covered by the definition of microbusiness in 2012 to its current level, Ofgem expected the new definition to capture 90% of non-half hourly (*NHH*) customers. This broad definition can capture businesses with consumption around 30 times typical domestic consumption. As the CMA reports in its findings, a 2014 Ofgem survey of microbusinesses found that 16% of respondents had spent more than £5000 on their electricity and 13% had spent more than £5000 on their gas, significantly above domestic expenditure levels.<sup>82</sup> At the opposite end, a large proportion of businesses spend a much smaller amount on energy. According to a survey for the Federation of Small Businesses (*FSB*), 44% of its members spend under £2,000 a year on energy and 57% spend under £3,000 a year.<sup>83</sup>
- 3.10.4 SSE suggests that the definition for electricity consumption be reduced from 100,000kWh to 30,000kWh and from 293,000kWh to 100,000kWh for gas, the level used by the CMA in much of its analysis of microbusinesses. This

<sup>82</sup> Mean figure for electricity and gas combined of £1,276 for domestic customers. See TNS BMRB, *Retail Market Review baseline survey: report prepared for Ofgem* (2014), cited in PFs, Appendix 9.1, p. A.9.1-6.

<sup>83</sup> FSB, *FSB "Voice of Small Business" survey panel – April/May 2014 energy survey* (2014), p. 10., cited in PFs, Appendix 9.1, p. A.9.1-6.

would still afford the protection to smaller customers that the CMA and Ofgem are, quite rightly, seeking, and would also increase the attractiveness of the development of PCWs (by ensuring that all of the microbusiness customers would be billed on simpler NHH unit rates). This reduced consumption definition would also allow suppliers to support the principle of a pilot to further sub-divide microbusiness customers into those whose consumption is below 10,000kWh. This would allow SSE to offer these customers a published price, a move which we understand would be supported by both the CAB and the FSB. In summary, SSE believes that these proposed changes of microbusiness customer definitions would give the smaller users both the protection and simplicity sought and allow SSE (and the other suppliers) to be more flexible in what is offered to the larger SME customers.

- 3.10.5 If the existing Ofgem definition of microbusinesses is to be used in the application of the CMA's remedies, then it is vital that the CMA considers the direct and unintended impacts of these remedies potentially being applied to all SME customers. It is microbusiness customers in particular which the CMA has identified as in need of additional support. Imposing remedies which apply to all SME customers would therefore not be reasonable. Furthermore, applying remedies to such a wide definition of microbusiness may not be practically possible or the costs may be disproportionate.

**3.11 Remedy 7a – introduction of a new requirement in the licences of retail energy suppliers to provide price lists for microbusiness customers on their own websites and to make this information available on PCWs***Introduction and overview*

- 3.11.1 SSE does not recognise the CMA’s provisional finding of an AEC in the microbusiness segment.<sup>84</sup> SSE already provides its prices to customers (through an online quoting system) and TPIs (as part of commercial arrangements). Nevertheless, SSE welcomes this remedy as a means of increasing transparency and engagement in the market as long as the requirements on suppliers are reasonable and proportionate, so as not to unnecessarily restrict or burden suppliers and increase costs. Furthermore, whilst SSE believes that availability of pricing information is not a barrier to PCW activity in the non-domestic market, SSE would be open to sharing information with PCWs entering the market (as has been communicated by SSE to parties interested in this space over the years).
- 3.11.2 While a full impact assessment would need to be carried out once the detail of the proposed remedy were known, the impact on systems and costs should be relatively low as long as the requirements are reasonable in terms of the formatting and frequency of data provision. If the remedy were such that SSE’s existing processes and systems are deemed to meet its conditions then SSE would be able to implement this quickly (almost immediately) and effectively. By contrast, a remedy which requires suppliers to provide prices in specific formats and at the time requested by the receiving party would be disproportionate, as this could impose a heavy burden on suppliers (in terms of non-standardised templates and data submission) and take some time to implement.
- 3.11.3 These issues of formatting and frequency of data provision will be vital considerations when assessing the impact and the reasonableness of this remedy. If the CMA believes that prescription of data templates should be part of the remedy, then SSE suggests that the most workable solution would be to have one standard, yet flexible, format for all TPIs and PCWs in order to reduce the burden of this requirement and the associated staff and systems costs that would result. However, consultation would be required to ensure that all suppliers are able to comply with the proposed format and provide the necessary information.
- 3.11.4 As discussed in response to Remedy 6, SSE has always been open to the idea of a microbusiness PCW and has always been willing to share its prices with parties looking to set up such a site. While simplified templates and an obligation on suppliers to provide prices could facilitate the operation of such a site, SSE’s understanding is that availability of price information is not the main cause for a lack of PCWs in the microbusiness energy sector. It is the marketing and commercial viability of the PCW model in this segment that has proven difficult and seems to be the main reason why non-domestic PCWs do not proliferate.

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<sup>84</sup> See PFR, Section 8.

- 3.11.5 SSE would also seek to ensure that any requirement to provide prices to TPIs does not inadvertently require SSE to work with all TPIs. In particular, depriving suppliers of the right not to work with TPIs that engage in poor practices could have a detrimental effect on customer trust and engagement. An obligation on suppliers to publish prices via their own websites would ensure complete transparency without involving TPIs or leading to confusion as to on whose behalf the TPI is acting.
- 3.11.6 It would also be beneficial for this remedy to be implemented in parallel with Remedy 7b which should improve TPI practices and exclude those who fail to meet the requisite standards. Further to this, it should be noted that prices offered to customers are dependent on credit ratings and so publication of these prices should not oblige a supplier to supply at that price.

Answers to questions

***(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?***

- 3.11.7 This measure would increase price transparency for microbusiness gas and electricity tariffs since customers would be better able to compare prices from all suppliers.
- 3.11.8 While SSE recognises that a lack of standardised formats could make data collection more onerous for a PCW, any remedy which is too prescriptive around pricing formats could inadvertently restrict flexibility and innovation in the market to the detriment of customers. Any requirement for standardised templates to be provided by suppliers would need to allow enough flexibility or provide a clause for the exclusion of non-standard prices.
- 3.11.9 A full and thorough consultation would be required to ensure the viability of any template-based approach.

***(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?***

- 3.11.10 All information required to engage effectively in the search and switching process is already available to microbusinesses in their contracts and on their bills. Microbusinesses can also get this information by telephoning their supplier and asking for a summary of these factors. SSE is currently developing a new “switching guide” for non-domestic customers which will include all of this information in a user-friendly, easy to reference format. The target is to launch this pack at the end of 2015. SSE is also upgrading its website to better provide this information to customers in a more user friendly format.

- 3.11.11 The process of quoting and switching product should get easier for customers following the introduction of smart meters. Smart meters will make changes to metering arrangements faster and simpler. For example, changing from day/night rates or peak/off-peak rates will be possible remotely, meaning that suppliers will be able to offer their full suite of products to customers without concerns around the physical limitations of the meter.

***(c) How long should energy suppliers be given to provide the required information?***

- 3.11.12 As outlined above, SSE already provides its prices to customers (through an online quoting system) and TPIs (as part of commercial arrangements). On the basis that this remedy would be a continuation of existing practices, SSE believes that it (and other energy suppliers) should be able to implement this requirement with immediate effect.

***(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?***

- 3.11.13 SSE strongly believes that an online quoting system is the most effective means of implementing this remedy. Prices for microbusinesses depend on a number of factors including: meter type, profile class, and region which mean that prices matrices are required to identify a price for a specific customer. While these matrices could be published in document form on each supplier's website, it is unlikely that customers would find these documents particularly helpful. The proposed measure would therefore not have the intended effect of increasing transparency or facilitating greater engagement. In particular, small microbusiness customers who may be less informed about how prices are applied may struggle to use these documents. As such, an online quoting system which guides microbusinesses through the relevant parameters and provides a tailored quote would be of much greater benefit.

- 3.11.14 SSE operates an online quoting system and understands that many of the other non-domestic suppliers also offer a system of this nature, so this would provide an effective means of implementing this remedy.

### 3.12 **Remedy 7b – introduction of rules covering the information that third party intermediaries are required to provide to microbusiness customers.** *Introduction and overview*

- 3.12.1 SSE does not recognise the CMA’s provisional finding of an AEC in the microbusiness segment.<sup>85</sup> Nevertheless, TPIs provide important services and SSE welcomes this remedy as a method of improving transparency and trust in TPIs, as well as ensuring that microbusiness customers are provided with the information that they need to make informed choices about their energy supplier. Ofgem has been developing a code of conduct for non-domestic TPIs. Although Ofgem has deferred its consultation on the code, pending the outcome of the CMA’s investigation, it has set out a set of principles that it expects TPIs to adhere to. These principles include the basic standards of honesty, respect, accuracy, transparency, customer focus and professionalism.<sup>86</sup> Ofgem’s preferred approach is to underpin this code with a licence condition that mandates that suppliers only work with code-accredited TPIs.<sup>87</sup> SSE supports this measure in principle, provided that obligations for code-adherence are placed directly on TPIs, as suppliers have no control over the conduct of these organisations. SSE would not want to be liable for the activities of an entity over which it has no direct control. The most effective and reasonable approach would therefore be to place the obligation directly on TPIs.
- 3.12.2 SSE has participated in Ofgem’s development of a code of conduct for TPIs (the ***Ofgem Proposed TPI Code of Conduct***) and believes that this remedy cuts across some of the ambitions of that work. It would be rational and efficient to include this requirement within the Ofgem Proposed TPI Code of Conduct which also covers other areas such as sales practices. SSE agrees that a requirement on information provision by TPIs is needed to improve transparency in this area and suggests that mandatory participation by TPIs in the Ofgem Proposed TPI Code of Conduct, designed to incorporate this information element, would be a logical and effective means of implementing this.

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<sup>85</sup> See PFR, Section 8.

<sup>86</sup> See Ofgem, *Open letter on next steps on our project for a code of practice for the non-domestic third party intermediary (TPI) sector* (5 March 2015) – available at <https://www.ofgem.gov.uk/ofgem-publications/93764/openlettertpiprinciplesmarch2015forweb-pdf>.

<sup>87</sup> See Ofgem, *Open letter on next steps to the non-domestic TPI code of practice project* (7 August 2014) – available at <https://www.ofgem.gov.uk/publications-and-updates/next-steps-non-domestic-tpi-code-practice-project>.

Answers to questions

***(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, i.e., that TPIs were providing the specified information?***

- 3.12.3 SSE welcomes this remedy as a means of improving transparency over incentives and the range of the quotes provided by TPIs. However, it is important that other issues that have been identified as being of concern, such as poor sales and marketing practices by some TPIs, are also addressed to enhance microbusiness customers' trust.
- 3.12.4 Ofgem would be a logical owner of obligations on TPIs to provide the required information as it now has expanded powers to manage some aspects of the conduct of TPIs in the energy market under the Business Protection from Misleading Marketing Regulations.<sup>88</sup> SSE believes that the most difficult aspect of this remedy is monitoring compliance with it as this would potentially be difficult and costly. Having said that, Ofgem already has well developed systems for monitoring obligations on suppliers which could be applied to monitoring compliance with these requirements by TPIs, although some additional information-gathering powers may be required. The methods which could be applied include: routine reporting, periodic information requests and market monitoring.
- 3.12.5 Some tracking could be achieved through a requirement for inclusion of these factors in complaints reporting from suppliers. This could be implemented through existing Ofgem powers.
- 3.12.6 If Ofgem adopts these requirements as part of its remit then the funding of these activities should be managed by Ofgem. With regards to the Ofgem Proposed TPI Code of Conduct, it was suggested that the initial set up costs, estimated at a total of £0.5 million, should be covered by energy suppliers and that the ongoing costs would be covered by TPIs. This proposal seems reasonable and the costs do not seem disproportionate. If the costs of the CMA's remedy were expected to be significantly higher, then this proposal would need to be reconsidered and SSE would seek confirmation that the benefits to customers would outweigh the costs.

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

- 3.12.7 SSE believes that there are two main aspects to the information that TPIs should provide to microbusinesses:
- (a) Whether the TPI is offering a whole-of-market quote or a quote from a limited set of suppliers; and

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<sup>88</sup> Ofgem (2015), *Next steps on our project for a code of practice for the non-domestic third party intermediary (TPI) sector* as cited in *PFs*, Appendix 9.1, p. 41.



- (b) The level and type of commission which the TPI is being paid and how this affects the customer's price.

***(c) Could the provision of certain types of information have unintended consequences (e.g., 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?***

- 3.12.8 SSE does not foresee this sort of unintended consequence from this remedy, so long as the information were presented in a clear manner that would not confuse or mislead customers. For example, commissions should be presented as part of the quote with the final price still clearly presented as the main element to the customer.

***(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?***

- 3.12.9 SSE believes that the specified information should be provided to customers both in writing and orally at different stages in the process, when it is most appropriate. As initial quoting for microbusinesses (by TPIs) is generally carried out by telephone, it would be most appropriate for information to be communicated orally at this stage. The same information should then be provided in writing alongside contracts when provided for signature.

- 3.12.10 SSE also believes that increased visibility of the impact of TPI commissions on a customer's annual bill would be beneficial in increasing the transparency and customer understanding of these arrangements. However, the nature of variable commission structures makes this potentially challenging to achieve in practice. SSE suggests that a more manageable solution would be for suppliers to provide microbusiness customers with an annual statement which shows how much of the customer's annual bill is attributable to the TPI commission. In order to make sure that the requirement were applied in the most cost effective way, a degree of flexibility would be required to allow suppliers to implement this remedy in the most appropriate manner.

- 3.12.11 While a thorough impact assessment would need to be undertaken to assess the implications of this requirement, an initial feasibility review by SSE suggests that provision of commission information on an annual statement to microbusiness customers would be manageable. Implementation timescales would be dependent on the level of individual suppliers' systems changes required to deliver this requirement. In SSE's case, they should be relatively short, potentially within a 12 week timeframe.

***(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?***

- 3.12.12 SSE has supported the development of the Ofgem Proposed TPI Code of Conduct which has sought to address many of the same issues covered by this remedy. SSE is aware from the PFs, and from discussions with

customer groups such as the CABs and the Federation of Small Businesses, that many of the issues identified regarding trust and engagement with TPIs relate to the sales and marketing practices of some TPIs.<sup>89</sup> Whilst this information remedy would increase transparency, it would not of itself address these concerns. SSE would therefore support this remedy in parallel with the Ofgem Proposed Code of Conduct being made mandatory.

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

- 3.12.13 See point (d) above with regards to inclusion of TPI commission in communications from suppliers and point (e) above with regard to other measures which could be address by the Ofgem Proposed TPI Code of Conduct.

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<sup>89</sup> CMA Provisional Findings, Appendix 9.1: Microbusinesses page 35, 36 & 37.

**3.13 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 contracts on to new contracts with a narrow window for switching supplier and/or tariff.**

*Introduction and overview*

- 3.13.1 As explained in the PFR, the microbusiness sector is highly competitive and customer engagement is generally high. Moreover, customers on default tariffs are not necessarily less engaged than other microbusiness customers.
- 3.13.2 SSE (and some other suppliers) voluntarily stopped auto-rollover of microbusiness contracts in April 2014. Nevertheless, it is clear that these arrangements can be a barrier to engagement for the small proportion of the market who remain on such tariffs.
- 3.13.3 SSE considers that the model adopted by SSE and numerous other suppliers as a replacement to auto-rollovers provides a more effective approach to engaging those customers who do not renew at the end of their contract period.<sup>90</sup> This model allows the customer to change their contract at any time following the end of their contract, while providing reasonable notice to suppliers.

***(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)?***

- 3.13.4 The greatest benefits for customer engagement could be obtained by prohibiting auto-rollovers. This measure would allow all customers who have reached the end of their existing contract to move to a new contract or switch supplier at any point following their move to a default tariff, with only limited notice (currently 30 days) being required. This measure would also help reduce customer confusion, as some customers may be under the false impression that their supplier no longer carries out auto-rollovers in light of the significant media coverage of the removal of these types of contracts by some of the larger suppliers.
- 3.13.5 A consistent approach of prohibiting auto-rollovers completely would ensure that it would be easier for microbusiness customers to understand their options at the end of a FTC and would be a more effective approach allowing them to engage either with suppliers or TPIs. If the proposed remedy were implemented by allowing auto-rollover contracts, as long as they include a suitable switching window, only a portion of this increased engagement could be realised since switching would be restricted to the period of the window.

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<sup>90</sup> Analysis by SSE shows that [3<] % of customers who moved on to SSE's VBR have subsequently switched tariff or supplier, demonstrating that the increased flexibility offered by this approach has increased customer engagement.

***(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?***

- 3.13.6 This would be highly unlikely. Existing requirements on suppliers to communicate clearly with microbusiness customers would continue to apply. Customers would therefore understand the options available to them at the end of their FTC, including their right to terminate their contract and switch to a different supplier. The interaction of this remedy with proposed Remedies 9 and 10 also needs to be taken into account.

***(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?***

- 3.13.7 SSE's VBR (the main replacement for auto-rollover contracts) currently requires customers to provide 30 days' notice to terminate their contract. This notice period reduces the risk associated with supplying these customers. The main difference between VBR customers and FTC customers is that the fixed term contract customer gets the benefit and price security attached to the forward hedge and their lower risk profile. Reducing the minimum notice period to less than 30 days would significantly increase the risks associated with supplying customers on the VBR.
- 3.13.8 If customers notify SSE of their intention to terminate its contract, they will move to a deemed tariff. Because notice has effectively been served by these customers, the risks associated with continuing the energy supply are considered to be significantly higher (as the customer could leave at any time) and so an additional risk premium is added to prices.
- 3.13.9 SSE believes that a requirement for a minimum 30 days' notice is reasonable and proportionate to the risks of supplying a microbusiness customer not on a FTC. If a remedy prohibiting auto-rollovers was implemented (which SSE considers would be effective in addressing the concerns identified by the CMA), allowing for a reasonable minimum notice period would support the effectiveness of this remedy (as it would help suppliers to reduce the risk profile, and therefore prices charged, to out of contract customers). As explained above, imposing a maximum notice period would not be required, as existing requirements to communicate with customers would suffice to deter suppliers from seeking to impose notice periods that are unreasonably long.

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

- 3.13.10 Under the current regulatory regime, the contract end date, termination date and whether the customer has terminated or renewed its contract is shown on the customer's bill. In addition, all energy suppliers are already required to send microbusiness customers a renewal offer at least 60 days before their contract expires (SSE sends this at 70 days and also sends a letter every six months to customers on VBR tariffs or deemed rates). These communications provide a prompt to customers that they are nearing the end

of their contract and offer the opportunity for the customer to engage in a new contract. In the case of SSE, the renewal letters also explain that the customer will be placed on SSE's deemed rate if they have terminated their contract or the VBR if they have not.

- 3.13.11 In SSE's experience, the current regime is sufficient to ensure that customers are aware of the end of their contract and engage with the market. In addition to SSE's own experience, the BMG Survey has shown that customers are responding to these prompts.<sup>91</sup> Increasing the requirements on suppliers to prompt customers would not be reasonable or proportionate, given: the increased costs that this would impose; the already high level of customer engagement; and the fact that some customers may wish to remain on a variable contract for a certain period – *e.g.*, because they are carrying out an assessment of alternative contract offers, planned changes to business location, or business arrangements which would make a FTC unsuitable).
- 3.13.12 If other suppliers are permitted to continue to offer auto-rollover contracts those suppliers should be required to inform customers that they are nearing the end of their contract in order to facilitate engagement. Otherwise, as the CMA has identified, these customers could end up being on auto-rollover contracts if they do not in engage during the window available to them.

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<sup>91</sup> The BMG Survey found that of those businesses that have noticed these dates on their bills and shopped around in the last 12 months (16% of all businesses), 64% said they were prompted to do so by the dates included on the bill. (*BMG Survey*, p. 32).

### **3.14 Remedy 9 - measures to provide either domestic customers and/or microbusiness customers with different or additional information to reduce actual or perceived barriers to accessing and assessing information**

#### *Introduction and overview*

- 3.14.1 SSE is committed to improving engagement in both the domestic and microbusiness segments, notwithstanding that the CMA has not established the necessary AECs to justify this remedy.<sup>92</sup> To avoid the proposed remedy having unintended consequences, the detail of how it would work in practice needs to be carefully considered (including the use of field trials where possible). The CMA should also consider alternative remedies (including Remedy 3 and rolling back the “clearer information” element of RMR, as well as relaxing other regulation)<sup>93</sup> as a more effective, less onerous means of achieving its aim.
- 3.14.2 SSE has provided comments on this potential remedy separately for domestic and microbusiness customers as the considerations and impacts differ for each sector.

#### **Domestic**

*(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?*

#### *Bills and consumer engagement*

- 3.14.3 The current format and content of bills do not facilitate engagement - customer feedback repeatedly shows that bills are too complex. Consequently SSE does not support additional information being added to bills. This measure would not achieve the objectives the CMA is seeking to realise, namely better, more targeted and relevant customer communications and greater competition and innovation by suppliers. Instead, SSE would support the removal of prescriptive information requirements in favour of rules which allow suppliers to listen to their customers, trial new designs and find the optimal solution.
- 3.14.4 As noted in SSE’s response to the CMA’s Issues Statement (the **RIS**), bills are a leading cause of customer complaints.<sup>94</sup> Recent consumer surveys by Which?<sup>95</sup> and GoCompare<sup>96</sup> both showed that the majority of customers find

<sup>92</sup> See PFs, Sections 3 and 8.

<sup>93</sup> See PFs, Section 4.

<sup>94</sup> RIS, para. 6.2.23.

<sup>95</sup> See Which?, *New Which? research shows energy customers bamboozled by bills* (19 April 2015) – available at <http://press.which.co.uk/whichpressreleases/new-which-research-shows-energy-customers-bamboozled-by-bills/>.

<sup>96</sup> See GoCompare, *Energy bills continue to top the list of baffling bills* (20 November 2014) – available at <http://www.gocompare.com/press-office/2014/11/baffling-bills/>.

their energy bills more confusing than any other household bill. GoCompare's survey also showed that a third of customers will not read bills which they find confusing; meaning that customers may miss out on important information contained on their bill.

- 3.14.5 Bills are a pivotal point of contact between suppliers and customers. It is thus imperative that they are as customer-friendly as possible, otherwise, they risk causing customer confusion, frustration, detriment and disengagement. SSE would support a move to a principles-based approach to bill content and format (in line with Ofgem's ambition to remove prescriptive conditions and introduce more principles-based regulation (**PBR**)). Such an approach allows suppliers to act on customer feedback, innovate and trial new designs. This also applies to other routine communications also.<sup>97</sup> SSE is very keen that the needs and wants of its customers are reflected in its communications and thus seeks feedback from customers through research, customer forums, an online customer feedback programme ("*Customer Voice*") and other customer interactions. It is in customers' best interests that SSE is able to deliver optimal customer centric communications.
- 3.14.6 [REDACTED],<sup>98</sup> [REDACTED].<sup>99</sup> [REDACTED]. It is not currently possible to create a bill which both provides what customers want and is also compliant with the existing licence conditions.

#### *RMR and bills*

- 3.14.7 As highlighted in the PFs, the format and content of energy bills has been significantly and negatively affected by RMR rules, even though they were intended to make bills clearer and simpler. Prior to the RMR, a total of three pages in the supply licences set out the requirements of both bills and annual statements. Post-RMR there are nine pages of requirements for bills (and 16 pages of requirements for annual summaries).<sup>100</sup> This represents an inordinate increase in the level of prescription of both content and layout of customer bills.
- 3.14.8 In addition to the obligations set out in SLC31A (which include that bills must contain Cheapest Tariff Message (**CTM**), a Tariff Comparison Rate (**TCR**) and a quick response (**QR**) code), there are a number of other conditions (which were in place before the RMR) which necessitate information on bills:

<sup>97</sup> These communications include: annual summaries (SLC31A); price increase notices (SLC23); end of fixed term contract notices (SLC22C); and contract variation notices (SLC23). The current requirements create confusing and unintuitive documents which do not engage customers.

<sup>98</sup> See [REDACTED].

<sup>99</sup> See [REDACTED].

<sup>100</sup> RIS, Annex 6.2, para. 4.

- (a) SLC20: information on the distributor's enquiry service must be on every bill; customer's supply number must be on every bill; and information about dispute settlement must be on every bill;
  - (b) SLC21: fuel mix disclosure must be provided on or with a bill at least annually; and
  - (c) SLC31: information on CAB must be on every bill; and information on energy efficiency advice must be given on every bill.
- 3.14.9 The effect of SLC31A in addition to these existing requirements is that bills are very lengthy, potentially confusing and lead to complaints. While items such as the distributor's contact details (required during a power cut) have a real benefit, additions such as QR codes are unlikely to add value for the majority of customers.

#### *Future developments*

- 3.14.10 When designing remedies, the CMA should be mindful of the impact of smart metering on bills. To this end SSE encourages the CMA to take stock of industry research when designing billing remedies in order that the changes made are enduring.<sup>101</sup>

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

- 3.14.11 It is important that customers are provided with sufficient information upon which to base their decisions. At present SSE considers that customers are provided with too much information.
- 3.14.12 When shopping around (especially when using PCWs or supplier websites), the Tariff Information Label (**TIL**) – a standardised means of conveying key information about tariffs – is a useful tool for customers. There is scope to refine the TIL further to make it an even more useful document, by providing personalised information.
- 3.14.13 During the sales process, the customer is told their principal terms, the information contained on the TIL and their Personal Projection; this is ample information upon which to base a decision. However, as noted the RIS and also in the RUIS,<sup>102</sup> the customer journey through the sales process is long and involves the provision to customers of a considerable amount of information; it is difficult for anyone to assimilate so much detail over the course of a single conversation. After signing up to a new tariff, SSE provides customers with a hard copy of their Terms and Conditions which they can review in their two week cooling-off period. This ensures that customers are able to evaluate their tariff and any other terms prior to switching fully.

<sup>101</sup> See, e.g., VaasaETT, *Case study on innovative smart billing for household customers* (August 2013), prepared for the World Energy Council and ADEME – available at <http://www.vaasaett.com/2015/03/innovative-billing-for-household-consumers/>.

<sup>102</sup> See RIS, paras. 6.3.25 – 6.3.26 and RUIS, paras. 2.6.2(c)(iv) and 8.10.9.



- 3.14.14 There is scope to reduce these information requirements to allow sales calls to be more effective. To this end, SSE would not support any further information being added to the sales process and considers that the current requirements should be reviewed and streamlined such that they provide customers with all relevant information but without overloading them with extraneous detail.

***(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?***

- 3.14.15 SSE uses two main forms of prompts: information on bills; and email prompts.
- 3.14.16 Following a successful trial, SSE implemented “*I Read, U Read*”, a solution which prompts customers, via email, to provide a meter reading prior to an estimated bill being released. The email contains a link to the page on SSE’s website where they can input a reading. This makes it incredibly simple for customers to provide their meter reading. The customer response to this campaign has been very positive.
- 3.14.17 Bills state where an estimated reading has been provided and this can act as a prompt for customers to provide an actual reading. The response to this has not been as positive as the response to the “*I Read U Read*” prompts. The “*I Read U Read*” prompts cut down on hassle for customers; they receive only one bill and it is accurate (in comparison to prompts on bills which require customers to respond to a prompt on an estimated bill which results in them receiving an accurate re-bill).
- 3.14.18 SSE does not use telephone call prompts. It is unclear whether these would encourage engagement or be seen as a nuisance. As noted in the response to question S.91 of the Retail Supply Financial and Markets Questionnaire (SQ), SSE provides customers with a number of easy, quick and free ways to provide meter readings, including Meterline (a freephone automated meter reading telephone line).
- 3.14.19 Offering a discount or reward to customers for providing meter readings may further encourage customers to provide readings proactively, however the RMR tariff discount restrictions prohibit suppliers from doing so.
- 3.14.20 It should be noted that the upcoming national roll-out of smart meters will improve the accuracy of billing and make meter reading prompts largely irrelevant for the majority of 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 (SVT) and/or other default tariff and encourage them to check whether they are on the most appropriate tariff for them?***

- 3.14.21 Current bills cover these points to a certain degree. However SSE believes that information provision to customers who are nearing the end of their contract, or who have rolled on to the SVT, could be improved.

- 3.14.22 Customers are provided with a notice 42-49 days before the end of their FTC to notify them of their options and that they will transfer on to the cheapest SVT if they choose to take no action. Customers may also receive further marketing material from their supplier at the end of their contract. While SSE has some concerns over the format and content of the end of fixed term letter (as required by SLC22C), it does provide customers with adequate information and notice.
- 3.14.23 Bills inform customers of which tariff they are on (in the “*About Your Tariff*” box) and prompt customers to take action. The current prompts (the switching reminder and CTM) are not necessarily very engaging or customer friendly. Prompts should apply to the bills of all customers, not only those who have moved on to the SVT at the end of a FTC.
- 3.14.24 These customer communications could be improved by introducing principles based rules which set out the intended outcome, but allow suppliers to tailor these communications to customers’ needs and trial new formats. A customer-centric approach is the key to ensuring that communications contain the details that customers need and value.

*Other potential remedies*

- 3.14.25 **Rolling back/relaxing RMR and other regulation.** SSE considers that the “*clearer information*” element of the RMR rules, particularly the rules governing bills and annual statements, price increase notifications and end of fixed term letters,<sup>103</sup> are overly-prescriptive, hinder consumer engagement, and contribute to a negative perception of suppliers (which, in turn, discourages consumers from engaging). The effect of these rules are exacerbated by other regulations (predating RMR) which lead to excessive information on bills.<sup>104</sup> SSE considers that these regulations should be relaxed or rolled back to encourage consumer engagement.
- 3.14.26 Some of the “*fairer treatment*” RMR rules are also impeding customer engagement. Licence conditions and amendments introduced to protect consumers mean that simple changes and variations to customers’ contracts are now subject to counterintuitive and non-customer friendly rules,<sup>105</sup> while suppliers are prohibited from offering customers fixed discount tracker tariffs (due to the ban on increasing prices on a fixed-term tariff).<sup>106</sup> Removing

<sup>103</sup> See RUIS, para. 8.10.6, RIS, Annex 6.2, and SSE’s response to the SQ, S.103. The SLCs affected are: SLC31A: *Bills, statement of account and Annual Statements* and associated schedules – see para. 3.14.8 above; SLC23: *Notification of Supply Contract terms* and associated schedules; and SLC22C: *Fixed Term Supply Contracts*.

<sup>104</sup> Currently mandatory billing information includes: information on the distributor’s enquiry service; the customer’s supply number; information about dispute settlement; fuel mix disclosure; information on CABs; and information on energy efficiency advice.

<sup>105</sup> See SLC23A: *Mutual Variation*.

<sup>106</sup> SLC22C.11: *Fixed Term Supply Contracts*. The RMR rules allow one form of automatically indexed tariff. However the index must be based on a reference price which the supplier does not control (and cannot therefore track the SVT). This arrangement is more complicated than previous tracker tariffs and no supplier has been able to devise a commercially viable and compliant tariff.

these elements would increase suppliers' ability to innovate and help foster further consumer engagement with the market.

- 3.14.27 In addition to the restrictions stemming from RMR, other regulatory interventions have also had a detrimental impact on customer engagement. In particular, the reach of the sales regulations, coupled with the understandably cautious view that suppliers take because of Ofgem's stated approach to enforcement, makes certain types of sales interaction with customers – such as the use of TPIs, face-to-face sales<sup>107</sup> and sales calls – either very burdensome or virtually impossible.<sup>108</sup> SSE considers that these restrictive regulations should be lifted. Consumer protection arrangements and the Standards of Conduct licence condition (SLC25C) are sufficient to ensure that customers are adequately protected when they sign up to an energy contract.
- 3.14.28 **Switching campaigns.** Whilst broadly supportive of prompts to support customer engagement, it has not been at all evident to SSE that the more recent introduction of more prompts *on bills* has actually increased domestic customer engagement. SSE considers that other means are more effective at engaging customers. For instance, DECC's evaluation of its recent “*Power to Switch*” campaign showed an increase in switching through Ofgem accredited PCWs of 80% and additional savings made of £25m during the campaign period. The use of switching campaigns is further supported by industry research which states that switching activity in Belgium and New Zealand has been boosted by “*some outstanding marketing activity and committed supporting regulatory and public awareness campaign activities.*”<sup>109</sup> The CMA should therefore explore the use of campaigns as a remedy rather than mandating extra information on bills since the available evidence and SSE's experiences suggest that campaigns are a more effective means of prompting engagement.

### **Microbusinesses**

- 3.14.29 Changes to the information included on bills for microbusiness customers have been recently implemented by Ofgem<sup>110</sup> and early results suggest that

<sup>107</sup> Face-to-face sales are subject to additional, burdensome regulations (SLC25). Face-to-face sales are a way of engaging customers, particularly those without internet access, or who prefer direct contact, but the current rules make sales through this channel especially lengthy and off-putting to customers and suppliers. SSE would like to see these requirements reviewed and modified in order to allow face-to-face sales to develop more effectively (this may be in the form of venue-based rather than doorstep selling).

<sup>108</sup> See PFR, para. 4.5.

<sup>109</sup> See VaasaETT, *The most active energy markets in 2013 revealed* (16 December 2013) – available at <http://www.utilitycustomerswitching.eu/424/> “*In both New Zealand and Belgium, activity has been boosted by some outstanding marketing activity and committed supporting regulatory and public awareness campaign activities, compared to Great Britain for instance where attempts to protect customers from untransparency and unscrupulous retailer activities may have contributed to lower levels of customer choice and reduced customer activity.*”

<sup>110</sup> Ofgem measures introduced in March 2014 included the requirement for suppliers to put the last date to give notice of termination and the contract end date on bills.

these have increased awareness of the relevant factors and engagement by businesses. It is important that the CMA does not damage this progress by pushing for further information which could risk overcomplicating bills and diluting the beneficial effects of the information and prompts that are currently in place. SSE considers that the current framework is sufficient and care should be taken to avoid the excessive detail that has dogged the domestic market with all the attendant unintended consequences, which the CMA is now seeking to address.

- 3.14.30 It is essential that any recommendations to include additional information on bills are trialled to check feasibility and customer response, and to assess the potential benefits for microbusiness customers against the projected costs.

***(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?***

- 3.14.31 SSE's bills for SME customers currently include two pages of content. Much of this content is regulated and effectively fills the bill at its current length. This regulated content includes information such as contract end date which was introduced to encourage engagement, and does seem to have resulted in an increase of awareness and engagement by customers.<sup>111</sup> SSE estimates that there is space to add short simple content to the bill (*i.e.*, one line of text) while maintaining its current length. SSE would discourage the CMA from remedies requiring significant changes and additional content on bills which would increase the overall bill length as it is expected that customers would be less likely to look through multiple pages. SSE feels strongly that bills for microbusiness customers should not be forced to replicate the long and complex bills that have been regulated for domestic customers, as it has already been shown that these requirements have not improved customers' understanding of their bills.
- 3.14.32 The time required to include any additional information on bills will depend on the extent of the additions. Basic changes to current content and inclusion of short, simple additions (*e.g.*, one line of text) could be introduced through current systems with minimal time to implement. While a full assessment would need to be made, the timescales involved are estimated to include a period of four weeks to implement system changes that would apply the change to the format of the bills, then a further six months would be required to allow a full billing cycle for all microbusiness customers. If the changes to bills were more substantial or complex then

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For April 2015 measures, see Ofgem, *Decision on automatic rollovers and contract renewals for micro-business consumers* (28 November 2014). These measures included: allowing microbusiness customers to give notice to terminate a contract no more than 30 days before a contract ends; providing current prices and annual consumption details on renewal letters for microbusiness FTCs, and acknowledging a termination notice from a microbusiness customer within five working days of receipt, or as soon as reasonably practical thereafter.

<sup>111</sup> The BMG Survey found that of those businesses that have noticed these dates on their bills and shopped around in the last 12 months (16% of all businesses surveyed), 64% said they were prompted to do so by the dates included on the bill (*BMG Survey*, p. 32).

this could require significant development work which would significantly increase the timescales required for implementation. In the most extreme cases, changes could take over a year to implement.

- 3.14.33 [X]. Any changes required to bills should be compatible with electronic formats.

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

- 3.14.34 SSE believes that the current Terms and Conditions supplied to microbusinesses are appropriate for their contracts. These are standard terms and conditions include all necessary details for the customer to agree to the contract that they have been offered.

- 3.14.35 The BMG Survey found that approximately 85% of respondents who had recently read or glanced at their contract document showed no dissatisfaction with various aspects of these documents, such as clarity and usefulness of information and the length/size of the contract document.<sup>112</sup> SSE is currently developing a new “switching guide” for non-domestic customers which will include key information in a user friendly, easy to reference format. This should help to address the concerns of the limited proportion of businesses who may feel that current contract documents are too lengthy or complex. The target is to launch this pack by the end of 2015. The pack will be available online and could be sent to customers.

***(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?***

- 3.14.36 SSE bills for SME customers already include a prompt for customers to read their meter where an estimated meter reading has been used in the calculation of the bill. Because bills are generally issued on a quarterly basis, and make a direct connection between the meter reading and the bill received, this is a suitably regular and effective prompt to customers. SSE would welcome a remedy which makes this a standard requirement on bills.
- 3.14.37 Telephoning customers to prompt them to read their meters would be burdensome and add to the irritation of customers who feel that the calls they receive regarding their energy, largely from TPIs, are already at a

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<sup>112</sup> BMG Survey, p. 26. This figure includes those who rated their satisfaction with aspects of their contract as being between 3 and 5 inclusive, where 1 was “very dissatisfied” and 5 was “very satisfied”.

nuisance level.<sup>113</sup> Additionally, SSE would have to assess whether prompts of this nature would be allowed under current contact permissions.

3.14.38 SSE does not believe that the impact of improved accuracy of bills resulting from more regular meter readings would lead to a significant enough improvement in engagement to justify the additional costs involved in prompting customers by telephone. If the CMA were minded to recommend this approach, a trial should first be carried out to assess whether the benefits to customers would outweigh the increased costs before mandating any full roll-out.

3.14.39 Measures based on the provision of meter readings will be made obsolete by the introduction of smart metering, as readings will be carried out remotely. Any measures regarding prompts for businesses to read their meters would need to include a sunset clause which ended this requirement with the introduction of smart metering.

***(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?***

3.14.40 Contract end dates are already included on bills for microbusinesses, serving as a prompt to customers that they need to arrange a new contract. This measure was introduced in 2014 and does seem to have improved awareness of contract end dates and notice dates and shopping around by customers. The BMG Survey found that of those businesses that have noticed these dates on their bills and shopped around in the last 12 months (16% of all businesses), 64% said they were prompted to do so by the dates included on the bill.<sup>114</sup> Furthermore, these customers also receive communications at least 60 days in advance of their contract end date, warning them that they are approaching this date and prompting them to arrange a new contract. These two measures are thought to have resulted in a significant improvement in awareness of these key dates, with the BMG Survey showing an increase in the proportion of microbusinesses and small businesses that knew that they could renegotiate or give notice of termination had increased from 63% to 73%. SSE expects that this proportion will continue to increase as customers pass through future contract rounds.<sup>115</sup>

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<sup>113</sup> “[E]vidence of dissatisfaction with cold-calling by brokers in the answers provided to the survey and when [BMG] initially contacted respondents. During the process of recruiting businesses to take part in the survey a large number refused because they thought they were being cold called by a broker.” (BMG Survey, p. 43). The BMG Survey also found that “many businesses – including those that had actually used broker services – expressed their frustration with the high volume of cold calls they receive from energy brokers. Most said that they were called several times a week, with one company receiving three calls a day five times a week.” (BMG Survey, p. 17.)

<sup>114</sup> BMG Survey, p. 30.

<sup>115</sup> BMG Survey, p. 32.

- 3.14.41 Bills for customers who have moved to default tariffs at the end of a contract do state that customers are on an out of contract rate (VBR) or deemed rate, but they do not currently include a prompt to review whether there are more appropriate tariffs available.
- 3.14.42 A separate prompt is provided by letters which SSE sends to customers on deemed and out of contract tariffs every six months to prompt the customer to review their contract arrangements. This is not a licence requirement and was instigated by SSE to encourage engagement of customers who had transferred to default tariffs, particularly those who had moved to these rates as a result of the ending of auto-rollovers. This is further discussed in response to Remedies 8 and 10.
- 3.14.43 SSE would welcome a move to include prompts on bills that encourage customers to review their contract arrangements as long as the length and format of this prompt were<sup>116</sup> kept reasonable and proportionate within the overall bill. SSE would discourage the CMA from proposing that prompts on bills recommend specific alternative contracts to customers as decisions on the most appropriate tariff for their needs should be made by the customer.

#### *Conclusion*

- 3.14.44 In conclusion, SSE would not support additional mandated material being added to domestic or microbusiness bills. It is in customers' interests that suppliers are able to respond to feedback and trial new designs in order to develop the optimal customer communications; research has shown that crowded bills do not appeal to customers. There are other, simpler means (such as awareness campaigns) which can be used to engage customers and provide prompts effectively. These alternative methods would also avoid potential adverse consequences, such as the alienation of customers, which might result from additional mandated information.

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<sup>116</sup> See the response to question (a) at [para. 3.14.31](#) of this Response for further discussion of the proportionality of inclusions on bills.

### 3.15 Remedy 10 – measures to prompt customers on “default” tariffs to engage in the market

#### *Introduction and overview*

- 3.15.1 SSE is broadly supportive of prompts to customers to engage with the market so long as they are proportionate and well-considered to maximise their effectiveness. SSE does not consider however, that customers on “default” tariffs are less engaged than other customer groups, nor that an AEC has been adequately demonstrated in either the microbusiness or domestic segments.<sup>117</sup> The proposed remedy has the potential for unintended consequences, which, as for Remedy 9, could discourage engagement. The costs may also outweigh the possible benefits if the measure decided upon is onerous. For example, if suppliers were required to call customers every month, this would be likely to drastically increase the cost to serve and could lead to increased numbers of customer complaints from customers who do not like to be cold called.
- 3.15.2 The CMA should therefore trial the proposed remedy before it is rolled out to the entire industry, so as to provide evidence of the effectiveness of such a remedy before implementation.

#### **Domestic customers**

- 3.15.3 The CMA’s assumption that a domestic customer on an SVT is disengaged (as they are on an SVT by default) is incorrect. Some customers actively choose to be on SVTs as they prefer the tariff’s flexible nature and the absence of an exit fee if they subsequently decide to switch. SVT customers may also have engaged in the energy market in other ways, by changing payment method or billing type.

#### **Microbusinesses**

- 3.15.4 SME customers on default tariffs are also not necessarily disengaged. Indeed, this is recognised in the PFs, which acknowledge that microbusiness customers on default tariffs are “*not necessarily less engaged*” than other microbusiness customers.<sup>118</sup> Like their domestic counterparts, some SME customers prefer the flexibility of a variable contract, and do not wish to be tied in to an FTC.

*(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?*

- 3.15.5 In order to encourage customers to act on these prompts, communications should include all the information that a customer would require in order to

<sup>117</sup> See PFs, Sections 3 and 8.

<sup>118</sup> PFs, Appendix 9.1, para. 47.



carry out a price comparison such as meter type, current tariff name and annual consumption. If an independent PCW were set up (*see* Remedy 6), reference to this site could also be included in the prompts.

- 3.15.6 SSE does not expect that information regarding switching levels within the customer's region will lead to a significant increase in engagement and would be more expensive to implement than "generic" prompts. Prompts should be simple calls to action and not full of complex information (as noted in the response to Remedy 9, research has shown that customers favour simpler communications and customers do not see prompts as something essential on bills).
- 3.15.7 SSE does not believe that suppliers should be required to include specific wording in prompts to customers on default tariffs. SSE considers that PBR could be introduced instead, to allow suppliers to decide when prompts are appropriate and how best to display them. PBR could require that a prompt is mandated but allow suppliers to choose which type of prompt to give, for example:
- (a) Prompts to change to a cheaper payment method;
  - (b) Prompts to change to a cheaper billing method;
  - (c) Prompts to save energy; and/or
  - (d) Prompts to switch tariff.
- 3.15.8 SSE already issues prompts to microbusiness customers on default tariffs encouraging them to contact SSE to discuss a new contract. SSE writes to those customers who are on its VBR rates every six months, to remind them that they may not be on the most cost-effective solution for their business. SSE's response rate to these communications is just under [X]%. Similarly, SSE also writes to deemed rate customers two weeks after they have gone onto deemed rates, and then every six months thereafter.
- (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.***
- 3.15.9 SSE's understanding is that current data protection rules do not allow suppliers to contact customers by any means other than post when prompting customers to review their contracts unless additional marketing permissions have been granted. This is because a prompt to review the contract effectively falls under marketing to the customer, as the supplier is attempting to sell the customer a new contract. These rules would limit the potential for prompts in alternative forms to be provided by suppliers. Switching prompts are therefore qualitatively different to overdraft reminders.
- 3.15.10 Even if these data protection issues could be worked around, or customers opt-in to additional contact, the cost of providing prompts by many means other than post could be prohibitive, with a very poor cost benefit ratio. Text messaging prompts would most likely be a relatively low cost measure

but it is not clear whether they would lead to significant engagement or whether the benefits of this would also be low. These additional costs could also act as a barrier to entry for new/small suppliers.

- 3.15.11 Suppliers should be afforded the freedom to trial different methods of providing prompts, different types of prompts and different wording, rather than there being prescriptive rules around the form that such prompts should take. This would allow suppliers to comply with the spirit of the remedy in the least disruptive manner for their business. It would also be in keeping with best regulatory practice and behavioural economics approaches.
- 3.15.12 As previously highlighted (in response to Remedy 6), outbound telephony is unlikely to be appreciated: it was for this reason that SSE stopped cold calling for domestic customers. Feedback from microbusinesses is that many already consider the telephone calls that they receive from TPIs to be a nuisance. As such, it is unlikely that customers will respond positively to a telephone call regarding their energy supply, pushing them to switch tariff or supplier. This approach would also be one of the most costly options to add and would place a large burden on all suppliers in terms of resources, irrespective of size.

***(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?***

- 3.15.13 SSE does not consider that the timing and frequency of prompts should be a prescriptive requirement, as this is more costly and more difficult to implement and would be a disproportionate remedy with no additional benefit to engagement.
- 3.15.14 Domestic and microbusiness customers are issued with bills on a quarterly and six-monthly basis (further discussion of inclusions on bills is included in response to Remedy 9). As such, SSE suggests that incorporation of prompts with bills would be a more appropriate and effective means of issuing these prompts to customers on a regular basis without requiring additional fulfilment. This would mean that the proposed remedy would be cheaper to implement and less intrusive to customers. Anything more than this is likely to irritate customers and could lead to customers ignoring prompts and disengaging. Specific prompts that are not easily differentiated from marketing material would also likely to annoy customers who have not given marketing consent.
- 3.15.15 A supplier wishing to provide the best customer experience should be allowed to “cycle” the prompts (e.g., payment method prompt on one bill, energy efficiency tip on the next, etc) as this might be less irritating and more engaging than repeated messages. However, this should not be a requirement. Trials are the most effective way of establishing which prompts are popular with customers.
- 3.15.16 As noted above, SSE currently provides written prompts to its microbusiness customers on VBRs and deemed rates on a regular basis. However, there are specific occasions where bespoke prompts may be beneficial, e.g., when the

customer first moves to a default contract or when occupancy of a property changes. Regular six monthly or quarterly updates following these initial prompts would seem appropriate. It would also likely be of benefit to provide a one-off prompt to customers on evergreen tariffs (who do not currently receive prompts) to advise that they may be better off on a FTC.

- 3.15.17 The frequency of prompts will also influence the cost of implementing this measure, as issuing more frequent prompts (*i.e.*, outside billing cycles) will be significantly more expensive and will impose costs on all suppliers, irrespective of size. This additional cost could be manageable if the prompt were to be provided by post. However, if the prompt were to be provided through other means, (for example by telephone (notwithstanding the current issues around marketing permissions)), then the cost associated would be substantial and would ultimately be passed on to customers.

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

- 3.15.18 As discussed above, the main problem with the issuing of prompts are the restrictions created by data protection rules. This restriction would equally apply to the transfer of customer data to a third party (such as Ofgem) in order for it to provide prompts, which would not be allowed under current regulations. As such, suppliers are currently the only party that can effectively issue prompts to customers. Additionally, suppliers have the necessary information to provide tailored advice on the best tariff etc for the customer, as they can base their advice on usage.

- 3.15.19 Again, the nature of the prompts being issued would also be a relevant consideration in this decision as the party issuing the prompts will have to fund the costs of doing so.

- 3.15.20 Alternatively, it is possible for Ofgem or another organisation to run a national advertising campaign to promote switching (such as DECC's "*Power to Switch*" campaign which appeared to increase switching rates – DECC figures report that their campaign resulted in customers saving £25m). A similar campaign could also be run for SME customers.

***(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?***

- 3.15.21 While SSE recognises that a prompt when a customer purchases a new property could be beneficial, this sort of remedy could be very difficult to implement. Customers do not consistently provide details of a change of tenancy or proprietorship to their supplier. This is why a number of customers end up on default rates as no proprietor information is provided to the supplier.

- 3.15.22 To ensure a consistent approach to house buyers, SSE would support an industry-wide application such as this. Also, whilst SSE would be content for prompts to be provided by property agents, solicitors or mortgage providers in a property sale scenario, many properties (particularly in the

non-domestic sector) are leased, and where these are private leases there may not be an agent or other third party involved to provide a prompt. An alternative measure could be to include a notice in the meter cupboard or on the Energy Performance Certificate.

- 3.15.23 SSE's comments on issuing prompts to microbusiness customers on default tariffs are contained in response to question (c) above. SSE is currently designing a "Switching Guide" designed to inform customers when they sign up to a contract. The target is to have this pack ready for issue at the end of 2015. The pack will be available on SSE's website and a variant of this pack could also be designed to be sent out to customers (such as on a change of tenancy). This would act as an additional prompt to the customer to contact SSE and arrange a contract.

*(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.*

- 3.15.24 While SSE recognises the benefits of prompting customers on default tariffs to engage in the market, it has a number of fundamental concerns about this aspect of the remedy proposal.
- 3.15.25 Data protection regulations would prevent energy suppliers from sharing or publishing the details of customers who are on default tariffs. Data protection serves an important purpose, which is right and proper as a measure to protect the privacy of customers. The CMA has not made it clear how it would anticipate overcoming the various data protection obligations. Privacy issues were discussed extensively as part of the policy development for smart meter roll-out and led to suppliers producing data privacy statements.
- 3.15.26 Providing details to TPIs or other suppliers would increase the targeting of these customers who could be inundated by unwanted calls. This measure would not help restore restoring trust in the market. An unintended consequence of this particular approach would be that it would increase distrust in the market and further impact upon the reputation of suppliers (as some negative TPI practices have included TPIs attempting to pass themselves off as a supplier). Previous conduct by some TPIs in the non-domestic market suggests that such behaviour would pose a particular risk in this market.
- 3.15.27 As such, SSE does not believe that supplying a list of its customers on default tariffs to its competitors or TPIs would be appropriate. It would also not be necessary if Remedy 7 were to be implemented as the unintended behaviour described above in para. 3.15.26 would not occur.

### 3.16 **Remedy 11 - a transitional “*safeguard regulated tariff*” for disengaged domestic and microbusiness customers.**

#### *Part A - Summary of SSE’s views on the transitional price cap*

- 3.16.1 SSE considers that such an onerous remedy as the proposed reintroduction of price controls could only be justified if it were designed to fix a very real and serious AEC. As explained in detail in Section 3 of SSE’s response to the PFs, the CMA has not identified such an AEC. Such a significant market intervention is neither proportionate nor effective at addressing the alleged harm and SSE is concerned that the principal remedy aimed at providing transitional protection for disengaged customers will in practice have unintended consequences and do far more harm than good.
- 3.16.2 Furthermore, there are a number of practical concerns with what has been proposed, in particular:
- (a) The complexities of setting tariff prices to be applied by the range of different suppliers in the market, with different mixes of customers and therefore with different costs to serve mean that it would be impossible for the CMA to set a tariff cap at the “*right*” level. As the CMA itself acknowledges,<sup>119</sup> if the price were set too low it would have a “*damaging impact on competition*” and if set too high it would “*provide no protection to customers*”.
  - (b) The difficulties associated with setting the tariff cap at the “*right*” level would be compounded if it were aimed at a small, hard-to-define category of customers. It would be unfeasible to set a price control on a 1% margin with 70% uncontrollable costs. Even if the price control were set on the basis of a slightly higher margin, inevitable cost forecasting errors would quickly put suppliers into a loss-making pricing position and even the threat that this might occur could deter entry and expansion. Whatever price control mechanism were used, it would be hard to limit the adverse effect of further regulatory uncertainty and the potential impact this would have on competition and investment.
  - (c) There is also the risk of suppliers being deterred from competing for loss-making customers altogether leading to an adverse impact on the very customers the regulated tariff is designed to protect.
  - (d) The CMA has identified previous regulatory interventions as either constituting an ongoing AEC, in the case of RMR tariff restrictions, or having “*contributed to a softening of competition on the SVT,*”<sup>120</sup> in the case of SLC25A. The proposal to roll out a regulated tariff would be likewise a retrograde step and would cause more issues than it attempts to resolve. This would occur particularly in the case of the domestic market, where the suggested prohibition on all other

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<sup>119</sup> NPR, para. 93.

<sup>120</sup> PFs Summary, para. 150.

evergreen tariffs<sup>121</sup> is even more restrictive than the tariff rules under RMR. In this regard the proposed safeguard would directly undermine the increased scope for innovation that Remedy 3 (which SSE supports) would otherwise provide. Any safeguard tariff is likely to reduce customers' potential engagement in the market as, by definition, it may be expected to reduce the incentive to switch (noting the CMA survey findings that domestic dual fuel customers require an average saving of £158 per annum in order to switch)<sup>122</sup> as customers are likely to assume that the safeguard tariff represents the best option for them in the market. A similar effect might be expected in the microbusiness segment.

- (e) The CMA cites the example of price regulation in New South Wales, Australia (*NSW*) as evidence in support of this remedy.<sup>123</sup> However, the reality is that regulatory authorities there are actually moving away from regulated prices. SSE does not consider NSW as an appropriate benchmark for the reasons articulated in the response by Littlechild *et al.*<sup>124</sup> In particular, the CMA has failed to identify a relevant example where price regulation has been successfully re-introduced as a transitional measure in a competitive market.
- (f) Finally, the CMA would need to give due regard to whether introducing any form of price control is appropriate under EU legislation.<sup>125</sup>

3.16.3 The reintroduction of any form of price control would be a significant intervention in the market with profound implications for competition and therefore for domestic and microbusiness customers. This is particularly the case since deeper inspection of the CMA survey results indicates a mixed and diverse picture of engagement across different categories of customers and a weak link to vulnerability indicators. Given these concerns, it is important that the CMA is very clear about the exact problem that this remedy would seek to address and is as targeted as possible in defining the groups of customers that it is intended to protect.

*Other remedies offer more constructive alternatives*

3.16.4 SSE entirely agrees with the principle of helping a clearly defined group of disengaged and vulnerable customers. However, this is most effectively and proportionately done through existing initiatives or implementing some of the other proposed remedies, which are specifically designed to improve

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<sup>121</sup> NPR, para. 92.

<sup>122</sup> Ipsos MORI, *Customer Engagement with the Energy Market – Tracking Survey 2014* (June 2014), p. 21.

<sup>123</sup> NPR, para. 94.

<sup>124</sup> See Littlechild *et al.*, *Submission on Summary of Provisional Findings Report and Notice of Possible Remedies* (16 July 2015) (the *Littlechild PFs and NPR Response*), paras. 55 – 57.

<sup>125</sup> Such as the Internal Energy Market Rules, which set out the specific circumstances under which it may be appropriate for governments or regulators to set end user energy prices.

engagement and/or promote a framework that allows for effective competition.

- 3.16.5 SSE welcomes measures where clearly required, to protect a particular, identifiable group of the most vulnerable customers, who may be viewed as less engaged (either compared with other vulnerable customers or with the wider base of all customers). If this is the objective that the CMA is seeking to meet then it would be far more appropriate to introduce additional protections for these customers via government intervention *e.g.*, through state-funded agencies set up to tackle fuel poverty.
- 3.16.6 In general, SSE has a strong preference to see remedies which would promote effective competition as this would be to the benefit of *all* customers. SSE regards the proposed revision of domestic tariff regulations (Remedy 3) as likely to result in improvements in engagement, innovation and competition for domestic customers. Other measures, which include options to improve customer engagement, may act to increase the effectiveness of this fundamental change.
- 3.16.7 SSE considers that the microbusiness segment is already competitive. Well-considered information remedies may help to promote greater engagement from microbusinesses in this market. However, these measures would be undermined if a regulated price cap acted to reduce the level of saving that currently exists to incentivise engagement.

#### *Conclusion*

- 3.16.8 SSE is opposed to the safeguard regulated tariff on the grounds that the AEC on which it is predicated does not exist, that the proposed remedy is disproportionate and that it would cut across all of the beneficial effects of the remedies designed to enhance competition.<sup>126</sup> In particular:
- (a) If this remedy were combined with tighter EBIT margins (~1%), more regular customer switching, and customers' average expected saving required to incentivise a switch (~£158) then the reality is that this does not form part of a commercially viable framework for competition and would disincentivise new entrants or expansion;
  - (b) The proposed remedy is unjustifiably complex and costly and not reasonable nor practicable;
  - (c) The proposed remedy would produce unintended consequences and may not provide consumer benefits;
  - (d) The proposed remedy would undermine effective competition;
  - (e) There is no evidence that the proposed remedy would be effective;
  - (f) The CMA fails to consider more effective alternative remedies to achieve its aims; and

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<sup>126</sup> See PFR, Section 3.

- (g) The proposed remedy would not achieve its aim within a relatively short period of time and would be overtaken by developments such as the smart roll-out.

*Part B - Discussion of the process and practicalities of a regulated tariff*

- 3.16.9 If the CMA were to decide to proceed with this remedy, then it would be important to find an approach that minimised the impact on other remedies and on the competitive market. A less intrusive approach which would have the least consequence for the market would be to set a nationwide maximum average revenue for energy, in p/kWh, as measured on a typical size of customer for each fuel in the domestic and non-domestic markets. However, this approach may not provide the kind of protection which the most vulnerable customers may genuinely need.
- 3.16.10 For any form of safeguard regulated tariff SSE regards it as absolutely critical that a strict sunset clause (such as reaching a milestone associated with smart meter roll-out) is set at the outset; alternative approaches based on defined success criteria may never be met, should the unintended consequences of this remedy completely undermine other measures to improve competition.
- 3.16.11 The NPR states that:
- “We note that [Remedy a] differs significantly from the transitional safeguard price cap (Remedy 11). First, Remedy 11 is targeted only at tariffs used by disengaged customers (the default tariff), and not all tariffs.”*<sup>127</sup>
- 3.16.12 SSE strongly disagrees with the premise that all customers on “default” tariffs are disengaged. The CMA has conflated this – in SSE’s view, misguided – assessment of disengagement with vulnerability. The terms are not synonymous. As a consequence, this remedy would affect approximately 70% of domestic customers and can hardly be described as “targeted.” Whilst a smaller proportion of the microbusiness market would be affected, there would be a significant number of microbusiness customers who would face a reduced incentive to engage as a result of this remedy.<sup>128</sup> The wide impact of this proposal suggests that it would be unreasonable and disproportionate to introduce this measure on the basis of the AECs in the PFs.
- 3.16.13 The risk of adverse unintended consequences affecting a wide group of customers may lead the CMA to try and target the remedy at a smaller group; in the domestic sector in particular it may be better to target only the most vulnerable customers. The difficulty with this approach would be in ensuring that suppliers are all in a position unambiguously to identify the relevant customers. This has always been the most challenging aspect of any measures intended to address vulnerability. SSE believes that the most

<sup>127</sup> NPR, para. 138.

<sup>128</sup> Approximately 20% and 25% (respectively, electricity and gas) microbusiness customers would be covered by the safeguard tariff (see PFs, Appendix 9.1, para. 48).



reliable means of doing this successfully would require some kind of data sharing arrangement, whereby the Department of Work and Pensions could identify the right group.

- 3.16.14 If the unintended consequences of this remedy acted to reduce the effectiveness of other remedies then it would create the risk that any success criteria defined *a priori* to identify the point at which the safeguard could be removed, may never be met. For this reason a sunset clause must accompany this remedy.
- 3.16.15 There are a number of important issues regarding the correct approach to take in attempting to set the level of the safeguard tariff, which are equally applicable to both market sectors. Some issues are covered in the answers which follow, with further discussion of the more technical aspects of tariff setting provided in the separate **Annex to Remedy 11** attached to this Response. The annex highlights the difficulty of forecasting *all* uncontrollable costs (not simply wholesale energy costs) and covers the following topics:
- (a) Uncertainty of network and policy costs can exceed 1% of the total bill, even as close as six months in advance of becoming actuals;
  - (b) The actual costs for Feed in Tariffs (*FiTs*) and CfDs are only known in arrears;
  - (c) Uncertainty of wholesale costs make the choice of reference price critical – errors in Ofgem’s SMI forecast of energy costs have been shown to underestimate market out-turns by the equivalent of 2% of the total domestic bill;
  - (d) The price cap determination would need to set the proportion of fixed costs to be recovered through the unit rate – this choice determines the level of risk borne by suppliers (and is therefore a commercial decision);
  - (e) Which consumption level is used to set the price and, for all time of use and DTS tariffs, what split is assumed between peak and off-peak consumption;
  - (f) A choice needs to be made regarding regional price differentials: the safeguard price cap effectively imposes a prohibition on regional price discrimination on SVTs; and
  - (g) In the non-domestic sector there is further complexity in setting prices related to the treatment of bad debt risk and the seasonality of consumption.
- 3.16.16 Price regulation would end up distorting the market whatever approach is taken. SSE regards these considerations as sufficient to suggest that the level of the price cap would need to be frequently monitored and potentially updated during the period it has effect. This may mean that the costs of administering the transitional price cap would be substantially more onerous than the CMA intends. There would also be a considerable amount of

upheaval for suppliers and for customers as the price cap is introduced. A significant effort would be required to explain the change to customers. The implementation of this transitional measure would therefore divert resources away from the important work required to successfully deliver remedies to improve the framework for effective competition.

- 3.16.17 Given these concerns and even allowing for the details of the price cap as proposed, SSE does not agree that Remedy 11 would lead to differences of outcome compared to the limitations which the CMA attributes to traditional price controls:

*“Finally, we noted that price controls can create significant distortions in markets if the level of the controls are set inappropriately [sic]. If the regulated price is set too high, it will be less effective in constraining the regulated firm(s)’ market power than it should be. In contrast, if the regulated price is set too low, the regulated firm will not have an incentive to invest in maintaining levels of quality. For these reasons, price controls are usually only implemented where there is no reasonable prospect of competition, and it is exceptional for them to be put in place where the supply structures enable choice.”<sup>129</sup>*

- 3.16.18 The **Annex to Remedy 11** provides further details relevant to all of the answers below to the questions posed by the CMA.

***(a) Should the safeguard tariffs be set on a cost-plus basis, or should they be related to other retail prices?***

- 3.16.19 Cost-plus is liable to lead the CMA into the assessment of costs, profits and risk where CMA work has not yet produced a robust answer upon which any remedy could be justified. SSE’s view is reflected in the assessment of five former energy regulators.<sup>130</sup>
- 3.16.20 A more realistic benchmark would be the current level of SVTs where some form of average could form the basis of setting the safeguard tariffs. All retailers should be covered. Since small suppliers currently price SVTs at a similar level to larger suppliers there is no reason for an exemption.
- 3.16.21 Subsequent adjustments would be needed to take account of movements in industry-wide costs which would require monitoring (either by the CMA or Ofgem). While there is scope for inaccurate assessment on this issue, at least it would be limited to the movement rather than the base figure. Such adjustments may be of similar magnitude to the forecast errors discussed in the **Annex to Remedy 11**.
- 3.16.22 Another option which would reduce the risk for suppliers would be to set a limit on the premium which each supplier could charge over and above the level of their cheapest tariff – commonly known as relative price control. This approach would allow suppliers to set tariffs at a level which reflects their own assessment of costs. Limiting discounts in this way would put a

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<sup>129</sup> NPR, para. 136.

<sup>130</sup> Littlechild PFs and NPR Response.

strong emphasis on fairness as a criterion but some would fear that it would limit the scope of competitive discounting. On the other hand, it might also be viewed as a strengthening of the competitive pressure which operates between SVT and non-standard tariffs (NSTs).

***(b) If the safeguard tariffs were set on a cost-plus basis, which approach(es) we should consider to determining the wholesale energy cost element of the tariffs? What are the relative merits of the proposed approach(es) in the context of the purpose of the safeguard price cap?***

3.16.23 Any determination of wholesale costs must be based on a hedging policy which can be implemented in the market. This question therefore highlights the problem with this approach because either the CMA or Ofgem would in effect be setting the same hedging policies for all suppliers, making suppliers' business models more homogeneous. It would be important to monitor the extent to which this convergence of supplier requirements has the unintended consequence of damaging liquidity in the market.

3.16.24 For the sake of stability and to ease the path of transition, a reasonably long timeframe for hedging baseload requirements would be required reflecting the ranges of forward purchasing currently employed on the market (between one and three years). In contrast, a shorter timeframe running some months ahead might be required to allow suppliers to meet shape requirements for their portfolio.

3.16.25 A proper allowance would need to be made to meet the risk of unexpected changes in volume due to weather variations etc. There should be periodic checking against out-turns such as the Consolidated Segmental Statement (CSS) reports to ensure that there were no systematic underestimation of the actual wholesale costs faced by supply businesses.

***(c) Could the imposition of a transitional safeguard price cap result in energy suppliers reducing the quality of service offered to customers on this tariff? Is this risk reduced by customers' ability to choose alternative, unregulated tariffs?***

3.16.26 Yes, SSE sees this as one of the unintended adverse consequences of this remedy which mean it may not provide a benefit to consumers. Lower quality of customer service is, however, a minor risk compared with the other potential unintended consequences in terms of reduced switching, reduced market entry, lower investment and the potential general softening of competition.

***(d) Should all domestic and microbusiness customers on default tariffs be rolled onto the safeguard tariff, or should this remedy only apply to a subset of these customers? If this remedy should not apply to all customers, why? And how should energy suppliers identify those customers who should be covered?***

3.16.27 The CMA must define the appropriate group of customers based on the issue which it is attempting to resolve through this remedy. SSE believes that it is wrong to conflate disengaged and vulnerable customers, and this error is

further compounded by the CMA's subjective assertion that all customers on evergreen tariffs are disengaged. This does not reflect the reality of the market – greater precision in this assessment would help to mitigate the serious risk of adverse unintended consequences identified above.

*Domestic customers*

- 3.16.28 If a cap were set, it should reflect a simple average price per unit for a reference consumption level. This way it could be pitched at the current average level of SVTs for all suppliers (large and small). As discussed above, SSE considers that any approach to price regulation would distort the market.

*Non-domestic customers*

- 3.16.29 In order to allow suppliers to operate with a reasonable business model, there should be some differential between “*deemed*” customers who have positively indicated that they will leave but have failed to do so and “*default*” evergreens who have decided, notwithstanding prompts, to take no action one way or the other. It should be noted that SSE introduced the VBR partly in response to customers requesting an evergreen tariff for microbusinesses.

***(e) How should the headroom be calculated to provide the right level of customer protection while not unnecessarily reducing healthy competition?***

- 3.16.30 The headroom should be consistent with the level of discounts required by customers to switch, as revealed through customer survey data (such as the GfK Survey or polling carried out by Ofgem as part of its market monitoring work).
- 3.16.31 The temptation would be to minimise the headroom to a lower level but this would reduce switching. Therefore if this path were taken, expectations more broadly in the market should be set realistically (*i.e.*, that over the transitional period in which the safeguard tariff operated, switching would be expected to be lower than current levels).

***(f) What regulatory information would be required to set the safeguard tariffs?***

- 3.16.32 If prices were set on a cost-plus basis, even very onerous information requirements would fail to capture the risk judgements required to set the tariff at the appropriate level. A starting point for the type of information required, however, would be the inputs to the pricing models obtained by the CMA from suppliers' responses to S.85 of the *SQ*. The information provision and tariff setting exercise would prove to be extremely onerous for suppliers and the regulatory body alike.
- 3.16.33 If set with reference to current average SVT levels, the requirements would be much less onerous. This would need to be indexed to major cost movements either with reference to a future SMI type indicator or another independent calculation of yardstick costs.

- 3.16.34 In both cases, CSS outturns would need to be carefully monitored to ensure that there was not a systematic bias in the calculation in a similar way identified by NERA with reference to the SMI.<sup>131</sup>

***(g) How long should the safeguard price caps be kept in place? Is it appropriate to include a specific sunset provision, or should there be a commitment to review the need for and level of the safeguard price caps after a certain period of time?***

- 3.16.35 A sunset clause would be essential for this proposed remedy. Due to the likely impact on competition within the market any attempt to set conditions to define the circumstances under which the safeguard could be removed would create a significant risk that the price control would remain in place indefinitely, to the detriment of customers and competition.

- 3.16.36 The CMA would also need to give due regard to whether introducing any form of price control is appropriate under EU legislation. The Internal Energy Market rules set out the circumstances under which it may be appropriate for governments or regulators to set end user energy prices. Of particular relevance here is the requirement under article 3(2) of both Directives 2009/72/EC and 2009/73/EC that any “*obligations which may relate to... price of supplies... shall be clearly defined, transparent, non-discriminatory [and] verifiable.*”<sup>132</sup> Further clarification of this requirement was issued following the *Federutility* case, which stated that where a price control is introduced it must be of limited duration.<sup>133</sup>

***(h) How frequently – if at all – would the level of the cap need to be reassessed? If the cap is set on the basis of directly passing through wholesale and network costs, then it may not be necessary to revisit the safeguard price level.***

- 3.16.37 Regardless of whether the tariff were set on a cost plus basis or indexed to movements in cost, the level of the cap should be reassessed at regular intervals to protect against cost shocks which are a regular feature of the market. If the CMA got it wrong then suppliers could either fail or not be prepared to remain in the market. If it were to be set against other price levels (e.g., premium to fixed rate), it could be allowed to automatically adjust; the frequency with which indexed adjustments are made to prices and period of notice required before such changes can take effect.
- 3.16.38 Setting these parameters would be critical as the effective date would need to allow sufficient time for all suppliers to implement a price increase. This timing would necessarily need to account for the slowest systems changes

<sup>131</sup> See NERA, *Energy Supply Margins: Commentary on Ofgem’s SMI* (January 2015).

<sup>132</sup> Directive 2009/72/EC of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC and Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC.

<sup>133</sup> See Case C- 265/08, *Federutility and Others v Autorità per l’energia elettrica e il gas*, 20 April 2010, ECLI:EU:C:2010:205 – available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62008CJ0265&from=EN>.

and notification processes of affected suppliers, suggesting that a price control update window would be the more pragmatic option. However, this approach would create a tension, as such arrangements for price adjustments militate against frequent changes whereas infrequent adjustments would require greater “headroom” in the price control to account for cost variations which are a feature of the market.

- 3.16.39 Consideration of whether different arrangements would be required for domestic and non-domestic price adjustments, to reflect the differing requirements obtaining to price increases in these markets.

***(i) Which energy suppliers should be subject to the safeguard cap, and why? Should it be restricted to the Six Large Energy Firms, or should all retail energy suppliers be covered?***

- 3.16.40 All retailers should be covered in order to comply with the EU requirements that price controls are non-discriminatory.<sup>134</sup> Even without an EU obligation it would distort the market even further if only some suppliers were subject to the price cap. The proposed remedy would also be confusing for customers. Suppliers currently price SVTs at broadly similar levels so there is no reason for an exemption. However, a process would be necessary to adjust prices charged by small domestic suppliers to reflect the effect of the current exemptions from social and environmental schemes.

***(j) How should the transition from the current arrangements be managed? We note that an immediate requirement to change the prices for all customers on standard variable tariffs, rollover, evergreen, deemed and out of contract tariffs might put pressures on certain suppliers more than others. Should there be, therefore, a period over which the safeguard price cap is phased in? If so, how long should this period be and how should the transition work?***

- 3.16.41 It would be necessary to set a deadline date for full compliance with sufficient time for each supplier to plan their own path of adjustment. The length of this period should be subject to the same considerations as the process for adjusting prices to reflect changing costs, as described under (h), above.
- 3.16.42 However, if this remedy were introduced, it would be disruptive and confusing for customers. It would therefore need to be carefully communicated and managed to avoid the risk of either alienating customers or creating distrust.
- 3.16.43 SSE has undertaken projects to migrate large numbers of customers to new tariffs or to change significant aspects of customers’ existing tariffs; in both cases the elapsed time from concept to delivery was around twelve months.<sup>135</sup> SSE anticipates that the transitional safeguard tariff would represent a similar challenge, which could detract from efforts to deliver

<sup>134</sup> See para 3.16.2(f) of this Response.

<sup>135</sup> See SSE, *Response to the RMR 4 Tariff Request* (15 May 2015).

other remedies (such as the roll-back of RMR tariff rules and the development of effective nudges to promote engagement). Consideration would also need to be given to the length of time required for the regulatory body to determine the prices for the safeguard tariffs.

***(k) Would energy suppliers have the ability to circumvent the remedy, for example, by encouraging disengaged customers to switch on to less favourable, unregulated tariffs, and how such risks could be mitigated?***

3.16.44 It should not be regarded as “*circumvention*” of the remedy if a customer chooses a FTC that is priced above the variable tariff price cap; this would be particularly relevant to longer term tariffs (*e.g.*, with two or three year terms).

3.16.45 A price cap is an extreme form of intervention in the market and as such requires greater clarity of purpose. The CMA has proposed safeguard regulated tariffs as a transitional arrangement to protect disengaged customers until such time as measures to promote engagements prove effective. The CMA should not consider a price cap as an enduring arrangement required to protect customers from their own choices when they engage with the market and actively select a specific tariff. Existing regulations already ensure that customers are provided accurate and non-misleading information about the details of their chosen tariff.

***(l) Should the CMA set the level of the safeguard price caps itself, or should make a recommendation to Ofgem to do so?***

3.16.46 If Ofgem were to set the level, it would introduce another potential conflict with the objective of promoting competition. Since this would counteract the effectiveness of Remedy 16, SSE believes that the CMA should take full responsibility for all decisions in this area.

***(m) Are there any potential unintended consequences of setting safeguard price caps, for example, in terms of their potential impact on the level of other, unregulated tariffs?***

3.16.47 This remedy would act to reduce the effectiveness of other remedies intended to provide the framework for effective competition and facilitate widespread customer engagement. A price cap would reduce the incentive for customers to shop around and switch either tariff or supplier, would not foster customer trust and engagement, would distort competition and would therefore reduce switching.

3.16.48 The CMA should be cognisant of the likelihood that a cap would compress differentials in two ways. The first is obvious; the reduction in the standard price would simply reduce the gap over the discounted acquisition product. The second effect requires greater insight into the way in which high profile discounts are created in the low margin retail supply market. This means that the discount would be dampened by the alteration in the commercial case for the acquisition product. This alteration would be based on an assumption that a reasonable proportion of the gained customers would, in due course, spend some period of time on the standard product. With lower

margins on the standard product, the scale of discount must be curbed to make the commercial case viable.<sup>136</sup>

- 3.16.49 A further consideration in the scope for discounting in the market in the presence of a safeguard price cap is the potential impact of the CMA's lack of clarity on price discrimination, which was discussed in the response from five former regulators.<sup>137</sup> In the absence of a clear indication on the regulatory stance around this issue, a safeguard tariff is likely to encourage a cautious approach to discounting; this would have a deleterious impact on competition for the generality of customers.
- 3.16.50 Lastly, careful thought needs to be given to the potential impact of a safeguard tariff on the particular group of customers which this remedy is intended to help. Vulnerable customers are generally at the lower end of the income scale and this means that there is also some tendency to be at the lower end of the usage spectrum. SSE has observed throughout the investigation that usage levels have a profound impact on the size of monetary savings available to customers who switch with smaller customers getting smaller savings on a like-for-like switch. It is also the case that on a like-for-like tariff case, smaller customers will be less profitable (on a per customer basis) than customers with higher usage. With reference to the commercial case for acquisition, it should be clear that the commercial benefit of gaining small customers is much lower than for a larger customer other things being equal. In terms of the impact of a further compression in margin, whatever the effect at the mean or median of the distribution, the economics are going to be considerably worse at the small end as shown in the illustration below.
- 3.16.51 This shows that the unintended potential damage to competitive pressure from a safeguard cap would likely be particularly pronounced at the low end of the usage scale, where many of the most vulnerable customers are to be found. It also shows the potential further damage that would ensue if the standing charge deviates from cost by as little as plus or minus 10% (calculated on the basis that the operating profit at median consumption is controlled at 1%). Again the effect would be particularly pronounced at the tails of the distribution.

**Illustration of distribution of operating profit per (DF) customer according to usage**

[X]

<sup>136</sup> See SSE, *Commercial case for acquisition* (June 2015) which describes the non-viability of providing a sufficient discount to prompt switching if EBIT margins are as low as 1%.

<sup>137</sup> See *Littlechild PFs and NPR Response*.



*Conclusion*

- 3.16.52 The answers to the above question should be read in conjunction with the preceding section and the **Annex to Remedy 11** (which discusses SSE's views on the safeguard tariff in more detail).

### **3.17 Remedy 12a - requirement to implement Project Nexus in a timely manner**

- 3.17.1 As stated in the RUIS and PFR, SSE believes that the introduction of a revised settlement regime under Project Nexus will address some of the concerns regarding the disproportionate level of unidentified gas costs currently borne by domestic suppliers. However, SSE continues to believe that there is further work to be done to address the underlying issue of unidentified gas. Whilst more accurate readings will deliver greater certainty of the true position, it is not clear that an increased volume of meter readings in the system will necessarily be effective in reducing costs by reducing the volume of unidentified gas.<sup>138</sup> As such, the CMA's proposed remedies will not be effective in seeking to address the root cause of the issue. SSE continues to consider that further work is necessary to address the market distortions caused by the issue of unidentified gas in a non-robust way and this may be an area which the CMA wishes to consider further.
- 3.17.2 Although SSE is supportive of the “*timely*” implementation of Project Nexus, SSE does not consider it appropriate, or necessary, to implement a remedy to impose a specific deadline on the implementation, as Ofgem is already taking the lead on this (*see* the response to (b) below). It is preferable for there to be a delay in implementation so as to resolve any identified issues, than for Project Nexus to be pushed forward to meet a specific deadline with issues continuing following implementation, which could have significant consequences for all shippers/suppliers operating in the retail gas market.

#### ***(a) How long should parties be given to implement Project Nexus?***

- 3.17.3 SSE is supportive of the timely implementation of Project Nexus – an important technical and complex project associated with the operation of the gas market. It is disappointing that the October 2015 timescale will not be achieved. However, SSE fully expects Project Nexus to be implemented on 1 October 2016. No suggestion to the contrary has been raised by the CMA. Given that Ofgem is working to ensure the timely delivery of Project Nexus and there is no indication that the current timetable will slip, SSE considers it disproportionate to impose this remedy.

#### ***(b) Should the CMA implement this remedy directly (e.g., via an order and/or licence modification) or should it make a recommendation to Ofgem to implement the remedy?***

- 3.17.4 As noted above, SSE is supportive of the “*timely*” implementation of Project Nexus, however there is no reason advanced by the CMA to indicate that such a remedy is necessary or proportionate. The industry is already working with Ofgem to facilitate the timely implementation of the project – Ofgem has appointed a project management and assurance manager to

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<sup>138</sup> There may be scope for improvements in the system which could be delivered through a review of the system operator (*SO*) incentives (covering, for example, improved metering or a greater incentive to identify and resolve persistent leaks). However, this measure would need to be subject to a thorough cost benefit analysis.

provide independent advice on the delivery of the project and has set up a steering group. The steering group represents a cross-section of the industry, including larger and independent shippers, gas transporters and independent gas transporters. Ofgem and Xoserve also sit on the group.

- 3.17.5 However, as a more general observation, the appointment of an independent and experienced project manager (potentially by Ofgem) should be procured for any project of this magnitude (risk and cost) at the beginning of the project, rather than at a point when there is obvious evidence of issues. This, coupled with the proposals to stabilise the regulatory and policy framework envisaged in Remedies 15-18, would ensure a fair and balanced approach to all parties as they seek to implement systems and ensure lower levels of risk to key industry processes and reduce potential customer impact.

### **3.18 Remedy 12b - introduction of a new licence condition on gas shippers to make monthly submissions of AQ updates**

*(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 updating still be effective in terms of removing the scope for gaming of the system?*

- 3.18.1 This remedy is not necessary, given the relatively imminent implementation of Project Nexus (scheduled for October 2016). Currently, for all customers with an AQ of less than 73,200 kWh (which includes the vast majority of customers) energy is settled based on the AQ value and so shippers are able to manipulate the AQ values downwards. However, with the implementation of Project Nexus, energy will be reconciled back to actual meter readings. As a result, if a shipper had AQ values that were too low, when the readings were reconciled back to the initial energy allocation based on the AQ values, the shipper would be out of balance and so would have to buy the extra energy at potentially a higher price. Therefore, from a risk mitigation viewpoint there is an incentive to get AQ values as accurate as possible to minimise the imbalance. There exists a theoretical risk of gaming if no meter readings are provided for more than three years (because after this date the energy may not be reconciled and so the energy allocated based on the AQ becomes the final position). However the implementation of Project Nexus will incentivise the provision of meter readings and the updating of AQs.
- 3.18.2 Additionally, notwithstanding the fact that it would be impractical and disproportionate to require the mandatory monthly updating of AQs (through the acquisition of meter readings) for “*dumb meters*”, the remedy would not actually be capable of implementation pre-Nexus due to technical system limitations and the industry code governance that provides protection to all parties against this. It is also not capable of being implemented quickly enough to have any effect pre- Nexus implementation.
- 3.18.3 The implementation of Project Nexus will almost completely eradicate the scope for gaming the system, subject to a minor exception. Technically, even following Project Nexus, a shipper could seek to hold its AQ level lower so as to gain an advantage from transportation charges. Transportation charges are based on an AQ which is set in December each year, which is then used from the following April. However, transportation charges only amount to around 20% of the total cost of gas, so it is likely that any benefits from gaming in this way would be minimal. Additionally, it would be complex to seek to manipulate the AQs to benefit from transportation charges; a shipper’s system would have to be set up in such a way to allow it to do so. So whilst there is the theoretical opportunity for some gaming relating to transportation charges, in practice it is unlikely that this would actually occur.
- 3.18.4 There is also ongoing work being carried out by Ofgem to monitor the AQ process closely through a combination of information requests and consideration of the annual MOD081 reports. These reports are available to

other industry participants (on an anonymised basis), so there is ongoing scrutiny over shippers' AQ submissions.

- 3.18.5 As a general point, it is proposed that a Performance Assurance Framework (*PAF*) be introduced into the gas market arrangements following Project Nexus. As previously expressed, SSE is not convinced that the PAF will find any evidence of inappropriate behaviours connected to settlements: the nature of the new settlements system creates an incentive on shippers to obtain accurate readings and this incentive is reinforced by suppliers' interests in ensuring that sustained falls in the annual consumption of domestic customers are accurately recorded. In spite of this, SSE has been actively engaging in the modification process for a PAF, which puts in place an overarching monitoring framework. SSE supports this modification but does not believe that specified targets are required for the PAF at this stage. The PAF is predominantly a failsafe measure to assure the industry that all participants are adopting appropriate practices that remain within governance and that no parties are seeking to distort the settlements regime for gain. SSE expects that the PAF observations following the implementation of Project Nexus will support the analysis shared above.

**3.19 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**

3.19.1 The current electricity settlement process reflects the limitations of a system based on periodic readings of “dumb” meters. The current settlement process generally works well, and the roll-out of smart meters will offer scope for improvements to be made to the efficiency of the settlements process.

3.19.2 The proposed remedy to agree a binding plan for the introduction of HH settlement at this stage is premature. Until the smart meter roll-out is sufficiently advanced, the costs of HH settlement will vastly outweigh the benefits realised by those without smart meters.

3.19.3 The CMA has also failed to address the issue of whether HH data is required in order to deliver significant improvements to the settlement arrangements. As noted previously,<sup>139</sup> the CMA has made no attempt to quantify the benefit of this proposed remedy. The CMA has not considered the effectiveness of the current process to derive consumption profiles. A “Profiling Taskforce” was established in 1994 to undertake a programme of analyses in order to define the number and type of profiles to be used in settlement, with the specific intention of finding a robust method for assessing demand profiles that would avoid the significant expense of installing HH metering in all premises and passing data at that resolution through the whole settlements system. SSE would expect that the shape which would be required to be balanced based on HH data would match the profiled demand shape so closely that HH settlement would not result in materially different imbalance costs for suppliers.

3.19.4 Based on the above, this remedy is neither proportionate nor well-targeted, nor likely to be effective. Once smart meter roll-out is sufficiently advanced, a plan can be put in place to introduce HH settlement.

*(a) Would this remedy be effective in stimulating tariff innovation, in particular in terms of time-of-use tariffs?*

3.19.5 Once introduced, following a critical mass installation of smart meters, SSE agrees that half-hourly settlement would further facilitate innovation in smart time-of-use (*ToU*) tariffs. In the meantime, however a far more effective and timely way of stimulating tariff innovation, including in TOU tariffs would be to lift the tariff cap and the other RMR restrictions, which is contingent on Remedy 3.

*(b) How long should parties be given to agree this plan?*

3.19.6 Moves towards HH settlement are already in progress for profile classes 5-8. Procedural steps have also been taken which will accommodate HH settlement in profile classes 1-4 in future. For example, one of the

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<sup>139</sup> See *Gas and Electricity Settlement Working Paper Response*.

modifications to industry codes to deliver HH settlement for profile classes 5-8 has also made it possible for HH tariffs to be created in the Common Distribution Charging Methodology specifically for customers in profile classes 1-8.

- 3.19.7 HH settlement relies on smart meter implementation. The DCC services are not yet in place. However, the DCC is likely to be operational by the end of 2016. Until the smart meter roll out is sufficiently advanced, the material costs of HH settlement will vastly outweigh the benefits realised by those with smart meters - current settlements systems are unlikely to be able to cope with the higher volumes of data that would result if all customers moved to HH settlement. New systems to support HH settlement would be required and are already factored into suppliers' detailed roll-out plans. The smart metering programme could not realistically be accelerated without compromising on quality, stability and overall customer outcome.
- 3.19.8 A plan would also need to be agreed in relation to how to protect customers from certain costs (such as TNUoS and Triad charges) as there is a risk that, during a transition from NHH to HH, domestic or small non-domestic could be exposed to charges which belong to larger non-domestic customers. This is an existing issue which has been temporarily addressed under the Connection and Use of System Code to facilitate mandatory settlement of Profile Classes 5-8 (BSC P272), however an enduring solution would be required before HH settlement could be implemented.
- 3.19.9 In any event, a binding plan should not be put in place without a full and thorough analysis of costs, benefits and deliverability and a strategic body (whether independent or Ofgem led) should have responsibility for scheduling the move to HH settlement for domestic customers. SSE is, however, engaged in discussions at the Settlement Advisory Reform Group under the Balancing and Settlements Code. Part of the group's activity is looking at elective half hourly settlement of smaller customers (Profile Class 1-4), how their data could be used and how it would impact settlements.

***(c) What are the principal barriers to the introduction of a cost-effective option to use half-hourly consumption data in electricity settlement for profile classes 1 to 4? How could these be reduced?***

- 3.19.10 As noted above, the principal barrier to the introduction of a cost-effective option to use HH consumption data in electricity settlement for profile classes 1-4 is the cost of upgrading both supplier settlement systems and central systems, to allow for such settlement to take place. This is not simply a case of an upgrade to systems to manage additional volumes of data, but involves a fundamental system redesign to allow the system to be able to process the large volumes of data.
- 3.19.11 A further barrier is securing customer agreement that suppliers may collect HH data from them as they may raise privacy concerns. These concerns would need to be fully reviewed in the context of the Data Protection Act, licence conditions and industry codes.

***(d) Should the use of half-hourly consumption data in settlement for these profile classes (or certain of them) be optional for energy suppliers, or should it be mandatory? What are the advantages/ disadvantages of each approach?***

*Mandatory*

- 3.19.12 Assuming that the barriers to facilitate a system that allows for universal HH settlement were overcome, the system would be required to operate on the basis that all customers would be settled on a HH basis. The alternative is that the customer population as a whole would have paid for a system which would only be used by some. This outcome would negatively impact a cost benefit analysis on moving to universal HH settlement. Furthermore, if HH settlement were not made mandatory, there would be a need to fully maintain NHH and HH settlement regimes as opposed to managing any residual supplies where HH data was unavailable as an exception process. The running of two regimes would again have an impact on costs.

*Optional*

- 3.19.13 SSE does not immediately see any advantages of providing suppliers with optionality on settling customers on a HH basis. However in instances where a smart meter is not installed, the customer opts-out of providing HH data or if the supplier cannot access the HH data, there would be a need to manage these situations in settlements. This is, however, different to managing a scheme where suppliers could move customers in and out of HH settlement according to the preference of the supplier. Such a move to and from HH settlement could impact and potentially further complicate the change of supplier process.

***(e) Are there any distributional considerations that we should take into account in relation to time-of-use tariffs? For example, might vulnerable customers end up paying more if they fail to change their consumption patterns? Or will the decline in the required generation capacity outweigh any increase in peak prices?***

- 3.19.14 Any customer may end up paying more than they otherwise might need to if they choose a ToU tariff which does not suit their consumption patterns. However, it is unlikely that non-ToU tariffs would be removed from the market. Consequently, any customer who did not want a ToU tariff (or was unable to have one) could remain on a non-ToU tariff.
- 3.19.15 Any potential customer detriment would depend on how the supplier set their ToU tariff (for example what premium they applied to peak time consumption) and the number/length of peak times.
- 3.19.16 The CMA would have to take into account distributional considerations. Evidence from existing multi-rate Distribution Use of System (DUoS) charges suggests that customers may have difficulty in understanding these tariffs. If this is the case, the proposed remedy would result in unfavourable outcomes for vulnerable customers. For these issues to be addressed, a broad discussion with Distribution Network Operators would be required to



ensure the relationship between load management and ToU tariffs did not negatively impact costs to supply electricity.

*(f) When should the (optional/mandatory) use of half-hourly consumption data replace settlement based on assumed customer profiles? Is it necessary to wait until 2020 when all domestic customers have smart meters installed? Alternatively, could the use of half-hourly consumption data be phased in for those customers with smart meters prior to 2020?*

- 3.19.17 It would not be proportionate or reasonable to rush through the implementation of HH settlement before a significant proportion of customers have smart meters. In order to answer this with any level of accuracy, SSE would need to continue assessment of the data that it gathers from smart meters and continue ongoing work in the industry to review how data for smaller customers can be used. It is not appropriate to make a decision on what data would be used and when before first having a significant population of data from which assessments and conclusions can be drawn.

### 3.20 **Remedy 14 - remedy to improve the current regulatory framework for financial reporting**

3.20.1 As a UK publicly listed company, SSE is bound by the highest standards of financial reporting. SSE has always been committed to enhancing the transparency of the measurement and performance of its businesses over and above its statutory obligations. SSE is therefore open to the suggestion that improvements could be made to the current regulatory framework for financial reporting and has, to this end, engaged constructively with Ofgem through bilateral meetings and consultations to improve the robustness of reported financial information. SSE believes that the overall transparency of generators' and suppliers' revenues, costs and profits is currently fit for purpose and advanced against other comparable markets.

3.20.2 The CMA's provisional finding that "*clear and relevant financial reporting concerning generation and retail profitability*" has contributed to an AEC in relation to regulatory decision-making is thus surprising and unfounded.<sup>140</sup> As explained in SSE's response to the PFs, the CMA has not been able to provide any direct evidence of specific difficulties experienced by Ofgem and therefore this remedy is not justified, proportionate or well-targeted.<sup>141</sup>

3.20.3 More fundamentally, SSE believes that this remedy has the potential for unintended consequences, including reduced innovation and diversity of business models in the market, which would be to the detriment of customers. It is therefore important that due consideration is given to the following issues: whether data is confidential; whether the policy intention is to deliver transparency of profits actually earned by companies or *comparability* of profits based on a stylised assessment of a notional standalone businesses; and the risk that the adoption of a stylised assessment would have the unintended consequence of driving convergence in company structure such that operations actually match the financial reporting requirements.

*(a) Should the scope of the individual areas reported on align with the scope of the markets as set out for generation and retail supply in our provisional findings? For example, should a requirement to report wholesale energy costs on the basis of standard products traded on the open wholesale markets be imposed?*

3.20.4 The current scope for reporting results separately for generation and supply, as obligated by the CSS, is appropriate. Furthermore, SSE has no objection to the inclusion of the trading function on the face of the CSS to improve transparency. However, the financial reporting framework must substantially align with the energy firms' published accounts. It would thus be unreasonable and disproportionate to impose the requirements that have been proposed.

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<sup>140</sup> PFs Summary, para. 205(a).

<sup>141</sup> See PFR, Section 11.

3.20.5 For example, SSE has external legacy power purchase agreement (**PPA**) contracts with Seabank and Marchwood which involve real physical cash flows; these plants provide power for over one million homes. Without the PPAs they would never have been built and contributed to the GB energy market. To ignore these agreements on the basis that they are not a “*standard product traded on the open wholesale markets*” would materially misstate SSE’s accounts and would not deliver the objective of greater transparency.

3.20.6 Standardisation does not improve transparency; indeed, a presentation of results which involves a highly complex and contrived reconciliation to the energy firms’ published accounts is not in the best interest of any stakeholders, including customers and investors. A mandated approach which does not reflect the commercial reality under which a firm operates produces a counterfactual world which would be uninformative and difficult to explain to stakeholders.

***(b) What regulatory reporting principles would be particularly relevant to the preparation of regulatory financial information in this sector?***

3.20.7 The overriding regulatory reporting principle which must be adopted is that the reported accounts should reflect the way the businesses are run, not mandating comparability based on a theoretical view of a standalone business.

3.20.8 Mandated comparability would obscure or even destroy transparency as the results reported by the energy companies would represent a theoretical model which does not exist, rather than reporting the commercial reality.

3.20.9 In this regard, the available evidence, consistent with SSE’s experience, indicates that the current reporting system – the CSS – is fit for purpose. In particular:

- (a) The independent reviews of the CSS conducted by BDO LLP on two occasions has found the existing reporting arrangements to be broadly “*fit for purpose and transparent*,”<sup>142</sup> and
- (b) Ofgem has consistently indicated that it is confident that the profits declared by the energy firms were the ones that they actually made from their activities in generation and supply.<sup>143</sup> In its most recent report on the subject, Ofgem stated that, because of reforms, the CSS for 2013 “*provide greater transparency than in the past, and we are even more confident that they present an accurate picture of generation and supply profitability.*”<sup>144</sup>

<sup>142</sup> PFs, Appendix 11.1 paras. 13 – 14.

<sup>143</sup> PFs, Appendix 11.1 para. 14.

<sup>144</sup> Ofgem, *The revenues costs and profits of the large energy companies in 2013* (October 2014) p2.

***(c) Would summary profit and loss account and balance sheet information for each area be sufficient to enable the effective regulation of the sector and the development of appropriate policies? Or should the large domestic and SME energy suppliers be required to collect and submit additional, more granular financial information?***

- 3.20.10 SSE considers that the CSS is a proportionate response to the issue of transparency and agrees that some further development might be beneficial, but is concerned that the consequence is that commercial confidentiality might be compromised by excessive disclosure.
- 3.20.11 The energy firms who are currently under an obligation to prepare the CSS already provide profit and loss account data for the principal market segments (domestic electricity, domestic gas, non-domestic electricity, non-domestic gas, conventional generation and renewable generation).
- 3.20.12 SSE also discloses its turnover and EBIT for its trading business within the CSS because it is a reconciling item to the published group accounts. SSE has no objection to the inclusion of the trading function on the face of the CSS to improve transparency.
- 3.20.13 The provision of balance sheet information at reporting segment level would be very difficult to achieve, onerous to produce and of uncertain benefit. Furthermore, a granular balance sheet at market segment level would require a significant level of estimation and assumption which SSE believes could not pass a series of external audit tests (now required to produce the CSS).
- 3.20.14 SSE is aware that the provision of a balance sheet would be required for the calculation of a Return on Capital Employed (**ROCE**). SSE has argued strongly that ROCE is not an appropriate measure for a supply business. In addition, the CMA has had to make several adjustments to the capital employed and to the EBIT to arrive at a ROCE calculation (the results of which SSE disputes). As a result, a straight calculation from an enhanced CSS would be meaningless.
- 3.20.15 To facilitate transparency SSE could provide a balance at total generation and total supply level. However the profit and loss account and the balance sheet must be wholly consistent with SSE's published accounts to avoid unintended consequences arising from a misguided objective that standardisation and comparability on a stylised "market orientated" approach which would not deliver the desired increased transparency.

***(d) Should Ofgem require that the summary profit and loss and balance sheet information be audited in accordance with the regulatory reporting framework?***

- 3.20.16 The CSS is already subject to external audit in accordance with Standard Condition 19A of the Gas and Electricity Supply Licences and Standard Condition 16B of the Electricity Generation Licences. The directors of SSE have engaged the auditor of SSE Plc, KPMG LLP, to audit the CSS.
- 3.20.17 Should the regulatory reporting framework change significantly from its current form in SLA19A, it would be essential for the CMA or Ofgem to

engage with audit firms who have a client in the sector at the outset of the process, to establish a framework upon which the audit firms would be prepared to issue an audit opinion. A more onerous audit process would be likely to result in an additional cost.

***(e) Should this remedy apply to the firms that are currently under an obligation to provide Ofgem with Consolidated Segmental Statements? Or should it apply to a larger or narrower set of firms?***

3.20.18 SSE has previously argued that there would be important benefits to transparency if all suppliers and generators above a *de minimis* level were required to publish financial reports for relevant segments, in accordance with a proportionate and measured licence obligation. The original policy intention that led to the introduction of the CSS was to facilitate market entry through the provision of clear and accessible information on profitability. It is clear that the performance of recent entrants and mid-tier suppliers or generators would provide particularly pertinent information for potential market entrants.

3.20.19 Widening the number of suppliers subject to the obligation to publish financial reports would provide further significant benefit to the market. A lack of obvious available benchmarks for comparison of reported profitability has inhibited the success of the CSS in providing transparency. SSE believes that this would be greatly mitigated if the obligation were widened to cover a greater diversity of market participants: all VI firms (importantly this must include those active at the large end of the non-domestic market); all standalone suppliers (public perception that profits are acceptable is likely to be increased by a better understanding of the profitability of suppliers at all scales); and all standalone generators (above a *de minimis* level chosen to exclude micro-generation).

3.20.20 Requiring new entrants to publish a CSS would provide a more complete picture of profitability in supply (public understanding of the market will be enhanced by greater awareness of the low or zero margins of rapidly expanding small suppliers). Similarly the EBIT margins of independent generators could provide a more robust context to understand the CSS of the large vertically integrated firms.

***(f) What would be the costs of imposing such a remedy? We note that some firms' reporting systems are not currently capable of providing information on such a "market-orientated" basis and that our remedy could require significant additional system requirements.***

3.20.21 In March 2015, SSE implemented revised transfer pricing arrangements which have the effect of providing a more "*market orientated*" energy price. This change, described in more detail in SSE's CSS for the financial year ending 31 March 2015,<sup>145</sup> was facilitated by SSE's investment in a new energy trading risk management system.

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<sup>145</sup> See SSE's Consolidated Segmental Statement for the Financial Year ending 31 March 2015 at <http://sse.com/media/330020/CSS-2014-15.pdf>.

- 3.20.22 If major changes were to be made both in terms of the required scope and granularity of regulatory reporting, the CMA would need to have due regard to the additional systems work that would be required (affecting the energy trading risk management system, the customer billing system, the energy risk professional system and other settlement systems) on the part of SSE, which could be disproportionate relative to the perceived benefit.
- 3.20.23 It is difficult to assess the cost of additional systems' requirements, the feasibility of integration with existing systems, and also the timescale over which changes could be implemented. Given SSE's difficulty in responding to questions S.93-S.96 of the *SQ*, it is possible that SSE might not be able to comply with a very granular reporting requirement. A highly uncertain estimate of the costs to SSE would be between £500,000 and £1,000,000, with a timescale of 12 to 18 months to carry out the necessary work.

***(g) Should the CMA implement this remedy by way of licence modifications or by way of a recommendation to Ofgem?***

- 3.20.24 SSE considers that it would be more appropriate to implement this remedy by way of a recommendation to Ofgem. This would improve efficiency as any changes required by the CMA could be considered in tandem with any modifications which Ofgem is currently developing (SSE believes that Ofgem is currently planning further modifications to the relevant licence conditions).

***(h) To what extent should this financial information on performance be published?***

- 3.20.25 As explained earlier in this Response, SSE believes the CSS in its current form provides an acceptable public communication of the profits of the obligated energy firms. Whilst there is no clear tangible benefit from the publication of balance sheet information, SSE has no objection in principle to this information being published.
- 3.20.26 The CMA must have due regard to SSE's major concerns over the publication of more granular information which could be commercially sensitive. An illustration of the tension between transparency and confidentiality is the treatment of Energy Company Obligation (**ECO**) costs: detailed disclosure could affect live contract negotiations for the delivery of measures to meet ongoing obligations and potentially risk increasing the total cost of delivery. In this case, SSE has advocated that publishing aggregated costs of meeting environmental obligations (including FiTs and Renewables Obligation (**RO**), as well as ECO) is a more proportionate and reasonable approach. The proposed remedy as it stands is disproportionate with potentially severe unintended consequences and no guarantee of effectiveness.

### **3.21 Remedy 15 - more effective assessment of trade-offs between policy objectives and communication of impact of policies on prices and bills**

3.21.1 As explained in the *PFR*, features of the regulatory and policy process have contributed to the policy and regulatory decision-making concerns that the PFs identify. There has been a lack of effective communication of the forecast and actual impacts of energy policies which companies have been required to deliver with the competitive market framework. SSE therefore welcomes this remedy as it is consistent with the principles of better regulation. Furthermore, stability in the regulatory policy framework is essential. Suppliers sometimes struggle to explain the impact of rising policy costs to customers: a more effective assessment and communication of expected impacts could mitigate this to the benefit of engagement and trust in the market.

*(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? Which existing bodies are best positioned to undertake this role?*

*(f) 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?*

3.21.2 Critically, the potential impact of any regulatory or policy interventions in the market should be adequately assessed prior to implementation. This assessment should include costs and benefits incurred as a result of the adoption of particular measures, and should continue post-implementation. The regulator and, where, relevant government, should communicate findings to other stakeholders and, ultimately consumers.

3.21.3 In addition SSE, like the CMA, would welcome measures that ensure efficient prioritisation of changes so consumers receive the intended benefits quickly. Establishing an overarching strategic prioritisation body would achieve this aim and ensure a greater degree of cross-industry coordination when implementing strategic industry reforms. This body could also play an important role in communicating these strategic decisions to customers to the benefit of engagement and trust in the market.

### 3.22 **Remedy 16 - revision of Ofgem's statutory objectives and duties in order to increase its ability to promote effective competition**

3.22.1 SSE welcomes this remedy to clarify Ofgem's position as the regulatory and competitive market framework needs stability so that it works for consumers, businesses and industry participants.

*(a) What specific changes should be made to Ofgem's statutory objectives and duties in order to ensure that it is able to promote effective competition in the energy sector?*

*(i) For example, would it be possible to revert to the role of competition that existed before the introduction of the Energy Act 2010?*

3.22.2 The regulatory framework has become increasingly more complex since the introduction of the Energy Act 2010 and relevant EU legislation. Ofgem now has a number of objectives, which extend beyond its competition objectives to contend with:

- (a) Duties under EU legislation<sup>146</sup> including (but not limited to) responsibility for REMIT; the third party access regime; transmission unbundling and certification; and the development and implementation of the European Network Codes (*ENCs*); and
- (b) Administrative responsibility<sup>147</sup> for a number of government schemes including numerous consumer and environmental schemes and programmes such as the Warm Home Discount (*WHD*); the RO; FiTs; ECO; and the Government Electricity Rebate.

3.22.3 However, whenever Ofgem has discretion over policy direction, it should focus primarily on competition as its main objective. This approach would avoid the implementation of measures which have unfortunately had an adverse effect on competition (as RMR did when consumer protection was prioritised).

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<sup>146</sup> The EU Third Package, for example, sets out a number of duties for regulatory authorities, notably Article 37 of the Electricity Directive and Article 41 of the Gas Directive (articles entitled "*Duties and powers of the regulatory authority*").

<sup>147</sup> Discharged by Ofgem E-Serve.



**3.23 Remedy 17 – introduction of a formal mechanism through which disagreements between DECC and Ofgem over policy decision-making can be addressed transparently***(a) In which circumstance should Ofgem have the right or duty to express views on DECC’s policies and DECC/Ofgem strategy for their implementation? What format should such views take? Should DECC have a duty to formally respond?*

*(b) In what circumstances should Ofgem have the right to seek a formal direction from Ofgem to implement a certain policy?*

*(c) Would DECC’s formal direction undermine (or appear to undermine) Ofgem’s independence?*

*(d) Would other measures be effective in promoting the independence of regulation?*

3.23.1 SSE welcomes this remedy, which it considers would be effective in achieving the objectives sought. Introducing a formal mechanism for DECC/Ofgem policy reconciliation would increase transparency and improve the quality of public debate and policy decision-making without imposing unnecessary and disproportionate reporting and other obligations on energy firms.<sup>148</sup>

3.23.2 In order for this remedy to operate as effectively as possible, the CMA should consider the role of the Devolved Administrations when considering how this remedy would work in practice.

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<sup>148</sup> Such as previous interventions which led to additional information on bills; annual refunds of Direct Debit credit balances of £5 or more.

- 3.24 Remedy 18a – recommendation to DECC to make code administration and/or implementation of code changes a licensable activity** SSE agrees that improvements to the operation of the codes system are necessary to ensure developments can be delivered in a timely and efficient manner. In particular, industry code governance could be improved to facilitate innovation and enable the energy markets to keep pace with regulatory developments and wider policy objectives.

*(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?*

- 3.24.2 Network Owners' licences require code administrators to be subject to the Code Administration Code of Practice<sup>149</sup> (CACoP), which Ofgem controls. This means that, in effect, code administration is a pseudo-licenced activity through the Network Owners' licences. Code administrators must also comply with the relevant code and associated licences (with the relevant code taking precedence where there is a conflict between it and the CACoP).
- 3.24.3 There are no provisions in the Gas Act 1986 or the Electricity Act 1989 to allow for code administration or delivery of code changes to be a licensable activity. Implementing this remedy would therefore involve a change to primary legislation. There are no clear benefits to such an approach as opposed to the current CACoP.
- 3.24.4 A more proportionate and efficient means of achieving the outcome of this remedy, but without the added bureaucracy and complexity, would be to strengthen the CACoP. The CACoP could be strengthened by requiring that code panels and executive committees include clauses in their contracts to ensure that code administrators comply with CACoP.

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

- 3.24.5 It is important for code administrators to be afforded the flexibility to work effectively. However, there is a balance to be struck between providing them with this flexibility and ensuring value for money. Code administrators tend to be paid by the meeting, thus it is appropriate for the oversight role to be retained by another party.

*(c) Would this remedy be more effective if Ofgem or DECC were to impose stricter requirements relating to the selection (e.g., competitive tender), financing and/or independence of code administrators (and/or delivery bodies)?*

- 3.24.6 SSE strongly supports the introduction of competitive tendering for code administrators and delivery bodies as it should help improve standards

<sup>149</sup> See Ofgem, *Code Administration Code of Practice* (26 February 2015) – available at <https://www.Ofgem.gov.uk/licences-codes-and-standards/codes/industry-codes-work/code-administration-code-practice-cacop>.

whilst reducing costs. The move towards competitive tendering should be considered even if this remedy (or the strengthened CACoP) is not implemented.

- 3.25 Remedy 18b – granting Ofgem more powers to project-manage and/or control timetable of the process of developing and/or implementing code changes** SSE recognises the importance of oversight of strategic changes and would welcome a greater degree of cross-industry and cross-code coordination. It therefore supports this remedy. However, where Ofgem proposes the content of a modification, process issues may arise where Ofgem also holds the decision-making power. SSE therefore believes that the most reasonable approach would be to ensure that appeal rights are preserved so that parties have comfort that there is a route for implementation decisions to be appropriately and independently assessed.

*(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?*

- 3.25.2 SSE recognises the importance of oversight of strategic changes and supports the objectives of this remedy, noting that a strategic body which sits above all of the industry codes could help achieve a greater degree of cross-industry and cross-code coordination. This sort of strategic body could help to deliver efficient prioritisation and implementation of industry changes (particularly those covering areas of new technology, UK policy and cross-code modifications) so consumers receive the intended benefits promptly.

- 3.25.3 If Ofgem were to take on this role, process issues could arise where Ofgem had proposed the content of the modification. Accordingly, a more effective model could be to have an independent strategic code body in this role instead of Ofgem, meaning that the situation would not arise where the proposer is also the decision-maker. However, provided appeal rights were preserved, there would always be a route for implementation decisions to be appropriately and independently assessed.

*(b) Would this undermine the principle (and effectiveness) of industry-led code changes?*

- 3.25.4 This remedy would not necessarily undermine the principle of industry-led change although it would require Ofgem's engagement in the modification process to be appropriately managed. Ofgem would have to be set binding and robust objectives and be required to clearly demonstrate the need for intervention. Without clear rules and transparency of decisions, intervention may occur more frequently than justified, reducing the efficiency and effectiveness of this remedy.

*(c) Should this power be limited to the completion of certain elements of the development or implementation phase (e.g., consultation, setting up working groups)?*

- 3.25.5 In assessing the effectiveness of the proposed remedy, SSE has considered the structures used elsewhere. In the Australian energy market, any citizen (including the regulator) can propose changes to market rules. If Ofgem were to have a role in the modification process, a similar principle would best achieve the objectives sought: Ofgem should not have special privileges and should be treated as any other party.

***(d) Should Ofgem's ability to use this power be limited to defined circumstances (e.g., modification proposals which are relevant to Ofgem's principal objectives) or should it be left to Ofgem's discretion?***

- 3.25.6 Ofgem's intervention must be aligned to its principal objectives. Before taking action, Ofgem must be able to demonstrate, in a robust and transparent way, that the intervention is consistent with its objectives.

**3.26 Remedy 18c – appointment of an independent code adjudicator to determine which code changes should be adopted in the case of dispute** SSE recently responded to Ofgem’s open letter on code governance.<sup>150</sup> In this letter, SSE shared its developing thinking on the prospect of a strategic code body, noting the potential benefits for the industry.

3.26.2 As noted in response to Remedy 18b, SSE recognises the importance of oversight of strategic changes and supports the intent of this remedy, noting that a strategic body which sits above all of the industry codes could help achieve a greater degree of cross industry and cross code coordination. This sort of strategic body could help to deliver efficiency benefits when prioritising and implementing industry change, especially in those areas covering new technology and UK policy. This would ensure that consumers receive the intended benefits promptly.

3.26.3 SSE considers that the remit of this body could go further than what has been outlined in the CMA’s remedy. A further role could be to signpost all parties to sections of the industry codes which are relevant to them; this service would be particularly beneficial for new entrants and other industry participants with limited resources.

*(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?*

3.26.4 There are benefits from having an independent strategic body in this role. It would bring an unbiased, objective viewpoint and a focus on strategy and planning which would not be compromised by competing objectives.

3.26.5 In order to be fully effective, any strategic body should have an independent chair and a body of staff to undertake the strategic role. It would be beneficial for such a body to be supported by an advisory panel comprising representatives from industry, consumer bodies and Ofgem.

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

3.26.6 It is unclear how the introduction of an independent strategic body to manage and plan strategic change across industry codes could cause a lack of coordination.

3.26.7 The impact should be beneficial: energy market participants would have a clearer idea of upcoming changes so will better be able to plan; the rate of change would be more realistic; and more time and focus could be given to delivering value to the benefit of consumers and competition.

<sup>150</sup> See SSE, *Response to further review of code governance* (26 June 2015) – available at [https://www.ofgem.gov.uk/sites/default/files/docs/2015/07/sse\\_response.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/07/sse_response.pdf).

#### 4. **Comment on remedies which the CMA is minded not to consider**

- 4.1.1 SSE has reviewed the remedies the CMA is not minded to consider and agrees that they would not be proportionate and reasonable in the context of the current market features of the market identified by the CMA as giving rise to the purported AEC.
- 4.1.2 ***Remedy a – price control regulation of all domestic and microbusiness retail energy tariffs:*** SSE agrees with the CMA’s assessment that this remedy would be disproportionate to the provisional findings. It should not be considered further.
- 4.1.3 ***Remedy b – requiring energy firms to inform customers about the cheapest tariff on the market (across all suppliers):*** SSE agrees with the CMA’s assessment that this remedy would undermine the effectiveness of other remedies intended to promote customer engagement. Furthermore SSE notes there is no precedent for this type of measure in any other competitive market; this extraordinary intervention should not be considered further.
- 4.1.4 ***Remedy c – opt-out collective switching of disengaged customers:*** SSE agrees with the CMA’s assessment that this type of remedy “*would not be effective or proportionate.*”<sup>151</sup> In addition to the detrimental consequences noted by the CMA, SSE believes that customer complaints would rise significantly as a consequence, further impacting the quality of service that suppliers are able to provide. This remedy should not be considered further.
- 4.1.5 ***Remedy d – introduction of a single price for gas and electricity customers:*** SSE agrees with the CMA’s assessment; this remedy would stifle innovation, impede competition and would put at risk any demand side response benefits arising from the roll-out of smart meters. The remedy should not be considered further.
- 4.1.6 ***Remedy e – introduction of price non-discrimination provisions:*** SSE agrees with the CMA’s assessment that this type of remedy would hamper the framework for effective competition in the market. The CMA has also stated that it is likely SLC25A “*contributed to a softening of competition on the SVT,*”<sup>152</sup> which further strengthens the case against this type of remedy. It should not be considered further.
- 4.1.7 ***Remedy f – a transitional safeguard regulated price structure:*** SSE agrees with the CMA’s decision not to pursue this remedy. The most important consideration, which the CMA has apparently missed, is that this type of tariff structure would have a profound distributional impact, reducing incentives for customers with lower usage to engage with the market. This remedy should not be considered further.

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<sup>151</sup> NPR, para. 144.

<sup>152</sup> PFs Summary, para. 150.

## SSE: RESPONSE TO PROVISIONAL FINDINGS

## ANNEX 2: VULNERABLE CUSTOMERS STATISTICAL ANALYSIS – FRONTIER ECONOMICS

**The PFs fail to identify the main drivers of customer engagement**

1. In Appendix 8.1 of the PFs, the CMA reports that it has found that the respondents who are “*more likely to have never considered switching supplier and less likely to have shopped around in the last three years, switched supplier in the last three years or to consider switching supplier in the next three years*” are those with any of the following demographic characteristics:
  - (a) Household incomes under £18,000 a year;
  - (b) Living in rented social housing;
  - (c) No qualifications;
  - (d) Aged 65 and over;
  - (e) Have a disability; and
  - (f) On the PSR.<sup>1</sup>
2. As Table 1 below shows, more than half of respondents to the survey fell into one or more of these “*vulnerable*” groups.

**Table 1: Percentage of customers who meet/do not meet at least one of CMA’s “vulnerability” indicators**

Meets one or more of CMA’s characteristics	Percentage	Count
<b>No</b>	45%	3139
<b>Yes</b>	55%	3860
<b>Total</b>	100%	6999

3. At a simple level, the demographic characteristics listed above do correlate with disengagement. As Table 2 sets out, customers who meet one or more of the CMA’s criteria for vulnerability are 16-47% less likely to switch energy providers, depending on the measure of engagement used.

<sup>1</sup> PFs, Appendix 8.1, para. 64.



**Table 2: Percentage of customers who have switched, by “vulnerability” indicator**

Meets one or more of CMA’s characteristics	(1) Switched supplier in last 3 years	(2) Switched supplier in last year	(3) Ever switched supplier	(4) Ever switched (incl. internal)
<b>Yes</b>	20%	9%	39%	52%
<b>No</b>	32%	17%	50%	62%
<b>Total</b>	25%	13%	44%	56%

4. However, it would be incorrect to infer from this that possessing any one of these characteristics will, in itself, make a customer less likely to switch supplier. There are two reasons for this.
5. *First*, these demographic characteristics are correlated with one another. The CMA’s series of cross tabs fail to identify which of these indicators are the key drivers of disengagement. This can be seen from Table 3 below, which shows the correlation coefficients between all but one of the combinations of variables to be positive and statistically significant.<sup>2</sup> This makes it difficult to disentangle the effect of individual characteristics on the basis of correlation analysis alone.

<sup>2</sup> The p-value is reported in parentheses. The only exception is the correlation between 65+ and the social housing indicator. The correlation coefficient for this is negative, but the result is not significant at the 5% level.

**Table 3: Correlation between “vulnerability” indicators cited by CMA**

	<b>65+</b>	<b>&lt;£18,000</b>	<b>No qualifications</b>	<b>Registered on PSR</b>	<b>Disabled</b>	<b>In rented social housing</b>
<b>65+</b>	1					
<b>&lt;£18,000</b>	0.1087 (0.000)	1				
<b>No qualifications</b>	0.2522 (0.000)	0.2025 (0.000)	1			
<b>Registered on PSR</b>	0.3245 (0.000)	0.1347 (0.000)	0.1782 (0.0000)	1		
<b>Disabled</b>	0.1353 (0.000)	0.2064 (0.000)	0.1437 (0.0000)	0.1769 (0.0000)	1	
<b>In rented social housing</b>	-0.0198 (0.096)	0.2713 (0.0000)	0.136 (0.0000)	0.0906 (0.0000)	0.1652 (0.0000)	1

6. *Second*, the demographic characteristics cited by the CMA are correlated with other factors that may influence switching behaviour. This means that socio-economic and demographic characteristics may not be real drivers of levels of customer engagement, but merely correlated with the underlying causes. The customer survey results indicate that these correlated factors include:

- (a) *Internet access.* The CMA has suggested that the internet has significantly reduced search and comparison costs in recent years but there appear to be specific barriers to engagement for those who either do not have access to the internet or do not feel confident using it.<sup>3</sup> As Table 4 below shows, 30% of customers who meet one or more of the demographic criteria cited by the CMA do not have internet access, compared to only 3% of those who do not.<sup>4</sup> Lack of internet access is particularly common among customers aged 65 or over, those with no qualifications, and those with disabilities. This opens the possibility that the lower average levels of switching identified for these customer groups may in part be driven by lack of internet access (or possibly lower confidence in using the internet) rather than intrinsic disengagement from the energy market.

<sup>3</sup> *PFs*, para. 8.94.

<sup>4</sup> Statistically significant results are marked with asterisks (\*\* for 1% significance level, \* for 5% significance level).

**Table 4: Percentage of customers with/ without/without internet access**

Meets one or more of CMA's characteristics	Internet access**	No internet access**
Yes	71%	30%
No	97%	3%
Total	83%	17%

**Table 5: Percentage of customers in CMA's "vulnerable" groups with/without internet access<sup>5</sup>**

Customers in CMA's vulnerable	Internet access	No internet access
<£18,000**	70%	30%
65+**	59%	41%
No qualifications**	70%	30%
In social housing**	67%	33%
Disabled**	59%	41%
On PSR**	63%	37%

- (b) *Warm Home Discount (WHD)*. As Table 6 below reports, 11% of survey respondents who met one or more of the CMA's demographic criteria are WHD recipients, compared to only 1% of those who did not. This is unsurprising given that recipients of pension credit (who would have been disproportionately drawn from the low income and 65+ age groups) formed the "*Core Group*" customers eligible for the WHD at the time that the customer survey was conducted.<sup>6</sup> Given that WHD recipients are on favourable tariffs, one would expect them to switch less than other customers. Further, there was a level of discretion in the awarding of WHD by different energy suppliers. This means that customers receiving WHD from one supplier may have been disinclined to switch suppliers, in case they were not eligible for WHD under the new supplier.

<sup>5</sup> Significance levels reported compare internet access among the "vulnerable" group (e.g., <£18,000) to those not in that group (e.g., >£18,000), with "don't knows" and otherwise missing responses excluded.

<sup>6</sup> In addition to this, there was a "*Broader Group*" of customers who were on low incomes and/or recognised as being vulnerable were also eligible for a WHD at the time of the customer survey.

**Table 6: Percentage of customers on WHD, by customer group**

(i) All age groups

Meets one or more of CMA's characteristics	On WHD	Not on WHD
<b>Yes</b>	11%	89%
<b>No</b>	1%	99%
<b>Total</b>	7%	93%

(ii) 65+ age group

On WHD	<18,000	£18,000- £36,000	£36,000+	Refused/ don't know	Total
<b>Yes</b>	25%	1%	0%	13%	14%
<b>No</b>	75%	99%	100%	87%	86%
<b>Total</b>	100%	100%	100%	100%	100%

(iii) 65 or under age group

On WHD	<18,000	£18,000- £36,000	£36,000+	Refused/ don't know	Total
<b>Yes</b>	10%	1%	1%	4%	4%
<b>No</b>	90%	99%	99%	96%	96%
<b>Total</b>	100%	100%	100%	100%	100%

(c) *Contact by suppliers.* As Table 7 below shows, customers from lower income groups are less likely to have been directed contacted by other suppliers suggesting they switch suppliers, or by their own supplier about switching tariffs. This may be relevant to the extent that supplier contact facilitates switching and/ or prompts customers to consider switching.

**Table 7: Percentage of customers contacted by suppliers, by income group**

Contacted by supplier	<18,000	£18,000- £36,000	£36,000+	Refused/don't know	Total
<b>Own</b>	28%	33%	34%	31%	31%
<b>Other</b>	42%	45%	46%	42%	44%

7. The PFs do not seek to disentangle these different factors to identify those that directly increase customer switching and/ or engagement from those that are merely correlated with the relevant drivers. To investigate the underlying drivers of engagement, we ran a logistic regression of actual switching behaviour on the demographic characteristics listed by the CMA, and the three factors that we have identified as being correlated with these customer characteristics (internet access, WHD and contact by suppliers).

8. We consider past switching behaviour (as measured by switching suppliers in the last three years, one year and ever, as well as internal switching) to be the most relevant measure of customers' propensity to switch, as this captures their actual behaviour. However, for completeness and to inform our interpretation, we also consider the following dependent variables:
  - (a) Customers' reported likelihood of switching supplier in the next three years. This is correlated with actual past switching behaviour (at the 1% significance level), though the correlation is not very strong (correlation coefficient of 0.2-0.3 depending on the measure of switching used).
  - (b) Customers' confidence in their own ability to make the right switching decision or find the right deal. These measures are also correlated with actual past switching behaviour at the 1% significance level, although the correlation is similarly not very strong (0.1-0.2 for both measures).
9. In addition to our baseline model described above, we consider two alternative models:
  - (a) *Excluding contact by suppliers.* If suppliers select customers for contact based on their propensity to switch, contact by suppliers may be endogenous. We therefore tested the sensitivity of our results to the exclusion of the "*contact*" variables.
  - (b) *Including preferences over price and non-price factors.* The cross tabulations above indicate that different priorities over price, customer service, reputation and other services offered are strongly related to switching behaviour. Further, these such preferences may vary across customer groups. We ran a version of the baseline model including preferences over price and non-price factors, to disentangle differences in inherent engagement between customer groups from differences in their preferences and/ or priorities.

The specifications considered are summarised in Tables 8 and 9 below.

**Table 8: Regression models of underlying drivers of switching behaviour:  
dependent variables**

	Baseline (1)	Excl. contact (2)	Incl. preferences (3)
<b>Actual switching behaviour</b>			
Switched suppliers in the last 3 years	x	x	x
Switched suppliers in the last year	x	x	x
Ever switched suppliers	x	x	x
Ever switched suppliers and/or tariffs	x	x	x
<b>Switching intentions</b>	x	x	x
Likely to switch suppliers in the next 3 years	x	x	x
<b>Switching attitudes</b>	x	x	x
Confident about being able to make the right decision	x	x	x
Confident about being able to find the right deal	x	x	x

**Table 9: Regression models of underlying drivers of switching behaviour:  
independent variables**

	Baseline (1)	Excl. contact (2)	Incl. preferences (3)
<b>CMA vulnerability indicators</b>			
Age	x	x	x
Household income	x	x	x
Level of qualification	x	x	x
Whether on PSR	x	x	x
CDSP indicator (carer/disabled/single parent)	x	x	x
Housing tenure (own outright, rent privately, rent socially or other)	x	x	x
<b>Correlated characteristics</b>			
Internet access	x	x	x
Whether on WHD	x		x
Contact by suppliers	x		
<b>Preferences</b>			
Consider price essential			x
Consider customer service essential			x
Consider brand/ reputation essential			x
Consider other services essential			x

10. The results of this analysis indicate that the main drivers of customer switching are internet access, not being in receipt of WHD and supplier contact. By contrast, socio-economic and demographic characteristics have little or no identifiable effect after controlling for these factors. The only clear exception is household tenure type, which does appear to influence propensity to switch. However, the evidence does not suggest that social housing renters are less likely to switch than private renters or that they feel less confident about their ability to switch or find the right deal.
11. Excluding contact by suppliers has negligible effect on the estimated coefficients of other variables, which suggests that endogeneity is not a

problem. Based on specification 3, customers who value price are significantly more likely to have switched suppliers and/ or tariffs, whilst those who value customer service are significantly less likely to have switched; this supports our findings above that preferences have an effect on switching behaviour. Taking preferences over price and non-price factors into account slightly reduces the estimated effect of age, qualifications, tenure type and internet access.

12. We discuss the results of our baseline regression in greater detail below. Detailed results of specifications 2 and 3 are reported in **Appendix 1** to this Annex.<sup>7</sup>

### **Statistically significant variables**

#### *Internet access*

13. The regression analysis indicates that internet access is the biggest driver of engagement. All else being equal, customers with no internet access are on average 12-15 percentage points less likely to have ever switched supplier, and 6-12 percentage points less likely to have switched recently. This is substantially larger than the marginal effect of old age or low income.
14. Customers without internet access are also 6-12 percentage points less likely to be confident in their ability to switch (make the right decision or find the right deal), and also 17 percentage points less likely to switch in the next three years.
15. Internet access is the only variable that has a statistically significant effect on all the measures of switching and confidence that we tested.

#### *Contact from suppliers*

16. Contact from other suppliers increases the probability of ever switching supplier and/or tariff by 10-15 percentage points, and of switching in the last 3 years by 6 percentage points. The effect on switching in the last year is not statistically significant.
17. Contact from customers' own supplier further increases the probability of ever switching supplier or tariff by 15 percentage points. It also increases the probability of customers feeling confident about making the right decision or finding the right deal by 4-7 percentage points.
18. Contact from suppliers appears to be the second most important and consistent driver of engagement, after internet access.

#### *WHD*

19. Recipients of a WHD are on average 7-10 percentage points less likely to switch across all four measures of actual switching. They are also 13 percentage points less likely to consider themselves likely to switch suppliers in the next three years.

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<sup>7</sup> The reported coefficient is the average marginal effect across observations.



20. However, the evidence that is available does not suggest that these WHD customers are more likely to be intrinsically disengaged from the market. The regression results indicate that WHD customers are no less likely to feel confident about making the right decision, and indeed 7 percentage points more likely to feel confident about finding the right deal. This suggests that the low propensity of these customers to switch is due to their already being on favourable tariffs, as noted above.
21. It is however conceivable that regression coefficients on the WHD variable are picking up the effect of being a “vulnerable” customer. Unfortunately it is impossible to isolate this “vulnerability” effect, given the broad age and income bands used by the survey data. In this respect, the survey is not well designed for the purposes of identifying the reasons why customers with a high level of vulnerability may be less likely to switch provider.

#### *Tenure type*

22. The results of the regression analysis indicate that household tenure type does influence propensity to switch, but there is no clear link to customer “vulnerability”:
  - (a) Compared to customers who have a mortgage, customers who rent privately are 6-17 percentage points less likely to have ever or recently switched, whilst customers in social housing are 4-13 percentage points less likely. They are also 11-16 percentage points less likely to consider switching in the next three years.
  - (b) However, there is no statistically significant difference between private and social renters based on any of the four measures of actual switching behaviour.
  - (c) Further, the results indicate that customers who own their home outright are also 4-7 percentage points less likely to switch than those with a mortgage, and 6 percentage points less likely to consider switching in the next three years.
23. There are no statistically significant differences in customer confidence among any of the four tenure types. In particular, renters are no less likely to be confident in their ability to switch than home owners. This suggests that the results may stem from the nature of rental contracts and/or differences in preferences of those that rent, rather than differences in customer confidence or willingness to engage in the market.

#### **Statistically insignificant variables**

##### *Age*

24. Compared to customers aged 35-44, customers below the age of 34 are on average 9 percentage points less likely to have ever switched suppliers and/ or tariffs, all else being equal. However, the relationship is not statistically significant for switching in the last 1 or 3 years. This is therefore likely to reflect the shorter period of home rental or ownership on the part of younger customers, rather than a higher degree of disengagement

25. Compared to customers aged 35-44, customers above the age of 55 are 5-6 percentage points less likely to have switched supplier in the last three years, and also 15-20 percentage points less likely to consider switching in the next three years. However, this relationship is not statistically significant for any of the three other measures of actual switching.
26. Over 65s are also no less likely to feel confident in their ability to switch (those aged 55-64 are 6 percentage points less likely to feel confident about making the right decision).

#### *Income*

27. Compared to customers earning £18,000-£36,000 a year, those earning less than £18,000 a year are no less likely to have ever or recently switched, when other factors are controlled for. This means that the CMA's finding that low-income customers are less likely to switch is driven by the correlation between income and other factors that significantly affect switching behaviour (such as internet access, contact from suppliers, WHD and rental status as identified above), rather than any inherent disengagement on the part of low-income customers.
28. The results indicate that these lower income customers are on average 6 percentage points less likely to feel confident about finding the right deal; however, as noted above, this does not appear to affect their actual propensity to switch.

#### *Qualifications*

29. Customers who have no qualifications are on average 7 percentage points less likely to have ever switched supplier or tariff, compared to customers with A-levels. They are also 6 percentage points less likely to consider switching in the next three years. However, they are no less likely to switch based on any of the other three measures of actual switching; nor are they less likely to feel confident about their ability to switch.
30. Customers with degrees are on average 4 percentage points more likely to have switched in the last three years, compared to those with A-levels. Curiously, the results also indicate that customers with degrees are the least confident about their ability to switch of all qualification groups.

#### *PSR*

31. The regression results indicate that customers registered on PSR are less confident about their ability to switch. However, they are no less likely to switch in practice, or to consider themselves likely to switch in the future. This implies that being on PSR does not in itself make customers less likely to switch.

#### *CDSP indicators*

32. The regression results indicate that carers, customers with disabilities and/or single parents are no less likely to switch, no less likely to consider switching

in the next three years, and no less confident about their ability to switch, than customers who do not fall into any of these categories.

33. The fit of the baseline model is relatively strong, generating 60-87% correct predictions for actual past switching, 64% correct predictions for future switching, and 59-69% correct predictions for confidence in the ability to switch.
34. The full results of this logistic regression analysis are printed in **Appendix 1** to this Annex, which also contains the results of our two alternative specifications.

## APPENDIX 1: LOGISTIC REGRESSION ANALYSIS RESULTS

### Logistic regression (1) – baseline regression

The table below shows the results of logistic regression of switching behaviour and attitudes to switching, as described in

Table 18. Regression models of underlying drivers of switching behaviour: dependent variables

	Baseline (1)	Excl. contact (2)	Incl. preferences (3)
<b>Actual switching behaviour</b>			
Switched suppliers in the last 3 years	x	x	x
Switched suppliers in the last year	x	x	x
Ever switched suppliers	x	x	x
Ever switched suppliers and/ or tariffs	x	x	x
<b>Switching intentions</b>			
Likely to switch suppliers in the next 3 years	x	x	x
<b>Switching attitudes</b>			
Confident about being able to make the right decision	x	x	x
Confident about being able to find the right deal	x	x	x

Table 19

Table 37. Baseline (1) logistic regression results

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
VARIABLES	Switched supplier in last 3 years	Switched supplier in last year	Ever switched supplier	Ever switched (incl. internal)	Likely to switch in next 3 years	Confident about making right decision	Confident about finding right deal
18-35	-0.00717 (0.0229)	0.0251 (0.0178)	-0.0901** (0.0260)	-0.0852** (0.0276)	-0.0896** (0.0268)	0.0123 (0.0262)	-0.00235 (0.0279)
45-54	-0.0311 (0.0197)	-0.0206 (0.0137)	0.0160 (0.0235)	0.0126 (0.0243)	-0.112** (0.0230)	-0.0361 (0.0231)	-0.0211 (0.0242)
55-64	-0.0501* (0.0215)	-0.0209 (0.0152)	-0.0104 (0.0255)	-0.00318 (0.0266)	-0.146** (0.0258)	-0.0587* (0.0253)	-0.0299 (0.0266)
65+	-0.0600* (0.0242)	-0.0204 (0.0178)	0.000550 (0.0286)	0.00735 (0.0291)	-0.195** (0.0288)	-0.0249 (0.0277)	-0.0528 (0.0300)
Refused	0.0310 (0.0642)	-0.0454 (0.0321)	-0.00937 (0.0617)	0.0339 (0.0618)	-0.0273 (0.0654)	-0.0182 (0.0687)	-0.0948 (0.0707)
Under £18,000	-0.0130 (0.0206)	0.00514 (0.0160)	-0.0453 (0.0245)	-0.0362 (0.0246)	-0.0162 (0.0242)	-0.0454 (0.0238)	-0.0623* (0.0256)
£36,000+	0.0158 (0.0185)	0.0221 (0.0138)	0.00313 (0.0224)	0.00436 (0.0231)	0.00107 (0.0220)	0.0161 (0.0226)	-0.00139 (0.0236)
Refused/ Don't know	-0.0242 (0.0172)	-0.00920 (0.0125)	-0.0330 (0.0210)	-0.0430* (0.0215)	-0.0484* (0.0205)	-0.00101 (0.0204)	-0.00402 (0.0222)
Degree	0.0367* (0.0169)	-0.000125 (0.0132)	0.0250 (0.0205)	-0.00206 (0.0216)	0.0408* (0.0206)	-0.0559** (0.0200)	-0.0772** (0.0219)
GCSE	-0.00910 (0.0195)	-0.0116 (0.0155)	0.00406 (0.0235)	-0.00244 (0.0242)	-0.0437 (0.0239)	-0.0337 (0.0228)	-8.19e-05 (0.0246)
No qualifications	0.0109 (0.0236)	-0.0302 (0.0173)	-0.0306 (0.0268)	-0.0689* (0.0274)	-0.0624* (0.0264)	-0.0410 (0.0236)	-0.0258 (0.0268)
Refused/ Don't know	-0.0664* (0.0274)	-0.0452* (0.0199)	-0.0641 (0.0372)	-0.109** (0.0404)	-0.0455 (0.0409)	-0.0255 (0.0362)	-0.0130 (0.0412)
Registered on PSR	0.0121 (0.0210)	-0.00920 (0.0164)	0.0108 (0.0227)	0.0225 (0.0222)	0.0320 (0.0225)	-0.0546* (0.0219)	-0.0684** (0.0236)
Recipient of WHD	-0.106** (0.0241)	-0.0781** (0.0142)	-0.0784* (0.0316)	-0.0705* (0.0325)	-0.129** (0.0351)	0.00907 (0.0291)	0.0639* (0.0319)
Carer	0.0111 (0.0310)	-0.00437 (0.0217)	0.0418 (0.0356)	0.0155 (0.0369)	0.0202 (0.0363)	-0.0112 (0.0349)	-0.0192 (0.0369)
Disabled	-0.00934 (0.0343)	0.0121 (0.0260)	0.0392 (0.0416)	0.0137 (0.0432)	0.00961 (0.0410)	-0.00772 (0.0417)	0.00874 (0.0435)
Single parent	0.0645 (0.0423)	0.0371 (0.0315)	0.0820 (0.0469)	0.0471 (0.0459)	0.00472 (0.0457)	-0.0177 (0.0431)	-0.0419 (0.0461)
Multiple CDSP indicators	0.00499 (0.0252)	0.0115 (0.0174)	0.0391 (0.0293)	0.0198 (0.0316)	0.0167 (0.0299)	0.0252 (0.0298)	0.0140 (0.0312)
Own outright	-0.0673** (0.0177)	-0.0396** (0.0134)	-0.0697** (0.0212)	-0.0595** (0.0216)	-0.0624** (0.0213)	-0.00278 (0.0207)	-0.00927 (0.0221)
Rent private	-0.0959** (0.0197)	-0.0564** (0.0141)	-0.156** (0.0239)	-0.166** (0.0253)	-0.107** (0.0245)	0.0120 (0.0249)	0.0442 (0.0259)
Rent social	-0.0754**	-0.0449*	-0.112**	-0.125**	-0.158**	-0.00957	0.0455

	(0.0228)	(0.0175)	(0.0263)	(0.0272)	(0.0274)	(0.0252)	(0.0270)
Other	-0.0273	-0.0127	-0.0485	-0.0624	-0.103**	0.000954	0.00870
	(0.0344)	(0.0281)	(0.0380)	(0.0390)	(0.0375)	(0.0377)	(0.0397)
No internet access	-0.121**	-0.0592**	-0.121**	-0.147**	-0.176**	-0.124**	-0.0658**
	(0.0185)	(0.0148)	(0.0230)	(0.0239)	(0.0238)	(0.0236)	(0.0246)
Ever contacted by other supplier	0.0593**	0.0115	0.154**	0.1000**	-0.0201	0.0174	-0.0129
	(0.0125)	(0.00959)	(0.0146)	(0.0150)	(0.0143)	(0.0142)	(0.0152)
Ever contacted by own supplier				0.145**	-0.0138	0.0350*	0.0709**
				(0.0163)	(0.0153)	(0.0153)	(0.0164)
Observations	6,990	6,990	6,990	6,990	6,990	6,990	6,990
Standard errors in parentheses							
** p<0.01, * p<0.05							

### Logistic regression (2) – removing supplier contact indicators from the analysis

The table below shows the results of logistic regression 1 change if supplier contact indicators are removed from the analysis.

Table 38. Specification (2) logistic regression results (excluding contact by suppliers)

	(1)	(2)	(3)	(4)	(5)	(6)	
VARIABLES	Switched supplier in last 3 years	Switched supplier in last year	Ever switched supplier	Ever switched (incl. internal)	Likely to switch in next 3 years	Confident about making right decision	Confident about finding right deal
18-35	-0.0163	0.0231	-0.112**	-0.106**	-0.0861**	0.00863	-0.00316
	(0.0227)	(0.0174)	(0.0261)	(0.0278)	(0.0267)	(0.0263)	(0.0279)
45-54	-0.0309	-0.0206	0.0173	0.0164	-0.112**	-0.0353	-0.0201
	(0.0197)	(0.0137)	(0.0238)	(0.0246)	(0.0231)	(0.0231)	(0.0242)
55-64	-0.0478*	-0.0205	-0.00242	0.00734	-0.147**	-0.0565*	-0.0282
	(0.0216)	(0.0153)	(0.0259)	(0.0268)	(0.0258)	(0.0253)	(0.0266)
65+	-0.0611*	-0.0208	-0.000745	0.0135	-0.196**	-0.0235	-0.0495
	(0.0244)	(0.0178)	(0.0289)	(0.0294)	(0.0288)	(0.0277)	(0.0299)
Refused	0.0272	-0.0460	-0.0172	0.0216	-0.0255	-0.0218	-0.0987
	(0.0658)	(0.0321)	(0.0647)	(0.0625)	(0.0652)	(0.0691)	(0.0711)
Under £18,000	-0.0154	0.00472	-0.0522*	-0.0448	-0.0150	-0.0473*	-0.0637*
	(0.0208)	(0.0160)	(0.0249)	(0.0254)	(0.0242)	(0.0239)	(0.0255)
£36,000+	0.0173	0.0224	0.00631	0.00632	0.000673	0.0161	-0.00196
	(0.0187)	(0.0138)	(0.0229)	(0.0238)	(0.0220)	(0.0225)	(0.0236)
Refused/ Don't know	-0.0269	-0.00971	-0.0406	-0.0510*	-0.0472*	-0.00260	-0.00480

	(0.0173)	(0.0125)	(0.0214)	(0.0221)	(0.0204)	(0.0204)	(0.0221)
Degree	0.0352*	-0.000400	0.0208	-0.00487	0.0414*	-0.0565**	-0.0771**
	(0.0170)	(0.0133)	(0.0209)	(0.0221)	(0.0206)	(0.0199)	(0.0219)
GCSE	-0.00865	-0.0115	0.00553	-0.00908	-0.0430	-0.0353	-0.00398
	(0.0197)	(0.0155)	(0.0241)	(0.0250)	(0.0238)	(0.0229)	(0.0246)
No qualifications	0.00992	-0.0303	-0.0345	-0.0795**	-0.0611*	-0.0433	-0.0292
	(0.0235)	(0.0173)	(0.0268)	(0.0279)	(0.0264)	(0.0236)	(0.0268)
Refused/ Don't know	-0.0668*	-0.0453*	-0.0668	-0.102*	-0.0459	-0.0238	-0.00840
	(0.0276)	(0.0199)	(0.0379)	(0.0407)	(0.0409)	(0.0360)	(0.0412)
Registered on PSR	0.0121	-0.00919	0.0112	0.0223	0.0321	-0.0547*	-0.0688**
	(0.0211)	(0.0164)	(0.0231)	(0.0230)	(0.0226)	(0.0219)	(0.0236)
Recipient of WHD	-0.103**	-0.0777**	-0.0666*	-0.0610	-0.131**	0.0109	0.0632*
	(0.0246)	(0.0142)	(0.0325)	(0.0340)	(0.0351)	(0.0291)	(0.0320)
Carer	0.00873	-0.00482	0.0354	0.00356	0.0216	-0.0139	-0.0220
	(0.0314)	(0.0218)	(0.0366)	(0.0375)	(0.0363)	(0.0349)	(0.0369)
Disabled	-0.0147	0.0111	0.0248	-0.00558	0.0122	-0.0120	0.00547
	(0.0347)	(0.0261)	(0.0425)	(0.0435)	(0.0409)	(0.0417)	(0.0435)
Single parent	0.0639	0.0370	0.0798	0.0382	0.00557	-0.0198	-0.0447
	(0.0428)	(0.0317)	(0.0476)	(0.0473)	(0.0457)	(0.0430)	(0.0462)
Multiple CDSP indicators	0.000251	0.0106	0.0271	0.00455	0.0188	0.0219	0.0119
	(0.0256)	(0.0175)	(0.0302)	(0.0318)	(0.0298)	(0.0298)	(0.0311)
Own outright	-0.0674**	-0.0396**	-0.0700**	-0.0614**	-0.0622**	-0.00316	-0.0102
	(0.0179)	(0.0134)	(0.0215)	(0.0219)	(0.0214)	(0.0207)	(0.0221)
Rent private	-0.101**	-0.0575**	-0.171**	-0.185**	-0.105**	0.00819	0.0408
	(0.0196)	(0.0140)	(0.0242)	(0.0258)	(0.0245)	(0.0250)	(0.0258)
Rent social	-0.0757**	-0.0451**	-0.112**	-0.128**	-0.158**	-0.0101	0.0441
	(0.0231)	(0.0175)	(0.0269)	(0.0278)	(0.0273)	(0.0252)	(0.0271)
Other	-0.0276	-0.0128	-0.0485	-0.0652	-0.103**	8.26e-05	0.00709
	(0.0347)	(0.0282)	(0.0385)	(0.0384)	(0.0376)	(0.0374)	(0.0392)
No internet access	-0.123**	-0.0596**	-0.128**	-0.162**	-0.174**	-0.127**	-0.0699**
	(0.0184)	(0.0147)	(0.0230)	(0.0241)	(0.0238)	(0.0236)	(0.0245)
Observations	6,990	6,990	6,990	6,990	6,990	6,990	6,990

Standard errors in parentheses

**Logistic regression (3) – adding customer preferences and priorities into the analysis**

The table below shows the results of the logistic regression when customers' stated preference and priorities over price and non-price factors are added to the analysis (alongside customer characteristics and contact by suppliers).

Table 39. Specification (3) logistic regression results (including preferences over price and non-price factors)

	(1)	(2)	(3)	(4)	(5)	(6)	
VARIABLES	Switched supplier in last 3 years	Switched supplier in last year	Ever switched supplier	Ever switched (incl. internal)	Likely to switch in next 3 years	Confident about making right decision	Confident about finding right deal
18-35	-0.00209 (0.0224)	0.0265 (0.0177)	0.0870*** (0.0256)	0.0830*** (0.0274)	-0.0898** (0.0261)	0.00973 (0.0262)	-0.00262 (0.0277)
45-54	-0.0281 (0.0189)	-0.0199 (0.0135)	0.0181 (0.0229)	0.0127 (0.0240)	-0.108** (0.0223)	-0.0365 (0.0230)	-0.0223 (0.0241)
55-64	-0.0456** (0.0209)	-0.0197 (0.0151)	-0.00463 (0.0251)	0.000355 (0.0263)	-0.135** (0.0250)	-0.0585** (0.0253)	-0.0319 (0.0264)
65+	-0.0465* (0.0242)	-0.0155 (0.0179)	0.0189 (0.0280)	0.0208 (0.0288)	-0.171** (0.0284)	-0.0192 (0.0276)	-0.0501* (0.0297)
Refused	0.0373 (0.0645)	-0.0465 (0.0301)	0.00169 (0.0607)	0.0431 (0.0626)	-0.00579 (0.0659)	-0.00466 (0.0648)	-0.0750 (0.0698)
Under £18,000	-0.00253 (0.0206)	0.0122 (0.0160)	-0.0333 (0.0242)	-0.0259 (0.0245)	-0.00904 (0.0239)	-0.0424* (0.0241)	-0.0634** (0.0253)
£36,000+	0.0119 (0.0178)	0.0206 (0.0133)	0.000413 (0.0217)	0.00115 (0.0226)	0.00103 (0.0211)	0.0200 (0.0225)	0.00220 (0.0234)
Refused/ Don't know	-0.0132 (0.0170)	-0.00265 (0.0125)	-0.0181 (0.0206)	-0.0289 (0.0212)	-0.0335 (0.0199)	0.00824 (0.0205)	0.00271 (0.0217)
Degree	0.0248 (0.0165)	-0.00571 (0.0130)	0.0136 (0.0199)	-0.0103 (0.0212)	0.0318 (0.0197)	0.0571*** (0.0201)	0.0787*** (0.0215)
GCSE	0.000930 (0.0194)	-0.00631 (0.0157)	0.0143 (0.0230)	0.00722 (0.0237)	-0.0338 (0.0230)	-0.0351 (0.0228)	-0.00454 (0.0242)
No qualifications	0.0338 (0.0241)	-0.0167 (0.0185)	-0.00755 (0.0265)	-0.0464* (0.0268)	-0.0344 (0.0257)	-0.0382 (0.0236)	-0.0296 (0.0265)
Refused/ Don't know	-0.0556** (0.0282)	-0.0397* (0.0205)	-0.0465 (0.0370)	-0.0900** (0.0404)	-0.0203 (0.0415)	-0.0222 (0.0358)	-0.0162 (0.0406)
Registered on PSR	0.0110 (0.0207)	-0.00922 (0.0159)	0.00771 (0.0225)	0.0190 (0.0221)	0.0245 (0.0217)	-0.0523** (0.0217)	0.0634*** (0.0231)
Recipient of WHD	0.0929*** (0.0258)	0.0731*** (0.0155)	-0.0587* (0.0329)	-0.0501 (0.0334)	-0.105** (0.0349)	0.00999 (0.0290)	0.0638** (0.0317)
Carer	0.00323 (0.0306)	-0.0105 (0.0219)	0.0344 (0.0350)	0.0108 (0.0361)	0.0137 (0.0347)	-0.0115 (0.0344)	-0.0197 (0.0362)
Disabled	-0.0124 (0.0342)	0.0110 (0.0266)	0.0360 (0.0414)	0.0110 (0.0426)	0.0110 (0.0395)	-0.00917 (0.0413)	0.0110 (0.0431)
Single parent	0.0763* (0.0421)	0.0425 (0.0325)	0.0921** (0.0462)	0.0574 (0.0448)	0.0171 (0.0441)	-0.0144 (0.0429)	-0.0368 (0.0454)
Multiple CDSP indicators	-0.00633 (0.0247)	0.00389 (0.0178)	0.0291 (0.0286)	0.0126 (0.0306)	0.00482 (0.0285)	0.0261 (0.0292)	0.0180 (0.0305)



Own outright	0.0564*** (0.0172)	-0.0333** (0.0132)	0.0572*** (0.0208)	-0.0483** (0.0214)	-0.0426* (0.0205)	-0.00116 (0.0207)	-0.0112 (0.0219)
Rent private	0.0781*** (0.0195)	0.0477*** (0.0143)	-0.132*** (0.0236)	-0.142*** (0.0249)	-0.0799** (0.0243)	0.0180 (0.0246)	0.0424* (0.0257)
Rent social	-0.0561** (0.0230)	-0.0349** (0.0176)	0.0875*** (0.0264)	-0.103*** (0.0272)	-0.128** (0.0269)	-0.00238 (0.0251)	0.0506* (0.0269)
Other	-0.00467 (0.0347)	0.00203 (0.0289)	-0.0253 (0.0384)	-0.0437 (0.0398)	-0.0789* (0.0369)	0.00548 (0.0374)	0.00494 (0.0389)
No internet access	0.0912*** (0.0208)	-0.0415** (0.0174)	0.0829*** (0.0238)	-0.112*** (0.0243)	-0.133** (0.0247)	-0.114*** (0.0237)	0.0642*** (0.0247)
Ever contacted by other supplier	0.0585*** (0.0123)	0.0104 (0.00949)	0.155*** (0.0144)	0.100*** (0.0148)	-0.0179 (0.0139)	0.0153 (0.0141)	-0.0179 (0.0150)
Ever contacted by own supplier				0.147*** (0.0161)	-0.00858 (0.0149)	0.0363** (0.0152)	0.0707*** (0.0161)
Price essential	0.0676*** (0.0193)	0.0345** (0.0149)	0.0938*** (0.0226)	0.0778*** (0.0232)	0.177** (0.0210)	-0.0342 (0.0222)	0.0765*** (0.0237)
Price very important	0.0319* (0.0165)	0.0171 (0.0128)	0.0544*** (0.0203)	0.0527** (0.0209)	0.148** (0.0185)	-0.00647 (0.0195)	-0.0276 (0.0210)
Price not important	-0.116*** (0.0287)	0.0781*** (0.0163)	-0.146*** (0.0377)	-0.136*** (0.0486)	-0.117** (0.0382)	-0.130*** (0.0493)	-0.0532 (0.0511)
Price - Don't know	-0.0639 (0.0541)	0.00414 (0.0510)	-0.0674 (0.0623)	-0.0675 (0.0616)	-0.00360 (0.0670)	-0.139** (0.0706)	-0.259*** (0.0674)
Customer service essential	0.0660*** (0.0231)	0.0510*** (0.0153)	0.0946*** (0.0280)	0.0894*** (0.0293)	-0.138** (0.0284)	-0.0355 (0.0283)	0.0283 (0.0308)
Customer service very important	0.0528*** (0.0174)	-0.0177 (0.0132)	0.0658*** (0.0206)	0.0677*** (0.0215)	-0.0781** (0.0213)	-0.00547 (0.0207)	0.0212 (0.0219)
Customer service not important	0.0608*** (0.0150)	0.0552*** (0.0116)	0.0504*** (0.0179)	0.0271 (0.0186)	0.0509** (0.0178)	0.00292 (0.0178)	-0.00812 (0.0188)
Customer service - Don't know	-0.0551 (0.0498)	-0.0430* (0.0225)	-0.0343 (0.0604)	-0.0529 (0.0536)	-0.131* (0.0518)	-0.0293 (0.0501)	-0.110** (0.0552)
Reputation/ brand essential	-0.0203 (0.0188)	-0.0149 (0.0141)	-0.00761 (0.0230)	-0.0152 (0.0237)	-0.0449* (0.0222)	-0.0175 (0.0231)	-0.0423* (0.0244)
Reputation/ brand very important	-0.00547 (0.0170)	4.47e-05 (0.0131)	0.00338 (0.0209)	-0.00530 (0.0217)	-0.0289 (0.0199)	-0.0135 (0.0209)	-0.0229 (0.0221)
Reputation/ brand not important	0.0187 (0.0394)	-0.00586 (0.0279)	-0.0111 (0.0478)	0.0160 (0.0528)	-0.0456 (0.0452)	-0.0494 (0.0477)	-0.0272 (0.0505)
Reputation/ brand - Don't know	-0.152*** (0.0506)	-0.0397 (0.0488)	-0.120 (0.0879)	-0.0541 (0.110)	-0.204* (0.0844)	-0.0730 (0.0862)	-0.0853 (0.0967)
Other services essential	-0.0238 (0.0277)	-0.00468 (0.0226)	-0.0647** (0.0321)	-0.0580* (0.0332)	-0.0827* (0.0339)	0.0100 (0.0301)	0.0424 (0.0336)
Other services very important	-0.0211 (0.0218)	-0.0102 (0.0169)	-0.0480* (0.0257)	-0.0600** (0.0264)	-0.0375 (0.0265)	-0.0276 (0.0261)	0.0190 (0.0270)
	0.0646***	0.0326**	0.0557***	0.0410*	0.0353	-0.0145	-0.00611

Other services not important	(0.0168)	(0.0128)	(0.0204)	(0.0215)	(0.0202)	(0.0203)	(0.0215)
	-0.0539	-0.00313	-0.0961*	-0.0792	-0.0726	-0.0634	-0.0877*
Other services - Don't know	(0.0409)	(0.0325)	(0.0531)	(0.0539)	(0.0522)	(0.0470)	(0.0522)
Observations	6,990	6,990	6,990	6,990	6,990	6,990	6,990

Standard errors in parentheses

\*\* p<0.01, \* p<0.05

## SSE: RESPONSE TO NOTICE OF POSSIBLE REMEDIES

### ANNEX TO REMEDY 3 – DOMESTIC TARIFF RESTRICTIONS

1. SSE considers that it would be counterproductive to attempt to itemise a list of acceptable tariff offerings which the CMA should consider. Therefore this annex does not attempt to provide an exhaustive list of tariff offerings potentially enabled by the removal of the RMR domestic tariff restrictions. Instead, it itemises the minimum scope of licence modification required in order to enable a slightly wider range of tariff offerings for customers:
  - (a) Versions of tariffs based on consumption level *i.e.*, a high consumption version with a high standing charge and low unit rate, a low consumption version with low/no standing charge and medium consumption version with medium standing charge and unit rates:
    - (i) The tariff cap (SLC 22B.1 – SLC22B.2C) currently makes this unfeasible.
  - (b) FTC fixed discount “tracker” tariffs which track a supplier’s SVT at a specified discount – SSE used to offer these types of tariffs and they proved popular with customers:<sup>1</sup>
    - (i) The ban on increasing prices on an FTC (SLC 22C.9) prohibits these tariffs; and
    - (ii) There are exceptions to compliance with this ban, however these exceptions would result in impractical and confusing tariffs (SLC 22C.10 - SLC 22.11B).<sup>2</sup>
  - (c) Innovative ToU tariffs which allow customers to benefit from smart meters – at the time of making the domestic RMR proposals, Ofgem indicated that the core tariff proposals may be incompatible with smart ToU tariffs,<sup>3</sup> later, Ofgem’s CEO stated that they saw the tariff cap as an interim measure:<sup>4</sup>
    - (i) The tariff cap (SLC22B.1 - SLC22B.2C) greatly restricts suppliers’ ability to offer a range of smart tariffs.

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<sup>1</sup> See SSE’s response to S.81 of the *SQ*.

<sup>2</sup> The RMR rules allow one form of automatically indexed tariff, however the index must be based on a reference price which the supplier does not control (and cannot therefore track the SVT). This arrangement is more complicated than previous tracker tariffs and no supplier has been able to devise a commercially viable and compliant tariff. SSE is unsure if this confusing type of tracker tariff would be at all popular with customers.

<sup>3</sup> See Ofgem, *The Retail Market Review: Domestic Proposals* (1 December 2011) – available at <https://www.ofgem.gov.uk/ofgem-publications/39648/rmr-domestic-consultation-december-2011.pdf>.

<sup>4</sup> See <http://www.telegraph.co.uk/finance/newsbysector/energy/11181402/Ofgem-chief-signals-u-turn-over-energy-tariff-cap.html>.

- (d) “Non-standard” SVTs – as SSE has noted previously,<sup>5</sup> the “*dead tariff*” rules have shifted competition and acquisition activity primarily into the FTC market, disadvantaging customers who prefer SVTs:
  - (i) The ban on creating new dead tariffs (SLC22D.1 – SLC22D.1A) means that when an SVT is withdrawn from sale, all customers must be migrated off it.
- (e) Acquisition tariffs which are for new customers only might help to boost engagement and switching levels:
  - (i) The requirement to have tariffs available to new and existing customers (SLC22B.29) means that acquisition tariffs are not permitted.
- (f) Loyalty tariffs which are exclusively for existing customers and reward them for their loyalty:
  - (i) The requirement to have tariffs available to new and existing customers (SLC22B.29) means that loyalty tariffs are not permitted.
- (g) Tiered rate tariffs (rates that vary depending on level of consumption), which allow suppliers to offer a commercially viable nil standing charge tariff (and which do not result in customers with high consumption paying excessive prices):
  - (i) The unit rate and standing charge requirements (SLC22A) do not allow for tiered rate tariffs; and
  - (ii) The definition of ToU rates and ToU tariff in SLC1 prohibit ToU tiered rates.
- (h) Social tariffs for customers in fuel poverty:
  - (i) The tariff cap (SLC22B.1 – SLC22B.2C) hinders suppliers from offering tariffs aimed at a limited audience;
  - (ii) Discount restrictions (SLC22B.3 – SLC22B.7) mean that suppliers cannot offer extra discounts or larger discounts to vulnerable customers; and
  - (iii) Whilst suppliers can apply for a derogation, this process is rather slow and reduces the ability of suppliers to be flexible and reactive in their tariff offering.
- (i) Niche tariffs (such as “*green*” tariffs):
  - (i) These tariffs have a limited appeal and as such are not commercially viable whilst the tariff cap (SLC22B.1 – SLC22B.2C) remain in place.

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<sup>5</sup> See RIS, Annex 6.2, paras. 14 – 17; and RUIS, para. 8.8.6.

- (j) Bundled products and services:
    - (i) The bundling rules (SLC22B.8 - SLCB.28) greatly restrict suppliers ability to offer products and services with tariffs and the intent of these obligations is unclear and confusing; and
    - (ii) The rules also make it impossible for suppliers to give customers “*surprise and delight*” rewards, unless the details of these gifts have been set out in the terms and conditions.
  - (k) It would also be in customers’ interests for suppliers to offer a range of discounts (such as prompt payment discount, refer a friend discount and discounts for taking out multiple additional services):
    - (i) Restrictions on cash discounts (SLC22B.3 - SLC22B.7) mean that suppliers are unable to offer any discount other than for online account management and duel fuel or an adjustment for paying by Direct Debit.
2. Removing the tariff restrictions would additionally allow PCWs to compete through exclusive tariffs and cashback offers. These rewards would act as an encouragement for customers to shop around and switch, whilst increasing the competitive pressure on PCWs. This development would be beneficial to customers:
- (a) PCW-exclusive tariffs would require the removal of the tariff cap (SLC22B.1 - SLC22B.2C), the discount rules (SLC 22B.3 - SLC 22B.7) and exclusion from, or removal of, CTM; and
  - (b) PCW exclusive rewards and cashback would require removal of the bundling rules (SLC 22B.8 - SLCB.28).

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## SSE: RESPONSE TO NOTICE OF POSSIBLE REMEDIES

### ANNEX TO REMEDY 11 – TRANSITIONAL SAFEGUARD TARIFF

#### 1. Inherent difficulties with price control

- 1.1 Forecasting supply costs is problematic due to the uncertainty and risks inherent in the market. In a low margin business like energy supply this can easily lead to supply businesses being pushed into a loss making position.

##### *Timing of cost assessments*

- 1.2 The timing of cost assessments is critical. The cost assessments should either take place in April, when network use of system charges and the RO are set, or closer to winter when wholesale prices for delivery in January and February are more certain (the coldest months with the highest demand) and demand forecasts are less uncertain. This timing would allow better management of market risk. Regardless of the choice, a price control would be likely to reduce wholesale liquidity as all suppliers would have an incentive to operate a retail hedge that aligns well with the timing of the price control.
- 1.3 SSE's long experience of pricing in the retail supply market confirms the problematic nature of anticipating movements in costs. A common misunderstanding is to attribute all the risk to the volatility of the wholesale market along with the volume and price risk which go with short term disturbances such as unexpected weather variations. These factors are, of course, an important source of risk as described in previous submissions to the CMA; a paper by Frontier Economics demonstrated the potential scale of this volatility,<sup>1</sup> but non-energy costs also contribute significantly to deviations in expected outturn costs.

##### *Forecasting costs*

- 1.4 The inherent difficulty in forecasting key costs is captured in the table and chart below. These show SSE's evolving view of non-energy direct costs affecting pricing decisions for 2015-16 up until the forecasts became actuals (these costs make up around 35% of the bill). Even at six months ahead of delivery the forecast error equates to 1% of the total bill. This forecasting uncertainty is inherent in the process rather than being the result of the methodology adopted.
- 1.5 It is unclear how the regulated price accommodate FiTs and CfDs, since these are only known retrospectively. This would suggest that some margin for uncertainty would be required within the price cap. Currently each supplier makes its own decision regarding management of such uncertainty, but it is unclear how a regulator could objectively identify a reasonable approach to be applied by all suppliers, with no reference to the risk appetite of each supplier.

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<sup>1</sup> See Frontier Economics, *Estimating the capital employed for a standalone GB energy retailing company: Further considerations regarding collateral and risk capital* (December 2014).

- 1.6 Important choices affecting the level of price controls must also be made regarding the choice of reference for wholesale energy costs. Should forecasts use published rates or independent forecasts? What hedging assumptions should be made? A forward element of energy cost will still be exposed to market volatility – what allowance should be made for this? How would shape and swing costs be dealt with? Market volatility risk (*i.e.*, price movements on unhedged volumes) and swing (*i.e.*, variations in demand due to changes in customer numbers or consumption patterns and the impact of weather) cannot be suitably wrapped up in a fee-based arrangement with a third party. The degree to which shaping costs would be accounted for under such arrangements is also questionable.

**Materiality of non-energy direct cost projection errors on prices**

[X]

**Evolution of non-energy direct cost forecasts used in pricing calculations for 2015/16**

[X]

- 1.7 As an illustration of the difficulties faced when setting prices, it is worth considering the challenges faced by Ofgem in reporting on forward-looking costs and prices. Ofgem publishes a forward-looking assessment of domestic cost and prices in its Supply Market Indicators (*SMI*) report. NERA reviewed the SMI data<sup>2</sup> and concluded that Ofgem had persistently overstated profit margins, by £17-29 per customer in the period January 2009 to January 2013. Oxera also found that the updated SMI continued to overstate revenues and understate costs in the period covering the calendar year 2013. The result was an over-prediction of margin per customer of £9 for gas and dual fuel, while the figure for electricity was £23. If a calculation like the SMI had been used by a regulating agency as the basis for setting a cap, profits would have been systematically depressed against the expected level by around 2%.
- 1.8 This depression could be viewed as a relatively low disturbance in some lines of business but it should be noted that the CMA has indicated that it regards the reasonable range for out-turn margin in a competitive supply business to be 1-3%. One benefit of a CMA review of the issues surrounding the setting of a safeguard price cap would be that the significance of the risks facing retail supply would become more apparent along with the inadequacy of the CMA's assumptions on the profitability benchmark.

*Accommodating different groups of customer*

- 1.9 Setting a price cap could lead a regulating authority into potentially deep commercial judgements over the appropriate structure of tariffs. Setting tariffs

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<sup>2</sup> See NERA, *Energy Supply Margins: Commentary on Ofgem's SMI* (January 2015).

requires striking a balance between different cost and risk components and determining their key drivers against the practicalities of setting rates that can be billed and understood by customers.

- 1.10 A key dilemma in the case of pricing domestic gas is the treatment of use of system capacity charges which must somehow be balanced between standing charges and unit rates to avoid undue complexity in tariff structures. If a greater proportion of capacity cost is collected through unit rates (in order to keep standing charges low) the consequence will be a greater risk to short term retail supply margins as a result of any fluctuations in consumption. This is a commercial judgement on risk which is best made by the party taking the risk rather than a regulatory authority. A price cap could require a regulating authority to make potentially difficult commercial judgements over the appropriate structure of tariffs. Balancing the different cost and risk components and judging the practicalities of setting rates that can be billed and understood by customers would seem to take regulation into a wholly inappropriate sphere with scope for a series of unintended consequences.
- 1.11 The clear conclusion is that if the route of price capping is taken, the CMA should aim to be broad and avoid differentiating between customer groups as much as possible (*e.g.*, a less intrusive approach would be to set a nationwide maximum average revenue for energy to domestic customers (in p/kWh, as measured on a typical size of customer)) for each fuel.

#### *Regional Differentials*

- 1.12 Similarly use of system costs vary by region which creates a further potential unintended consequence of the safeguard price cap. The prohibition on price discrimination (SLC25A) is no longer in force, which means that it is permissible for suppliers to choose to offer significant differentials between regional prices for SVTs (indeed, competition may drive this behaviour). However, a regulatory authority setting a detailed tariff cap would need to accurately price regional differences cost reflectively. This consideration means that the safeguard tariff would effectively equate to the reintroduction of a prohibition on-price discrimination applied to the SVT segment.

#### *Payment Method Differentials*

- 1.13 A key issue receiving scrutiny by regulators, politicians, consumer groups and other stakeholders is the differentials set by suppliers between different payment methods.<sup>3</sup> On the one hand, there is an over-arching principle in regulation that these must be cost reflective (as per SLC27.2A) although certain dispensations are looked on benignly in case of the cross-subsidy to benefit PPM customers and the flattened charge arrangements for EBICO customers.
- 1.14 There would also be judgements required regarding discounts for online customers and the potential benefit from paperless billing. Among other

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<sup>3</sup> See response to the SQ, S.54 and S.61 - S.62 and S.82 on SSE payment differentials and for evidence on cost differentials submitted by SSE to Ofgem.



issues, a view on the appropriate level for a dual fuel discount, if any, would need to be specified if the path of a detailed safeguard price cap was chosen.

- 1.15 These issues would be a problematic area for regulators to take on in the process of safeguard price cap setting.

#### *Time of Use Tariffs*

- 1.16 Another area of tariff sensitivity exists around the setting of off-peak rates versus day rate. [X]. This should be seen in the context of the heavy burden levied on electricity units taken at night by the way in which government schemes are financed.
- 1.17 The appropriateness of a regulatory agency setting a detailed cap recognising a cross-subsidy between day rates and off-peak rates in these tariffs.

## **2. Other tariff types**

- 2.1 A detailed setting of a tariff cap would raise the issue of how to set the level of more challenging tariffs. If prices for some tariff types are set with reference to the regulated SVT cap then how should the differential be set? The CMA or Ofgem would need to appraise the costs of Economy 7, Economy E10, and the regional variants of DTS tariffs properly. Each of these has their own particular characteristics with respect to: split of peak and off-peak consumption; times for off-peak, which vary by region; and regional use of system charges as discussed above.

## **3. Non-domestic customers**

- 3.1 The issue of tariff structures, standing charges, capacity charges, regional differentials and time of use effects also apply to SME customers. However, there are a number of considerations which would be particularly important in relation to setting prices for this group.
- 3.2 For instance, the question of how to reflect bad debt risk across non-domestic tariffs. The risk of bad debt would need to be considered in setting tariff rates and also in comparison with those applied to deemed rates.
- 3.3 Seasonal effects would be another important consideration for the level of a cap in the business market. There is a strong differential between the costs of supplying volumes to a customer in winter in comparison to summer. Setting a cap on an annual average basis would put a supplier at risk if they only had the customer during winter months.

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