

ENERGY MARKET INVESTIGATION

Summary of response hearing with E.ON on 25 August 2015

Opening statement

1. While E.ON understood the CMA's reasoning for not provisionally finding an AEC in relation to small supplier exemptions, it asked the CMA to reconsider its provisional view and E.ON's proposal that the small supplier exemption be removed. E.ON proposed that a secondary trading or buy-out mechanism could be put in place to enable small suppliers to comply with these obligations and avoid any problems involving barriers to expansion or disproportionate costs being levied on small suppliers. E.ON also argued that this would remove the market distortion it considered was caused by the exemption.
2. E.ON considered that the CMA's provisional findings on profitability were flawed because they were based on inappropriate analytical methods and were selective in nature. This had led to unreliable results. E.ON's view was that the CMA's reliance on Return on Capital Employed (ROCE) was inappropriate for a supply business which was asset-light. E.ON also believed that the CMA's analysis of efficient pricing and costs suffered from relying on similar assumptions to its ROCE analysis as well as having other issues of its own. E.ON considered that margin benchmarking was a more appropriate analytical method, but argued that the way the CMA had conducted this analysis so far was overly narrow and highly selective, and led to unreliable conclusions. E.ON considered that evidence it had submitted on using a broader range of benchmark comparators demonstrated that the GB energy supply industry was not making excessive profits. E.ON expressed concern that this flawed analysis had become the leading story when the CMA published its findings, which was damaging to the industry.
3. E.ON was also concerned about the CMA's finding that there was an overarching feature of weak customer response giving rise to suppliers having unilateral market power. E.ON argued that as the CMA's profitability analysis was flawed it did not provide evidence of excessive profits and hence that customers were being exploited by suppliers. It also argued that evidence of customer disengagement was inconclusive and that switching gains would be present in all competitive markets. E.ON argued that the CMA's customer survey supported the proposition that customers took account of more than

just price when deciding whether or not to switch suppliers. It did not believe that there was robust evidence that customers were disengaged such that there was UMP, which suppliers might exploit. It was not possible for E.ON to distinguish between its SVT customers, and hence it treated every SVT customer as if they were engaged or potentially engaged and active. E.ON recognised that there might well be some customers who were less active, but these were protected by those who were active or could potentially be so.

4. E.ON considered that the SME market was currently experiencing an increase in levels of competition and market participation. [REDACTED] E.ON had sought to increase its engagement with SME customers through a number of measures, including greater engagement at contract renewal through clearer communication, discontinuing auto-rollovers and seeking to improve the view of TPIs. E.ON was concerned that the CMA did not appear to have factored in E.ON's view about the greater risks, particularly around bad debt, that suppliers faced in the SME market.
5. While E.ON fundamentally disagreed with some of the CMA findings and some of the remedies based on them, it did agree with some of the CMA's proposed remedies; such as those on improving customer communications, locational pricing, and smart meters for pre-payment customers; which it considered were aligned with its strategy of creating a trusted partnership with its customers.

Profitability analysis

6. E.ON argued that its preferred measure of profitability would be return on sales margin because this was the best way to assess an asset-light industry. The period over which this should be assessed was 2007 to 2013 because this would cover the whole of an economic cycle. E.ON said its EBIT margin over the period 2007 to 2013 was around [REDACTED], which when compared to other industries was not excessive. E.ON did not suggest that its figure represented that of a benchmark 'efficient' supplier, but suggested using benchmarks based upon a number of other sectors.
7. E.ON had reviewed the various elements of the CMA's profitability analysis and considered that the results were very sensitive to very small changes in the underlying assumptions, which could reasonably be made. It highlighted the CMA's own cost benchmarking analysis in this regard, which showed significant inconsistency in terms of which firm was at the 'efficient' cost level. It also argued that as the various elements of the CMA's profitability analysis shared some assumptions as well as having several inconsistencies, they should not be seen as independently corroborating each other's results.

Retail remedies

Remedy 3 – Remove from domestic retail energy suppliers’ licences the ‘simpler choices’ component of the RMR rules

8. E.ON was supportive of removing some of the rules introduced in this part of Ofgem’s retail market reforms (RMR). It was not in favour of reversing all of the RMR changes, for example the ban on multiple evergreen tariffs. Changes to the RMR rules needed to be considered carefully so that suppliers develop products that meet customers’ needs, resulting in improved competition and a building of trust with customers.
9. If the four-tariff rule was removed and regulation was based around active enforcement of broad principles of treating customers fairly, then it was possible that some suppliers would attempt to probe the boundaries of what was ‘fair’ and E.ON could differentiate itself by ensuring it behaved fairly. In addition, SLC25 and 25C (standards of conduct) required suppliers to ensure customers really understood what tariffs meant financially and promote fairness, and these would remain.
10. One way of assisting customers to understand the financial implications of tariffs would be to provide them with a way of taking their current energy usage and calculating what they would pay on different tariffs. E.ON noted that the class which the CMA suggested, of irredeemably disengaged customers, would not be helped by such a facility, but it argued that very few customers were irredeemably disengaged and quoted from the CMA’s survey in relation to percentage of customers who have either switched, shopped around to compare or considered switching. E.ON argued that it was not possible for suppliers to know which of their SVT customers were engaged and which were not. SVT customers were not a homogenous group, and those which were more active protected those who were less. E.ON considered that removing the four-tariff limit and allowing suppliers more flexibility on tariff design would lead to more customers to becoming engaged.
11. Encouraging customers to check more than one price comparison website (PCW) when shopping around might increase customer reluctance to use PCWs as it would make the process appear more complicated. If a customer used one site then they would have engaged with the market.

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

12. E.ON’s view was that an Ofgem PCW that covered the whole of the market and allowed transactions to be completed through it would massively distort

the PCW market. However, a site, whether provided by Ofgem or some other body, that simply provided data about all the tariffs available on the market might be beneficial as it would allow consumers to be confident that they were reviewing the whole market and would avoid the issues noted in paragraph 11 above. E.ON was aware that Citizens' Advice was proposing to set up a similar service, and E.ON considered that they could be a better provider of such a service than Ofgem as Citizens' Advice's work already involved dealing with customers who were likely to be less engaged. E.ON noted that Citizens' Advice already had shops and telephones and hence could provide this service.

13. If the CMA's remedies allowed suppliers to make exclusive offers via PCWs, E.ON would not have any objections with having to provide information about these offers to a whole-market PCW.

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

14. E.ON's view was that there was currently too much information on customer bills and that the quantity and nature of this information was not helping to engage customers. The bill was currently used to try to address too many objectives. Customers only wanted an accurate bill which told them how much they owed. If the bill was to have another objective, then it should be to encourage customers to engage in the market. Any more information would undermine the core messages.
15. E.ON had commissioned research that suggested that current bill formats contained too much information and confused customers. Further research should be done to work out how best to present the essential information noted above to customers. E.ON considered that the CMA's remedies in this area should prescribe a very limited number of objectives for bills and then allow suppliers and Ofgem to work how these should be achieved.

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

16. E.ON considered that 'calls to action' for consumers to engage with the market in bills and other material could be improved and made less confusing. E.ON noted the recent DECC campaign which had led to a large increase in the number of customers switching. E.ON understood that DECC was planning to run another similar campaign. An annual government campaign might be helpful. Equally, campaigns by other agencies might be of use.

17. Annual statements could also be improved. Currently their content included information about efficiency, savings, and how customers could pay. It was not clear what their focus was, and like bills they needed to be simplified and targeted to provide information that customers wanted and which they could use. The advent of smart meters, in conjunction with the CMA's proposals, could lead to major improvement on how messages were provided to customers and their engagement with the market.
18. E.ON did not consider that there was a conflict of interest in suppliers providing information about engagement to consumers. Its strategy had been to gain its customers' trust by helping them to switch to the best tariff it could offer them.
19. As far as SMEs were concerned, E.ON had continued with its proactive stance in terms of approaching customers prior to and during contract renewal. While the information in the offer letter that E.ON sent to customers was prescribed, E.ON did conduct research to understand how best to increase customer engagement. Two years ago, [redacted] of E.ON's SME customers' contracts automatically rolled over; this figure had reduced to approximately [redacted], so it was possible to prompt customers to engage with contract renewal.
20. E.ON suggested that suppliers could be required to 'take all reasonable steps' to contact microbusiness customers on deemed or out-of-contract tariffs twice a year to try to get them to engage with the market. This had the advantage of putting the onus on the supplier. This would be much harder to do with domestic customers because the domestic market was much larger, so bills and other existing communication channels were preferred in that market.
21. The line between marketing to and servicing existing customers was very fine. Where customers did not give permission for companies to contact them further with marketing materials, it could make keeping customers informed and engaged more difficult. E.ON spent considerable time considering whether particular communications were 'service' or 'marketing' messages before issuing them.
22. E.ON's view was that more could and should be done to engage customers. However, it was concerned that telling SVT customers that they were not on indefinite evergreen contracts would be untrue and could lead to vulnerable customers being worried that their energy might be switched off. If annual fixed-term contracts replaced all evergreen contracts in the domestic sector; this would bring it more into line with the SME market and could arguably increase the opportunities for and actual engagement. However, E.ON expressed concerns with the approach of forcing action upon customers and

about what would happen at renewal. In addition the default fixed contracts would need to have no exit fees in order to avoid the issues of auto-rollover. E.ON would consider further what other consequences there would be if only fixed contracts were allowed and whether such a system would provide the right sort of trigger point for engagement.

23. E.ON noted that while it was not the case at present, there had been times in the past when there had been fixed-price tariffs higher than the SVT. Also, some SVT customers might genuinely prefer to be on an SVT tariff in order to avoid sudden changes in the size of their bills at renewal. E.ON wanted to engage with its SVT customers because by doing so it believed they would be more likely to stay with E.ON. It offered its customers on fixed tariffs its price alert service which would inform them whenever it launched a new comparable-term fixed tariff. E.ON wanted to engage with its customers so that they trusted E.ON and would be less likely to switch away. This would enable E.ON to grow its business.
24. E.ON considered that the price it charged for its fixed tariffs, which was lower than its SVT price, was fair. It disputed the Panel's use of the word 'rents' in relation to the prices E.ON charged its SVT customers even if the CMA might have found this in relation to other companies. Some customers found one-year fixed tariffs unattractive because they thought prices might fall in the meantime. Whether or not an SVT price fell would depend on the supplier's hedging strategy. E.ON had noted that some of its fixed-price customers had moved to new fixed price tariffs before the end of their initial tariffs' term.

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

25. E.ON argued that the CMA's customer survey showed that levels of consumer engagement were good, in that 89% of consumers knew they could switch, a large percentage had shopped around and 44% had switched supplier at some time in the past. E.ON noted that, in July, there had been the highest July switching number in the residential market that had been seen in three years. E.ON said that the GB energy market had previously been described as the most competitive energy market in Europe, so it was strange to be considering price regulation for it. E.ON argued that neither the levels of switching nor suppliers' profitability justified such an intervention.
26. E.ON considered that if the CMA was minded to pursue the introduction of a regulated tariff; then that tariff should be limited to the most disengaged customers in the market. E.ON noted that that the CMA had suggested that there was a greater propensity among certain classes of customer, who had a degree of vulnerability, to be less engaged with the market and that, if you

were to protect a class of customers, it should only be these. This could better be done through government measures like the Warm Homes Discount, although this could also be improved.

27. The introduction of a regulated tariff would lead to the convergence of the suppliers' hedging strategies in order to be able to match the regulated price. If this led to a shorter hedging strategy, then suppliers might have to change their retail prices more often, which could discomfit SVT customers who were used to the less frequent price changes they currently experienced. Some of the other suppliers' costs involved would simply be passed through to consumers, but this would vary from region to region. Determining the level of indirect costs was not straightforward as it would be necessary to decide what the benchmark for these should be.
28. E.ON agreed with the suggestion that a safeguard tariff would lead to those customers on it becoming more disengaged as they would feel protected by such a tariff even if there were cheaper offers available. If a regulated tariff only applied to a sub-set of customers, it could require suppliers to run two separate hedging strategies and could lead to the safeguard tariff being higher than the supplier's own SVT. E.ON asked what basis of costs would be used to calculate the regulated tariff (using a cost-plus basis) and argued that using an inappropriate industry norm on costs could lead to significant issues for those suppliers who were arguably 'less efficient' than the norm (in the period before they were able to improve their efficiency).
29. E.ON noted that a range of different industry participants and interested parties had raised concerns about operation, unintended consequences, and the practicality and proportionality of a regulated tariff.

Remedy 5 – Requirement that energy firms prioritise the roll-out of smart meters to domestic customers who currently have a prepayment meter

30. E.ON's existing policy was to prioritise the roll-out of smart meters to its prepayment customers. E.ON said there were some technical issues with the CMA's suggested remedy as well as the potential for unintended consequences which could raise the overall cost of the smart meter rollout programme.
31. E.ON had recently announced that it would make all its tariffs available to its pay as you go customers along with discounts equivalent to those available to its direct debit customers. E.ON considered there was a competitive advantage for it in focusing on its prepayment customers and by doing so, attracting other companies' prepayment customers.

32. E.ON was currently installing SMETS 1-compliant meters with the intention that these would be enrolled with the DCC. SMETS 1-compliant meters had almost the same specifications as SMETS 2 meters and E.ON believes these would only need a small upgrade. These were different from SMETS 1-capable meters which would need upgrades to be enrolled with the DCC. E.ON considered that obstacles to the prioritisation of smart meter delivery to prepayment customers could be overcome.

Remedy 7a – Introduction of a new requirement in the licences of retail energy suppliers to provide price lists for microbusinesses on their own websites and to make this information available to PCWs

33. E.ON's view was that even if the microbusiness remedies were limited to businesses in profile classes 3 and 4, there was a much greater degree of complexity in tariffs and pricing than for domestic customers. This level of complexity meant that although these customers would look at prices posted on suppliers' websites they would still contact the supplier to negotiate.
34. Going forward, E.ON considered that quotation tools for energy could work in a similar way to those for insurance. While it might be possible to design a quotation tool which took into account variables like credit risk, payment method, and time of use, E.ON's experience was that very few of its business customers signed up to their tariff online. They wanted to have a conversation and liked to feel that they had negotiated with their energy supplier.
35. Prices produced by quotation tools ought to leave some room for negotiation and be a trigger for such a conversation. E.ON approached renewal offers with existing customers in a similar way.

Remedy 7b – Introduction of rules governing the information that TPIs are required to provide to microbusiness customers

36. E.ON was in favour of the introduction of an Ofgem-sponsored code of practice for TPIs selling energy to businesses. E.ON had its own code which had a set of principles to which the TPIs it contracted with had to adhere. E.ON had been working closely with Ofgem for the past couple of years on getting an Ofgem-sponsored code implemented across the industry. E.ON said that TPIs would welcome such a code as it would provide consistency. Any Ofgem-sponsored code needed to include consequences for misbehaviour. There were some practices in this market, such as aggressive cold calling, that needed to be addressed.

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

37. E.ON agreed with this remedy but considered that it should be extended to auto-rollover terms in existing contracts as otherwise it would not benefit a significant portion of the market (around 40% could be on longer term contracts and some of these may not benefit for some time) for a number of years. E.ON also raised a concern around how well this remedy could be made to work if a customer's energy supply was bundled with other services.

Industry governance remedies

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

38. E.ON was broadly in favour of this remedy.

Remedy 18b – Granting Ofgem more powers to project-manage and/or control timetable of the process of developing and/or implementing code changes

39. E.ON was cautiously supportive of this remedy. It considered that it would be helpful for Ofgem to project manage code modifications and ensure that timetables for their consideration were met, particularly where the relevant industry participants' natural incentives were not to progress a modification quickly. As far as the technical elements of code modifications were concerned, E.ON considered these were best left to industry participants as Ofgem did not have the required level of detailed knowledge. It noted that making code administration a licensable activity might be of some help in encouraging code administrators to progress modifications more quickly. E.ON noted that this remedy might also help to improve perceptions of the code modification process across the wider industry.

Remedy 18c – Appointment of an independent code adjudicator to determine which code changes should be adopted in the case of dispute

40. E.ON was concerned that the introduction of another body into the code modification process could add complexity to the process along with uncertainty about the role of the new body. Simplifying the current process would be preferable. It was noted that the CMA already acted as an appeal body for code modifications.

Remedy 12a – Requirement to implement Project Nexus in a timely manner

41. E.ON considered that the revised proposals and deadline for the implementation of Project Nexus offered an effective solution for its implementation as far as the incentives on gas suppliers to participate were concerned. E.ON noted that Xoserve did not have similar incentives as the suppliers, and that Ofgem did not have the ability to officially sanction Xoserve in the way that it could suppliers should Xoserve not deliver by the revised deadline.

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

42. E.ON considered that the above remedy would be unnecessary if Project Nexus was implemented in a timely manner (as per remedy 12a above) as the code requirements for shippers to act properly in respect of submitting Annual Quantity updates ought to be sufficient. Up to a point, more frequent updates would make AQs more accurate and bring gas settlement more in to line with the system for electricity, and E.ON would be in favour of this in principle.

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

43. While E.ON supported the introduction of half-hourly settlement (HHS) for domestic customers, it considered that this would be best driven forward by the industry responding to customer need rather than the imposition of a timetable at this time, as there were a number of hurdles which needed to be overcome before HHS could be implemented. There was already a significant amount of change in the industry going on at the moment, eg smart meter rollout, and E.ON was concerned that a timetable for the introduction of HHS could overwhelm the industry's resources. Also, there was the possibility that a centrally-mandated solution for HHS could wind up being superseded by future technology. A plan for the introduction of HHS would be developed when there was sufficient customer demand, and an Ofgem with increased powers in respect of industry codes ought to be able to ensure this.
44. E.ON considered that there should be an elective regime for half-hourly settlement based on suppliers working to meet their customers' needs. Customer interest in time-of-use tariffs would be driven by innovation in other areas like smart household products and home energy storage. If half-hourly settlement was elective, then those consumers who benefited from it would be

the ones that paid for it, if it was mandatory, then all consumers would have to pay even if not all of them would benefit.

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

45. E.ON was in favour of the introduction of locational pricing for transmission losses. Much of the work needed to introduce locational pricing had been done and there was no good reason why this should not be done via code modification SP 229.

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

46. E.ON was in favour of this remedy and considered that its implementation would prevent instances of technologies being favoured without the support of a robust analysis. E.ON considered that where a CfD was being allocated outside the auction process there should be a cost-benefit analysis. For example, new nuclear plants should not simply be automatically granted CfDs, rather competitive processes should be used whenever possible.

Remedy 2b – DECC to undertake and consult on a clear and thorough assessment before allocating technologies between pots and the CfD budget to the different pots

47. E.ON was in favour of this remedy. Ultimately, it considered that a position where there were no pots and the CfD auctions were technologically neutral would be desirable, but in the meantime, it was in favour of increased transparency and robustness of decision-making in how technologies and funds were allocated to each pot.
48. E.ON also noted that there had been instances where energy policy and funding decisions had been made outside DECC. It gave the example of the Swansea tidal project, which had been announced by HM Treasury. It also mentioned the Treasury’s decision to remove Levy Exemption Certificates. It noted that in these cases, because they had been the Treasury’s decisions, they had not been subject to the same consultative processes or transparency requirements as decision made by DECC. E.ON considered that all policy decisions relating to energy should be subject to the same transparency and consultation requirements. It noted that it might be beyond the CMA’s powers to implement such a remedy.

Remedy 14 – Remedy to improve the current regulatory framework for financial reporting

49. While E.ON was generally of the view that the current financial reporting requirements for energy companies gave sufficient transparency, it did have some proposals in relation to this remedy including prohibiting cost subsidies between separate parts of energy companies and prohibiting discrimination in trading. Companies' compliance with these prohibitions could be policed by Ofgem via its current market monitoring powers and by requesting information from suppliers.
50. In theory it would also be possible to make trading a licensable activity, although this might run into jurisdictional issues if a company's trading business was not located in Great Britain, eg E.ON's was located in Germany.

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

51. E.ON was broadly in favour of this remedy. E.ON's view was that Ofgem's role should be that of an economic regulator with a primary duty to promote competition. It was concerned that if Ofgem's role also included commenting on government policy then this would prevent it from focusing as clearly as it ought to on economic regulation. If it was felt necessary for an external body to comment on government energy policy, then this might be best done by an independent panel of experts.

Remedy 17 – Introduction of a formal mechanism through which disagreements between DECC and Ofgem over policy decision-making can be addressed transparently

52. E.ON stressed that it was important that Ofgem was seen as being an independent economic regulator in accordance with the requirements of the EU energy market liberalisation package.