

Energy Market Investigation Provisional Decision on Remedies Response of E.ON

1 INTRODUCTION

1. On 7 July 2015, the Competition and Markets Authority (the “**CMA**”) published its summary of provisional findings (the “**Summary of Provisional Findings**”), along with a notice of possible remedies (the “**PRs**”). On 10 July, the CMA published its full report on its provisional findings (the “**PFs**”), along with associated appendices (the “**PF Appendices**”). E.ON responded to all of these documents in its Response to Provisional Findings and Possible Remedies (the “**E.ON Response to the PFs and PRs**”) submitted on 5 August 2015.
2. On 16 December 2015, the CMA published an addendum to its provisional findings (the “**Addendum to PFs**”), along with a second supplemental notice of possible remedies (the “**Second Supplemental Remedies**”). E.ON responded to these documents in its Response to the Addendum to Provisional Findings and Second Supplemental Notice of Possible Remedies (the “**E.ON PPS Response**”) submitted on the 13 January 2016.
3. On 10 March 2016, the CMA published its summary of provisional decision on remedies (the “**PDR Summary**”). On 17 March 2016, the CMA published its full provisional decision on remedies report (the “**PDR Report**”), with appendices (the “**PDR Appendices**”) published on 18 March. This document represents the response (the “**E.ON PDR Response**”) from E.ON to the PDR Report and PDR Appendices.
4. We reserve the right to submit further comments on the PDR Report and PDR Appendices, including taking account of further comments made by third parties, if E.ON considers it appropriate to do so, subject to the final deadline for all parties’ responses before the final report.

2 EXECUTIVE SUMMARY

5. **E.ON welcomes and is supportive of the remedies the CMA proposes which will help ensure that Contract for Differences (“CfDs”) awarded outside of the competitive allocation process are justified and that allocation of technologies and budget to the various CfD pots is sufficiently scrutinised.**
6. **E.ON agrees with the CMA’s provisional finding that the current system of allocating losses to market participants on a uniform basis creates a cross subsidy and distorts competition in the market. We therefore agree that**

addressing this issue should bring a net benefit to customers and hence we support its introduction.

7. **E.ON does not agree that the evidence supports a provisional finding that disengagement and weak customer response create an adverse effect on competition (“AEC”) specific to prepayment meter (“PPM”) customers overall as a class.** The key issues within the prepayment segment (the “PPS”) are the technical constraints which make it difficult for suppliers to offer the full range of tariffs, particularly fixed-term, fixed-price tariffs, to customers with PPMs.
8. **E.ON has significant concerns with the CMA analysis using the ‘direct’ detriment approach. The wide range of methodological flaws, incorrect assumptions and inconsistent approaches within the CMA’s calculation of detriment significantly undermines the robustness and validity of the results and hence they cannot be relied upon.** The CMA's analysis forms the basis for much of its consideration of the remedies package. Given the material flaws in the CMA's approach, E.ON considers that the CMA's reasoning related to the efficacy and proportionality of those remedies is unsound. In particular, the CMA's apparent reliance on the direct approach means that it runs the risk of a reliance on an irrelevant and flawed analysis in the place of more relevant and appropriate methodologies (such as margin on sales) when determining the need and proportionality of intervention in the energy market.
9. **Most particularly, the approach uses just two market participants to construct a competitive benchmark and the exogenous adjustments made are insufficient to control for differences across the industry, particularly in respect of the hedging of the most significant cost, wholesale energy.**
10. **E.ON also has significant concerns with the CMA’s ‘indirect’ detriment approach. We continue to assert that return on capital employed (“ROCE”) analysis is an inappropriate approach for an asset light industry such as energy supply, and that the updated ROCE analysis presented for E.ON continues to overstate returns primarily through the under valuation of intangible assets.** E.ON also considers the CMA’s indirect costs analysis to be methodologically weak with all cost differentials being labelled as inefficiency with insufficient assessment made of the underlying drivers. In addition, selection of a lower quartile from a population of 6 is unlikely to lead to statistically significant results.
11. **E.ON continues to assert, as set out in our previous submissions, that profitability analysis, to be robust, should be based on a wide range of techniques and comparators.** Margin analysis should include industry comparators in the UK and overseas and data from the wider retail sector, and analysis should be over the full business cycle. We are concerned to see that a

margin analysis, which we believe to be the most appropriate financial analysis tool for this sector, no longer features directly in the CMA's analysis.

12. **Whilst E.ON agrees with the principle behind the Retail Market Review ("RMR") in terms of a simple, open and transparently fair market, E.ON agrees with the CMA finding that the 'simpler choices' component of the RMR has resulted in a stifling of innovation** through greater uniformity of tariffs, potentially misleading information to customers and an increase in the difficulty of rewarding low volume users. We therefore welcome the CMA's recommendations to Ofgem to remove certain conditions from the standard licence conditions.
13. **E.ON broadly supports the CMA's proposal around reform of the settlement process.** E.ON agrees that the long term ambition should be for all customers to be settled using half-hourly ("HH") data and that the approach for this should be to consult on a robust plan to implement this. Similarly, E.ON supports the objective to have accurate gas settlements and hence supports Project Nexus and the introduction of a performance assurance framework.
14. **E.ON supports the objective of removing the technical constraints that exist in the PPS and sees this as the key step to allow competition to flourish in the segment.** Therefore, whilst we welcome the implementation of the Debt Assignment Protocol (the "DAP"), we are concerned to see that other remedies which prohibit upfront charges for meter switches or security deposits are not being taken forward.
15. **E.ON believes that it is essential that customers have access to complete, accurate information that they are able to understand and therefore welcome the proposal for an Ofgem-led programme.** In particular, we support its emphasis on using randomised controlled trials ("RCTs") to ensure that what is implemented is effective and has the intended effect.
16. **E.ON supports the principle behind Ofgem's intention to move away from rules based regulation and towards principles based regulation ("PBR") and we are fully engaged with the consultation process.** However, E.ON has some concerns with Ofgem's current approach and it is important that any PBR is customer focussed and not overly complex.
17. **E.ON is broadly supportive of providing third party intermediaries ("TPIs") with access to industry data that would enable them to provide a more engaging service to customers.** However, it is not clear to E.ON that giving price comparison websites ("PCWs") access to the Electricity Central Online Enquire Service ("ECOES") and the Single Centralised Online Gas Enquiry Service ("SCOGES") would be effective at reducing erroneous transfer and believe

mandatory participation in Midata for all suppliers with access for PCWs based upon customer consent would be more appropriate.

18. **E.ON has significant concerns with the proposal for an Ofgem database for customers who have been on a default tariff for more than 3 years and believes there is a considerable risk that this will erode, rather than improve, trust in the market.** Furthermore, E.ON remains concerned as to whether the remedy is fully compliant with data protection legislation and believes the risks associated with data security are substantial.
19. **E.ON recognises that there are additional barriers for customers who have restricted meters, but these barriers can be addressed.** [REDACTED]. We therefore welcome the CMA proposals to remove these barriers for customers across this segment.
20. **E.ON is strongly opposed to the introduction of a regulated price cap tariff for prepayment customers as it will distort competition in the market, have significant unintended consequences, work against the other proposed remedies thereby reducing their effectiveness and is not proportionate.** Such a price cap is a seriously regressive step and runs counter to market liberalisation and competitive markets.
21. **Without prejudice to our views above on the price cap, E.ON submits that should the CMA continue with the price cap, it is extremely important that the CMA seek to minimise the distortion to competition in the market.** The current proposals are based upon materially flawed assumptions and methodologies and are likely to result in the price cap being set at a level which is unfounded and unsustainable, exacerbating the distortion to competition in the market.
22. **Additionally, E.ON believes that it is important that this prejudicial outcome is not further exacerbated, through the inappropriate inclusion of the regulated tariff in the mix when communicating Could You Pay Less (“CYPL”) messages relating to the competitive market, to customers.** That calculation should only cover competitive market tariffs open to all. The same goes for any potential market-wide cheapest tariff messaging that result from the proposed Ofgem-led programme.
23. **E.ON submits that it is also clearly not proportionate for the cap to extend to Smart Pay as You Go (“PAYG”) customers.** The CMA has recognised that the features it has noted that give rise to the PPM AEC will, to a significant extent, be addressed by smart metering and proposes that the price cap is likely no longer to be required once Smart meters have been rolled out. It also recognised the potentially damaging impact that such a remedy may have to competition and

innovation in the PPS. E.ON believes it is therefore perverse and unjustified for the CMA to impose a price cap on smart PPMs.

24. In light of the practical difficulties and negative consequences of implementing the remedy and the materially flawed detriment analysis on which the remedy is based, **E.ON considers that such a remedy will not be effective, practicable or proportionate and risks undermining the benefits of competition for PPM customers** (by discouraging them from engaging with the market).
25. **E.ON supports the principle behind driving greater transparency in the Microbusiness market in order to help customer engage further.** However, we are concerned that the CMA has not continued with its proposals for a TPI Code of Conduct, which would work in conjunction with this remedy, ensuring that trust in TPIs is not undermined.
26. **E.ON supports the proposals to prohibit the inclusion of conditions in auto-rollover contracts which create barriers for customer wishing to switch suppliers.** Removal of these conditions will make it easier for customers to compare contracts on a like-for-like basis, and hence result in customers receiving contracts which are best suited for them.
27. **E.ON agrees that Ofgem’s statutory objectives and duties to promote effective competition should be clarified by amending the Gas Act 1986 and Electricity Act 1989.** E.ON also supports the CMA’s proposals to improve the relationship between DECC and Ofgem through joint statements on policy implementation and by requiring Ofgem to publish opinions on draft legislation and policies which are likely to have an impact on their statutory objectives.
28. **E.ON supports the recommendation for Ofgem to produce an annual state of the market report to highlight the impact of policies on costs, security of supply and decarbonisation, which E.ON believes should be drafted in clear, simple customer language.** However, the CMA could go further to ensure that DECC’s impact assessments are sufficiently scrutinised.
29. **E.ON continues to support Ofgem in its work to continually improve and develop the efficacy of financial reporting through the CSS and, whilst there is scope for improvement, the existing reporting framework currently provides a high degree of transparency and assurance around the profitability of the Six Large Energy Firms (the “SLEFs”).** However, it is important that the reporting regime does not constrain energy firms from operating the corporate structures that they believe gives them their best competitive position. Therefore, very careful consideration needs to be taken in defining the detail of the changes proposed by the CMA to ensure that the right balance is struck. E.ON therefore supports the provisional decision for any remedy to be through a

recommendation to Ofgem to modify the relevant Licence Conditions, as we would wish to see a thorough consultation process take place.

30. **E.ON believes that a number of the proposals aimed at improving the governance of industry codes could be effective.** However, we have concerns that they may introduce more complexity and processes into the current arrangements rather than simplifying them. As a result, they could increase the burden associated with code governance.
31. **Given the significant development of the proposed remedies and the use of a new 'direct' measure of alleged detriment E.ON is surprised not to be offered a formal hearing with the CMA panel.** We are concerned that by only being afforded a written opportunity to respond to the PDR Report in this response we have been unable to explore the CMA's latest thinking and our immediate interpretation of the published material. There is therefore a risk that our views will not properly have been heard and considered by the CMA and of a misunderstanding of our respective positions that has no opportunity to be resolved ahead of the publication of the CMA's Final Report.
32. **Indeed, the publication at such a late stage in the Investigation of the new approach to calculating alleged detriment and of a package of remedies which is, in a number of respects, very different from those stated to be under consideration in the CMA's PRs, raises inherent concerns that the CMA is not in a position to conduct a proper consultation.**
33. **The CMA has a duty to consult on the revised approach to alleged detriment and the new package of remedies.** One of the requirements of a proper consultation is that the CMA Panel Members must have a genuinely open mind on the matters under consultation. The late stage at which such a significant change in approach has been made raises questions as to the extent to which a proper consultation can be conducted and, in particular, the extent to which the Panel Members' minds can be genuinely open on the matters under consultation. Given this risk, we would, as a minimum expect a hearing to be made available for a full and proper exploration of the new issues raised in the PDR.

3 WHOLESALE ELECTRICITY MARKET REMEDIES

3.1. Allocation of CfDs

34. E.ON welcomes and is supportive of the remedies the CMA proposes which will help ensure that CfDs awarded outside of the competitive allocation process are justified and that allocation of technologies and budget to the various CfD pots is sufficiently scrutinised.

35. As was set out at paragraph 65 of the E.ON Response to PFs and PRs, the CMA could go further by requiring DECC to publish milestones that lead to technology neutral auctions for all.

3.1.1. DECC to undertake and consult on an impact assessment before awarding CfDs outside the auction mechanism

36. E.ON supports this remedy which ensures that the circumstances under which a CfD is allocated outside of the competitive process are transparent and can be scrutinised adequately.

37. As highlighted in the E.ON Response to PFs and PRs¹, we believe DECC should use the competitive process to allocate CfDs wherever possible but we do accept there may be some, limited exceptions where allocation outside of this framework could result in an overall net benefit to customers. The benefit to customers of awarding such contracts must be made clear, as the CMA recognises.

38. We agree with the CMA that it is not appropriate to impose absolute rules determining the situations in which non-competitive allocation would be allowed, in practice it would be very challenging to define these rules in advance.

39. We also agree that DECC should be required to consult at two stages: before and after negotiations with prospective parties, this ensures sufficient transparency.

3.1.2. DECC to undertake and consult on an impact assessment before allocating technologies between 'pots' and the CfD budget to different pots

40. E.ON believes the overall aspiration of the CfD allocation process should be to move all technologies into a single, technology neutral pot. We support this remedy as a step to achieving this by ensuring technologies and the CfD budget are only allocated to the non-established pot where absolutely necessary. We believe the CMA could go further and require DECC to set out milestones which lead to technology neutral auctions as soon as possible.

41. We highlighted in the E.ON Response to PFs and PRs² that the allocation should be reviewed before each auction round so we are pleased to see the CMA recommend this approach.

42. We note that, since the CMA's publication of its PFs and PRs, the Government has proposed to exclude onshore wind from future CfD allocation rounds. This goes against the principle of technology neutrality and could result in higher costs to

¹ E.ON Response to PFs and PRs, para 59

² E.ON Response to PFs and PRs, para 69

customers by excluding a cheap source of renewable electricity. It is concerning that the CMA makes no reference to the impact of excluding onshore wind in its PDR Report.

3.2. Locational adjustments for transmission losses

43. In the E.ON Response to PFs and PRs³, E.ON stated that it agreed with the CMA's provisional finding that the current system of allocating losses to market participants on a uniform basis creates a cross subsidy and distorts competition in the market. We therefore agree that addressing this issue should bring a net benefit to customers and hence we support its introduction.
44. However, E.ON has concerns with the change to the proposal which now intends to allocate 100% of the losses to generation, compared to the existing arrangements which apply a 45%:55% split between generation and demand respectively. E.ON is concerned that, as demand response becomes more prevalent in the market and competes with generation directly to provide a number of energy balancing services, the change to the allocation will mean that there are different market signals between demand and generation, which could lead to inefficiencies.
45. In addition, allocating all the losses entirely to generation moves the GB system of loss allocation in the opposite direction to that of the rest of Europe, which typically puts most of the costs associated with losses on to demand alone. This therefore creates the risk that the proposal may, at some stage, be deemed inconsistent with draft or existing European legislation in this area.

4 UPDATED ASSESSMENT OF AECs AND DETRIMENT AFFECTING DOMESTIC CUSTOMERS

46. As we have stated in the E.ON Response to PFs and PRs⁴, E.ON does not agree with the CMA finding of an AEC through an overarching feature of weak customer response. The CMA customer survey shows that most people are aware they can switch supplier (89% know), are aware they can switch payment method (81% know) and are aware they can switch tariff (76% know).
47. The evidence presented by the CMA shows that significant numbers of customers are engaged, have been engaged and switched in the past (66% of respondents from the CMA customer survey have either switched supplier, shopped around to compare suppliers or considered switching suppliers), or are likely to become engaged and switch again in the future (79% of respondents had either

³ E.ON Response to PFs and PRs, paras 45-47

⁴ E.ON Response to PFs and PRs, paras 72-74

considered switching, or were likely to consider switching in the next 3 years or both).

48. The customer survey does not support the CMA's statement that "*material numbers of customers appear fundamentally disengaged*" and exemplifies the underlying weakness in the CMA's conclusions. Nonetheless, E.ON still supports additional measures to inform and engage customers which we see as fully aligned to our 2016 – 2018 strategy to become our customers' partner of choice for energy solutions⁵. Therefore, whilst we dispute the AEC itself, we support those remedies which seek to make improvements in this area, and provide further detail on these later in this response.
49. In preparation of the PDR Report, the CMA has undertaken further analysis to support its view of the AECs and detriment affecting domestic customers and we comment on these in turn in the sections below.

4.1. Updated analysis of gains from switching

50. The CMA has updated its analysis on gains from switching available to customers in the period Q1 2012 to Q2 2015 and relies on this as evidence of customers being disengaged. However, as we stated in the E.ON Response to PFs and PRs⁶, the CMA acknowledges that gains from switching are likely to be present in most markets. E.ON would support the view that gains are required for competitive markets to function, as they provide an incentive for customers to engage. Indeed, a market with low potential gains from switching is more likely to see limited levels of engagement and switching, which arguably could be considered less competitive. Hence, it is not the case that the presence of gains from switching in a market indicates a lack of competition.
51. The CMA customer survey supports this view in its analysis of the *required* gains for customers in order for them to consider switching. The results of this analysis (Table 12 Appendix 8.1) produced a median value of £120, with nearly 40% of customers requiring over £200 of potential savings before they would consider switching, i.e. competition and switching are driven by the gains available rather than their being evidence of a less competitive market. However, even these potential gains available from switching do not cover the full set of decision making that a customer goes through – price is not the only consideration in a customer's decision to switch.
52. The CMA suggests that, due to the homogenous nature of energy, the primary factor in deciding to switch is price. E.ON would agree that price is an important

⁵ This has replaced our 2012 – 2015 Strategy, which the CMA has previously seen

⁶ E.ON Response to PFs and PRs, paras 75-79

consideration for customers but would suggest that, as in most competitive markets, there are many other factors which a customer would take into account when considering switching. Many customers are satisfied with the service they receive and therefore trust their own supplier more than they do other suppliers as a general class, and this is likely to influence their decision whether or not to switch supplier. This is reinforced by the CMA customer survey analysis (Figure 22 in Appendix 8.1) which shows that around 60% of respondents are either satisfied with their existing tariff or are confident that they are on the best deal with their existing supplier. Customer service also plays an important part in a customer's decision making process with regards to switching

53. E.ON therefore contends that, whilst the physical product is homogenous, it is not necessarily viewed as such by customers. There are many other elements of the service of this product which are heterogeneous and result both in a range of prices available in the market and an influence on the decisions customers make in whether to act on potential savings.

4.2. Customers on PPMs

54. The CMA published an addendum to its provisional findings on 16 December 2015, which set out its views on an additional AEC specific to the PPS and has updated some of its analysis in this area in its PDR Report.
55. The E.ON PPS Response⁷, set out our view that the key issues within the PPS are the technical constraints which make it difficult for suppliers to offer the full range of tariffs, particularly fixed-term, fixed-price tariffs, to customers with PPMs. In our view, competition in the PPS between suppliers is strong, but it is based around the standard variable tariffs (“SVTs”) that suppliers are able to offer to PPM customers within the technical constraints associated with the PPM infrastructure.
56. It is these technical constraints, and not a lack of competition, which explains why the updated gains from switching analysis for the PPS conducted by the CMA observed these to be fairly static over the period analysed and why the CMA's alleged differential between prepayment tariffs and the market leading direct debit fixed-term tariffs was large.
57. E.ON believes that the aspiration for the PPS should be that PPM customers have access to the same tariffs as non-PPM customers (with an additional cost to serve if appropriate and justified), that they should be fully integrated into the competitive market (i.e. without the technical constraints already referred to) and that there should be no difference between PPM and non-PPM customers, at

⁷ E.ON PPS Response, paras 14-19

least in terms of tariffs they can access. Smart meters remove the technical barriers which have prevented this in the past.

58. E.ON is delivering this aspiration through its smart PAYG proposition which allows PPM customers access to exactly the same E.ON tariffs as any other customer. PAYG is a priority in our smart roll-out plans from 2016 and we are targeting the proposition at PPM customers. This demonstrates that the PPM market opportunity is attractive and one that suppliers are actively pursuing. Indeed, E.ON had taken this decision as a competitive acquisition play in the market. The national smart meter roll-out will ensure the vast majority of PPM customers have the ability to access all tariffs in the near future (although we note that other suppliers may or may not choose to make all of their tariffs available to PPM customers).
59. The CMA makes a number of statements about the characteristics of PPM customers, but the concerns we highlighted in our PPS response have not been addressed⁸. The CMA has compared customers in the PPS with customers paying by direct debit and concluded that they are less engaged and active. However, given the technical constraints in the PPS, it is perhaps not surprising that there is less engagement compared to a segment with no constraints, such as direct debit.
60. What should be noted is that the CMA analysis shows that the PPS is as engaged and is in many cases more engaged than standard credit customers⁹. It would therefore seem likely that, if the technical constraints were removed, customers in the PPS would be even more engaged, and the (adverse) comparisons that the CMA seeks to draw to direct debit customers would be reduced.
61. Further evidence supporting the view that PPM customers are engaged can be found from the tenants survey which found that *“prepayment customers who rent may be as engaged as non-prepayment customers who rent”*¹⁰ and *“prepayment customers appear more engaged than non-prepayment customers when controlling for certain demographics and household characteristics”*¹¹.
62. The CMA has not properly explored the segment in depth and even states *“We do not know how many PPM customers could benefit from a low cost switch to a credit meter and therefore to a competitive DD segment acquisition tariff.”*¹²

⁸ E.ON PPS Response, paras 20-24

⁹ PDR Report, para 3.89-3.90 and Table 3.2 show that prepayment customers are not significantly more or less likely to have switched supplier in the last year compared to either direct debit or standard credit customers and they are more likely to have switched supplier in the last three years compared to standard credit customers

¹⁰ PDR Report, para 3.105

¹¹ PDR Report, para 3.106

¹² Addendum to PFs, para 22

E.ON suggests that the CMA needs to explore this question and understand its potential outcomes. This is particularly important given that around 85% of PPM customers are free to engage with the market with a credit meter if they so wish (subject to appropriate credit checks)¹³. It is also important to see how this relates to the levels of fuel poor customers in the PPS, where DECC's most recent statistics¹⁴ showed that approximately 22% of electricity and 21% of gas PPM customers are classed as fuel poor.

63. E.ON expressed in the E.ON PPS Response our view that any AEC could apply only in respect of PPM customers who either could not access other tariffs in the market or were discouraged from doing so through charges or security deposits. Overall, E.ON does not agree that the evidence supports a provisional finding that disengagement and weak customer response create an AEC specific to PPM customers overall as a class.

4.3. Customers on restricted meters

64. The CMA has identified that customers on non-E7 restricted meters (hereafter referred to as 'customers on restricted meters') face additional barriers to accessing and assessing information and barriers to switching. E.ON accepts that this very small segment (around 2% of customers) do face additional barriers to engagement with the market due to the lack of widespread support for individual meter types. The tariffs they are offered are often bespoke and complex, making comparisons difficult, particularly as they are not typically supported by PCWs.

65. E.ON has already taken action to address these barriers for customers [REDACTED].

66. Whilst E.ON believes that the bespoke tariffs it has historically offered to customers with these meters have delivered value to customers, [REDACTED]¹⁵.

4.4. Updated analysis of detriment

67. The CMA has updated its analysis of detriment, introducing a new 'direct' approach to calculating detriment to support its previous 'indirect' approach which focused on profitability and costs.

68. E.ON's view is that profitability analysis, to be robust, should be based on a wide range of techniques and comparators. E.ON believes that margin analysis is the most appropriate primary indicator and endorses widely drawn industry

¹³ Addendum to PFs, para 47 highlighted that approximately 15% of customers in the PPS are in debt to their supplier. This means that 85% are not and are free to engage in the wider market with a credit meter if they so wish.

¹⁴ Annual Fuel Poverty Statistics Report 2015, Chapter 3.4:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/468011/Fuel_Poverty_Report_2015.pdf

¹⁵ [REDACTED]

comparators in the UK and overseas as well as from wider retail sectors with comparable features, with analysis over the full business cycle. The CMA's 'direct' and 'indirect' approaches, in E.ON's view, do not combine to give a wide enough comparison in terms of technique, industry or period.

69. E.ON believes that both the CMA's 'direct' and 'indirect' methods are inappropriate and provide a significant over-estimation of detriment as summarised below.
70. E.ON's key concerns in relation to the 'direct' approach include:
- a. The direct approach relies on the incorrect assumption that energy products are homogenous, and the fact that this is incorrect makes it inappropriate to set a single price benchmark. This implies that the CMA's estimate of consumer detriment will be materially overstated as it will label as detriment price differences that are actually the result of legitimate product differentiation;
 - b. Basing the competitive benchmark on data from just two competitors (First Utility and Ovo) from a market of over 40 participants is an insufficient basis from which to draw robust conclusions;
 - c. The prices of these two suppliers are unlikely to be sustainable in the long term and they are therefore inappropriate for a competitive benchmark and their use is likely to substantially overestimate consumer detriment. The CMA's conclusion that these prices are indeed sustainable, based on margin analysis, is not sound: First Utility's margins of an average of 1.5% is significantly below margins based on any widely drawn study and is only supported by the CMA's own flawed and inappropriate ROCE analysis. Ovo's loss making position is expected by CMA to reverse but this assertion is not based on quantifiable evidence. We also note that First Utility's 1.5% margin is only 50% of the lower "reasonable" margin aspiration of Ovo¹⁶, the other "benchmark" player, as reported in the Summary of Provisional Findings;
 - d. Adjustments made by the CMA to the competitive pricing benchmark to take account of exogenous cost differences between suppliers are extremely limited and significantly underestimate the complexity of the industry and its cost drivers. In particular, differences in hedging of the most significant industry cost, wholesale energy, are not taken into account at all and costs of compliance with environmental and social obligations are not adjusted for, even though the sample companies did not become fully liable for these costs until 2015;

¹⁶ And that of Co-operative Energy – see PFs Appendix 10.6, para. 20(f) and the PDR Report, para 3.195

- e. Due to data availability for the approach chosen, this analysis covers only the years 2012 to 2015. This period is insufficient to draw conclusions for an industry which features long term decision making, as demonstrated by hedging and customers' requirements to avoid frequent volatile price changes.
71. E.ON's key concerns in relation to the 'indirect' approach include:
- a. As previously submitted by E.ON to the CMA, ROCE is an inappropriate approach for an asset light industry such as energy supply, and the CMA's updated analysis of ROCE as set out in the PDR does not change E.ON's view;
 - b. The CMA's updated ROCE analysis, as well as being inappropriate, contains a number of errors which means that CMA's ROCE estimate for E.ON (although hugely reduced from its first attempt) is still substantially overstated. Most significantly, the CMA continues to understate the value of E.ON's customer list and billing system;
 - c. There are serious methodological weaknesses in the CMA's indirect cost analysis, and all cost differences are assumed to result from inefficiency without sufficient consideration of the underlying drivers;
 - d. In addition, selection of a lower quartile from a population of 6 is unlikely to lead to statistically significant results.
72. We provide further detailed comments on both the direct and indirect methods in the sections that follow.

4.4.1. Direct approach

73. The CMA has introduced a new method of determining detriment which it believes gives a more accurate measure based on actual market prices. In effect, it assumes that the difference in prices available in the market between a calculated "competitive benchmark price" and the SLEFs average tariff prices represents a detriment to the customer. This leads to an alleged calculated detriment of £1.7bn a year over the period as a whole.
74. E.ON has significant concerns with this approach to calculating detriment and therefore the CMA's reliance on this measure in its PDR Report. We discuss these concerns below.

[Validity of using a single benchmark price as a comparator](#)

Product Differentiation

75. As we stated in our response on the gains from switching analysis, the CMA itself acknowledges that gains from switching are likely to be present in most markets. It is therefore inconsistent and irrational to suggest that the entire difference between prices can be considered detriment. Indeed, a market with no

difference in prices would have very little switching and engagement, and yet the CMA suggests that *any* difference is detrimental to customers. Therefore, some level of price differentials is in fact an indication of a well-functioning market, rather than an indication of detriment.

76. The CMA analysis also ignores the fact that customers typically have a price differential below which they would not consider switching, as discussed above in paragraph 47. This varies from customer to customer and depends upon a wide range of characteristics such as how much time a customer has available and how important they perceive switching suppliers to be compared to other priorities in their life. However easy switching is, it will still involve an element of time and effort commitment on the part of customers. In any market, there will be a level of price differential below which a customer will not consider it a priority to switch. Other factors also influence the price at which a customer would consider switching, such as the level of service they receive from their supplier and the innovations that their supplier offers them.
77. E.ON worked hard to build up good relationships with its customers through its Trusted Energy Partner strategy¹⁷ and continues to do so with its strategy to become its customers' partner of choice for energy solutions. E.ON believes that this is an important driver of retention of customers. We have seen our NPS score improving over the last few years, in line with our customer service and believe this plays an important part in a customer's decision making process with regards to switching. Poor customer service does lead to customers leaving a supplier and, we would suggest, makes it less likely that they will return to that supplier, even if it may be cheaper.
78. Having good customer service is an important consideration to customers, as evidenced by the fact that nearly all commercial PCWs have some form of service rating alongside their price quotes. Indeed, the CMA's customer survey also supports this conclusions:
- While cost / tariff was cited as the most important factor considered when choosing a supplier, "Quality / Reliability" and "Good quality service" were mentioned by approximately 50% of respondents as factors that were also considered.¹⁸
 - When respondents were asked to rate the importance of different factors in choosing a supplier, "Good customer service" and "simple/ easy to

¹⁷ We shared our "Trusted Energy Partner" strategy with the CMA at our site visit on 22 September 2014, and also in our Opening Statement at the formal Hearing on 4 March 2015. This has now transitioned to our new three-year Strategic Framework for 2016-18, where our vision is to be our customers' partner of choice for energy solutions. [X].

¹⁸ CMA energy market survey report, figures 29 and 30.

understand tariffs” were two of the three most highly rated factors (rated by 83% and 78% as essential or very important respectively – cheap tariff was also rated as essential or very important by 78% of respondents). “Tariffs tailored to your energy usage or circumstances” was also rated as essential or very important by 61% of respondents.

79. Ignoring these elements of customer choice and characteristics within its analysis of detriment and instead relying wholly on price undermines the robustness of the CMA’s analysis, leading to materially flawed conclusions and potentially ineffective and disproportionate remedies.

80. The CMA’s approach is also inconsistent with statements the CMA has made elsewhere in its PDR Report, in relation to what it considers to be the benefits of its remedies package. Specifically, the CMA states that it expects its remedies to:

*“promote competition in the retention and acquisition of domestic customers and encourage retail energy suppliers to be more innovative in both the products and services they offer to their customers and in managing their retail activities so that they can offer cheaper prices **and better quality of service** (emphasis added).”¹⁹*

81. This statement and the CMA’s analysis of non-price detriment assumes that service quality and product innovation are relevant dimensions of competition. E.ON would agree. However, this is inconsistent with the CMA’s repeated and strongly expressed view that energy is a homogenous product, as well as the CMA’s direct methodology for measuring customer detriment.

82. E.ON submits that the CMA is incorrect to assume purely that energy is a homogenous product. Instead, the CMA’s analysis should take into account that the energy supply market is differentiated in terms of the product and suppliers’ characteristics. As a result, the CMA is incorrect to assume that all differences between the SLEFs’ prices and the CMA’s measure of a single competitive benchmark price point equate to evidence of consumer detriment. In fact, some of those differences in prices relate to differences in product characteristics and level of customer service, which would exist in any well-functioning market.

Impact on investment and innovation

83. By focussing on a single competitive benchmark price – and ignoring product differentiation – the CMA risks undermining incentives to innovate with different tariffs and to invest in greater quality of service (by contrast with some of its remedies, which aim to encourage innovation). Suppliers will have an incentive to invest in products with different characteristics or to improve quality of service

¹⁹ PDR Report, para 3.236

only if this is a differentiating factor which is valued by customers or can be recovered through appropriate prices. The CMA's approach to measuring detriment, which assumes that any price over the competitive benchmark (once network and payment costs are taken into account) is uncompetitive, is likely to undermine suppliers' confidence that investments in innovation or service can be recovered without this being viewed as uncompetitive.

84. Indeed, as we discuss later in our response, the CMA methodology for setting the price cap for PPM customers, which uses a very similar approach to its detriment analysis, is likely to significantly dampen competition and undermine innovation.

[Inappropriate choice for calculating the benchmark](#)

85. The CMA analysis of detriment also builds upon the flawed methodology of cherry-picking Ovo and First Utility as appropriate benchmarks for competitive prices and hence detriment. In our Response to the PFs and PRs²⁰, E.ON detailed the issues with using just two suppliers for benchmark analysis from a market with over 40 current participants rather than using a robust and broad range of comparators.

86. The CMA has failed to recognise that Ovo and First Utility are likely to have significantly different operating models compared to other, more established operators. Both suppliers are relatively recent entrants into the market, following aggressive acquisition strategies as they seek to grow market share, potentially driving towards a stock market flotation²¹. E.ON strongly questions the validity of using these suppliers and does not believe they represent a comparable, sustainable benchmark.

[Sustainability of First Utility's margin](#)

87. The CMA claims that First Utility's earnings before interest and tax ("EBIT") margin (of 1.3% in 2013 and 1.9% in 2014) is on average above the level that the CMA's ROCE analysis would imply is a sustainable, competitive level (1.5%) and therefore that First Utility's prices are sustainable and it is a reasonable candidate for competitive benchmark pricing.

88. Setting aside that, in 2013, First Utility's margin was actually *below* what the CMA judges to be a sustainable level, E.ON notes that the CMA has not taken into account a number of points made by E.ON and other suppliers that would imply that the 1.5% EBIT margin calculated as a result of the ROCE analysis is not

²⁰ E.ON Response to PFs and PRs, paras A.100-A.104

²¹ <http://www.ft.com/cms/s/0/fb7bd6fe-2fc4-11e5-8873-775ba7c2ea3d.html> and <http://uk.reuters.com/article/us-firstutility-ipo-idUKKBN0H20WL20140907>

reliable. In Section 4.4.2 below, E.ON discusses in more detail its comments on the CMA's measurement and use of ROCE analysis in the PDR Report.

89. In addition, E.ON notes that the CMA's reliance on a 1.5% margin from its ROCE analysis as being adequate and sustainable is at odds with other evidence on competitive margins in retail energy businesses:
- a. *Regulators of energy supply markets in other countries:* Regulated energy supply margins for suppliers in Northern Ireland and Australia (at 2.2% and 5-6% respectively) are substantially in excess of the CMA's estimate of a sustainable competitive margin for the GB energy supply market. As E.ON has highlighted in previous submissions²², if anything, one should expect regulated margins for regulated supply businesses to be below those for unregulated competitive energy suppliers – the fact that the CMA's estimated sustainable EBIT margin is substantially below margins set by regulators therefore shows that the CMA's estimate is significantly understated;
 - b. *CEPA, on behalf of Power NI:* in a report for Power Northern Ireland, CEPA estimated that an EBIT margin in the range of 3-4% would be consistent with a benchmarking analysis to other industries, significantly in excess of the CMA's estimate of 1.5%;
 - c. *Ofgem:* in its 2011 RMR report, Ofgem calculated a benchmark EBIT margin for the energy supply market, based on an analysis of margins in other, comparable sectors²³. Ofgem estimated a range of between 3% to 9% , but even the lower end of this range is substantially in excess of the CMA's estimate of a sustainable, competitive EBIT margin;
 - d. *E.ON's benchmarking analysis submitted in response to the Provisional Findings:* E.ON's analysis of a set of comparable firms in other sectors produced an average EBIT margin of 7.5%.
90. There is, therefore, substantial evidence that 1.5% is too low a benchmark for a competitive, sustainable EBIT margin. Indeed CMA itself, in the Provisional Findings Report, came to a provisional view that margins in the range of 1 to 3% would appear to provide a guide to the competitive EBIT margin based on current business models. Whilst E.ON provided arguments in response as to why this range was too low, this evidence also suggests that First Utility's margins are unsustainably low and therefore that its prices are also unlikely to be unsustainable. This, in turn, implies that the CMA's direct approach to measuring consumer detriment, which uses First Utility's prices as a benchmark, is inappropriate and likely to materially overestimate consumer detriment.

²² E.ON Response to the PFs and PRs, paras A.105 - A.107.

²³ Ofgem Retail Market Review – Findings and initial proposals, 2011, Appendix 9, paras 1.6 to 1.12

Profitability of Ovo

91. In the PFs, the CMA stated that Ovo itself estimated that a reasonable EBIT margin for a retail energy supplier operating with an efficient level of costs was between 3-4%²⁴, with an inefficient supplier earning commensurately less²⁵. However, in its PDR Report, the CMA notes that Ovo was loss-making in 2014²⁶, not attaining its efficient reasonable margin of 3% and therefore significantly undermining the CMA's assertion that Ovo *currently* represents a supplier with a sustainable margin.
92. The CMA has stated that it expects Ovo's profitability to increase over time, without an increase in Ovo's prices, because of expected reductions in Ovo's cost base. However, the CMA has provided no robust or quantitative analysis – or indeed any analysis at all - of by how much Ovo's cost base can be expected to fall (nor over what time frame) and whether any reductions will be enough to offset Ovo's losses without any increase in prices.
93. The CMA argues that Ovo can expect to incur lower customer acquisition costs in future, as its rate of customer acquisition naturally declines.²⁷ However, it is unclear what the CMA includes as customer acquisitions costs in this statement and by how much the CMA expects Ovo's rate of customer acquisitions to decline. The CMA is introducing remedies which are aimed at reducing barriers to switching and facilitating customer engagement, which might be expected to increase Ovo's rate of acquisition. In this context, it is particularly important for the CMA to have a robust view on what costs are likely to be incurred by suppliers (including Ovo) to acquire customers in the future.
94. Without robust analysis of Ovo's expected future cost base, it is unclear how the CMA is able reliably to conclude that the current prices charged by Ovo are sustainable over the longer term, given that Ovo is currently making losses. The CMA cannot rely on pure assertion alone. As a result, the CMA's reliance on Ovo's tariffs in its competitive benchmark price is inappropriate, and will lead to the CMA's estimate of consumer detriment being over stated.

Issues with calculating the benchmark

95. Even setting aside the concerns highlighted above with regards to the methodology, the CMA has also failed to account for the impact of a number of key costs when calculating its benchmark price and we discuss these below.

²⁴ PFs, Appendix 10.6, para 20 (f)

²⁵ Similarly, in the PFs, para 10.86, Co-operative Energy also cite this 3% margin

²⁶ PDR Report, para 3.195

²⁷ PDR Report, para 3.196

Impact of wholesale hedging

96. The CMA has failed to account for the significant impact associated with different wholesale hedging strategies that suppliers use. E.ON has raised the impact of different hedging strategies previously²⁸ and is concerned that the CMA has failed to understand the potential magnitude of this. Recent wholesale market conditions have resulted in some suppliers, typically mid-tier and smaller suppliers, benefiting from their hedging strategies in terms of the costs associated with procuring wholesale energy. However, in a rising wholesale market, such hedging strategies would bring a significant cost disadvantage compared to suppliers with longer hedges. Any analysis needs to be robust against external market conditions, and not just one version of those conditions and so should be tested against different variations. The CMA has failed to conduct any checks in this regard.
97. The CMA has not set out any analysis of suppliers' hedging policies as part of its analysis of consumer detriment using the direct approach, and in particular has not adjusted its estimate of the competitive benchmark price to take into account any differences in hedging policies and therefore in wholesale costs incurred by different suppliers. E.ON submits that this is incorrect. The CMA has recognised that energy suppliers may select a forward purchasing strategy which may result in them incurring costs which turn out to be either above or below the market price at the time of delivery, but that it would be misleading to seek to categorise a certain level of wholesale energy costs as efficient on an ex post basis.²⁹
98. However, by failing to adjust its competitive benchmark price for differences in wholesale energy costs across suppliers, the CMA's analysis of consumer detriment using the direct approach implicitly assumes that the wholesale costs incurred by First Utility and Ovo (which are a function of their particular hedging policies) are efficient. E.ON considers that this implicit assumption is inappropriate (and is inconsistent with the CMA's statement set out in the previous paragraph).
99. Therefore, E.ON submits that differences in wholesale energy costs should be treated as "exogenous" cost differences and factored into the CMA's direct detriment analysis.
100. The CMA has considered the potential impact of hedging strategies, but simply dismisses it stating that "*if the mid-tier suppliers raised their prices [as a result of increasing wholesale prices] we would expect this to lead to the SLEFs increasing*

²⁸ E.ON Updated Issues Response, para 141-144

²⁹ PDR Report, para 3.197

*their prices as well*³⁰. E.ON strongly disputes this claim, which is seriously prejudicial and again pure assertion, and for which the CMA has provided no evidence or substantiation. The CMA's logic implicitly assumes that there is a fixed differential between First Utility's and Ovo's prices and the SLEF's prices – in other words, the CMA's position effectively assumes its conclusion, by assuming that its current level of perceived detriment would remain even if costs were different.

101. The CMA's argument also implies that movements in the SLEFs' prices are unrelated to the SLEFs' costs and that competition between the SLEFs (as well as between SLEFs and the mid-tier suppliers) are not a relevant factor in the SLEFs' pricing. These implications are unfair, unrealistic and not supported by the evidence. For example, in each of the SLEF's ex-incumbent regions, a substantial proportion of customers over the years have switched to other providers within the SLEFs, clearly demonstrating that competitive pressure on the SLEFs is not limited only to First Utility and Ovo. Overall, therefore, the CMA has no robust argument for not taking into account differences in wholesale energy costs in its consumer detriment analysis. The CMA should take into account differences in wholesale energy costs across suppliers in calculating its competitive benchmark price, and by failing to do so, the CMA has materially overestimated consumer detriment.

Impact of customer mix

102. Differences in customer mix across suppliers might give rise to differences in costs to serve for different suppliers' customer bases. The CMA's approach of adjusting only for differences associated with payment type may not fully capture such differences. For example, different demographic groups might be associated with higher costs to serve. A failure to adjust for any systematic differences in costs to serve would imply that the CMA's detriment calculation is unreliable – and to the extent that the SLEFs have a higher proportion of certain customer groups with higher cost to serve, then the CMA's detriment calculation would be overstated.
103. In discussing these points, the CMA states that it does not expect there to be a systematic bias to its detriment calculation as a result of differences in customer demographics. This is based on its view that, while the SLEFs may have a higher proportion of some customers which are more costly to serve, First Utility and Ovo have more "active" customers which the CMA states are also likely to be more costly to serve.

³⁰ PDR Report, para 3.197

104. E.ON considers that the CMA’s position here is overly simplistic and not sufficiently robust.
105. First, the CMA has not done any analysis to check the different costs to serve of different customer profiles across First Utility, Ovo and the SLEFs. As a result, the CMA’s conclusion that there is no ‘systematic bias’ to its detriment calculation is not supported by reliable evidence.
106. Secondly, E.ON notes that the CMA has proposed a range of remedies with the aim of removing barriers to switching and increasing customer engagement. If these remedies have the effect that the CMA hypothesises they will, then it is likely that all suppliers will have a larger number of “active” customers and hence face similar costs to First Utility and Ovo for those customers. If the SLEFs also have higher proportions of other types of customers (such as those on the Priority Services Register) who also have higher cost to serve, then these costs should be taken into account in the CMA’s detriment calculation.

Impact of payment method cost differences

107. As set out above, the CMA adjusts its competitive benchmark price for exogenous cost differences associated with customers using different payment types – specifically, the CMA has acknowledged that there are higher indirect costs associated with prepayment and standard credit (“**SC**”) customers compared to customers on direct debit tariffs (“**DD**”) and adjusts its competitive benchmark price to try to reflect this
108. The CMA comes to a conclusion on the level of the cost differentials by reviewing a range of data sources and estimating a mid-point for the efficient level of indirect cost differential as compared to DD, of £54 for PPM. E.ON is concerned that the CMA’s analysis underestimates this cost differential and correcting for this reduces the CMA’s estimate of consumer detriment using the direct approach.

Environmental and Social Obligation Costs

109. Neither First Utility nor Ovo were fully obligated under the Energy Company Obligation (“**ECO**”) until 2015 and as a result benefited from a cost advantage that has not been controlled for in the CMA’s detriment analysis. CMA quotes the cost of being fully obligated as being between £36 and £60 per dual fuel customer and notes that these companies would have been subject to partial compliance³¹. The CMA dismiss the need for adjustment to take account of this on the basis that full compliance is reflected in their 2015 cost base but given that

³¹ PDR Report, para 3.177

the headline results from CMA's detriment analysis are quoted based on 2012 to 2015 averages we believe that this adjustment should be made.

Conclusions to the CMA's direct detriment analysis

110. E.ON contends that the wide range of methodological flaws, incorrect assumptions and inconsistent approaches within the CMA's calculation of detriment based upon a direct approach, significantly undermines the robustness and validity of the results and hence they cannot be relied upon. E.ON also contends that the period of time over which this analysis has been performed (2012-15) is insufficient to draw conclusions for an industry which features long term decision making, as demonstrated by hedging and price change frequency.
111. The CMA's analysis forms the basis for much of its consideration of the remedies package. Given the material flaws in the CMA's approach, E.ON considers that the CMA's reasoning related to the efficacy and proportionality of those remedies is unsound. In particular, the CMA's apparent reliance on the direct approach means that it runs the risk of a reliance on an irrelevant and flawed analysis in the place of more relevant and appropriate methodologies (such as margin on sales) when determining the need and proportionality of intervention in the energy market.

4.4.2. Indirect approach

112. As set out above, in addition to its analysis of consumer detriment using its direct approach, the CMA has sought to assess consumer detriment using an alternative methodology, the 'indirect approach'. This indirect approach aims to quantify the detriment through the use of the firms' financial results. Specifically, in its indirect approach, the CMA has attempted to quantify both:
- a. *The SLEFs' excess profits*: the CMA's analysis involves comparing each firm's ROCE with the industry weighted average cost of capital ("**WACC**"). The total returns in excess of WACC across suppliers constitute the CMA's estimate of excess profit, and is included in the CMA's estimate of consumer detriment using the indirect approach; and
 - b. *The SLEFs' cost inefficiency*: the CMA's analysis amounts to comparing the indirect cost bases of each of the SLEFs with what it has defined as efficient benchmark for indirect costs per customer – namely the lower quartile within the SLEFs of indirect costs per customer. The total indirect costs above this benchmark are treated by the CMA as inefficiency and are included in the CMA's estimate of consumer detriment using its indirect approach.

113. The CMA's estimate of consumer detriment using the indirect approach, therefore, is the sum of its estimate of excess profit and its estimate of indirect cost inefficiency across the SLEFs.
114. E.ON has significant concerns with the CMA's methodology for calculating both excess profits and indirect cost inefficiency, which it summarises in the rest of this section.

ROCE analysis

115. In the PDR Report, the CMA performs performed a ROCE analysis for each of the SLEFs and concluded that:

"The average profits in excess of the cost of capital earned on domestic customers across the Six Large Energy Firms as a whole were around £240 million a year, compared with around £280 million a year on SMEs."³²

116. The CMA argues that its ROCE calculation is a conservative estimate of the level of excess profit in the energy supply market. However E.ON considers that this is incorrect, for two broad reasons:
- a. Firstly, ROCE is inappropriate as a measure of excess profit in an asset light industry such as the energy supply industry and the results produced by such an analysis are unreliable. A more appropriate margin benchmarking analysis shows that there is not excess profit in the energy supply market.
 - b. Second, the CMA ROCE calculation is likely to be overstated due to a number of omissions and underestimates in the calculation.
117. E.ON discusses each of these points in turn in the rest of this section.

Appropriateness of ROCE analysis

118. As set out in E.ON's response to the CMA's Provisional Findings, the use of a ROCE methodology to assess detriment in an asset-light industry such as the energy supply market is inappropriate. In such an industry, the majority of a business's asset base relates to intangible assets, which are not fully reflected on the reported balance sheet. To ensure a robust ROCE analysis, these intangible assets need to be valued. However, robust intangible valuation is highly subjective, due to the number of assumptions that are required. This valuation issue often results in the capital employed part of the ROCE calculation being unreliable and understated. Additionally, as the levels of capital employed are

³² PDR Report, para 3.209

relatively low, the ROCE calculation is likely to be very sensitive to small adjustments in the assumptions used, resulting in volatile and unreliable results.

119. E.ON has previously submitted to the CMA that margin benchmarking, drawing on a wide range of comparators including from outside of the GB energy supply industry is a more appropriate basis for assessing profitability in the energy supply market. The CMA's ROCE implies a level of EBIT margin that is unrealistically low when compared to a range of evidence on margin benchmarks, as discussed in paragraph 89. This supports the view that the CMA's use of ROCE produces unreliable results, and is inappropriate for the energy supply industry.

Calculation of E.ON's ROCE

120. Setting aside E.ON's view that ROCE is inappropriate, if the CMA continues to rely on this analysis, it must correct a number of omissions and underestimates in its calculations of E.ON's ROCE. E.ON is pleased at the adjustments in the methodology that the CMA has already accepted, resulting in a substantial lowering of its ROCE assumption, but believes that further corrections are still required, including:
- a. *Underestimation of the value of E.ON's customer list:* it is our view that the CMA still significantly undervalues E.ON's customer list, through the use of a bottom-up cost methodology, which a) adopts a limited view of the relevant cost base and b) disregards the results from other valuation techniques such as a net present value ("**NPV**") analysis or market based measures.
 - b. *Underestimation of the value of E.ON's billing system through as a result of inappropriate assumptions about the billing system's useful economic life ("**UEL**"):* instead of a 20 year UEL, E.ON submits that a 10 year UEL would be more appropriate.
 - c. *Omission of certain exceptional items:* the CMA has not deducted any amortisation on E.ON's billing system, as it assumes this would be off-set by the ongoing repair and maintenance costs already within the P&L.³³ However, over the period 2009-2014, a substantial proportion of E.ON's IT repair and maintenance costs sat within exceptional items, which the CMA has excluded. This should instead include the portion of exceptional costs that relate to IT repair and maintenance within E.ON's profit figure in its ROCE analysis.

³³ PDR Appendix 3.4, para 55

Indirect cost benchmarking

121. In calculating consumer detriment using the “indirect” method, the CMA combines its estimate of excess profits with an estimate of the amount of the SLEFs’ indirect costs which it judges to be inefficient.
122. In order to estimate the SLEFs’ indirect cost inefficiency, the CMA has compared the indirect costs within the SLEFs over the period 2007 and 2014 across the following categories:
- a. bad debts and related costs;
 - b. metering and related costs;
 - c. sales and marketing costs;
 - d. customer service costs;
 - e. central services, IT costs, Property costs; and
 - f. other costs.³⁴
123. It has then benchmarked the total indirect costs per customer over the whole period to the lower quartile within the SLEFs, with the inefficiency then being calculated as:
- $$\text{Inefficiency} = \text{Suppliers' actual costs} - (\text{efficient indirect cost per customer} * \text{suppliers' number of customers})$$
124. The CMA found that in total, across the SLEFs, there was indirect cost inefficiency in the domestic segment of £2.3billion over the whole period analysed. E.ON’s indirect cost inefficiency was estimated as £[~~2.3~~]m.³⁵
125. It is E.ON’s view that the CMA’s methodology for estimating indirect cost inefficiency is characterised by serious methodological flaws, which mean that the results provide no reliable information on indirect cost inefficiency among the SLEFs. In addition, selection of a lower quartile from a population of 6 is unlikely to lead to statistically significant results.
126. *Failure to control for differences in cost allocation methodologies across suppliers*
127. Suppliers are likely to have different policies for allocating costs across different segments of the business, (e.g. domestic and SME). In addition, for some expenses, suppliers have a choice as to whether assign these as direct or indirect costs. Unless such differences are accounted for, any comparison of indirect

³⁴ See for example <Indirect costs for data room> file

³⁵ PDR Report, para 3.214

costs across the SLEFs will not be on a like-for-like basis. More specifically, suppliers that have accounting policies that allocate a larger proportion of costs to the domestic segment and/ or allocate a larger number of cost items as indirect cost, are likely to have larger indirect costs per customer – simply as a function of their accounting practices.

128. The CMA's analysis, however, does not take into account such differences in accounting policy. Therefore, it treats as inefficiency any indirect cost that is above its benchmark, even those differences that are purely an artefact of different accounting policies. As a result, the CMA's analysis overstates indirect cost inefficiency and, therefore, consumer detriment. If the CMA is to continue to use the indirect approach to measure consumer detriment, it must fully account for differences in suppliers' cost allocation methodologies before any weight can be placed on the results.

Failure to control for differences in firms' strategies towards capital versus operational expenditure

129. The relative balance of a supplier's indirect cost and capital base will be influenced by the particular strategy the supplier has chosen in relation, for example, to whether to lease or own assets and whether to pursue more capital intensive strategies. Suppliers with less capital intensive strategies are likely to have higher indirect costs, but this is a function purely of a strategic decision to pursue a less capital intensive strategy, and does not truly represent indirect cost inefficiency.
130. The CMA's analysis of inefficiency, however, focusses only on indirect costs and does not take into account differences in suppliers' strategies with respect to capital versus operational expenditure. Therefore, it will tend to label as inefficient those suppliers that have chosen to favour less capital intensive strategies. This is incorrect and implies that part of what the CMA has identified as indirect cost inefficiency is instead likely to be an artefact of differences in suppliers' strategies towards capital versus operational expenditure. As a result, the CMA's analysis overstates indirect cost inefficiency and, therefore, consumer detriment. If the CMA is to continue to use the indirect approach to measure consumer detriment, it must fully account for differences in suppliers' strategies towards capital versus operational expenditure.

Incorrectly assuming that lower costs are more efficient, for all cost categories

131. For certain cost categories, higher spend is likely to be more effective and consistent with strong competitive pressure. For example, larger spend on sales and marketing and customer retention is likely to be more effective in growing a supplier's customer base. In fact, when suppliers face greater competitive

pressure they may be expected to incur higher costs to compete to win and retain customers. Observing a supplier with a lower level of sales and marketing or customer retention cost, therefore, does not imply that that supplier is more efficient.

132. The CMA, however, treats lower indirect cost as more efficient regardless of the nature of the cost. In other words, the CMA does not assess whether for certain cost categories, higher levels of spend are more efficient and consistent with a well-functioning, competitive market. This implies that its indirect cost benchmarking analysis wrongly labels certain suppliers' costs as inefficient, thereby overestimating the level of indirect cost inefficiency among the SLEFs. This means that the CMA's estimate of consumer detriment using the indirect approach is overstated, and the CMA needs to correct this if it is to rely on this methodology in its final report.

Failure to control for differences in suppliers' payment type mix

133. The CMA has acknowledged that there are indirect cost differences according to the payment type used by the customers, i.e. DD, SC and PPM, and has quantified these differences in its analysis of consumer detriment using the direct approach. Despite this, the CMA has not controlled for these different costs within its indirect cost benchmarking exercise. This is likely to penalise firms with relatively more SC and PPM customers.

Conclusion on the CMA's indirect cost benchmarking

134. In E.ON's view, the flaws in the CMA's methodology listed above are fundamental weaknesses in the CMA's approach to indirect cost benchmarking, and all imply that the CMA's estimate is likely to be materially overestimated.

4.4.3. Quality of service and innovation

135. E.ON has previously commented that we have placed great emphasis on improving our customer service, seeing this as a way to create promoters of E.ON and help improve retention. Whilst not complacent about the quality of its service, E.ON is proud to have again been the highest performing of the larger suppliers in the 2015 uSwitch awards for customer satisfaction, following on from winning the award outright twice (2012, 2013) and again being highest of the large suppliers in 2014.
136. The CMA has suggested that the SLEFs provide a poorer quality of service to customers compared to that provided by smaller suppliers. This is at odds with the evidence provided above specific to E.ON and that provided by the Citizen's

Advice Bureau's (the "CAB") complaints league table for the period Q4 2015³⁶. In this, a number of the larger suppliers considerably outperformed the mid-size and smaller suppliers, with the CAB noting that Co-operative Energy was ranked lowest and had the highest customer complaint ratio ever recorded by the CAB³⁷. Co-operative Energy received 1,584 complaints per 100,000 customers which was 40 times higher than the best performer. Both First Utility and Ovo fared worse than four of the SLEFs in this research. E.ON, together with the other three large energy firms, are seen in the top five performers with the fewest complaints in the market.

Table 1: CAB complaints league table for the period Q4 2015

Rank	Supplier	Ratio	Movement since Q3 2015	Q3 2015 ratio	Q3 2015 rank
1	EDF Energy	34.5	▲	43.3	2
2	SSE	34.9	▼	38.7	1
3	British Gas	65.3	▲	86.4	5
4	E (Gas and Electricity)	74.1	◀▶	55.7	4
5	E.ON	88.9	▲	89.9	6
6	Flow Energy	89.0	▲	227.1	13
7	Utility Warehouse	91.2	▲	118.1	9
8	Good Energy	97.2	▲	149.4	12
9	Ecotricity	98.8	▲	124.8	10
10	Ovo Energy	102.6	▲	137.1	11
11	Utilita	126.7	▼	98.3	7
12	Green Star Energy	133.4	▼	49.1	3
13	Economy Energy	147.4	▼	110.4	8
14	Spark Energy	304.1	▲	482.8	15
15	First Utility	367.2	▼	455.9	14
16	npower	565.4	◀▶	690.1	16
17	Scottish Power	567.9	◀▶	740.3	17
18	Co-OpEnergy	1148.8	▲	1584.1	19
19	Extra Energy	1553.7	▼	1164.4	18

137. This is also reflected in the continued improvement in the number of complaints we have received per 100,000 customer accounts as reported by Ofgem (see figure 1 below). At the same time, some smaller suppliers have seen increases in the number of complaints they have received³⁸. It is therefore not correct to

³⁶ <https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/citizens-advice-consumer-work/supplier-performance/energy-supplier-performance/how-does-your-energy-provider-stack-up>

³⁷ <https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/gap-widens-between-energy-suppliers/>

³⁸ <https://www.ofgem.gov.uk/about-us/how-we-work/working-consumers/supplier-performance-consumer-complaints>

simply categorise the large six energy companies as having the poorest customer service in the market.

Figure 1: Largest Suppliers – Complaints received by company per 100,000 accounts

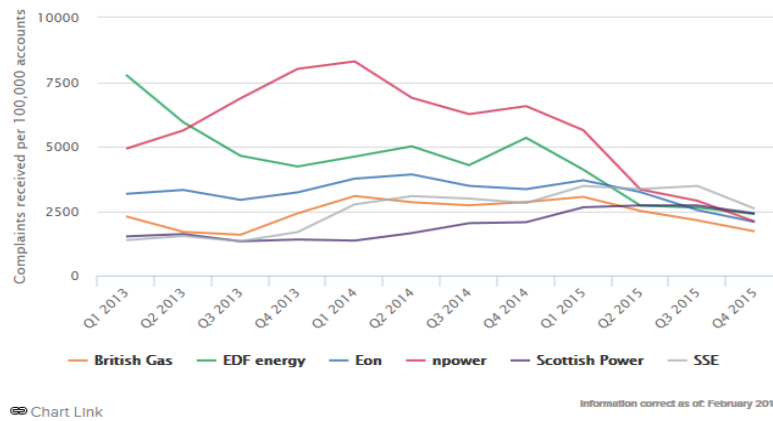


Chart Link

Information correct as of: February 2016

Source: Ofgem

- 138. E.ON therefore refutes the CMA statements that all of the SLEFs deliver a poorer quality of service compared to that provided by smaller suppliers and believes it is clear that service is an important differentiator which can have a material impact on customer decisions around switching. This is contrary to the CMA belief that energy is a homogenous product, sold wholly on price, and that all price differentials represent a detriment to customers and illustrates that the CMA needs to account for non-price elements in its detriment analysis.
- 139. It is the case that the RMR rules have stifled innovation and we welcome the remedies focussed at removing those constraints. We would also reiterate E.ON’s previously expressed view that smart meters, with their associated infrastructure and integration with wider digital capability, will overcome many of what might otherwise be seen as the potential barriers to greater customer engagement with and innovation in the market.
- 140. As early evidence of this belief we would point to our Smart PAYG proposition that smart metering has already made possible. Whilst this product is targeted at the needs of customers with PPM, it also offers a flexible and convenient way to manage their energy account that should resonate with all customers by providing more choice – if it is not completely derailed by the CMA’s proposed remedy relating to PPM customers, as we discuss further below.

5 DOMESTIC RETAIL REMEDIES

- 141. The CMA has developed a package of remedies to create a framework for effective competition; to help customers engage to exploit the benefits of

competition; and to protect customers who are less able to engage to exploit the benefits of competition.

142. Whilst E.ON agrees with the principles behind RMR in terms of a simple, open and transparently fair market, E.ON agrees with the CMA finding that the 'simpler choices' component of RMR has resulted in a stifling of innovation through greater uniformity of tariffs, potentially misleading information to customers and an increase in the difficulty of rewarding low volume users. We therefore welcome the recommendations to Ofgem to remove certain conditions from the standard licence conditions.
143. E.ON broadly supports the CMA's proposal around reform of the settlement process. E.ON agrees that the long term ambition should be for all customers to be settled using half-hourly data and that the approach for this should be to consult on a robust plan to implement this. Similarly, E.ON supports the objective to have accurate gas settlements and hence supports Project Nexus and the introduction of a performance assurance framework.
144. The CMA has proposed a number of remedies to address some of the technical constraints within the PPS. E.ON supports the objective of removing these technical constraints and sees this as the key step to allow competition to flourish in the segment. Therefore, whilst we welcome the implementation of the DAP, we are concerned that other remedies which would prohibit upfront charges for meter switches or security deposits are not being taken forward.
145. E.ON believes that it is essential that customers have access to complete, accurate information that they are able to understand. We therefore welcome the proposal for an Ofgem-led programme and its emphasis on using RCTs to ensure that what is implemented is effective and has the intended effect.
146. E.ON supports the principle behind Ofgem's intention to move away from rules based regulation and towards PBR and we are fully engaged with the consultation process. However, E.ON has some concerns with Ofgem's current approach and it is important that any PBR is customer focussed and not overly complex.
147. E.ON is broadly supportive of providing TPIs with access to industry data that would enable them to provide a more engaging service to customers. However, it is not clear to E.ON that giving PCWs access to ECOES and SCOGES would be effective at reducing erroneous transfer and we believe mandatory participation in Midata for all suppliers with access for PCWs based upon customer consent would be more appropriate.
148. E.ON has significant concerns with the proposal for an Ofgem database for customers who have been on a default tariff for more than 3 years and believes

there is a considerable risk that this will erode, rather than improve, trust in the market. Furthermore, E.ON remains concerned as to whether the remedy is fully compliant with data protection legislation and believes the risks associated with data security are substantial.

149. E.ON recognises that there are additional barriers for customers who have restricted meters, but these barriers can be addressed. [X]. We therefore welcome the CMA proposals to remove these barriers for customers across this segment.
150. E.ON is strongly opposed to the introduction of regulated price cap tariffs for PPM customers. This will distort competition in the market, have significant unintended consequences and work against the other proposed remedies, thereby reducing their effectiveness and practicability. Such a price cap is a seriously regressive step and runs counter to market liberalisation and encouraging a competitive market. A segment that has seen the arrival of new competitors with new business models and technological innovation should not be encumbered with regulated prices and such a remedy is not proportionate, especially given the flawed CMA analysis on detriment³⁹.

5.1. Creating a framework for effective competition

5.1.1. Withdrawal of the ‘simpler choices’ component of the RMR rules

151. In the E.ON Response to PFs and PRs⁴⁰, E.ON set out its views on the proposal to withdraw the simpler choices component of RMR. E.ON agrees with the principle behind RMR in terms of a simple, open and transparently fair market, but would suggest that whilst it has been successful in some areas, it has created issues in others.
152. Whilst elements of RMR have led to improvements to comparability, simplicity and fairness, E.ON agrees with the CMA finding that the ‘simpler choices’ component of RMR has resulted in a stifling of innovation through greater uniformity of tariffs, potentially misleading information to customers and an increase in the difficulty of rewarding low volume users.
153. In our response, and subsequently at our oral hearing on 25 August 2015, E.ON suggested that changes to the RMR rules needed to be considered carefully so that suppliers could develop products that meet customers’ needs, resulting in improved competition and a building of trust with customers. We therefore

³⁹ The CMA has elsewhere accepted that price regulation will discourage innovation and market entry (e.g. the *Private Healthcare Market Investigation*)

⁴⁰ E.ON Response to PFs and PRs, para 90-93

welcome the recommendations to Ofgem to remove certain conditions from the standard licence conditions.

154. Similarly, E.ON supports the addition of a standard of conduct in to SLC 25C to require suppliers to have regard in the design of tariffs to the ease with which customers can compare value-for-money with other tariffs on offer and we will embrace this condition, as we have the other standards of conduct.

5.1.2. Settlement reform

155. The CMA has proposed several areas in which it intends to reform the settlement of electricity and gas. Whilst E.ON does not agree that these areas constitute an AEC, we support measures to further improve the accuracy of the settlement process as beneficial to both suppliers and customers.

Electricity settlement reform

156. E.ON supports the long term ambition for all customers to be settled using HH data. E.ON believes that tariff innovation should and will be driven by customer demand and that use of HH consumption data in the settlement of domestic electricity meters is likely to facilitate tariff innovation. E.ON therefore welcomes the proposal to adjust the Smart Energy Code (and the related licence condition) and to conduct a broad and comprehensive piece of work to scope out details of how best to achieve a move to HH settlement.

Smart Energy Code

157. Due to data privacy concerns, DECC and Ofgem implemented a policy through the Smart Energy Code which prohibits suppliers from collecting consumption data with greater than daily granularity unless a customer had given explicit consent to do so, known as opt-in.
158. E.ON recognises the concerns around data privacy and agrees that these must be addressed. However, this creates a key barrier to implementing HH settlement and, potentially, to greater innovation in the market through increased understanding of customer usage patterns. E.ON therefore believes that it is sensible for DECC to consult on this again and assess any alternative options that may exist.

HH settlement

159. E.ON welcomes the proposals for Ofgem to conduct a central piece of work assessing the options for HH settlement as well as the requirement for DECC and Ofgem to publish and consult jointly on a plan on the approach to moving to HH settlement.

160. E.ON believes the details contained within the proposal for a full cost benefit analysis, assessing the cost-effectiveness of alternative designs, and seeking to reduce the costs of elective HH settlement would provide a comprehensive assessment. This would result in a robust understanding of what is needed, what the best options are for delivering it, how long these would take and what the broader implications for consumers might be. E.ON notes that an assessment for HH settlement has been undertaken in the Irish market and Ofgem could benefit from following a similar approach.
161. A clear plan for moving to HH settlement based upon this assessment would give certainty to the industry and would allow the timetable to be driven by the Smart rollout programme – completion of which is an essential component for HH settlement.

[Gas settlement reform](#)

162. E.ON supports the objective to have accurate gas settlements and believes that Project Nexus will deliver significant benefits in this area, with Ofgem taking responsibility for the development and delivery of a performance assurance framework.

Project Nexus

163. In the E.ON Response to PFs and PRs⁴¹ we clearly highlighted our support for Project Nexus. E.ON agrees that its implementation is a priority, but recognises the complexity involved and believes it requires a robust delivery that does not undermine the competitive market and adversely impact consumers.
164. E.ON notes that Ofgem has recently announced that it will take control of Project Nexus from a sponsorship perspective and will use PWC to help ensure a successful implementation. E.ON is supportive of this approach.

Meter Reading submissions

165. E.ON believes that Project Nexus will ensure that annual quantities (“AQs”) are updated whenever a meter read is taken and provided to Xoserve, and AQs can only be updated once meter reads are taken. As a result, we believe that a proposal for submitting all meter reading for non-daily metered supply points in GB to Xoserve as soon as they become available is a sensible approach. Requiring at least one meter reading to be provided for settlement within a year is sensible and is in line with existing EU Directives.

⁴¹ E.ON Response to PFs and PRs, para 341

Performance assurance framework

166. In the E.ON Response to PFs and PRs⁴², E.ON recommended the introduction of performance assurance to ensure read frequency was appropriate and that any delays in read submission were penalised appropriately. E.ON therefore welcomes the proposal for Ofgem to take responsibility for development and delivery of such a framework. E.ON believes that Ofgem should build upon work already completed in this area but would suggest a plan of how and when Ofgem would implement it would be helpful, together with a commitment to provide sufficient resources.

5.1.3. Remedies to address constraints on competition for PPM customers

167. E.ON set out its views on the CMA findings specific to the PPS in the PPS Response⁴³. We agree that there are a number of technical constraints in the PPS which make it difficult for suppliers to offer the full range of tariffs, particularly fixed-term, fixed-price tariffs, to customers with PPMs.

168. We therefore welcomed a number of the remedies that the CMA proposed to address these technical issues until the Smart rollout programme effectively removes them. As a result we are concerned to see many of these are not being taken forward by the CMA. We believe that prohibiting charging of security deposits for PPM customers when switching and prohibiting upfront charging for new meters when customers switch away from PPM would address some of the barriers, and urge the CMA to reconsider implementing these remedies.

169. However, the CMA has suggested a number of new remedies to address some of the technical barriers and we comment on these below.

Grouping of regional costs

170. The CMA identified that the prepayment infrastructure, and specifically the requirement to use tariff pages, imposes limitations on suppliers in terms of being able to offer multiple tariffs, particularly fixed-price, fixed-term tariffs in the PPS.

171. Recommending that Ofgem modifies SLC 22B.7(b) to allow suppliers to set prices to PPM customers on the basis of grouping regional cost variations should result in suppliers requiring fewer gas tariff pages and hence ease this limitation. However, alongside this remedy, the CMA has proposed to introduce regional price caps (resulting in 70 different price cap tariffs) for the PPS (our views on this

⁴² E.ON Response to PFs and PRs, para 347

⁴³ E.ON PPS Response, Section 3

remedy are discussed later in this response). This creates a strong incentive for suppliers to price regionally in the PPS in order to minimise the inefficiency and risks associated with not being compliant with the price cap and hence effectively undermines this remedy to address the technical constraint. This appears to be a perverse outcome given that the key constraint is a technical one, and E.ON urges the CMA to reconsider any remedy which may reduce the effectiveness of those remedies addressing the technical constraint.

[Ofgem control of gas tariff pages and cap](#)

172. The CMA has also proposed that Ofgem takes responsibility for the efficient allocation of gas tariff pages and that the SLEFs accept undertakings for a cap on the number of gas tariff pages (at 12).
173. E.ON accepts the principle behind these proposals and would support Ofgem control until such a time as the Smart rollout programme addresses these technical constraints. However, as highlighted above, the potential introduction of regional price caps potentially increases the requirement for gas tariff pages amongst all suppliers, making efficient allocation difficult. Again, we would urge the CMA to reconsider any remedy which exacerbates the technical constraints in the PPS.

[The DAP](#)

174. The PPS Response⁴⁴ outlined our support for reforming the DAP and the potential benefits to those PPM customers in debt as a result. We have worked with Ofgem to reform the DAP and voluntarily introduce the Point of Acquisition (“**PoA**”) model in April 2015 to negate the need for customer action once they had made the decision to switch suppliers.
175. We therefore welcome the recommendation to Ofgem to ensure that changes to the DAP are implemented by the end of 2016, in particular relating to objection letters, complex debt and issues relating to multiple registrations.

5.2. Helping customer engage to exploit the benefits of competition

5.2.1. Regulatory interventions to improve engagement/mitigate incentives to keep customers disengaged

176. E.ON welcomes the CMA’s desire to have Ofgem review the Simpler Choices aspects of RMR and for this to be done in a rigorous and customer centric way through the use of RCTs.

⁴⁴ E.ON PPS Response, paras 65-72

177. We are also supporters of Ofgem moving to a form of PBR, although we do have concerns as to how the implementation will be undertaken and ultimately how such regulation will be monitored and enforced. We are engaging with Ofgem on these questions.

[Ofgem-led programme](#)

178. It is essential that customers have access to complete, accurate information that customers are able to understand. E.ON has previously highlighted our concerns with the CYPL messaging, particularly around the ‘narrow and wide’ messages⁴⁵ and the mandated wording not providing a clear and strong call to action. We also highlighted the risk of the related Personal Projection overstating savings, our concerns regarding the format and content of information required on customer bills and the opportunity provided by the Annual Statement to create more engaging messaging.
179. E.ON therefore welcomes the proposed Ofgem-led programme and its emphasis on using RCTs to ensure that what is implemented is effective and has the intended effect. It follows that we would be pleased to participate in the programme and the systematic review of the ‘clearer information’ component of RMR.
180. That said, we would highlight two aspects that should not be overlooked. The first is that the mandated information required of suppliers in their communications with their customers has a number of regulatory sources⁴⁶ and it is important that Ofgem takes a comprehensive approach to the review of information and communication with customers.
181. We would request that Ofgem’s programme be explicitly focussed on delivering customer outcomes and impacts, in keeping with Ofgem’s desired move to more outcomes-based regulation overall, rather than prescription and standard template setting.
182. Subject to the above, E.ON supports the programme exploring the shortlist of measures set out by the CMA as we would agree with the need to prioritise changes to bill information and the messaging to customers coming to the end of a fixed tariff. However, we are concerned that proposal to look at a market-wide ‘Cheapest Tariff Messaging’ will reintroduce the idea of suppliers being required to advertise competitor products, with the associated competition and legal issues this creates. The CMA should be explicit that this aspect of the proposal is strictly limited to exploring whether an Ofgem derived market average cheapest

⁴⁵ E.ON Response to PFs & PRs regarding proposed Remedy 9

⁴⁶ E.ON Response to PFs & PRs, para 183 as an example of the requirements on customer bills

tariff would be effective at increasing customer engagement (i.e. that customers know approximately what the level of the cheapest tariff in the market is).

183. Similarly we would reiterate our concerns over changing the name of standard variable tariffs in manner that could mislead customers to believe that there is a risk to their energy supply or that they have no obligation to pay. However, we believe that rigorous trials will show that there are better ways to provide customers with a clear ‘call to action’.

Principles rather than rules

184. E.ON supports the principle behind Ofgem’s intention to move away from rules based regulation and towards PBR, building on the progress made through Standards of Conduct. We are fully engaged with Ofgem’s consultation process and further welcome their proposal to increase engagement with suppliers.
185. The introduction of PBR will be a culture change for both Ofgem and suppliers and constructive engagement with suppliers will be fundamental to ensure the new PBR regime is a success. We fear this will be a lengthy and difficult transitional period and agree that a phased approach for the implementation of PBR would be most appropriate and allow licensees time to embed and assess the impact of any changes, before Ofgem moves to the next phase.
186. E.ON does have a number of concerns with Ofgem’s proposed approach. In particular, the proposed broad principles, save for the principle of ‘not putting customer outcomes at risk,’ are not customer focussed and appear to add an additional layer of complexity to regulation, rather than simplifying the regulatory burden.
187. In addition we need to ensure that the enforcement regime is also developed and evolves in parallel with Ofgem’s regulatory framework. A desired outcome of a transition to PBR should be to facilitate greater innovation and competition. To promote this outcome, enforcement must be flexible and allow for different suppliers to comply with Ofgem rules in different ways.
188. Paragraph 6.77(b)(i) of the PDR quotes what E.ON believes to be First Utility’s views on collective switching and E.ON’s use of collective switches. However, the way the paragraph is drafted suggests that this represents the CMA’s views. It should be made clear that this is an opinion of a competitor and not a “fact”. E.ON does not accept the assertion that it engaged in collective switching schemes in order to segment the market⁴⁷. E.ON made the collective switch tariffs that it won available to its existing customers, despite not being required

⁴⁷ PDR Report, para 6.77(b)(i)

to do so by the rules and a number of them did switch under collective switches. It remains the case that suppliers are not required to include some collective switch tariffs in Cheapest Tariff Messaging, although Ofgem updated its interpretation of this rule in October 2015 to distinguish between ‘closed’ collective switches where eligible customers need to have registered interest before the scheme is awarded to a supplier, as opposed to ‘open’ collective switches that customers can continue to join, even after the scheme is awarded. Open collective switches must now be included in the Cheapest Tariff Messaging, whereas it remains that closed collective switches do not.

5.2.2. Harnessing the incentives of rival suppliers and TPIs to engage customers

189. E.ON is broadly supportive of providing TPIs with access to industry data that would enable them to provide a more engaging service to consumers solely to reduce the actual or perceived number of erroneous or failed switches.
190. However, E.ON is concerned to ensure that the robust protection and security of the data shared is assured through any processes put in place. Indeed, E.ON is concerned that the risks inherent in the collation and sharing of customer data, far outweigh the likely effectiveness of the proposed Ofgem controlled database and that this proposed remedy requires further consideration by the CMA.

[Enhancing the ability and incentives of third party intermediaries to promote customer engagement](#)

191. E.ON agrees with the CMA’s decision not to progress the proposal for an Ofgem PCW. The introduction of the CAB’s own service has delivered a trusted solution for customers whilst not undermining the business of the commercial PCWs active in the market.

PCW access to ECOES and SCOGES

192. E.ON is still not clear that giving PCWs access to the ECOES and SCOGES database would actually deliver a reduced number of erroneous transfers and failed switches, or improve customers’ perceptions of such issues, beyond the data available through the Midata programme. That said, we note that CMA intends this as an interim measure until the delivery of phase 2 of the Midata programme.
193. As recognised by the CMA, data protection is a key issue that must be addressed as part of this proposed remedy. Accordingly, a robust process for permitting access to ECOES and SCOGES data will need to be put in place and we would expect all access to be conditional on customers giving their express consent.

194. Additionally, we would highlight the need to also ensure that organisations accessing ECOES and SCOGES data have in place the requisite information security measures. E.ON would therefore expect that access would only be given to those organisations able to demonstrate that they have in place an externally assured information security process compliant with a recognised standard such as ISO27001.
195. We would also reiterate that, for ECOES, such safeguards should be put in place via the Master Registration Agreement (“**MRA**”) where access is only granted to those companies accredited by Ofgem. Ongoing audits could then be introduced to ensure compliance with the appropriate data protection and information security requirements. Similarly, for SCOGES, such obligations are likely to be delivered via the Uniform Network Code (“**UNC**”).
196. In order to best design the detail of these requirements E.ON would suggest a broad range of stakeholders should be included, including CAB and the Federation of Small Businesses (the “**FSB**”).
197. It is E.ON’s understanding that any order by the CMA would need to be directed to MRASCo, rather than Gemserv, to deliver changes to ECOES. We also understand that delivery of access to the gas data in SCOGES will need to be facilitated by the gas transporters as well as their agent Xoserve who provides the service.

PCW Whole of the Market Requirement

198. E.ON does not object to the CMA’s proposal to recommend to Ofgem that it amend the Confidence Code to remove the Whole of the Market Requirement from the Confidence Code, and instead to require accredited PCWs to be transparent over the market coverage provided to domestic customers.

Midata

199. E.ON supports the CMA’s decision for participation in Midata to be mandatory for all suppliers. This will ensure that the benefits of Midata are available to all customers, enabling the full realisation of the full benefits of the Midata programme.
200. We note the proposal to expand the scope of Midata for phase 2. This further emphasises the need to ensure that all parties accessing and using this data do so in strict compliance with Data Protection legislation. In this regard we would highlight the proposed inclusion of the Warm Home Discount (“**WHD**”) indicator as a particularly sensitive piece of personal data and consideration needs to be given to the risk of that information being misused and the impact this would have on affected customers.

201. Similarly we would reiterate that, whilst we would be supportive of PCWs having direct access to data beyond the current 30 minute quoting period, this must be something a customer explicitly allows. Accordingly controls should be put in place to ensure this wider access to a customer's Midata is managed compliantly.

[Ofgem-controlled database of 'disengaged customers'](#)

202. E.ON has significant concerns with the proposal for an Ofgem database for customers who have been on a default tariff for more than 3 years. As we, and consumer groups such as the CAB have stated before, there is a considerable risk that a remedy such as this will erode, rather than improve, consumer trust in the energy sector by facilitating unsolicited marketing and it is therefore likely to disengage customers. This negative impact needs to be properly understood ahead of full implementation to ensure that greater harm is not caused to the market, in the same way that the CMA recommends other improvements to engagement be designed through RCTs.
203. E.ON remains concerned as to whether the proposed remedy is fully compliant with data protection legislation. Whilst the CMA has stated that it has taken into consideration the relevant legislation, including the General Data Protection Regulation (due to be implemented in June/July 2016), the intent to proceed with an 'opt out' for affected customers appears at odds with the intent that a data subject's consent should be given by a clear affirmative action establishing a freely given, specific, informed and unambiguous indication of their agreement to their personal data being processed. It is E.ON's view that a decision to engage in the market should come from informed customers themselves.
204. This is a view that is consistent with the position taken by the Information Commissioner's Office ("ICO") who, in response to the PDR Summary, stated "*Whilst we understand the desire to ensure customers get the best available tariffs, any sharing of information must be done within the requirements of DPA and PECR. We have made this clear to the CMA. This may **require individual consent or additional legal requirements** (emphasis added) to enable the sharing of consumer data with Ofgem or energy suppliers*".⁴⁸ Given the ICO's previous concerns in relation to the remedy⁴⁹; E.ON cannot easily reconcile this with the CMA's proposed remedy design.

⁴⁸ <https://ico.org.uk/about-the-ico/news-and-events/news-and-blogs/2016/03/ico-statement-in-relation-to-competition-and-markets-authority-report/>

⁴⁹ see pages 7-9 of the ICO's response to the CMA's PRs <https://ico.org.uk/media/about-the-ico/consultation-responses/2015/1432296/ico-response-to-energy-market-investigation-notice-of-possible-remedies-20150803.pdf>

205. Indeed, in justifying its 'opt out' design, the CMA has drawn from the French *GDF Suez* case, noting that if a similar (low) rate of 'opt outs' were received this would enable a large number of customers to be contacted and engaged. Ignoring that the *GDF Suez* concerns a vastly different factual matrix and took place in a different jurisdiction⁵⁰, the CMA's view that there would be a direct correlation between a low level of opt outs and subsequent customer engagement is irrational and contradictory to the CMA's customer disengagement AEC. If customers are disengaged, as alleged by the CMA, it is unclear how the CMA has reached the conclusion that a lack of opt outs would result from a conscious decision by consumers rather than being a result of the disengagement.
206. The CMA also needs to ensure that there is compliance with all the aspects of data protection legislation dealing with how data is managed and maintained. We would assume that the CMA is of the view that, once the data is provided to Ofgem, they become the 'data controller' and entirely responsible for the compliant management, maintenance and processing of that data. If not, we struggle to see how suppliers would be able to meet their requirements under data protection legislation to ensure that their customers' data was being properly managed and processed and only being used for the strict purposes it was obtained for.
207. A further example of the need to understand the full implications of the requirements of data protection legislation would be to understand a supplier's obligations where a customer that falls within the scope of the database has already provided them with a request for their details not to be used for mailed marketing, particularly where they fail to respond to the prescribed 'opt out' letter. Can such silence, in relation to the database, override a pre-existing express request not to have their data processed for an analogous purpose? We would suggest that it should not.
208. Security of the database, and those accessing it, also needs to be carefully considered, and we note the proposal to use a cloud based database as opposed to a UK based server protected with firewalls. Not only is the data being collected extremely sensitive, it should also be recognised that marketing lists with the level of data being proposed for the database have great commercial value. E.ON would therefore expect Ofgem to have an externally assured information security process compliant with a recognised standard such as ISO27001, and only to share the data with organisations able to demonstrate the same standards of information security management. Indeed we believe this should be underpinned by a cross industry governance process put in place to

⁵⁰ We highlighted these concerns in the E.ON PPS Response, para 31

establish the relevant standards and processes and to deal with any issues and incidents that arise.

209. The risks of there being a breach of data legislation or information security cannot be underestimated once it is acknowledged that numerous parties and their agents will be given access to this data. Any breach of security or abuse of the data will not necessarily be easy to trace and therefore the contractual framework proposed will provide only limited assurance to those involved. However, we can be clear that the negative impacts on customer trust in the energy sector would be massive.
210. This is particularly so given the likelihood that the information trawl would not stop at post but would, as suggested in a number of press reports, also lead on to telephone numbers being sought out and used. This is likely to lead to, at least, irritation and for some customers, potentially also concern.
211. It is therefore not clear to E.ON that the estimated cost of £50,000 to £100,000 takes account of the data protection and security management precautions and safeguards that are required to ensure that our customers' data are properly and securely managed.
212. It is in the light of these risks and the difficulty in ensuring that this remedy is implemented well that we believe this remedy to be disproportionate. Postal contact, compared to other direct marketing methods, is known to have a poor response rate as well as a poor return on investment by comparison to other direct marketing methods and therefore it can also be expected to have a relatively low effectiveness in contrast to the scale of the risks regarding disengaging customers, data protection and data security.

5.2.3. Remedies for customers on restricted meters

213. E.ON recognises the barriers that currently exist for customers with restricted meters, but these barriers can be addressed [X]. [X], we support the proposals that require all suppliers to offer all their single-rate tariffs to all customers on restricted meters.
214. E.ON believes that this will open the market to these customers, both in terms of the tariffs available to them and also in terms of the *suppliers* available, given that this will include smaller suppliers who have historically avoided offering tariffs to these customers.
215. E.ON also supports the proposals to remind customers about their options to switch supplier or tariff, most likely provided through our existing communications which include such messaging and we support the requirement to provide contact details for CAB.

5.3. Transitional price cap for PPM customers

216. E.ON is strongly opposed to the introduction of a regulated price cap tariff for prepayment customers as it will distort competition in the market, have significant unintended consequences, work against the other proposed remedies thereby reducing their effectiveness and is not proportionate. Such a price cap is a seriously regressive step and runs counter to market liberalisation and competitive markets.
217. Without prejudice to our views above on the price cap, E.ON submits that should the CMA continue with the price cap, it is extremely important that the CMA seek to minimise the distortion to competition in the market. The current proposals are based upon materially flawed assumptions and methodologies and are likely to result in the price cap being set at a level which is unfounded and unsustainable, exacerbating the distortion to competition in the market.
218. Additionally, E.ON believes that it is important that this prejudicial outcome is not further exacerbated, through the inappropriate inclusion of the regulated tariff in the mix when communicating CYPL messages relating to the competitive market, to customers. That calculation should only cover competitive market tariffs open to all. The same goes for any potential market-wide cheapest tariff messaging that result from the proposed Ofgem-led programme.
219. E.ON submits that it is also clearly not proportionate for the cap to extend to Smart PAYG customers. The CMA has recognised that the features it has noted that give rise to the PPM AEC will, to a significant extent, be addressed by smart metering and proposes that the price cap is likely no longer to be required once Smart meters have been rolled out. It also recognised the potentially damaging impact that such a remedy may have to competition and innovation in the PPS. E.ON believes it is therefore perverse and unjustified for the CMA to impose a price cap on smart PPMs.
220. In light of the practical difficulties and negative consequences of implementing the remedy and the materially flawed detriment analysis on which the remedy is based, E.ON considers that such a remedy will not be effective, practicable or proportionate and risks undermining the benefits of competition for PPM customers (by discouraging them from engaging with the market).

[Impact of a price cap in the PPS](#)

221. E.ON believes that any remedies proposed by the CMA should focus on enhancing competition in the market as this represents the best approach to

delivering positive outcomes for customers. E.ON has argued against the introduction of a regulated tariff⁵¹ or price cap⁵² as it is highly likely to distort competition in the market, have significant unintended consequences and work against the other proposed remedies, thereby reducing their effectiveness and practicability as a package of remedies.

222. The CMA has rightly recognised that introducing a price cap across all SVT customers would *“run excessive risks of undermining the competitive process, potentially resulting in worse outcomes for customers in the long run”*⁵³. However, E.ON believes the risks of applying a price cap to the PPS are equally likely to undermine competition in that segment, significantly distorting the market. A price cap is a seriously retrograde step, taking the UK back to before 2002 and runs utterly counter to market liberalisation and competitive markets.
223. The CMA itself recognises this, saying that it believes that the “best, most sustainable approach” to reducing the detriment of the higher prices it believes it has observed is, in the long term “through fully competitive markets”⁵⁴.
224. Whilst E.ON accepts that there are a number of technical constraints in the PPS, it is those constraints, and not a lack of competition, which need to be addressed. E.ON believes that the aspiration for the PPS should be that PPM customers have access to the same tariffs as non-PPM customers (with an additional cost to serve where appropriate and justified) and that there should be no difference between PPM and non-PPM customers, at least in terms of tariffs they can access. This is exactly the approach E.ON has adopted, through its PAYG tariff, as the CMA is aware.
225. The CMA states that smart meters remove the technical barriers which arise from the dumb prepayment infrastructure, and should address the barriers to customer engagement⁵⁵. It therefore seems perverse and inconsistent to introduce a remedy which will *inhibit* the deployment of smart meters to the PPS. E.ON has previously described to the CMA its intention to target its Smart PAYG proposition at PPM customers, the result of a commercial decision based upon an attractive competitive opportunity in the market. Indeed, other suppliers are also actively pursuing this opportunity, demonstrating the benefits of competition in this area. This was, of course, also the thrust of some of the CMA’s earlier, more proportionate, remedies in this area.

⁵¹ E.ON Response to PFs and PRs, paras 204-249

⁵² E.ON PPS Response, paras 73-113

⁵³ PDR Report, para 7.17

⁵⁴ PDR Report, para 7.18

⁵⁵ PDR Report, para 113

226. Introducing a price cap to mitigate a perceived detriment in the short-term, undermines the attractiveness of PAYG propositions, given the inherent issues with how the price cap will be set. Furthermore, using two mid-tier suppliers, Ovo and First Utility, as the benchmark for a competitive prepayment tariff is significantly flawed.
227. In our discussions on the CMA's analysis of both direct and indirect detriment, we have highlighted the many issues with the CMA's analysis. Given that the approach the CMA has used to determine a competitive benchmark price for setting the price cap level is similar to its calculation of detriment (using the direct route), all the issues identified there and detailed in paragraphs 69 to 104 above apply equally to the price cap methodology. Those material flaws lead to an overestimation of detriment on the one hand and, on the other, result in a price cap that is at a lower level than a competitive and sustainable price would be (once the technical constraints are removed from the segment). Furthermore, the CMA has used its flawed detriment calculation to justify its price cap remedy, in which the same flaws are likely to lead to it being even more onerous. This challenges the assessment of proportionality that the CMA has conducted on this remedy.
228. Whilst the CMA recognises the risks to competition of its price cap, and seeks to remedy this by applying headroom to the price cap, the level of the headroom is unlikely to address the issues that result from the flawed benchmark. As a result, the incentives for customers of our smart PAYG proposition are likely to be significantly dampened, slowing its rollout and hence the deployment of smart meters into the segment and the passage of those customers into an unconstrained competitive world. Put simply, rather than moving PPM customers forward to a new solution in a digital age, it condemns them to continue to languish in an analogue era, less likely to access the benefits of competition. Given these issues, E.ON has serious concerns as to the practicability of this proposed remedy.
229. This effect is compounded by the increased risks that would be associated with offering tariffs into the segment other than those matched to the price cap. In order to be compliant with the price cap, a tariff to PPM customers must be below the level of the price cap, across a range of different consumption levels, with the price cap being updated on 1 April each year. This approach creates risks to suppliers of offering fixed-price, fixed-term tariffs which span two different price cap years. Should a fixed-price tariff be offered just before the new price cap level is set, this could result in a situation where the new price cap is set lower than the previous fixed-price tariff (given the issues with the price cap level discussed above). Unless "grandfathering" protection is permitted (which

brings with it its own questions around customers' understanding and perceptions of "fairness"), this would then require the price of the fixed-price tariff to be reduced in order to remain compliant, which could be done under the unilateral contract variation rules, but may result in the tariff now being loss-making for the supplier.

230. It is therefore likely that suppliers would seek to mitigate this risk by only offering tariffs which directly matched the price cap, and which therefore changed once a year in line with the price cap. This is likely to have knock-on impacts in terms of hedging too, with suppliers seeking to match their hedges to the price cap to reduce their risk of being out of the market. This itself will then have a further impact on liquidity in the market. As a result, the offering of a wide range of tariffs into the PPS using smart meters is likely to be significantly reduced. Customers are likely to believe that they are now 'safe' on a regulated tariff and hence would be less likely to engage if suppliers were able to provide more competitive tariffs. This undermines the benefits of smart PAYG propositions, financially but also in terms of the beneficial impact on customer engagement that such market-opening propositions could result in. Regulation will, quite simply, stifle innovation in the market.
231. The CMA has itself acknowledged the negative impact that excessive regulation can have on a market in terms of undermining effective and efficient competition and stifling innovation and has taken steps to remedy several areas where it has identified issues. Therefore, to propose the introduction of a regulated price cap tariff in the PPS runs contrary to this position and will create the very conditions that the CMA seeks to remedy (for example by removing the 'simpler choices' component of RMR). Furthermore, the CMA intends to introduce this regulation despite the fact that it has not properly explored the segment in depth.
232. Without prejudice to E.ON's disagreement with the imposition of a price cap remedy, if the CMA continues with its intention to introduce a regulated price cap, E.ON submits that the CMA needs to refine its criteria, potentially relating the tariff cap only to those PPM customers which are in debt and hence have additional barriers to switch (even though these are being addressed by the implementation of the DAP) or alternatively looking at fuel poor PPM customers (DECC statistics showed approximately 22% of electricity and 21% of gas PPM customers are classed as fuel poor).
233. Such an approach would remove the potential unintended consequence that the remedy may incentivise existing non-prepayment customers to switch from their credit meter to a classic prepayment meter in order to be eligible for the price cap tariff. Once customers make this switch, the same issues around hindering the rollout of smart meters described in the paragraphs above would apply.

Indeed, E.ON would suggest that the CMA needs to be very cautious in defining the criteria for eligibility in its final report to avoid such regressive outcomes. It is concerning that a lack of clarity in this area at this stage of the CMA's investigation will leave little room for consultation on a key principle of the proposal. Additionally, it is important that this prejudicial outcome is not further exacerbated, through inappropriate inclusion of the regulated tariff in the mix when communicating CYPL messages relating to the competitive market to customers. That calculation should only cover competitive market tariffs open to all⁵⁶. The same goes for any potential market-wide cheapest tariff messaging that results from the proposed Ofgem-led programme.

234. It is also clearly not proportionate for the cap to extend to Smart PAYG customers. The key underlying cause for the detriment identified by the CMA in the PPS is the effect of technical restrictions arising from dumb prepayment infrastructure and it recognises that Smart prepayment will not be subject to such restrictions⁵⁷. The CMA accepts that price caps bring with them distorted incentives⁵⁸. However, it observes that the features it has noted that give rise to the PPM AEC will, to a significant extent, be addressed by smart metering⁵⁹. It also notes that, generally, the cheapest prepayment tariff in a region relates to the Smart offering⁶⁰ and proposes that the price cap is likely no longer to be required once Smart meters have been rolled out⁶¹. It highlights the risk of customers subject to the cap losing "the habit of engaging in the market"⁶² and that it could act to reduce the strength of competition in the PPS⁶³ and may reduce innovation⁶⁴. Notwithstanding all of this, the CMA still believes it proportionate to impose a price cap on smart PPMs. This is perverse and unjustified. It is also hard to see how it is compatible even with Ofgem's existing duties to promote competition, wherever possible⁶⁵.
235. The CMA states that it has considered the potential for not applying the price cap to customers with Smart PPMs, but suggests this could create perverse incentives for customers or difficulties in monitoring compliance with the price cap. E.ON accepts these arguments, but suggests they are a clear signal of the distortion

⁵⁶ The workability of this mechanism in a world of more tariffs and exclusive tariffs needs further consideration by the CMA.

⁵⁷ PDR, para 7.8

⁵⁸ PDR, para 7.13 and footnote 15

⁵⁹ PDR, para 7.20

⁶⁰ PDR, para 7.153

⁶¹ PDR, para 7.211

⁶² PDR, para 7.241

⁶³ PDR, para 7.242

⁶⁴ PDR, para 7.252 – like E.ON's PAYG proposition, for example?

⁶⁵ Notwithstanding the cursory discussion of this in the PDR, para 7.268

that the price cap will bring to competition in the market, and hence reinforce our view that a price cap should not be imposed in the PPS.

236. E.ON does not believe that an area of the market that has seen the arrival of new competitors with new business models and technological innovation should be encumbered with regulated prices and hence is strongly opposed to a price cap for PPM customers, particularly at an unfounded and unsustainable level. In addition, the remedy goes against the aim of introducing smart meters into the segment as the best way of addressing the technical barriers, and is not based upon a robust analysis of the PPS. In light of the practical difficulties and negative consequences of implementing the remedy and the materially flawed detriment analysis on which the remedy is based, E.ON considers that such a remedy will not be effective, practicable or proportionate and risks undermining the benefits of competition for PPM customers (by discouraging them from engaging with the market).

[Specific issues with the price cap methodology](#)

237. Without prejudice to our view above that a price cap is not proportionate and will have a significant impact on competition in the market, E.ON sets out its concerns on several specific areas of the price cap design below which further impact its practicability and effectiveness.
238. As E.ON has previously set out, the introduction of regional price caps for the PPS will potentially result in 70 different price cap tariffs, in order to match the regional costs differences and tariff propositions. Whilst a supplier could potentially group some of its price caps together, this will lead to inefficiencies in achieving compliance with the price caps, as all the price caps in the group would have to be compliant with the lowest price cap in the group. This would exacerbate the issues already highlighted about the level of the price cap described above.
239. This creates a strong incentive for suppliers to price regionally in the PPS in order to minimise the inefficiency and risks associated with being compliant with the price cap and hence effectively undermines the CMA remedies that seek to address the technical constraints in the segment. This appears to be a perverse outcome given that the key constraint is a technical one, and E.ON urges the CMA to reconsider any remedy which may reduce the effectiveness of those remedies addressing the technical constraint.
240. The CMA also proposes a dual fuel price cap based upon a dual fuel benchmark and single fuel price caps based upon single fuel benchmarks. The CMA recognises that this could lead to a situation in which the dual fuel price cap is not equal to the sum of the single fuel price caps, but believes this approach is more

robust. However, it does increase the issues raised above in terms of the number of price cap tariffs required and is at odds with the pricing practices which are commonly used in the PPS, which typically do price the dual fuel tariff as the sum of the single fuel tariffs due to the technical constraints of the infrastructure. E.ON would therefore recommend that the CMA reconsider its thinking in this area.

241. E.ON notes the CMA statements that accurately reflecting policy costs in the price cap tariffs is likely to provide a challenge. The CMA then states that, given the uncertainty in these costs, it considers the best approach is to use DECC's projections for the maximum spend under the Levy Control Framework ("LCF") as a basis for indexation of these costs. E.ON understands the concerns that the CMA raised around the uncertainty of policy costs, but all these uncertainties still exist within DECC's projections, which is one of the reasons why DECC has included headroom within the LCF (currently headroom is set at 20%). Should DECC end up using this headroom, the accuracy of using the LCF projections as an index for policy costs will be undermined.
242. Furthermore, the LCF does not cover all policy costs that suppliers have to recover from customers and, although the CMA has made assumptions with regard to the ECO and WHD, it has ignored the significant impact of the capacity mechanism, which is not included within DECC's projected policy costs.
243. The capacity mechanism has procured capacity for the delivery year October 2018 to September 2019 at a cost of around £1bn (in 2012 money), which is to be recovered via suppliers. In addition, DECC is currently consulting on its intention to run another capacity auction in January 2017 for delivery in October 2017 to September 2018. The cost of this auction is unknown at this stage, but will need to be accounted for when setting the price cap for April 2017. Indeed, the CMA needs to account for the costs of all subsequent capacity auction costs when indexing for the overall policy costs. It should also be noted that, given that the capacity delivery years run from October to September, each price cap year will span two different capacity delivery years, which means costs will need to be averaged, potentially leading to periods of over and under recovery of costs for suppliers.
244. In addition, the CMA states that policy costs are becoming an increasingly large component of the overall costs borne by suppliers⁶⁶. This is demonstrated by the level at which the LCF increases to nearly £10bn by 2020 and would be compounded by the costs associated with the capacity mechanism described

⁶⁶ PDR Report, para 7.75

above. However, the methodology the CMA has used to produce the price caps depends upon indexing the relevant costs and then applying them based upon their component of the energy bill for the financial year 2014. Given the relative change in the importance of each cost component, E.ON considers it necessary for the percentage components to be updated annually as and when the overall price cap is updated. If this approach is not followed, the price caps are increasingly likely to become less or even un-representative of the costs that suppliers bear.

245. E.ON also has concerns around how this remedy will be applied to customers and in particular the eligibility requirements. These elements of the price cap need to be made clear to avoid perverse outcomes. For example, does the CMA intend for the price cap to apply to PPM customers that have switched from a credit meter to a PPM after the introduction of the price cap? Such customers would not have been included within the CMA's analysis on detriment and it is not clear that such a remedy should apply to customers who have made an active choice to switch to a PPM – they are clearly not disengaged and are willing to accept the potential constraints in the PPS until they are resolved by smart meters. Further, does the CMA intend to potentially create the incentive for customers to switch from credit to PPMs by allowing them access to the price cap? What is the CMA's policy here? Such concerns will need to be addressed in the detailed design of the price cap proposal.

6 MICROBUSINESS RETAIL REMEDIES

246. The E.ON response to PFs and PRs⁶⁷ outlined our view that the supply of energy to SMEs is a market in transition, where increasing competition is demonstrated by the growing level of participants in the market. E.ON has been successful in driving greater engagement with SME customers and has also seen increased customer satisfaction as a result. However, we recognise that there is not as much transparency in relation to the supply of energy to microbusinesses compared to the retail market and hence welcome proposals to improve this. In addition, we support measures that seek to limit the potential detrimental effect of auto-rollover contracts.

6.1. Detriment suffered by microbusiness

247. The CMA has updated its analysis of the detriment suffered by microbusiness customers based upon its view of profits in excess of the cost of capital earned by the SLEFs, with SME customers generating profits of approximately £280m⁶⁸ per

⁶⁷ E.ON Response to PFs and PRs, paras 250-252

⁶⁸ PDR Report, para 9.15

year in excess of the cost of capital. The CMA has then used the proportion of revenues attributed to microbusinesses compared to the SME segment to estimate that the SLEFs earned profits in excess of the cost of capital of £230m⁶⁹ per year.

248. However, the CMA analysis continues to ignore the significant risks associated with the supply of energy to microbusinesses⁷⁰, which is unreasonable and undermines the validity of their conclusions in this area.

6.2. Remedies for microbusiness

249. The CMA has proposed a package of remedies to improve transparency in the microbusiness market in order to help customers engage further. We comment on these in turn.

6.2.1. Creating a framework for effective competition

250. The CMA has proposed reform of the settlement process for electricity and gas and any such reforms would impact microbusiness customers as well as domestic customers. E.ON has discussed its views on these reforms in Section 5.1.2 and, whilst we do not agree that these areas constitute an AEC, we support measures to further improve the accuracy of the settlement process as beneficial to both suppliers and customers.

6.2.2. Helping microbusiness customers engage to exploit the benefits of competition

251. E.ON welcomes proposals to further increase customer engagement and believes this is fully aligned with our strategy. However, in the E.ON Response to PFs and PRs⁷¹, we expressed our view that introducing rules governing the information that TPIs are required to provide to microbusiness customers, used in conjunction with a TPI Code of Conduct would be effective at addressing the concerns around the role of TPIs and the impact that a small minority of TPIs have in terms of undermining trust in TPIs as a whole.
252. This is particularly important given that recent E.ON analysis suggests that TPI's now generate >50% of all switching that takes place within the SME market.

Figure 2: Switching in the SME segment by channel



⁶⁹ PDR Report, para 9.16

⁷⁰ E.ON Response to PFs and PRs, Section A.2.2

⁷¹ E.ON Response to PFs and PRs, paras 286-291

253. We are therefore concerned that the CMA does not propose to take these remedies forward. Whilst we agree that the price transparency remedy (discussed below) will address some of the aspects associated with the behaviour of TPIs, E.ON continues to believe that improvements can be made in this area.
254. Furthermore, the CMA states that it has discussed with Ofgem its draft Code of Practice and that the CMA considers that Ofgem has a clear intention to take this forward and introduce it, following a consultation process with industry. E.ON would strongly urge the CMA to strengthen this position by making a clear recommendation to Ofgem to do exactly that, including requiring Ofgem to produce a plan and timetable for its introduction. Given the CMA has made several other recommendations to Ofgem to engage in similar processes (such as the Ofgem-led consultation on RCTs, the recommendation for Ofgem to progress Project Nexus and produce an assessment and plan for the introduction of HH settlement), it is not clear why such a recommendation in this area has not been made. The proposal to have a TPI Code of Practice has been in development for four years by Ofgem – why does the CMA believe that it will now suddenly move forward with alacrity?

[Price transparency remedy](#)

255. E.ON believes that the introduction of a requirement for suppliers to disclose the prices of their acquisition and retention contracts to a well-defined ‘Proposed Segment’ of microbusinesses would be an effective remedy in improving price transparency. The E.ON Response to PFs and PRs⁷² suggested that an online quotation tool was likely to be the most effective method of achieving this. The CMA has also addressed our concerns about applying the remedy too widely, given the highly diverse nature of the SME segment, many of whom are engaged and sophisticated customers displaying similar characteristics to customers in the I&C segment. Focussing the proposal on a well-defined proposed segment will ensure the remedy produces efficient and effective outcomes.
256. However, E.ON urges that online quotation tools ensure a like for like comparison of prices to ensure customers can simply compare alternatives. There are differing approaches by suppliers to ‘pass through’ costs elements (e.g. Feed in Tariff, Electricity Market Reform Costs and Renewable Obligation costs), with some including them as fixed costs within the contract and others varying them as costs change in the course of the contract. This poses significant risks to price transparency with a real risk of greater customer confusion and therefore dis-engagement.

⁷² E.ON Response to PFs and PRs, paras 281-283

257. E.ON already publishes its deemed prices and agrees that these prices should be transparent for customers. However, given the specific nature of deemed tariffs (they are applied to customers who have not signed up to a contract but consume energy, most typically when such customers move into a new property), E.ON agrees with the approach of allowing these to be disclosed outside of the online quotation tool.
258. Out of Contract (“**OO**C”) tariffs apply to customers who have terminated their contracts with their supplier, with the intention of switching to a new supplier, but have yet to do so. Again, allowing these to be disclosed outside of the online quotation tool is a sensible approach and E.ON believes that the best place for them is within the terms and conditions of other tariffs, as an early indication of what would be charged in those circumstances, given their specific nature.

[Auto-rollover remedy](#)

259. The CMA has proposed prohibiting the inclusion of conditions in auto-rollover contracts which create barriers for customer wishing to switch suppliers. E.ON has previously expressed our concerns with auto-rollover contracts⁷³ in that they make it more difficult for customers to compare contracts on a like-for-like basis and therefore supports this proposal.
260. Prohibiting exit fees and/or no-exit clauses in the rollover contract as well as prohibiting exit fees in current and future OOC and evergreen contracts will allow customers to more easily compare contracts, enhancing the effectiveness of the price transparency remedy. Similarly, allowing customers to give a termination notice up to the last day of the initial fixed-term period will remove barriers to switching.

[Programme to provide microbusiness customers with information to prompt them to engage/Database remedy](#)

261. The CMA’s proposal to create a database for customers who have been on a default tariff for more than 3 years also applies to microbusiness customers. In paragraphs 198-208, we outlined our concerns with this proposal and these apply equally for microbusiness customers.

[Protecting customers who are less able to engage to exploit the benefits of competition](#)

262. E.ON also notes that the CMA does not intend to introduce a price cap for microbusiness customers on PPMs and agrees with the CMA that this would not

⁷³ E.ON Response to PFs and PRs, para 292

be a proportionate remedy given the large cost implications compared to the benefits for a very small number of customers.

7 REMEDIES RELATING TO THE GOVERNANCE OF THE REGULATORY FRAMEWORK

263. The CMA recognises that efficient and robust rules and regulations are fundamental to well-functioning energy markets and has identified several areas where such rules can be improved.
264. E.ON agrees that Ofgem's statutory objectives and duties to promote effective competition should be clarified by amending the Gas Act 1986 and Electricity Act 1989. E.ON also supports the CMA's proposals to improve the relationship between DECC and Ofgem through joint statements on policy implementation and requiring Ofgem to publish opinions on draft legislation and policies which are likely to have an impact on their statutory objectives.
265. E.ON also supports the recommendation for Ofgem to produce an annual state of the market report to highlight the impact of policies on costs, security of supply and decarbonisation. However, the CMA could go further to ensure that DECC's impact assessments are sufficiently scrutinised.
266. E.ON continues to support Ofgem in its work to continually improve and develop the efficacy of financial reporting through the CSS and, whilst there is scope for improvement, the existing reporting framework currently provides a high degree of transparency and assurance around the profitability of the SLEFs. However, it is important that the reporting regime does not constrain energy firms from operating the corporate structures that they believe gives them their best competitive position. Therefore, very careful consideration needs to be taken in defining the detail of the changes proposed by the CMA to ensure that the right balance is struck. E.ON therefore supports the provisional decision for any remedy to be through a recommendation to Ofgem to modify the relevant Licence Conditions, as we would wish to see a thorough consultation on this proposal.
267. E.ON believes that a number of the proposals aimed at improving the governance of industry codes could be effective. However, we have concerns that they may introduce more complexity and processes into the current arrangements rather than simplifying them. As a result, they could increase the burden associated with code governance.

7.1. Detriment arising from problems in the regulatory framework

268. The CMA state that the detriment associated with the issues identified in the regulatory framework are difficult to quantify, but are likely to be substantial

given that due to the nature of the energy markets, competition is shaped by the design of the regulatory framework to a much greater extent than in most other markets.

269. E.ON agrees that the impacts of a poor regulatory framework can be significant and hence any changes to this framework should be considered carefully and be based upon robust evidence and analysis. E.ON therefore questions the CMA's proposals to introduce regulated price caps in the PPS, a significant – and retrograde – change to the regulatory framework. This proposal is likely to create a detriment to customers by undermining competition and inhibiting innovation, thereby creating the very conditions that the CMA seeks to address through other remedies.
270. Whilst this detriment is difficult to quantify, as the CMA recognises, it should not be dismissed by the CMA when considering the necessity and proportionality of the regulated price cap remedy.

7.2. Package of remedies

7.2.1. Ofgem's duties and objectives

271. In the E.ON Response to the PFs and PRs, we highlighted our concerns that Ofgem's statutory objectives and duties to promote effective competition had been weakened by the inclusion of a new Section 3A(1C) in the Energy Act 2010. E.ON therefore welcomes the proposals to amend the relevant sections of the Gas Act 1986 and the Electricity Act 1989 in order to strengthen the focus on the competition duty.

7.2.2. Relationship between DECC and Ofgem

272. E.ON welcomes the CMA's two remedies to improve the relationship between DECC and Ofgem. In particular, we welcome the CMA's recognition of the need to clarify the relationship between DECC and Ofgem whilst ensuring the independence of Ofgem is preserved.
273. E.ON agrees with the proposal to establish a clear process requiring Ofgem to publish opinions on draft legislation and policy proposals that are relevant to its statutory objectives and that are likely to have a material impact on GB energy markets. This will help ensure the relationship between DECC and Ofgem is transparent. In particular, we are pleased that the CMA has recognised that any such publication must be made in a timely manner, to allow industry participants to respond to Ofgem's opinions through formal consultation.
274. E.ON agrees with the CMA's proposed remedy to recommend that Ofgem and DECC publish joint statements where the implementation of a DECC policy

requires Ofgem intervention. This is a sensible compromise which improves transparency of the process without the risk undermining Ofgem's independence.

275. E.ON agrees with the CMA that there is no need to introduce a new mechanism for Ofgem to seek a formal direction from DECC to implement a certain policy. As highlighted in the E.ON Response to PFs and PRs⁷⁴, we are concerned that such a mechanism could undermine Ofgem's independence.

7.2.3. Transparent analysis of the impacts of policy and regulation

276. E.ON agrees with the CMA's proposed remedy to recommend to Ofgem that it publish annually a state of the market report which highlights the impact of policy initiatives on costs, security of supply and decarbonisation. This will help stakeholders, including customers, understand the wider impacts and value from policy interventions. This should be in simple form, so that customers can actually understand it, and so that it can be a reliable, independent reference document that others can point to.
277. However, E.ON believes the CMA could go further to ensure DECC's Impact Assessments are sufficiently scrutinised. Whilst we recognise the role that the Regulatory Policy Committee ("RPC") plays in scrutinising DECC's Impact Assessments, we note that the RPC's guidelines⁷⁵ focus on the process and content of Impact Assessments rather than the quality or accuracy of their assumptions. We continue to believe there is merit in independent oversight or review of DECC's consultation and impact assessments to ensure the assumptions used are suitable.

7.2.4. Regime for financial reporting

278. E.ON continues to support Ofgem in its work to continually improve and develop the efficacy of financial reporting through the CSS and, whilst there is scope for improvement, the existing reporting framework currently provides a high degree of transparency and assurance around the profitability of the SLEFs. In addition, we note that the CMA has not yet made a final decision regarding the existence and form of any AEC that would, in turn, require a link between potential deficiencies in the current reporting regime and adverse effects on competition⁷⁶.

⁷⁴ E.ON Response to PFs and PRs, para 400

⁷⁵ <https://www.gov.uk/government/publications/how-the-regulatory-policy-committee-scrutinises-impact-assessments/regulatory-policy-committee-recommendations-used-when-scrutinising-impact-assessments>

⁷⁶ PDR Report, para 10.229

279. We would agree that any development or improvement should aim to further ensure that reported information is relevant, complete, understandable and comparable. However, given that the reporting regime must not constrain energy firms from operating the corporate structures that they believe gives them their best competitive position, there will naturally be complexity and compromise in pursuing these aims. Therefore very careful consideration needs to be taken in defining the detail of the changes proposed by the CMA to ensure that the right balance is struck.
280. E.ON therefore supports the provisional decision for any remedy to be implemented through a recommendation to Ofgem to modify the relevant Licence Conditions, as we would wish to see a thorough consultative process to ensure that the detail of any proposed changes are properly considered and debated to ensure that the aims of ensuring that reported information is relevant, complete, understandable and comparable are met.
281. We believe that the need for a detailed, consultative approach is underlined by the extensive consideration of the possible methods that might be required to achieve the changes sought by the CMA. Indeed, E.ON believes that it does currently report along market rather than divisional lines, and has previously supported the idea of reporting balance sheets, but without having the detail of precisely how these would be defined and applied we would naturally reserve our position.
282. However, at this stage we do have concerns regarding the CMA's description of the disaggregation of wholesale energy costs for retail supply between standardised opportunity cost and residual elements. The standardised opportunity cost, however it is arrived at in detail, assumes that there is a valid single benchmark for wholesale energy costs. E.ON believes that each company's wholesale energy costs are arrived at by a combination of the influences of customer needs, market availability and company risk appetite /preferences, and that it is invalid to attempt to produce a single benchmark for all suppliers. In doing so, this also runs the risk of reporting requirements inappropriately driving commercial hedging behaviours and strategies.
283. E.ON is able, in principle, to provide prior year comparatives. However, with regard to the implementation of any remedy, the CMA should note that any newly required information, such as theoretical purchase volumes and associated prices, would not be collected in the normal course of the firm's business. Such information may prove difficult to acquire retrospectively and we would therefore suggest that any such changes in reporting are only implemented after a complete financial year following the licence conditions amendment/introduction.

284. We note that the CMA is not proposing to change the existing definition of the 'Relevant Licensee' under the Generation and Supply Licences. Given the significant position that suppliers, other than the SLEFs, have established in the market place, particularly the mid-tiers such as Ovo, Co-Operative Energy, First Utility and Utility Warehouse, we cannot see how their continued exclusion from the reporting is consistent with the aim of ensuring that it is relevant, complete, understandable and comparable.
285. We would therefore reiterate our view that the requirement to produce and publish a CSS should apply to all licensed suppliers (electricity and gas). The burden of requiring a report from an Appropriate Auditor could be relaxed for suppliers with less than 250,000 customers to address any concern regarding the cost of securing an audit opinion, but without a consistent requirement on all suppliers the information that is ultimately published for Ofgem and stakeholders is not going to reflect a complete view of the market.

7.2.5. Governance of industry codes

286. The CMA has proposed a number of changes to the governance of industry codes in order to address its findings that the current system of code governance limits innovation and pro-competitive change and causes the energy markets to fail to keep pace with relevant policy objectives.
287. Whilst E.ON believes that a number of the proposals could lead to improvements in the governance of industry codes, we have concerns that they may introduce more complexity and processes into the current arrangements rather than simplifying them. The code governance processes require significant resource and care must be taken not to further increase this burden. Whilst some of the proposals create a greater role for Ofgem and code administrators, it is not clear that this necessarily reduces the resource requirements for other parties.

Strategic Direction and code-specific work plans

288. E.ON welcomes the principle behind Ofgem setting a strategic direction, in terms of determining how the code market rules should look in future and prioritising the changes required, but as a result it appears that it would then take a more hands off approach in terms of providing resource to progress changes.
289. E.ON believes it is therefore important that Ofgem fully understands the resources that the industry will need to deploy to meet its strategic direction and that there is a mechanism to ensure that it is held accountable to ensure that the demands it places on the industry are reasonable.
290. For example, it is proposed that Ofgem can choose not to become involved in the process of setting individual project plans and can simply set a strategic direction

for the industry to follow. Such a hands-off approach may prevent it from understanding the resource implications that its decisions are having on the industry. This could risk unrealistic expectations being set which limited industry resource would not be able to meet. This could divert resources away from internal projects, for example, which may better serve the interests of customers through better customer service, innovation or a lower cost to serve.

Consultative board

291. The package of proposals takes the onus for raising and prioritising changes needed to meet the challenges facing the industry away from industry parties and transfers it to Ofgem and code administrators. As a result, those parties with experience and expertise of operating in these competitive markets are partially disenfranchised from this process compared with the current process. Instead, this role would be undertaken by code administrators and Ofgem, both of whom would be less experienced. E.ON therefore proposes that there needs to be a clear process by which Ofgem and the code administrators can understand what is important going forwards so that work can be prioritised.
292. The creation of a consultative board is clearly a mechanism which has been proposed to achieve this. However, the scope of the issues that this consultative board has to address is significant. It covers a wide range of codes of an incredibly diverse nature, covering technical to commercial issues, in the retail and wholesale markets, across the gas and electricity sectors. Given the breadth of issues to consider, E.ON believes that it is unlikely that a company could provide one person with the range of knowledge required to attend such a board.

Ofgem prioritisation of modification proposals and direct intervention

293. The new package also sets out new powers for code administrators and Ofgem to initiate and prioritise changes, as well as powers for Ofgem to call in proposals and develop them themselves. E.ON suggests that it is important that there are clear rules and principles on how these powers will be utilised. For example, what would be the principle for determining whether a code administrator or Ofgem decides to initiate a change?
294. Whilst it is sensible to consider how strategically changes can be made and to consider how resources can be prioritised, this requires choices to be made about which modifications to take forward over others. That is, if some changes are prioritised then some other changes have to be deprioritised. E.ON believes that it is important that clarity is provided as to how this latter process would take place. At present, all parties are able to raised modification proposals and there are only very limited circumstances under which a code panel can refuse to

progress the development and assessment of the changes. Therefore, the vast majority of changes are progressed and it is not clear to E.ON as to whether this approach would continue.

295. E.ON is concerned that there is no mechanism for panels to reject changes on the grounds that they are not deemed a priority. In future, if changes were indeed to be rejected on the grounds that they were not deemed a priority, then the basis on which this could be done would have to be clear and written into the industry codes. Alternatively, if changes were to be deprioritised by pushing back the timescales for their assessment, then arrangements need to be in place to manage this over time to prevent a backlog from building up.

Code administrators

296. E.ON welcomes the proposal to make code administration an activity that is licensed by Ofgem. E.ON believes that this would ensure that code administrators are more accountable and that the service provided across codes is consistent. However, it is important that the costs of the licensing regime need to be considered and kept to a minimum, and roles and responsibilities of licensees need to be set out clearly. In addition, it is not clear to E.ON that consolidation of code administrators would lead to efficiencies by reducing the numbers of codes, although having fewer code administrators administering the codes overall should bring efficiency benefits.
297. E.ON supports the principle that code administrators would take on more of the burden of managing the assessment of changes and believe this could be helpful. In principle, this could free up some of the industry resource from administering the codes to raising, understanding and assessing changes to the arrangements. However, as highlighted above, the processes as set out currently do not seem to propose a reduction in the burden on parties in this respect.
298. E.ON would also suggest that it is important that Ofgem and DECC recognise the potential burden of implementing this proposal. Whilst the recommendation is to DECC to initiate a legislative programme, much of the activities involved in this process are likely to require significant industry input. First, it would be necessary to draft a prohibition order to define the licensable activity and enact this through legislation, then the licence itself would need to be drafted, parties would then need to apply for a licence before the transition from the current arrangements and contracts for industry codes (novation, termination, TUPE arrangements etc.) takes place.

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