

# COMPETITION AND MARKETS AUTHORITY ENERGY MARKET INVESTIGATION



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**Response to the Provisional Decision on Remedies**

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**7 April 2016**

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## Introduction and summary

- 0.1 EDF Energy plc ("**EDF Energy**") welcomes the Competition and Market Authority's ("**CMA**") proposals as set out in the Provisional Decision on Remedies ("**PDR**"). We have supported this investigation from the outset, consistently stating our desire to see fully engaged and empowered customers making informed decisions about their supplier, their choice of tariff, and their energy source – confident that there is a trusted and trustworthy market. EDF Energy believes that the CMA is close to establishing a proportionate and evidence-based package of remedies that will improve the energy supply market in Great Britain, and which in turn will help the industry in its ongoing efforts to re-establish trust in the sector for the benefit of consumers.
- 0.2 EDF Energy has made this response as full as possible given the time available but notes that it may be necessary and appropriate to make supplemental submissions.
- 0.3 EDF Energy agrees with the central finding of the investigation that many domestic customers are disengaged. For its part, EDF Energy has worked hard to help customers engage. The result is that 44% of our domestic customers (as at March 2016) have actively chosen one of EDF Energy's market leading low carbon 'Blue' products. This compares very favourably to an average of around 30% for the Six Large Energy Firms (identified by the CMA), with some firms having a considerably smaller proportion of customers who have actively moved away from default tariffs. Our engaged customers include many vulnerable customers, with 56% of customers (as at March 2016) on EDF Energy's Priority Services Register ("**PSR**") having chosen one of our 'Blue' products. EDF Energy has shown that it is possible to engage customers in their choice of tariff and supplier.
- 0.4 EDF Energy has also been ahead of the competition in implementing practices consistent with some of what the CMA is now proposing in the remedies package. For example, we publish tariffs for microbusinesses, and inform domestic customers clearly about cheaper competitor tariffs. It continues to concern EDF Energy that the CMA has not distinguished between the larger suppliers, both when describing the market and defining possible remedies. We therefore look forward in due course to the CMA articulating the differentiation that exists. This is a step that we believe is necessary to show the positive alternative approach taken by EDF Energy as a challenger brand. The distribution of any excess revenues and the differences in attempts to encourage customers to engage are of particular relevance.
- 0.5 It is not just the actions and activities of the energy suppliers that need to be considered. Price Comparison Websites ("**PCWs**") and other Third Party Intermediaries ("**TPIs**") are playing an increasing role in the energy sector. We note the importance that the CMA places on the role of these parties and strongly believe that their behaviour must be scrutinised as part of the enduring arrangements put in place to support customers. EDF Energy's view is that the activities of intermediaries should be subject to oversight through direct and effective regulation. EDF Energy is aware that the CMA, as part of its 2016/17 Annual Plan<sup>1</sup>, intends to undertake further analysis of these companies, with the aim of understanding whether the sector is operating competitively and in the best interest of consumers. EDF Energy supports the CMA's suggested areas of focus for this review, i.e. to determine whether there is a case for a common accreditation framework and whether PCWs should be subject to more rigorous propriety and transparency standards. It

<sup>1</sup> CMA Annual Plan 2016/2017, March 2016

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would be beneficial to also consider in this review the impact that the remedies resulting from the Energy Market Investigation might have on the activities of these companies.

- 0.6 EDF Energy notes the CMA's view that the energy supply sector is characterised by poor service. In making its assertion, we are disappointed that the CMA has not yet recognised the considerable progress to improve service that has been made recently amongst the large majority of firms operating in the sector, nor provided a substantiated evidential basis for this viewpoint. Over the past five quarters, EDF Energy has had a consistent record of improving its customer service against all of the published metrics. We continue to strive to be better and to set high standards. Should the CMA choose to include similar references to poor service in its final report, we believe that it will be necessary for the CMA to further substantiate the justification for this view. We would also expect the CMA, where appropriate, to reflect the need to maintain and improve customer service in the design of a number of its remedies.
- 0.7 As noted in EDF Energy's earlier responses to the CMA, we have always believed that the main area of focus for remedies must be to support customer engagement. We are pleased to see that the CMA has elected to limit the proposed price cap to customers on prepayment meters ("**PPMs**"). The cap, if designed in a workable manner and set at the correct level, should have minimal distortive effects on the competitive process. EDF Energy does, however, have concerns that certain aspects of the remedies put forward by the CMA may not adequately address the Adverse Effects on Competition ("**AECs**"). In particular, we are concerned that some of the remedies as currently described may not act in consumers interests and may lead to unintended consequences.
- 0.8 EDF Energy still believes that there are flaws in the reasoning underpinning particular findings, including the excess revenue (profitability) analysis and the manner in which the CMA has adopted, in our view, an unrealistic and unreasonable competitive benchmark to assess revenues and to underpin both the analysis of detriment and the proposed prepayment price cap remedy. We would encourage the CMA to reconsider the benchmark and, in particular, to refine its approach in the price cap so as to adopt a more suitable mechanism.
- 0.9 In considering this response, EDF Energy has judged each of the remedies against a series of design criteria which we see as aspects underpinning a robust, fair and competitive market:
- Empowers customers to make choices;
  - Provides triggers for customers to engage;
  - Helps the customers it is intended to help;
  - Encourages suppliers to compete and innovate, and is future-proof; and
  - Leads to no negative unintended consequences.
- 0.10 EDF Energy has carefully considered the overall consumer benefits of the proposed remedies package, including the practicality and complexity of implementation, and, on the basis that its residual concerns can be addressed through continued dialogue and consultation between the CMA, Ofgem and the industry, agrees with the overall direction of the remedies. Taken together, the remedies provide a firm basis for an improved market and, in particular, improved consumer engagement and access across the domestic and microbusiness markets. In order to be most effective, we are firmly of the view that the remedies package should be applied across the industry at the whole supply level, not just a small number of the larger suppliers.

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- 0.11 In summarising the key points in its response, we would highlight:
- a. Proposed remedy relating to a customer database**
- 0.12 EDF Energy agrees that well-designed prompts to customers can be effective in increasing engagement. We want to be able to compete effectively for the disengaged customers of our rivals, and we therefore recognise that the creation of a database of such customers has the potential to be a useful tool for both us and other suppliers, including smaller suppliers and new entrants.
- 0.13 EDF Energy, however, does have concerns that there are potentially serious unintended consequences from such a remedy being applied to domestic customers and the smallest microbusiness customers, such as sole traders who may operate from their homes. These concerns primarily relate to protecting customers from a) the misuse of their information b) addressing the risks of further disengaging customers that are currently difficult to reach as a result of bombarding them with unwanted marketing from multiple firms, and c) the need in our view to provide a means by which the success of the proposed remedy could be measured.
- 0.14 The combination of these factors means that an ill-designed remedy carries a real risk of increasing customer distrust and reducing engagement. For example, the industry will wish to avoid a scenario where some less reputable suppliers decide to act against the spirit and intent of the remedy, and use the opportunity to communicate as a means of misleading the customer through saying, for example, that the Government is “requiring them to switch”.
- 0.15 EDF Energy believes that the initial letter from existing suppliers (described as the “Opt-out Letter” by the CMA), if designed effectively, could be a more powerful prompt than any marketing received as a result of being included in a database. We have found in our trials that a message from a customer’s own supplier clearly stating that they may not be on the best deal in the market can be very effective, and builds trust with customers.
- 0.16 EDF Energy proposes that there should be:
- A requirement for domestic and microbusiness customers to positively consent to their data being collected, stored and shared, through clearly opting-in to such a scheme.
  - Robust and thorough trialling, and then prescription, of the form and content of the letter to notify customers that they may not be on the best tariff. For domestic and microbusiness customers, subject to the results of further testing, we would propose adopting a jointly branded letter from Ofgem and the customer’s own supplier setting out the potential savings available in the market (according to a calculation approved by Ofgem, and which may be on a per unit basis for microbusiness customers). This would include a specific opt-in provision for customers to consent to their details being included in the database and a further specific consent for their information to be shared with other suppliers.
  - Monitoring by Ofgem of the relative success of the industry in engaging previously disengaged customers to ensure that these efforts are having the desired impact. Ofgem should work with suppliers to address customer groups with high levels of disengagement and undertake additional actions, including further targeted trials and, for example, changes to the nature of the communications to customers.
- 0.17 EDF Energy believes that taken together, these proposals will provide a trigger for customers to engage. The CMA will no doubt be liaising closely with the Information Commissioner’s Office (“ICO”) to ensure compliance with data protection rules.

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**b. Proposed remedy to introduce a price cap for prepayment meter customers**

- 0.18 EDF Energy believes that improving customer engagement is the best way to ensure that suppliers compete to meet customers' needs. Price controls run the risk of distorting the competitive process, stifling engagement by customers and innovation by competing firms. Nevertheless, EDF Energy agrees with the CMA that prior to the delivery of fully functional and interoperable smart meters ("**SMETS2**"), PPM customers face additional barriers not faced by other customers that make it potentially more difficult for them to engage in the market. Under these circumstances, we therefore agree with the CMA's proposal to introduce temporary measures for PPM customers without interoperable smart meters.
- 0.19 EDF Energy agrees with the proposed hybrid approach of combining a benchmark with a cost matrix to set a PPM price cap. We do, however, have significant concerns about the methodology that the CMA has outlined both to set, and then review, the level of the cap on an ongoing basis. The price cap should be set at a level, and adjusted over time, through a mechanism that recognises the dynamic nature of competition and does not risk stranding customers on a poor tariff. Our concerns include:
- Using the average of two mid-tier suppliers' direct debit ("**DD**") tariffs as of 30 June 2015 to determine base revenues. Widening the peer group would appear appropriate and reduce bias. We do not believe that this benchmark from a single point in time represents a sustainable level of prices or business model for the industry as a whole. We note, for example, that OVO Energy has experienced sustained financial losses and has a customer base that is largely made up of customers on one year fixed deals - a benchmark that is not representative of the market.
  - The basis for the allowed headroom is unclear and appears arbitrary. In order to ensure that the cap does not stifle competition, and that headroom is sufficient to address the risks of outturn costs differing from forecasts, more rigorous analysis is necessary.
  - The proposed calculation of wholesale energy costs appears to create a strong incentive for suppliers to purchase all of their energy on the same day that the allowed cost is calculated. Such an approach would result in customers being exposed to changes in wholesale prices without any smoothing of costs that would result from an incremental approach to hedging, which gives a high risk of 'bill shock'. Clearly it is not optimal to concentrate trading activity in such a short period of time, and will also introduce exposure to the risk of market manipulation as has been observed in other markets in recent years (e.g. LIBOR). Further refinement of the approach to determining wholesale energy costs will be required.
  - The proposed approach of using allowed revenues for calculating transmission and distribution costs will lead to inaccurate costs for different customer groups as the allocation can change substantially from year to year. Using published prices as the basis for the network cost assumptions would result in a considerably more accurate method for both electricity and gas.
  - A number of additional costs need to be included in the cost matrix, including Balancing Services Use of System ("**BSUoS**") costs, the Capacity Market Supplier Charge, and various other industry infrastructure costs.
  - The assumption that the distribution of electricity consumption is the same for Economy 7 and standard meter customers is flawed, with Ofgem having found the opposite<sup>2</sup>.

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<sup>2</sup> Ofgem, Typical Domestic Consumption Values – 2015 Decision letter, 28 May 2015.

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0.20 Importantly, EDF Energy believes that without thorough consideration of wider potential impacts at this stage, there is a risk that the price cap could lead to unintended outcomes, including damaging innovation in PPM tariffs by suppliers. For example, suppliers may not be able to develop long-term fixed-price or time-of-use tariffs, as suppliers would not be in control of whether the cap is breached if wholesale prices are rising, or if the customer has a consumption profile different to that intended, respectively. In order to overcome these unintended consequences, suppliers should be able to seek derogations from Ofgem to allow them to offer tariffs outside a PPM price cap.

0.21 Ultimately, it is important that the cap does not provide customers with an incentive not to make active tariff choices, and it is for this reason that we do not believe that the cap should apply to PPM customers with a SMETS2 meter, as by this point such customers should have access to a wide range of tariffs. We propose that the price cap should be removed at an individual customer level, once a SMETS2 meter is fitted.

**c. Proposed remedy to introduce locational pricing of transmission losses**

0.22 EDF Energy agrees that the absence of locational pricing for transmission losses could be a feature of the wholesale market rules that constitutes an AEC. EDF Energy supports, in principle, the introduction of such cost reflective pricing. However, we believe that there are a number of material issues that the CMA has to further consider in deciding whether and how to introduce locational pricing.

0.23 Firstly, we have consistently noted throughout the investigation that it is vital to demonstrate the customer welfare benefits of such a remedy. By the CMA's own admission, the modelling work conducted has not produced a conclusive viewpoint on this. In our view, the evidential basis for the proposed AEC finding and consequently the justification for and proportionality of this proposed remedy does not appear to have been met.

0.24 Secondly, the CMA will need to address detailed design issues in its Order to National Grid if it proceeds with this remedy. The CMA has not yet adequately described the proposed scheme of implementation in enough detail for EDF Energy to determine the impact on its business or its customers of such a change. Greater clarification and definition are required so that parties will be able to address the CMA on such impacts, a relevant consideration before a decision is made to take this remedy forward.

**d. Proposed remedies relating to Ofgem, DECC and the industry codes**

0.25 EDF Energy welcomes the broad package of remedies aimed at improving the regulatory framework, in particular the CMA's proposals for governance reform and improvements that can be made in the wholesale market. We strongly support a role for Ofgem characterised by:

- Simpler and clearer focus on consumer benefit and competition.
- A strengthened relationship with DECC and closer scrutiny of the trade-offs between policy objectives and ensuring competitive outcomes.
- A more robust approach to collecting, analysing and articulating industry information.

0.26 We therefore strongly support the concept of establishing an Office of the Chief Economist at Ofgem that is able to act independently. We believe that this role would be substantially strengthened if the Office had independence from the Executive of Ofgem and instead reported directly to the Gas and Electricity Markets Authority Board ("**GEMA**").

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0.27 With respect to codes governance, we believe that the proposed remedies rely too greatly on Ofgem leading the overall strategy, development, implementation and process for code modifications. Such an increase in Ofgem's powers goes too far, risking unintended consequences in circumstances where the existing system is not fundamentally flawed. Increasing Ofgem's powers and responsibilities to implement changes without due assessment by experts in the industry could lead to sub-optimal changes being developed and further damage customer trust in the energy market.

0.28 It is imperative that decisions taken by the regulator are of high quality, justified and accountable, in order to protect consumer interests and promote competition. The introduction of any additional powers should therefore be accompanied with appropriate checks and balances and procedural rights that are at least commensurate with those that are currently in place for other Ofgem decisions, such as licence modifications and code modification directions.

**e. Financial Reporting**

0.29 EDF Energy supports appropriate steps to improve the usefulness of the current regulatory framework for financial reporting. We do not support the proposal for the Six Large Energy Firms to disaggregate their wholesale energy costs for retail supply between a standardised purchase opportunity cost and a residual element. It is not clear to us that this would provide Ofgem (or the wider public) with any meaningful information and, if in the public domain, would provide scope for misinterpretation that would unjustifiably damage customer trust.

0.30 More generally, EDF Energy is concerned that the requirement for only the Six Large Energy Firms to report financial information would not provide a full view of the market and would exclude domestic suppliers with substantially more than one million customer accounts from providing this information, as well as non-domestic suppliers (a number of which have larger market shares in terms of volume supplied than some of the Six Large Energy Firms). We believe that a more useful and future-proof approach would be to specify the size of a supplier at the time of reporting that must provide the information, rather than defining the remedy based on historic market shares.

**f. Timely and effective implementation of remedies**

0.31 EDF Energy observes that the provisional remedies package relies heavily on Ofgem for implementation and ongoing engagement with the industry on a number of points. Given the timing and the nature of some of the remedies, EDF Energy agrees that this is the right approach. We recognise that Ofgem is the body with the necessary expertise and relevant oversight of the industry and so is nominally best placed to follow through on many of these measures. Notwithstanding this, we expect that should the CMA, in its final report, decide to pursue the remedies outlined in the PDR, it will have due regard for the prevailing statutory and regulatory framework.

0.32 We believe that in its recommendations to Ofgem, the CMA should emphasise the need for robustly-tested practical and effective solutions, and must be able to demonstrate that the costs of implementation have been thoroughly considered alongside the desired consumer benefits. It will be important that any changes that Ofgem makes as a result of the CMA's recommendations are progressed in a timely manner, and that suppliers are provided with clarity as to how Ofgem will apply the new rules over the change period.

**g. Smart Metering**

0.33 The CMA is right to recognise that many of the current technical constraints on tariff choice and issues around engagement will be resolved or alleviated through the introduction of SMETS2



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smart meters (PDR, paragraph 4.72). Suppliers and the industry more generally, have been working on roll-out of SMETS2 for some time and are investing heavily in this programme. EDF Energy agrees that the overall remedies package must be designed and implemented with consideration of this imminent upgrade.

**h. Customer detriment analysis**

0.34 EDF Energy is pleased that the CMA appears to have moved away from relying solely on the Return on Capital Employed (“**ROCE**”) based methodology for assessing excess profitability, now referred to as the “indirect” approach. We note, however, that the two approaches now adopted by the CMA use very different methodologies, are both heavily reliant on assumptions, and result in significantly different estimates of consumer detriment. We have expressed our concerns with a number of aspects of the indirect profitability analysis in previous submissions and these have not yet been addressed. Our main observation about the CMA’s new “direct” approach is that it is not robust due to systematic differences in the business strategies, scale and customer characteristics of the mid-tier suppliers (that the CMA has identified as the basis of the benchmark) and the Six Large Energy Firms which are likely to bias the results. We further note that it has been calculated over a relatively short period. We expand on these points in the following section of this response.

**i. Unilateral Market Power**

0.35 As a final preliminary comment, EDF Energy notes that the CMA has not sought to expand on why it has used the term “unilateral market power” (“**UMP**”) and whether this is consistent with its own guidelines but, rather, focused on the substantive underlying issues. It also appears that both the reasoning on UMP and the indirect profitability analysis is not central to the CMA’s reasoning. EDF Energy agrees with this.

0.36 In its response to the CMA’s Provisional Findings<sup>3</sup>, EDF Energy noted that a finding of UMP does not necessarily follow from a finding of weak customer engagement, and encouraged the CMA to substantiate any such conclusion with robust analysis for each supplier separately. We continue to disagree that UMP exists on the part of EDF Energy. The CMA may wish to consider whether any use of the term in the final report should be omitted or clarified given the potential for it to be misread or misunderstood.

0.37 In conclusion, EDF Energy agrees that there is a firm basis for most parts of the remedies package. Our specific and more detailed comments are below, beginning with comments on the CMA’s updated analysis of customer detriment, and then following the structure set out by the CMA in Chapter 11 of the PDR.

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<sup>3</sup> EDF Energy, Response to the Provisional Findings, 5 August 2015, paragraphs 4.24-4.34

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## CMA Customer detriment analysis

- 1.1 In the PDR, the CMA presents the results of a new calculation of customer detriment caused by “excessive prices” which is referred to as the “direct approach” and a slightly amended version of the profitability analysis which is now referred to as the “indirect approach”.
- 1.2 We are pleased that the CMA appears to have moved away from relying solely on the ROCE based methodology for assessing excess profitability. We note, however, that the two approaches now adopted by the CMA use very different methodologies, are both heavily reliant on assumptions, and result in significantly different estimates of consumer detriment. The two methodologies are not directly comparable, as they are measuring different things across different time frames. It is therefore not possible to conclude that one approach provides a lower bound and the other an upper bound for the estimate of consumer detriment, or that one provides an independent cross check for the other.
- 1.3 EDF Energy continues to view the level of detriment identified in the CMA’s calculations as significantly overstated due to the subjective assumptions the CMA has chosen to continue to make.
- 1.4 It appears that many of the issues identified with the indirect calculation by EDF Energy and other respondents in previous submissions have not been addressed, and in some cases have also been repeated in the new direct approach analysis. In particular, the assumption that the behaviour of one or more mid-tier suppliers is scalable to the entire market is significant. Both First Utility and OVO Energy are in their growth phases with low returns and some losses in the period in question. Please see Appendix 1 for further detail on our views regarding the CMA’s approach to selecting a “competitive benchmark”.
- 1.5 EDF Energy’s supply business returned to profitability in 2014, having made losses across the period of the CMA’s study. Concerted efforts have been, and continue to be made to reduce indirect costs. For example, we have invested heavily over the period under review to install new systems, which are providing a strong platform to deliver improved efficiency. EDF Energy recognises that there have been inefficiencies in our indirect cost base in the past but consider that these have not been passed on to customers or contributed to excess profits. In particular, EDF Energy’s domestic retail prices are either below or only slightly above the efficient revenue benchmark calculated by the CMA, and they are consistently lower than industry averages over the period being investigated. We note that the CMA’s evidence and indirect analysis shows a highly skewed distribution of excess ‘profits’ (in fact revenues above the assumed benchmark) between the Six Large Energy Firms, and we would stress the importance of the CMA making these differences clear in its final report.

### Direct approach

- 1.6 The CMA’s direct approach to assess customer detriment is based on a hypothetical benchmark, rather than companies’ actual costs, and is a relatively short-term comparison. It focuses on the price differential between the Six Large Energy Firms and mid-tier suppliers during 2012-15. Mid-tier suppliers are currently in a customer acquisition and growth phase (in a period of falling wholesale prices) and likely to be sacrificing short-run profits to gain market share. The current low levels of profitability of the mid-tier suppliers may not be sustainable over a longer term or for businesses of the size of the Six Large Energy Firms, which face legitimate legacy costs, a more diverse customer base, and are structured to support a long-term, sustainable energy supply business model.
- 1.7 Our main observation about the CMA’s preferred direct approach is that it is not robust due to systematic differences in the business strategies, scale and customer characteristics of mid-tier suppliers and the Six Large Energy Firms which is likely to bias the results, notably:

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- a) *Different payment type mix* A comparison of efficiency between the Six Large Energy Firms and mid-tier suppliers will produce misleading results because mid-tier suppliers have very few standard credit customers (who are more costly to serve). With lower levels of indirect costs, mid-tier suppliers can offer DD customers lower tariffs than the Six Large Energy Firms who have a higher ratio of standard credit customers that have a higher cost to serve. A comparison of average prices between the mid-tier suppliers and the Six Large Energy Firms using the CMA's estimates of differentials rather than the actual figures will therefore be biased due to the different customer composition of the Six Large Energy Firms compared with the mid-tier suppliers.
- b) *Different customer preferences* Mid-tier suppliers' discounted offers are typically available for online customers who are much cheaper to serve than customers who prefer more traditional methods of communication (i.e. call centres and post). It is not possible for the Six Large Energy firms to force their diverse customers to migrate to online tariffs, even though it would save on call centre and other costs. Mid-tier suppliers can therefore take advantage of significant reductions in the costs of entry, due to innovations in IT and, for example, the increased popularity of online tariffs.
- c) *Customer Consumption* Mid-tier suppliers will tend to have higher consuming (and therefore more profitable) customers because low consuming customers have less incentive to switch suppliers due to the lower gains available to them.
- d) *Legacy costs* The Six Large Energy Firms have legitimate legacy costs due to IT systems, bad debts and staff pension costs. Mid-tier suppliers have no such costs and their relatively low customer numbers enable them to maintain a very low cost base. The assumption by the CMA that these low costs are scalable is not necessarily true. We have seen worsening customer service from some smaller suppliers recently as they have grown, which will require investment in systems and people to improve. We note also the statement by OVO Energy of the significant investment (and losses) required due to its increasing scale<sup>4</sup>. A continued very low rate of return may not support this investment.
- e) *Different hedging strategies* We note that the CMA states that it agrees "with RWE that the shorter-term hedging strategy pursued by some of the mid-tier suppliers would, in a rising wholesale market, have resulted in them incurring higher wholesale energy costs than the Six Large Energy Firms. However, if the Mid-tier Suppliers raised their prices we would expect this to lead to the Six Large Energy Firms increasing their prices as well, as the competitive constraint from the Mid-tier Suppliers would have relaxed." (PDR, paragraph 3.197). The CMA is mistaken in this assumption. In a rising wholesale market the Six Large Energy Firms would continue to compete with each other, and the CMA is incorrect to assume that the prices of the mid-tier suppliers are the only competitive constraint in the market. The current low prices of the mid-tier suppliers are a result of their shorter hedging strategies and the recent steep falls in wholesale prices, and not an advantage that can be assumed to be sustainable. If prices had risen over the period analysed by the CMA then, small suppliers would have been uncompetitive with the Six Large Energy Firms and potentially unsustainable. Indeed at the time of wholesale price rises in 2007/08, a number of smaller suppliers left the market, which demonstrates the flaws in the CMA's assessment (if the Six Large Energy Firms had increased their prices this may not have been the case). The Six Large Energy Firms do not have a short-term hedging strategy because of their diverse customer base. Whether one strategy results in prices that are higher or lower than the other at a particular point is a function of the trends in the wholesale market that cannot be reliably anticipated and will therefore vary over time. Given this, we would encourage the CMA

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<sup>4</sup> See "OVO Energy 2014 Financial Results & Trading Update" Press Release, September 2015. <http://tinyurl.com/zeld97>. Last accessed 6 April 2016.

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to reconsider its view on whether the proposed definition for the competitive benchmark is robust and sustainable.

### Indirect approach

1.8 EDF Energy welcomes the changes that the CMA has made to its profitability analysis (in particular the inclusion of 2007 and 2008) which have reduced the reported estimate of detriment for domestic customers from £1.2bn to £0.66bn per year and for Small and Medium Enterprise (“SME”) customers from £0.5bn to £0.28bn per year. We welcome the decreased reliance on this approach in the PDR, nevertheless we continue to have concerns due to the significant subjective adjustments that are required to create the results. We have highlighted these in previous responses but do not believe that the PDR addresses the issues sufficiently:

- a) *Return on Capital Employed* An overriding issue remains the inappropriate use of ROCE as a measure of supplier profitability. The results of the CMA’s ROCE analysis show wide swings in average ROCE from 7% in 2008 to 34% in 2010 (PDR, Appendix 3.4, Table 2), as well as a wide spread of results for different suppliers, calling into question the meaningfulness and reliability of ROCE for measuring retail energy suppliers’ profits.

The CMA states that its “ROCE analysis indicates that energy suppliers require an Earnings Before Interest and Taxation (“EBIT”) margin of just under 1.5% in order to make a reasonable return on capital employed.” (PDR, paragraph 3.193). This margin is based on a narrow set of comparators with different risk and cost characteristics to the Six Large Energy Firms’ domestic and SME businesses. This single point estimate is lower than the minimum value of the 3-8.9% range Ofgem considered reasonable in its 2011 Retail Market Review. It is also either lower, or in line, with the margins achieved in our Industrial & Commercial (“I&C”) business, which is lower risk due to the pass through nature of customer contracts. (I&C contracts will typically include an element of outturn wholesale and non-energy costs being passed through to the end customer.) The CMA relies on this 1.5% as if it is an absolute benchmark, rather than one that is highly sensitive to assumptions made by it. It is noteworthy that OVO Energy and First Utility obtained a combined EBIT margin loss of [X] during 2012-2014, well below the efficient benchmark defined by the CMA, and well below the level that shareholders would require to be willing to invest in a business.

- b) *Collateral* The CMA’s ROCE calculation is highly sensitive to the estimation of the capital employed in the Six Large Energy Firms’ supply businesses. In particular, the CMA’s exclusion of collateral from the Six Large Energy Firms’ balance sheets has the effect of substantially lowering the estimated capital at risk of a standalone energy supply business and therefore contributing to high and volatile combined ROCE values across the Six Large Energy Firms. Table 1 shows the effect on ROCE of increasing the levels of capital employed in the Six Large Energy Firms’ retail supply businesses to reflect the value of collateral that a standalone energy supplier would need in order to trade and manage its risks in wholesale markets. (NB. Our calculations are based on the analysis presented by the CMA in its Provisional Findings. We note these have been updated to some extent in the PDR, but the principle remains the same and the results remain indicative of the extent of the sensitivity.)

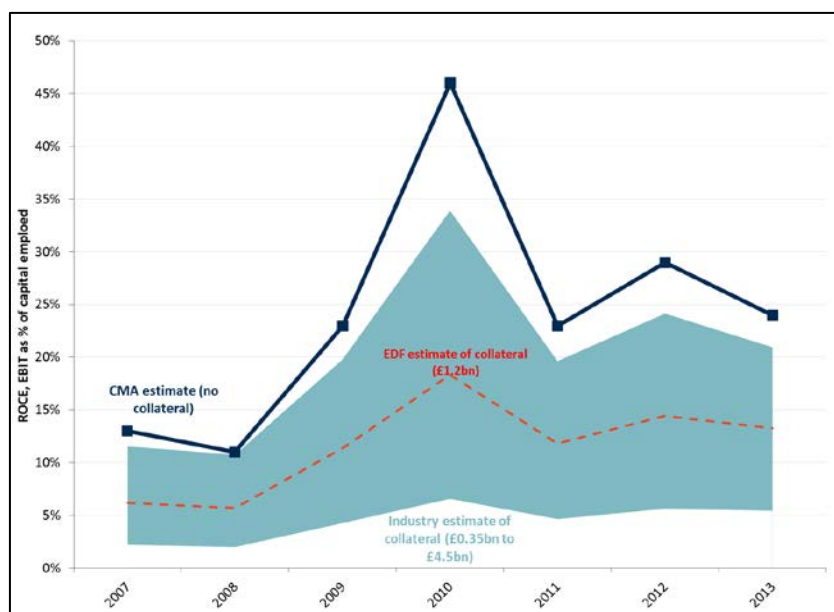
According to the CMA, industry estimates of the amount of collateral required for a standalone energy retail business ranged between £350m to £4.5bn. We have taken these estimates as the industry minimum and maximum values for collateral. We have then added these values to the capital employed estimates. We have also excluded (i.e. added back in) the trading fee that the CMA deducted from the Six Large Energy Firms’ EBIT. As shown in Table 1, with the minimum (£350m) value of capital, the average ROCE during 2009-13 is reduced from 27.9% to 23.2%. If we use the industry maximum estimate (£4.5bn), the

average ROCE is reduced from 27.9% to 5.3%. Finally, if we use EDF Energy's estimate of £1.2bn collateral, average ROCE is halved, from 27.9% down to 13.8%.

**Table 1 - Sensitivity of ROCE to inclusion of collateral in capital employed<sup>5</sup>**

		SLEFs combined						Average		
		2007	2008	2009	2010	2011	2012	2013	07-13	09-13
<b>CMA estimate</b>										
EBIT £ billion	[1]	0.50	0.40	1.10	1.80	1.30	1.60	1.60	1.19	1.48
Capital employed £ billion	[2]	3.85	3.64	4.78	3.91	5.65	5.52	6.67	4.86	5.31
ROCE	[3] [1]/[2]	13.0%	11.0%	23.0%	46.0%	23.0%	29.0%	24.0%	24.4%	27.9%
<b>Sensitivity - min industry estimate of collateral (£0.35 bn)</b>										
EBIT £ billion	[4]	0.69	0.62	1.36	2.04	1.52	1.84	1.84	1.41	1.72
Capital employed £ billion	[5]	5.95	5.74	6.88	6.01	7.75	7.62	8.77	6.96	7.41
ROCE	[6] [4]/[5]	11.6%	10.8%	19.8%	33.9%	19.6%	24.1%	20.9%	20.3%	23.2%
<b>Sensitivity - max industry estimate of collateral (£4.5 bn)</b>										
EBIT £ billion	[7]	0.69	0.62	1.36	2.04	1.52	1.84	1.84	1.41	1.72
Capital employed £ billion	[8]	30.85	30.64	31.78	30.91	32.65	32.52	33.67	31.86	32.31
ROCE	[9] [7]/[8]	2.2%	2.0%	4.3%	6.6%	4.7%	5.7%	5.5%	4.4%	5.3%
<b>Sensitivity - EDF estimate of collateral (£1.2bn)</b>										
EBIT £ billion	[10]	0.69	0.62	1.36	2.04	1.52	1.84	1.84	1.41	1.72
Capital employed £ billion	[11]	11.05	10.84	11.98	11.11	12.85	12.72	13.87	12.06	12.51
ROCE	[12] [10]/[11]	6.2%	5.7%	11.4%	18.3%	11.8%	14.5%	13.2%	11.7%	13.8%

**Figure 1 - Effect of collateral on the Six Large Energy Firms' ROCE**



This range shows the significant sensitivity caused by the CMA's assumption that collateral can be replaced by a trading fee. We appreciate that the CMA is trying to create a hypothetical efficient benchmark for the industry but asserting that both the scalability and pricing of the product is as assumed in the PDR, without also presenting sensitivity analysis, is misleading.

The CMA has stated, as part of the assumptions, that "for this model to provide a reliable benchmark of the costs of meeting an energy supplier's trading collateral requirements does not require that it be used by the whole of the GB retail energy supply industry" and that such arrangements are less likely to be used as a supplier grows. (PDR, Appendix 3.4,

<sup>5</sup> [8<]

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paragraph 5.6). This demonstrates that the market does not believe that such intermediary arrangements are the most suitable choice for trading collateral.

- c) *Variability in results* The CMA's indirect approach takes in the period 2007-08, when many of the Six Large Energy Firms were loss-making, and provides a more long-term perspective of the profitability of UK energy suppliers. It shows that annual profitability can vary significantly due to factors such as changes in wholesale prices and consumption levels. The indirect approach provides a more dynamic perspective of companies' profitability and demonstrates the sensitivity of profits to exogenous factors.
- d) *Differentiation of Six Large Energy Firms* The CMA's evidence and analysis shows a highly skewed distribution of excess 'profits' (in fact revenues above the assumed benchmark) between the Six Large Energy Firms, and between gas and electricity. We are encouraged that the CMA recognises the considerable variation within the Six Large Energy Firms in the extent to which individual suppliers price above the 'competitive' level. We understand that the CMA intends to address this more fully in its final report, and we would stress the importance of this. As discussed at our response hearing in July 2015, we have been concerned by the CMA's tendency to treat the Six Large Energy Firms as a block and would encourage the CMA to show the variation in prices between the Six Large Energy Firms, as well as between the Six Large Energy Firms and mid-tier suppliers. EDF Energy has shared with the CMA the steps that it has taken to act differently from our main competitors. We have acted to make it as easy as possible for customers to engage and choose their tariff, and we believe that our actions have resulted in EDF Energy having a relatively high proportion of engaged customers, with 44% of domestic customers on fixed-rate tariffs (as at March 2016). As a consequence we have very different profitability results from other suppliers.
- e) *Use of mid-tier suppliers as a comparator* In line with our previous responses, we consider the mid-tier suppliers to be a useful comparator to use in the profitability analysis. However, adjustments need to be made to make this comparison meaningful. Throughout its profitability analysis, the CMA continues to use mid-tier suppliers as a direct comparator to the Six Large Energy Firms without any adjustment. We would like to address two specific examples of this:
- i. The CMA does not consider the costs of running a legacy company to be applicable to its interpretation of returns required for investors. The CMA specifically cites the examples of pension deficit repair costs and essential costs for creating efficiency savings (e.g. IT rationalisation) as costs that should be dismissed (PDR, Appendix 3.4, paragraphs 130-133). These are significant and legitimate costs of running a legacy business and, while we agree that new entrants would not face such costs, we strongly consider that an investor in any of the Six Large Energy Firms would expect to see their return over and above such costs.
  - ii. The CMA has considered certain cases where mid-tier suppliers may have higher costs, such as spare capacity, but does not consider that these may also be the case for the Six Large Energy Firms (PDR, Appendix 3.5, paragraph 12). Newer firms are more likely to have invested in more flexible, lower cost systems that have the ability to grow as the supplier grows. There may be relatively small economies of scale where systems are concerned but these are more than offset by the efficiency and lower cost that comes from process efficiency and customer satisfaction i.e. getting the process right so the customer has as little need to contact his or her supplier. To the extent that mid-tier suppliers have any additional overhead cost per account due to their size relative to ourselves, we would highlight that we experience the same dynamic against our larger supply rivals. Furthermore, the CMA has only considered

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the impact of issues that would mean mid-tier suppliers have higher costs than the Six Large Energy Firms. No consideration has been taken into account that the mid-tier suppliers have lower customer servicing and bad debt costs due to their different payment and tariff mixes.

Overall the CMA has stated that it is using the cost ratios of the mid-tier suppliers as a sense-check rather than part of its analysis (PDR, Appendix 3.5, paragraph 22). However, we consider that the above points demonstrate the potential significant differences that need to be taken into account in interpreting this sense-check.

- f) *Segmented balance sheets* EDF Energy notes the CMA’s attempt to split retail supply balance sheets into segmented fuel-based balance sheets (PDR, Appendix 3.4, paragraphs 143-145) and consider this split to be highly subjective. We have previously outlined the challenges we have faced in presenting accurate balances for our full retail supply business without making assumptions. The CMA has then applied further significant assumptions to create an economic balance sheet and is now applying a third layer of high level assumptions in producing the segmentation. While this may provide some very high level indicative results, they are not calculated with sufficient rigour to be relied upon as a basis for conclusions.
- g) *SME profitability analysis* EDF Energy notes that the CMA has not appeared to have updated the analysis of SME profitability to reflect a consistent definition of the SME market. As previously highlighted, profit margins will vary significantly as the level of consumption increases. Any margin information therefore that is based on inconsistent definitions of what constitutes a SME customer has the potential to significantly skew the margin analysis. Figure 2 below demonstrates the potential effect. However, we consider the impact of this at an EBIT margin level will be significantly lower.

**Figure 2 - Indicative margin analysis of EDF Energy B2B customers by size**

[X]  
[X]  
[X]

## CfDs AEC

*DECC to conduct an impact assessment before awarding CfDs outside the auction mechanism and DECC to consult on allocation of technologies and CfD budgets between pots*

The CfDs AEC

11.3 The remedies package proposed to address the CfDs AEC and/or associated detriment is as follows:

- (a) A recommendation to DECC to undertake and consult on a clear and thorough impact assessment before awarding any CfD outside the CfD auction mechanism.
- (b) A recommendation to DECC to undertake and consult on a clear and thorough assessment of the appropriate allocation of technologies and CfD budgets between pots.

- 2.1 EDF Energy fully supports the CMA's proposal both that (a) DECC conduct an impact assessment before awarding CfDs outside the auction mechanism and that (b) DECC consult on the allocation of technologies and CfD budgets between pots.

### **DECC to conduct impact assessment before awarding CfDs outside the auction mechanism**

- 2.2 EDF Energy agrees that, wherever possible, competitive auctions are the best way of ensuring efficient allocation of CfDs and securing good value for customers. We also welcome the CMA's recognition that there are certain circumstances in which other mechanisms will be required in order to ensure "an efficient mix of generating technologies in the long run and/or [to] minimise costs to customers" (PDR, paragraph 2.156) and that these mechanisms must be properly assessed.
- 2.3 EDF Energy notes that it is not clear from the factors that the CMA has proposed DECC take into account (before and after entering negotiations) how central 'value for customers' will be to this process. The focus appears to be primarily on 'incremental' cost, with even the nominally separate 'externalities' factor being assessed in part on the basis of incremental cost incurred by the non-auction process project. The CMA proposes that DECC should consider a suitable counterfactual in undertaking its assessment of costs (PDR, paragraph 2.165). We believe that there may not always be a clear direct comparator for a project to be considered outside of the auction process. It may therefore be necessary for the impact assessment to take a wider perspective than a simple comparison of incremental costs and benefits. Although the relevant factors will vary on a project by project basis, it is important that the assessment takes a comprehensive view of the impacts of the project on the costs of the whole electricity system - long term customer value and the delivery of a sustainable and diverse generation mix should be central.
- 2.4 EDF Energy observes that the CMA commented that "DECC's main rationale for allocating a CfD to Hinkley Point C was not to reduce the cost of future nuclear plants" (PDR, paragraph 2.168, footnote 111) and that an assessment such as the one that the CMA recommends should take into account negative externalities from the impacts on the development of other technologies. We would note that, even if the reduction of the costs of future nuclear plants was not seen as the main rationale for the project, it would nevertheless be correct also to take into account in the assessment any benefits for the development of future nuclear plants that the project would be expected to deliver.
- 2.5 EDF Energy agrees with the CMA that some form of public consultation would be appropriate, and that this could be carried out in parallel with the State aid notification and approval process that is required for qualifying individual projects where a CfD is awarded outside of the



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competitive auction process (PDR, paragraph 2.162). We also consider that DECC should build into its process a justification of the factors selected to underlie its assessment of any given project and the differential weightings given to these factors in individual cases. The CMA currently places the emphasis on DECC being able to justify the initial departure from the auction process rather than the emphasis also being on DECC justifying its substantive assessment of individual projects.

### **DECC to consult on the allocation of technologies and CfD budgets between pots**

- 2.6 EDF Energy also welcomes the CMA's recognition that the long-run lowest cost path to meeting the Government's decarbonisation targets may be to provide support initially to certain less developed technologies (in particular those that offer the possibility of large-scale commercial deployment) and that effective allocation of technologies and CfD budgets between pots can support this if done properly.
- 2.7 EDF Energy agrees that accountable and transparent decision-making is vital. We welcome the CMA's recommendation that DECC should undertake regular reviews of the allocation of technologies and budgets to pots (PDR, paragraph 2.192) and that it consult on and assess the appropriate allocation before each CfD auction (PDR, paragraph 2.214). We also welcome the CMA's recognition that although at present, it will sometimes be appropriate to allocate different levels of support to different types of technology, in the long term the 'default' should be for all low carbon technologies to compete directly with each other.
- 2.8 EDF Energy considers that, in the interests of clarity, the CMA should propose a more objective/concrete list of factors for DECC to consider when allocating budget between pots. Such factors could include:
- Long-term potential for large scale deployment at competitive cost.
  - Magnitude of the potential total low carbon generation that the technology could deliver in the UK.
  - Progress in cost reduction delivered to date, taking account of the duration and the scale of deployment to date.
  - Contribution of the technology to diversity of supply.
  - Reliability and level of intermittency of the technology.
  - A full assessment of the total system costs associated with the technology, including (but not limited to) backup generation and grid reinforcement.
  - Level of development of an established supply chain.

## Locational Pricing AEC

*Locational pricing: Variable transmission losses to be priced on the basis of location and all losses to be assigned to generators - National Grid to implement a number of steps; Ofgem to assist*

The Locational Pricing AEC

11.4 The remedies package proposed to address the Locational Pricing AEC and/or associated detriment is as follows:

(a) An order (the 'Locational Pricing Order') on National Grid (and amendments to National Grid's licence conditions) that would set out, among other things:

(i) the formula to calculate the transmission loss factors (which ultimately feeds into the imbalance charges) for this purpose;

(ii) an obligation on National Grid to create a load flow model;

(iii) an obligation on National Grid to create a networking mapping statement and collect annually relevant network data;

(iv) an obligation on National Grid to appoint third party agents to collect metered volumes data and to calculate annually the transmission loss factors pursuant to the principles set out in the order and using the models created, and information collected, pursuant to the order;

(v) an obligation on National Grid to direct Elexon, as appropriate, to update the networking mapping statement and carry out other administrative tasks that are necessary to the calculation by the third party agents; and

(vi) an obligation on National Grid to raise any consequential code modification.

(b) A recommendation to Ofgem to support National Grid by taking necessary steps that might facilitate the implementation of the Locational Pricing Order.

- 3.1 EDF Energy supports the principle of cost reflective charging. To the extent that locational charging for electricity transmission network losses would result in more efficient dispatch and investment decisions we agree that theoretically it would deliver a reduction in variable losses, and a reduction in total energy costs relative to a geographically neutral charging methodology. However, while we support the CMA in principle, we consider that there are a number of issues for the CMA to further consider in order to determine whether and how to remedy any potential AEC.
- 3.2 The first issue is whether the updated analysis meets the evidential standard to justify a finding of an AEC and/or the proportionality of the remedy. In response to the Notice of Possible Remedies, and in particular recognising the rapidly changing generation market in GB, EDF Energy recommended that the CMA should undertake updated analysis in order to quantify the size of any detriment caused by the current absence of locational charging for losses, and to develop a realistic view of the achievable benefits of any scheme that may be considered for implementation under a range of scenarios. In order to undertake such analysis we said it would be important to clearly specify details of any potential remedy. This is because the design of any scheme will have a material impact on the extent to which market participants are able to respond to locational signals, including their ability and costs to hedge such uncertainty, and on the extent to which potential efficiency benefits might be achieved in practice.

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- 3.3 We recognise that the CMA has commissioned updated analysis from NERA to support its provisional decision to implement locational charging for transmission losses. However, we do not believe that the modelling satisfies the standard of evidence required to conclude that there is a certain net benefit, and, importantly, to proceed directly to implementation.
- 3.4 Furthermore, we would highlight that the 'Reference' scenario taken by NERA appears somewhat out of date given the recent fall in gas prices. The relative competitiveness of coal and gas generation in the current market seems to more closely resemble NERA's 'High' scenario than its 'Reference' scenario, although prices are at a much lower level in absolute terms than in either. Although we cannot see full details of NERA's modelling in order to be certain, the impact of this assumption is that NERA's results may be significantly overstating the incremental impact of introducing location losses on existing coal stations, including on EDF Energy's portfolio.
- 3.5 EDF Energy has constructed a load flow and dispatch model, and investigated some different potential future scenarios. Although limited work on this complex area has been possible in the time available, initial results appear to confirm our concerns that the potential benefits are uncertain, and likely to diminish or even reverse in future as the geographic pattern of flows in GB changes and marginal generation is less often in locations where it materially reduces transmission losses. We refer to this analysis further below and provide summary evidence in Appendix 2 along with technical comments on areas where greater clarity on the CMA's proposal would be helpful. We will be pleased to discuss our analysis further with the CMA.
- 3.6 Secondly, there are a number of detailed design issues that the CMA does not appear to have properly considered. The CMA will need to address these issues in its Order to National Grid if it proceeds with this remedy. In particular, the CMA has not yet adequately described the proposed scheme of implementation in enough detail for EDF Energy (and therefore we assume others) to determine the impact on its business or its customers of such a change. We strongly believe that greater clarification and definition are required so that relevant parties will be able to address the CMA on such impacts, a relevant consideration before a decision is made to take this remedy forward. We set out specific points below.

#### **Use of temporal average loss factors**

- 3.7 The CMA proposes largely basing its scheme on Balancing and Settlement Code ("BSC") modification proposal P229 (PDR, paragraph 2.83), where seasonal loss factor values would be set more than a year in advance and hence not represent actual losses, particularly when the unpredictability of intermittent generation such as wind and solar photovoltaic is considered. The CMA does not appear to have considered the extent to which the loss factors calculated well in advance will accurately reflect real-time losses and therefore have the potential to reduce total losses overall.
- 3.8 Our analysis indicates that there is a close correlation between the level of wind at a particular moment in time, the level of output from wind generation, the strength of the north-south flow on the transmission system and the corresponding variable losses on the system (please see Figure 2 of Appendix 2). Therefore any preset loss factors derived a long time in advance of real time, even seasonally, will be inherently inaccurate reducing any benefit in economic efficiency.
- 3.9 We have previously highlighted to the CMA the trade-off between accuracy of the loss factors, the ability of market participants to respond, and the relative implementation cost impacts of different approaches. We believe that good notice of loss factors is needed, in particular to allow smaller participants to respond. Nevertheless if this is the CMA's intention, in line with P229, then we note that the derived efficiency will be lower than the modelled theoretical efficiency improvements.

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### **Use of Marginal loss factors**

- 3.10 It is not clear to us as to what is exactly meant by proposed sharper signals on generation. We would welcome clarification from the CMA as to whether this means marginal loss factors as opposed to scaled or 'average' loss factors (as per previous BSC proposals including P229). Marginal loss factors risk over-recovery of variable losses and increase the significant distributional impacts between locations, regardless of whether behavioural changes deliver significant benefits or not.
- 3.11 We note that if it is the CMA's intention to use marginal loss factors then this will increase the risk of applying inaccurate loss factors to a party at any moment in time. While in theory marginal loss factors may better reflect the impact a marginal change in output will have on the variable transmission losses, at the same time, as we understand it, the CMA is proposing that these factors are calculated a year ahead based on seasons (as discussed above). Setting loss factors a year ahead based on seasons will have a level of inaccuracy when applied in real time. To then argue that marginal loss factors will provide sharper signals and bring greater operational efficiency needs more consideration. It is possible that marginal loss factors will exacerbate existing errors introduced through setting loss factors annually. Indeed this is one of the reasons why 'average' loss factors have been proposed in the past.
- 3.12 In our view, the CMA should set out clearly its proposal, including how it balances the trade-offs between marginal loss factors and other simplifications proposed in its remedy.

### **100% allocation to Generators**

- 3.13 The BSC currently charges 45% of total losses, including fixed and variable losses to delivery (i.e. generation) in aggregate, and 55% to offtake (i.e. demand) in aggregate, while preserving the locational variation of each. The CMA's provisional decision to charge 100% of losses to generation does not specify whether this means 100% of losses in aggregate while preserving locational differences for generation and demand (i.e. the current BSC approach which would be a lot simpler to implement), or whether it means that no demand would be allocated any part of transmission losses (or indeed something else). If the latter, we note that such an alternative approach would require detailed changes to the BSC and would need careful consideration and development.
- 3.14 We have assumed that the CMA intends to allocate the full losses volume in aggregate to generation while preserving the locational differences for generation and demand. If so, we can see no economic justification for such a change and it is not clear how this remedies the defect identified by the CMA. If the locational differences are preserved then the operational efficiency (dispatch decisions) will be identical whether losses are allocated 100% losses or 45% (assuming a closed GB system).
- 3.15 We note that due to electrical interconnection to continental Europe, a move from 45% to 100% will put GB generation at a cost disadvantage to continental generation and exacerbate existing cross border distortions. Systematic increases in the GB wholesale price relative to external systems (i.e. countries outside of the GB market) would be caused by this change, increasing the level of GB imports. This change will add around 1% to the costs of GB generation or £0.40/MWh. If this is the CMA's intention then we urge the CMA to reconsider this change.

### **Use of zones**

- 3.16 The details of the scheme modelled (by NERA) do not appear to align to the scheme envisaged for implementation (P229). The technical detail behind the proposed remedy has not been given so the exact relationship between the modelling performed and the solution to be adopted remains unclear. We note that the representation of locational loss adjustments in the modelling

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performed by NERA is not consistent with the BSC P229 solution that the CMA indicates as a potential ready-made approach for any locational losses scheme. Previous BSC proposals, including P229, used zones defined by distributional Grid Supply Point (“GSP”) Groups, with zonal locational loss factors applied to all transmission flows (except external interconnections), allowing locational impacts on generation embedded in distribution, which offsets demand, to be equivalent to those for transmission-connected generation, avoiding inefficient discrimination. The approach now proposed appears different to previous BSC solutions, and previously unforeseen and unassessed changes to the BSC would be required to implement it.

### **Market response**

- 3.17 We have previously highlighted (See EDF Energy’s response to the CMA’s Notice of Possible Remedies) that theoretical benefits may not be achieved in practice due to limits in response from market participants. It remains the case that the CMA does not appear to have considered the extent to which generation and demand would respond in practice to these signals to adjust their output, demand or, in the longer term, location. The actual response (and hence benefits) will be very dependent on the scheme design. It is unlikely that the theoretical efficiency benefits modelled will be derived in practice. While there may still be efficiency gains, the CMA should consider these in the context of the large distributional effects and the uncertain (and potentially negative) customer impacts.

### **Distributional impacts**

- 3.18 While there is some assessment of the distributional impacts based on the NERA work, the step redistribution of value between different locations will be significant, particularly for generators, compared with the benefits achieved. Only limited analysis has been performed on this. We would highlight that some previous BSC proposals (e.g. P200 and P204) sought to mitigate the distributional impacts for existing generation investments to avoid undermining historic investment.
- 3.19 In addition to the location and potential wholesale price impacts on parties, the timescale that the CMA has proposed to implement this change (October 2017) is already well within the contracting horizon for our generation and customers businesses. This means that there would be a further impact due to our already hedged and contracted positions, including the potential for windfall gains and losses for these businesses, and the likely need to reopen some contracts. The CMA does not appear to have given consideration to this impact in setting the timeframe or assessing customer impacts. We urge the CMA to reconsider the implementation timescales with this important matter in mind.

### **Customer impacts**

- 3.20 The results do not meet the evidential standard to demonstrate benefits to customers, with bills rising and falling at different times under different scenarios. This includes the system effectively inverting post 2025, creating higher costs to consumers due to rising wholesale prices. While we understand that these effects on the wholesale price are not systematic, it is credible that there are downside risks for customers from the scheme’s introduction.

### **Implementation Process and Governance**

- 3.21 With respect to the proposed method of implementation, by way of Order to National Grid rather than recommendation to Ofgem/industry participants to raise a code modification, this approach does not appear to allow for further consideration of the optimal scheme design by a wider community of industry experts, with opportunities to propose alternative design details, as would generally be the case with a BSC modification. We appreciate the CMA’s concerns that taking forward the remedy through a recommendation to Ofgem to raise a BSC modification

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would take time. However, we strongly believe that existing BSC proposals form a firmer basis for a robust solution than National Grid starting afresh, particularly given the issues noted above.

- 3.22 In addition, without significantly more clarity on the detail of the Order it is highly likely that National Grid will be required to consult with industry on its proposals to deliver the Order. It will be necessary to link National Grid's work to the BSC, and modify the BSC to ensure the market arrangements to include the new locational transmission losses scheme. Given this, BSC modifications will need to be raised in any case. Therefore it is not clear that the Order approach will necessarily deliver change in a more timely, or effective, manner than the existing BSC processes.

### **Summary**

- 3.23 In summary, we do not believe that the CMA has adequately met its evidential standard with respect to the customer benefits case such that further consideration by the CMA is needed:
- The proposed change is not sufficiently precisely defined to be sure that it is practically achievable, that there are not unforeseen implementation issues or that the modelling performed is consistent with it.
  - The NERA modelling has not considered a wide enough range of realistic scenarios to be confident that significant and proportionate consumer benefits are achievable. Large distributional impacts will occur regardless of whether benefits are achieved.
- 3.24 Further, we do not believe that the CMA has demonstrated that implementation by way of an Order will be more effective than existing industry processes and indeed without due process increases implementation risks and unintended consequences. In our view, this potential remedy would be most efficiently taken forward through the existing BSC process. This would allow for industry-wide assessment of the detail, including costs, benefits and robust achievable implementation targets for this complex technical and commercial change.

## Electricity Settlement AEC

### *Electricity settlement reform: DECC and Ofgem to conduct consultations and analysis on the move to half-hourly settlement and take related steps*

#### Electricity Settlement AEC

11.5 The remedies package proposed to address the Electricity Settlement AEC and/or associated detriment is as follows:

(a) A recommendation to DECC to consult on amending the provisions of the Smart Energy Code\* that prohibit suppliers from collecting consumption data with greater granularity than daily unless a customer has given explicit consent to do so.

(b) A recommendation to Ofgem to:

(i) conduct a full cost benefit analysis of the move to mandatory half-hourly settlement, including analysis of costs, benefits and distributional implications as well as mitigating measures;

(ii) start the process of gathering evidence for the analysis as soon as practicable;

(iii) consider the cost-effectiveness of alternative design options for half-hourly settlement such as a centralised entity responsible for data collection and aggregation; and

(iv) consider options for reducing the costs of elective half-hourly settlement, including (i) whether any of these options are likely to delay or accelerate the adoption of mandatory half-hourly settlement; and (ii) any challenges that may arise or benefits that may accrue from the existence of two settlement systems, including in particular the possibility of gaming/cherry picking behaviour.

(c) A recommendation to both DECC and Ofgem that they publish and consult jointly on a plan setting out:

(i) the aim of the reform for half-hourly settlement;

(ii) a list of proposed regulatory interventions (including code changes), and the relevant entity in charge of designing and/or approving such interventions, that are necessary in order to implement the half-hourly settlement reform;

(iii) an estimated timetable for the completion of each necessary intervention; and

(iv) where appropriate, a list of relevant considerations that will be taken into account in designing each regulatory intervention.

\* EDF Energy would highlight that the provisions concerning data access for smart metering are contained within the supplier and distribution licence conditions, not the Smart Energy Code.

- 4.1 EDF Energy agrees that the lack of a half-hourly settlement regime for domestic customers is a barrier to the development of innovative time-of-use tariffs. We therefore support the CMA's recommendation that Ofgem and DECC take steps to facilitate the collection of more granular consumption data (PDR, paragraphs 5.76 - 5.80).
- 4.2 EDF Energy would like to echo the caution that the CMA has expressed with respect to Ofgem's proposed sequencing for its programme to reform electricity settlement arrangements in Great Britain (as proposed in a letter dated 17 December 2015) (PDR, paragraph 5.54), under which Ofgem plans to first focus on removing barriers to elective half-hourly settlement and then to draw on the experience of elective half-hourly settlement in developing its views on mandatory

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half-hourly settlement (PDR, paragraph 5.62). The CMA has rightly noted that elective half-hourly settlement is unlikely to be an effective substitute for full, mandatory half-hour settlement (PDR, paragraphs 5.64-5.65). We believe that suppliers using elective half-hourly settlement should pay for the relevant changes. The use of elective half-hourly settlement will be a commercial decision and, as such, we consider it appropriate that the industry costs associated with the delivery of this service should be targeted at those who are using it.

- 4.3 EDF Energy supports the CMA's recommendation that Ofgem commence its analysis of the likely costs, benefits and distributional impacts of changes to electricity settlement provisions, as soon as possible (PDR, paragraph 5.72). We also support the CMA's recommendation that Ofgem and DECC publish and consult jointly on a plan setting out the aim of reform for half-hourly settlement and their proposed regulatory interventions (together with an estimated timetable for completion of interventions and the considerations behind interventions).
- 4.4 We would highlight that the industry changes required to deliver half-hourly settlement are likely to be complex and costly at a time when the industry is already managing the significant cost and complexity of other initiatives such as next day switching, Project Nexus, and the roll out of smart meters. It is therefore essential that any plan for half-hourly settlement is correctly sequenced given the other major changes currently in progress and should not put existing systems at risk. We agree that high quality project management and preparation is required if, for example, the problems reported by the CMA for Project Nexus and P272 are to be avoided.
- 4.5 In particular, there should be sufficient time provided to design, build and test any solution prior to implementation. This will ensure that the desired outcomes are delivered efficiently and a positive consumer experience is achieved, rather than prioritising an implementation date over quality and cost. For mandated half-hourly settlement to be most efficient and effective, it should take place after SMETS1 enrolment and adoption. It should also utilise a centralised Data Collector ("DC") / Data Aggregator ("DA") function. We are concerned that managing SMETS1 meters in volume on non-Data and Communications Company ("DCC") Smart Meter System Operator ("SMSO") would create costly short term IT changes.

#### **Method for data collection and aggregation**

- 4.6 With respect to the method of data collection and aggregation, EDF Energy welcomes the CMA's recognition of the theoretical benefits of a centralised system (PDR, paragraph 5.70), and the proposal that Ofgem should undertake an assessment as part of its future work. In our view, a centralised system would be the most efficient solution to develop the new automated processes required to cope with the increased volume of data flows resulting from the roll out of half-hourly settlement to all profile class 1 to 4 customers. EDF Energy continues to believe that a definitive decision on whether data collection and aggregation is centralised or left for suppliers to appoint their own DC/DA competitively is necessary to realise the full benefit of smart meters and would, therefore, welcome a clear view from the CMA on this point.
- 4.7 From a data protection perspective, EDF Energy is minded to consider that data anonymisation would be the best way forward given that half-hourly settlement will be mandatory. We would expect the CMA to seek advice on this point from the ICO, if it has not done so already.
- 4.8 Finally, as we explain further in Section 11 ('Codes AEC'), EDF Energy does not believe that a case has been made for Ofgem to be provided with additional broad powers allowing it to unilaterally make modifications to industry codes in respect of the faster switching and settlement reforms. Increasing Ofgem's powers to implement changes without due assessment by experts in the industry could lead to sub-optimal changes being developed and further damage customer trust in the energy market.



## Gas Settlement AEC

*Gas settlement reform: Ofgem and suppliers to implement specified measures intended to bring about more efficient cost allocation*

### Gas Settlement AEC

11.6 The remedies package proposed to address the Gas Settlement AEC and/or associated detriment is as follows:

(a) A recommendation to Ofgem to ensure implementation of Project Nexus by 1 October 2016 through monitoring closely the progress made by the industry in meeting intermediate milestones and to take (where appropriate) further measures to achieve this objective.

(b) An order on gas suppliers (and amendments to gas suppliers' standard licence conditions) to submit all meter readings for non-daily metered supply points in GB to Xoserve as soon as they become available, and at least once per year, save for non-daily metered supply points with a smart or advanced meter, which must be submitted at least once per month.

(c) A recommendation to Ofgem to:

(i) take responsibility for the development and delivery of a performance assurance framework to increase accuracy of the gas settlement process as soon as reasonably practicable, and at the latest within one year of our final report;

(ii) establish a project plan and allocate responsibility to Uniform Network Code parties to take actions for its implementation;

(iii) supervise its implementation; and

(iv) take appropriate steps to ensure that failure to meet targets under the performance assurance framework are sanctioned.

### Implementation of Project Nexus

5.1 EDF Energy is fully in support of Project Nexus, the benefits it will deliver and its timely implementation. We consider that it is important for Ofgem to monitor the implementation of the project and, where appropriate, take necessary measures to ensure its completion by 1 October 2016 providing this is in a manner that does not lead to spiralling costs or shortcuts being taken to meet the deadline.

### Additional measures proposed by CMA

5.2 EDF Energy agrees that the implementation of the original proposed remedy for the mandatory submission of monthly updates to Annual Quantities ("AQs") would be impractical and costly, at least until the majority of customers have had smart meters installed. We would highlight that there is already a Supply Licence (SLC 21B.4) requirement to take all reasonable steps to obtain a meter reading at least once every year. In addition, we note that Scottish Power has recently raised Uniform Network Code 'Modification 0570 - 'Obligation on Shippers to provide at least one valid meter reading per meter point into settlement once per annum', and this may represent a good basis from which to proceed.

5.3 EDF Energy supports the CMA's revised proposal on gas suppliers to submit all meter readings for non-daily metered supply points as they become available, and at least once per year. This will reinforce existing requirements to submit a reading into the settlement system every year, which in turn should result in an increase in settlement accuracy.

- 
- 5.4 The implementation of Project Nexus should address most of the current inefficiencies within the gas settlement system. EDF Energy supports the CMA's proposed remedies, including the development and delivery of a performance assurance framework. We believe that they are positive measures that should increase suppliers' incentives to provide more accurate and frequent updates on individual supply points, and should reduce the amount of unidentified gas and improve the allocation of its costs between suppliers.

## Prepayment AEC

### Overview

- 6.1 EDF Energy agrees with the CMA's provisional finding that there are features specific to the PPM segment that give rise to an AEC and that a number of these may be alleviated by the structural measures proposed by the CMA (i.e. grouping regional costs in order to allow for the rationalising of gas tariff pages, redistributing unused gas tariff codes, and ensuring proper and timely implementation of the Debt Assignment Protocol (“DAP”).
- 6.2 We continue to believe that the material feature negatively affecting competition in the prepayment sector is weak customer engagement. This is rightly at the centre of the CMA's proposed package of remedies. The CMA recognises the “materially higher levels of fundamental disengagement compared to direct debit customers” (PDR, paragraph 3.91) and that the results of the CMA's analysis of disengagement in the PPM sector “can be interpreted as evidence of disengagement irrespective of the size of potential gains [of switching]” (PDR, paragraph 3.92).
- 6.3 EDF Energy does not agree with the CMA's provisional finding that all suppliers have reduced incentives to compete for PPM customers (PDR, paragraph 3.27 and 3.149). EDF Energy has a clear ambition to grow its customer base and provide competitive tariffs both to attract and retain customers across all segments, as evidenced by our Blue+ Prepay tariff. Additionally, although there may be potentially higher acquisition costs and costs to serve indebted customers, EDF Energy does not differentiate between indebted and non-indebted prepayment consumers when seeking to attract new customers.
- 6.4 In this regard, EDF Energy welcomes the CMA's recognition that the main structural features provisionally identified as giving rise to or exacerbating an AEC in this segment will be resolved by the roll-out of SMETS2 meters and that some new entrants have responded to this opportunity by offering smart meters (albeit SMETS1) as an “acquisition strategy” (PDR, paragraph 3.77). We also note the CMA's recognition of the fact that independent suppliers' market shares in this segment are growing - and at a rapid rate in the case of dual fuel customers (PDR, paragraph 3.84).
- 6.5 Additionally, we continue to consider that the extension of Standard Licence Condition (“SLC”) 7 (i.e. deemed prices should not be “unduly onerous”) to all default prices would be, if accompanied by auditable guidelines/principles and properly enforced, a more effective and practicable solution than attempting to determine centrally a form of price cap. Despite this, we welcome the CMA's provisional finding that the utility of introducing a price cap remedy, if any, is inherently limited to the period pending implementation of the CMA's general package of remedies (PDR, paragraph 4.3).

### *Ofgem to modify suppliers' SLCs with respect to pricing of regional cost variations and to deprioritise enforcement pending change*

Proposed remedies specific to the Prepayment AEC

11.8 The remedies proposed to address part of the Prepayment AEC and/or associated detriment are as follows:

(a) A recommendation to Ofgem to:

(i) modify suppliers' standard licence conditions to introduce an exception to SLC 22B.7(b) so as to allow a supplier to set prices to prepayment customers on the basis of grouping regional cost variations which are applied to other payment methods within the same core tariff;

(ii) deprioritise potential enforcement action pending the modification of SLC 22B.7(b) against any supplier to a prepayment customer that sets prices to prepayment customers on the basis of grouping regional cost variations which are applied to other payment methods within the same core tariff;

[...]

- 6.6 We understand the CMA's intention to be that suppliers will be able to adopt a more flexible approach to devising PPM tariffs than is currently allowed under general domestic supply rules. This change will allow suppliers to set PPM prices without the obligation to apply uniform payment differentials across all regions. As such, this remedy seeks to remove an artificial constraint on tariff flexibility in the PPM segment and could theoretically free up tariff slots to be used in a manner that is better adapted to customers in the prepayment segment by allowing suppliers to make regional grouping decisions specific to the PPM segment.
- 6.7 We would welcome more detailed information on this remedy but, in principle, and based on our understanding, EDF Energy supports this proposal.
- 6.8 As a process matter, EDF Energy would also welcome more information on how the CMA envisages that Ofgem would "deprioritise" enforcement of this SLC pending change (or deprioritise enforcement of other rules). We understand this to mean that Ofgem would record any conduct diverging from the SLC pending its reform as a technical breach only and would not result in enforcement action, thus creating a legitimate expectation that the supplier would not be penalised. If this is the CMA's intention EDF Energy would encourage the CMA to require that Ofgem send a letter to suppliers confirming this understanding as soon as possible.

***Ofgem to take responsibility for a more efficient allocation of gas tariff pages, and the acceptance of undertakings from the Six Large Energy Firms***

Proposed remedies specific to the Prepayment AEC

11.8 The remedies proposed to address part of the Prepayment AEC and/or associated detriment are as follows:

(a) A recommendation to Ofgem to:

[...]

(iii) take responsibility for the efficient allocation of gas tariff pages; and

[...]

(b) The acceptance of undertakings from the Six Large Energy Firms or, absent such undertakings including the following three components:

(i) a cap on the number of gas tariff pages that any supplier can hold (at 12);

(ii) an obligation for suppliers to provide relevant information for Ofgem to monitor the allocation of the gas tariff codes; and

(iii) a condition that allows Ofgem to mandate the transfer of one or more gas tariff pages to another supplier.

(c) Absent such undertakings, we would recommend that Ofgem introduces a new licence condition in suppliers' standard licence conditions to include the three components set out above.

- 6.9 EDF Energy agrees that, pending roll-out of SMETS2, technical constraints in the PPM infrastructure will continue to limit the number of tariffs available to PPM customers. EDF Energy has itself in the past tried to buy additional electricity tariff slots, but was informed that this was not possible due to infrastructure constraints. We also note the CMA's recognition that "it would not be possible for any supplier, including the Six Large Energy Firms, to offer the same range of gas tariffs to prepayment customers as they do to customers on standard credit and direct debit" (PDR, paragraph 3.71).
- 6.10 EDF Energy would, therefore, welcome dialogue with the infrastructure operators around whether any currently unused gas tariff pages could be reallocated between suppliers and agrees that one way to achieve this would be to recommend that Ofgem take responsibility for leading this process.
- 6.11 Any such process must, however, take account of the fact that there are legitimate reasons for suppliers not using all slots that they hold at any one time e.g. slots need to be kept free so as to be able to offer future tariff options, bearing in mind that suppliers must account for a lag of several months between when each tariff ends and when slots are available again. It is also relevant to note that costs have been incurred in acquiring pages, a factor which should be relevant for any reallocation process.
- 6.12 We note that the CMA has proposed limiting the number of gas tariff pages per supplier to 12 [X]. We do not believe that any enduring fixed limit on pages is necessary or desirable. Once new pages are created, and the constraint on new entrants is therefore removed, the limit to 12 pages should also be lifted and any pages released should be returned to suppliers if they require them. Appropriate compensation arrangements should also be made for suppliers who are releasing pages that they have previously paid for.

***Ofgem to ensure changes to the Debt Assignment Protocol are implemented by the end of 2016***

Proposed remedies specific to the Prepayment AEC

11.8 The remedies proposed to address part of the Prepayment AEC and/or associated detriment are as follows:

(a) A recommendation to Ofgem to:

[...]

(iv) take appropriate steps to ensure that changes to the Debt Assignment Protocol are implemented by the end of 2016, and in particular in areas relating to objection letters, complex debt and issues relating to multiple registrations; including setting out clear objectives and a timetable with appropriate milestones, supervising progress against such objectives and milestones, and to take all steps, if and when necessary, to ensure delivery of these changes.

[...]

- 6.13 EDF Energy fully supports this proposal and agrees that the DAP has not been implemented consistently.
- 6.14 As the CMA has recognised, EDF Energy and ten other suppliers have already proactively taken steps to change their operation of the DAP through the Point of Acquisition ("**POA**") model. However, the POA remains a voluntary commitment and it has not been adopted by all parties, which has limited effectiveness of the change.
- 6.15 EDF Energy therefore welcomes the CMA's proposed recommendation that Ofgem take the lead in ensuring that DAP reform is achieved across all suppliers before the end of 2016.

## RMR AEC

### *Removal of restrictions on suppliers offering a greater range of tariffs, and deprioritisation of enforcement pending the change*

Proposed remedies concerning the RMR AEC

11.9 The remedies proposed to address the RMR AEC and/or associated detriment, as well as part of the Prepayment AEC and the Domestic Weak Customer Response AEC and/or associated detriment are as follows:

(a) A recommendation to Ofgem to:

(i) modify gas and electricity suppliers' standard licence conditions to:

- remove the following conditions (the 'Conditions'):

- the ban on complex tariffs (SLC 22A.3 (a) and (b));

- the four tariff rule (SLC 22B.2 (a) and (b));

- the ban on certain discounts (SLCs 22B.3-6 and 22B.24-28);

- the ban on certain bundled products (SLCs 22B.9-16 and 22B.24-28);

- the ban on certain reward points (SLCs 22B.17-23 and 22B.24-28);

- the prohibition against tariffs exclusive to new/existing customers (SLC 22B.30 and 22B.31); and

- make any necessary minor consequential amendments; and

[...]

(ii) deprioritise potential enforcement action pending the removal of the Conditions against any supplier that operates in breach of the Conditions;

[...]

- 7.1 EDF Energy fully supports the recommendation to remove the specified 'simpler choices' components of the Retail Market Review ("**RMR**") rules (PDR, paragraph 5.381), and welcomes the CMA's provisional finding that this liberalisation should include some aspects of the 'simpler choices' regime that are in addition to those initially envisaged in the Notice of Possible Remedies.
- 7.2 EDF Energy supports the simplification of choice and transparency for customers and initially supported introduction of the 'simpler choices' regime. In practice, however, the four tariff rule has prevented the development of innovative and consumer-friendly tariffs. We believe that there are alternative and less restrictive ways to achieve simplicity and clarity for customers, particularly with the introduction of smart tariffs.
- 7.3 We therefore support this remedy as it will allow greater commercial flexibility and promote competition between suppliers to develop more innovative tariffs that are better suited to customers' needs both now and in the future. However, we believe that due consideration will need to be given as to how the changes to the tariff rules will affect other licence condition requirements.
- 7.4 In particular, it is important to have clarity on the rules around the methodology and scope for what is presented to customers through the Cheapest Tariff Message ("**CTM**") on customer

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- communications. The lifting of the 'simpler choices' rules will allow exclusivity of prices not universally available to all customers and potentially for limited periods of time, as is already the case for collective switching. Clear rules will be required to prevent customers being misled as to the prices they can realistically achieve through switching. We believe that both market-wide and supplier cheaper tariff messaging will become impractical, and potentially misleading, after the removal of some of the 'simpler choices' licence conditions (PDR, paragraph 6.43) and in an era in which tariff-selection will be facilitated by greater availability of data online (in particular, consumption data, which is likely to influence optimal tariff choice).
- 7.5 EDF Energy would also propose, to support further innovation in tariffs, that a review is conducted by Ofgem of the current license conditions regarding tracker tariffs (SLC 22C.11). We believe that tracker tariffs can be attractive to customers but that the current restrictions unduly limit the ability of suppliers to offer these tariffs.
- 7.6 As with the recommendation to deprioritise potential enforcement action against suppliers in relation to changing SLC 22B.7(b) ('Prepayment AEC'), we would also welcome more information as to how the CMA envisages that Ofgem would "deprioritise" enforcement action against any supplier that operates in breach of the relevant RMR licence conditions pending their removal. We understand this to mean that Ofgem would recognise and communicate the fact that any conduct diverging from the SLC pending its reform is a technical breach only and would not result in enforcement action – thus creating a legitimate expectation that the supplier would not be penalised.
- 7.7 EDF Energy would encourage the CMA to require Ofgem to send a letter to suppliers as soon as possible confirming this understanding, if this is the CMA's intention, with clear timescales for when this deprioritisation would be effective from. In determining the timescale for initiating such deprioritisation, we would encourage Ofgem to consider the timescale for introducing the Standard of Conduct remedy regarding tariff design and the ease with which customers can compare value-for-money with other tariffs they offer, as described in paragraph 7.15. We do not believe that it is in the interests of customers or suppliers if tariffs are introduced in the short-term which would not comply with this new requirement.
- 7.8 EDF Energy agrees that the increased flexibility resulting from the withdrawal of the 'simpler choices' component of RMR will encourage competition between PCWs and also increase competition between PCWs and suppliers (PDR, paragraphs 5.408 et seq.), to the ultimate benefit of consumers.
- 7.9 EDF Energy notes that PCWs and other TPIs are playing an increasing role in the energy sector and believe that their behaviour must be scrutinised as part of the enduring arrangements put in place to support customers. It is essential that TPIs (including commercial PCWs) become subject to principles-based regulation through direct licensing, requiring them to treat customers fairly and transparently, so that they are held to a standard comparable with that for suppliers. The outcome should ensure a level playing field between suppliers and TPIs.
- 7.10 This regulation and licensing should be the responsibility of Ofgem and should apply to all TPIs that transact a sale with a supplier on behalf of a customer. We recognise that this will be a significant change and so support Ofgem's Code of Practice for TPIs, as well as strengthening the requirements for PCWs to be accredited under the existing Confidence Code, as an interim step while Ofgem's powers are established.
- 7.11 Lastly, we note that the PCW market is dominated by a small number of very large PCWs and we believe that it will be important for the CMA to monitor the market share (and profits) of these entities to ensure that no competition issues arise in this respect, and that the share of the value chain that they take (proportionate to the risks taken) is properly understood. We understand

that the CMA is likely to analyse such issues as part of its review of PCWs (as outlined in its 2016/2017 Annual Plan), and we look forward to the CMA's assessment of whether the sector is operating competitively and in the best interest of consumers.

***Suppliers to have regard in tariff design to the ease with which customers can compare value-for-money with other tariffs they offer***

Proposed remedies concerning the RMR AEC

11.9 The remedies proposed to address the RMR AEC and/or associated detriment, as well as part of the Prepayment AEC and the Domestic Weak Customer Response AEC and/or associated detriment are as follows:

(a) A recommendation to Ofgem to:

[...]

- introduce an additional standard of conduct into SLC 25C that would require suppliers to have regard in the design of tariffs to the ease with which customers can compare value-for-money with other tariffs they offer;

[...]

- 7.12 EDF Energy agrees that it is important to take steps to mitigate any unintended consequences associated with removing aspects of the 'simpler choices' component of the RMR rules (PDR, paragraph 6.82).
- 7.13 We agree with the CMA that improved access to Midata and Quick Response ("QR") codes will facilitate this process (PDR, paragraph 5.433), in that consumers will have better knowledge of their consumption and so will be better able to compare tariffs, particularly in conjunction with the CMA's proposals regarding empowerment of PCWs through data sharing (the CMA expresses confidence that PCWs will succeed in helping customers 'navigate' the increased number of tariffs at PDR, paragraph 5.433). We also agree with the CMA's assessment that suppliers have an incentive to ensure that the number and structure of tariffs are simple enough to be presented properly on PCWs, handled by their billing systems, and not such as to lead to reputational damage for the supplier (PDR, paragraphs 5.433-5.434).
- 7.14 We agree with the CMA's proposal that a principles-based rather than prescriptive rules-based approach is appropriate when seeking to promote comparability of tariffs (PDR, paragraphs 4.40 and 6.77 in particular). EDF Energy shares the CMA's concern that it will not be practicable to predict *ex ante* a set of rules governing tariff design in the event that the 'simpler choices' component of RMR is lifted. We also agree that "a more principles-based approach to regulation enables suppliers to innovate in the face of opportunities offered by new technologies and allows customers to benefit" (PDR, paragraph 6.101 (d)). An ongoing principle that suppliers must have regard, when designing tariffs, to the ease with which customers can compare the merits of each is more workable, less likely to stifle consumer-friendly innovation in tariff design, and less susceptible to gaming.
- 7.15 While we understand the sentiment behind the CMA's proposed "value-for-money" metric, we consider that this is a subjective judgement on the customer's part, dependent on how they value different factors such as inclusion of discounts and surcharges, fixed versus variable tariffs etc. We believe that it would instead be more appropriate for suppliers to show the 'all-in' cost of tariffs over a standardised period (e.g. first year) and that all offers should be presented on a consistent total cost basis so that customers can judge what the right choice is for themselves and for their circumstances.



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*Removal of the Whole of Market Requirement in the Confidence Code and the introduction of a requirement for accredited PCWs to be transparent over the market coverage they provide*

- 7.16 EDF Energy fully supports these proposals. Please see our more detailed comments in Section 8 (Prepayment and Domestic Weak Customer Response AEC), where we discuss the PCW-specific proposals more holistically.

## Prepayment and Domestic Weak Customer Response AEC

*Ofgem to establish an evidence-based programme focused on consumer-facing communications; supported by suppliers*

Proposed remedies concerning the Prepayment AEC and the Domestic Weak Customer Response AEC

11.10 The remedies proposed to address part of the Prepayment AEC and part of the Domestic Weak Customer Response AEC and/or the associated detriment are as follows:

(a) A recommendation to Ofgem to establish an ongoing programme (the 'Ofgem-led programme') to identify, test (through randomised controlled trials, where appropriate) and implement (for example, through appropriate changes to gas and electricity suppliers' standard licence conditions) measures to provide domestic customers with different or additional information with the aim of promoting engagement in the domestic retail energy markets, including a recommendation to conduct randomised controlled trials concerning the following shortlist of measures:

(i) changes to the information in domestic bills and how this is presented including a market-wide cheapest tariff message;

(ii) changes to the specific messaging that domestic customers receive in bills once they move, or are moved, on to an SVT and/or other default tariffs; and

(iii) changes to the name of the default tariffs.

(b) Either the acceptance of undertakings from gas and electricity suppliers to participate in the Ofgem-led programme, or, absent a satisfactory number of undertakings being agreed with suppliers, either:

(i) a recommendation to Ofgem to modify gas and electricity suppliers' standard licence conditions to introduce an obligation on suppliers to participate in the Ofgem-led programme or requiring the provision of prescribed information;

(ii) an order on gas and electricity suppliers to participate in the Ofgem-led programme or requiring the provision of prescribed information, (including associated amendments to suppliers' standard licence conditions); or

(iii) a recommendation to DECC to introduce legislation imposing a requirement on suppliers to participate in Ofgem-led research programmes.

[...]

- 8.1 EDF Energy agrees that the provision of high quality and relevant information must be a central part of the industry's commitment to ensuring that disengaged consumers are able to secure the full benefits of competition. We note the CMA's finding (described at PDR, paragraph 4.30) that "35% of [CMA] survey respondents said they had never considered switching supplier" and "56% of respondents said they had never switched supplier, did not know if it was possible or did not know if they had done so." These findings suggest that the main barrier to competition with respect to such consumers is access to information that empowers them to assess (with a minimum of effort) whether a switch would be in their interests.
- 8.2 While some suppliers "are likely to face a financial incentive to keep [consumers] as disengaged as possible" (PDR, paragraph 4.35), the CMA will be aware that EDF Energy has actively sought to encourage consumer engagement, in particular through roll-out of the innovative Blue+Price

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Promise tariff, where consumers are informed of the existence of more favourable tariffs across the market and given the opportunity to switch without exit fees. This tariff forms part of EDF Energy's wider Trust Agenda, as part of which EDF Energy has recognised the reputational and customer service value of being transparent with consumers and providing them with the reassurance that they are on a good deal.

- 8.3 Additionally, EDF Energy has taken a number of steps to help engage vulnerable customers, which have included emailing and sending direct mail to customers on the PSR and those who have claimed the Warm Home Discount ("**WHD**") requesting that they contact us to check if there was a better tariff for their needs.
- 8.4 EDF Energy does, however, agree that there is a role for the regulator in ensuring consistency of communications across different suppliers, and we fully agree with the CMA's proposal that this process must revolve around robust - and up to date - testing and the use of randomised controlled trials ("**RCTs**") (PDR, paragraphs 4.37 and 6.11, and paragraph 6.34 on the proposed RCT process).
- 8.5 EDF Energy also believes that an important element of a customer's decision to switch, the quality of service they might be expected to experience, is currently difficult to access. We would propose that Ofgem explores, and trials, methods of representing the levels of service offered by suppliers based on customer feedback and complaints, as is common in other industries.
- 8.6 Our experience of the existing regulations governing information displayed on bills and mandatory sales scripting has been that this has deterred some consumers from engaging with the switching process. Indeed, EDF Energy's concept testing of Blue+Price Promise confirmed that the more effort customers are required to put-in to explore the benefits and compare prices, the less appealing a tariff becomes. Consequently, EDF Energy welcomes the CMA's conclusion that future regulation must be thoroughly tested before implementation. More recently, we have engaged in some testing of simpler communications with some of our standard variable tariff ("**SVT**") customers - and found a response rate that is an order of magnitude greater than with the current format. We provide further details of this testing in Appendix 3. We look forward to engaging with Ofgem on the design of communications and providing relevant evidence in due course.
- 8.7 EDF Energy believes that Ofgem's role in the implementation of this proposal must also extend to reviewing the effectiveness of the measures devised under the programme on an ongoing basis - i.e. rather than Ofgem relying exclusively on its *ex ante* trialling, it must be obliged to review whether measures are effective when rolled out nationally, ideally in accordance with a metric set by the CMA. The metrics for success must therefore be incorporated either into the overall programme or alternatively alongside the roll-out of any new communications initiative, and the possibility provided for examining whether any particular customer groups prove to be less engaged than others, such as within a region, for example Scotland, or by customer type, such as those with single rather than dual fuel. Where a lack of engagement is identified Ofgem must work with suppliers to identify approaches that are more effective for those customer groups.
- 8.8 EDF Energy notes that the CMA's current proposal leaves open the possibility that Ofgem will be able to take a prescriptive approach both to determining the types of information that should be specified in communications and tested, and how this will be implemented (PDR, paragraph 6.37). The CMA recognises the merits of a principles-based rather than prescriptive rules-based approach (when seeking to promote comparability of tariffs at PDR, paragraph 4.40, and in the context of regulating "supplier behaviour" more generally, at PDR, paragraph 6.77).
- 8.9 Given the difficulty of predicting *ex ante* the types of issues that may arise, and the fact the suppliers' actively conduct their own research into this area (as recognised by the CMA at PDR,

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paragraph 6.72, before suggesting that such supplier-led tests could simply be superseded by a supplier's participation in the Ofgem-led programme), the Ofgem-led process must afford suppliers the opportunity to propose ideas, be consulted on research results, and contribute to the design of revised communications - rather than such measures being imposed centrally and unaccountably by Ofgem. This could potentially be achieved through adjusting the structure or processes of the "governance structure" envisaged by the CMA (PDR, paragraph 5.64). At the same time, some suppliers may well be disinclined to act in accordance with the spirit of the CMA's findings. Ofgem will therefore need to pay close attention to such behaviour and respond quickly.

- 8.10 With respect to the CMA's 'shortlist of measures' to be tested (summarised collectively at PDR, paragraph 6.43), as stated above in paragraph 7.4, EDF Energy would also observe that both market-wide and supplier CTM in their current form will become impractical and potentially misleading after the removal of some of the 'simpler choices' licence conditions (PDR, paragraph 6.43) and in an era in which tariff-selection will be facilitated by greater availability of data online. Additionally, we note that, assuming that the 'simpler choices' element of RMR is indeed abolished, the cheapest tariff for one particular consumer group will not necessarily be the cheapest for another (depending on discounts, rewards, bundling advantages or indeed other measures designed to attract particular groups). We would also expect the range of tariffs on offer to proliferate and evolve at a far faster pace than we see now. The inclusion of potentially ill-adapted or out-of-date information on an energy bill may lead to some consumers switching to tariffs that are not in fact best suited for their needs, while further harming trust in the industry.
- 8.11 EDF Energy does, however, support in principle the other 'shortlist' measures proposed by the CMA, namely that there be changes to the information received by domestic customers once they move onto an SVT or other default tariff (PDR, paragraph 6.23), and that the names of default tariffs be reconsidered (PDR, paragraph 6.24).

***Gemserv and Xoserve to provide PCWs with data; and DECC to make a number of changes to Midata programme to make participation compulsory, expand the scope of data fields, and enable PCWs to seek consumer consent to access data and send updated tariff comparison information based on any subsequent access granted to a customer's Midata***

- 8.12 EDF Energy supports the CMA's proposals to bolster the role and relevance of PCWs and agrees that TPIs, in particular PCWs "are an important means by which customer engagement can improve and effective competition can develop in the domestic retail markets" (PDR, paragraph 4.42). Additionally, we consider that PCWs must play a central role in improving price transparency and therefore engagement within the microbusiness segment. Our comments here are intended to apply to the role of PCWs (and other TPIs) in both the domestic and microbusiness arenas.
- 8.13 Accordingly, we address first some general points on optimising the role of PCWs, before commenting on the PCW-specific remedies proposed by the CMA in the domestic context, the PCW-specific remedies proposed in the microbusiness context, and finally some PCW-specific remedies that the CMA is currently not minded to take forward.

#### **Broader comments on optimising the role of PCWs**

- 8.14 As a preliminary point, EDF Energy agrees with the CMA's assessment that a differentiation needs to be made (and understood by consumers) between those PCWs acting as repositories for all available tariffs - such as the Citizens Advice non-transactional service for domestic customers now envisaged in lieu of an Ofgem hosted service - and PCWs that take on more the role of broker and may, subject to a liberalisation of 'simpler choices' component of the RMR, be in a

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position to contribute to the development of more innovative tariffs (PDR, paragraph 4.47). EDF Energy believes that both categories of PCW have an important role to play, but that it is vital that parties in the latter category are transparent with consumers about the limitations of their independence. As a minimum, this should include PCWs specifying the extent of their market coverage, and preferably any commercial agreements that may impact the offers presented to the customer. The latter should be presented in a consistent manner.

- 8.15 With respect to reliance on Citizens Advice, rather than Ofgem, to provide an independent comparison service for domestic customers, EDF Energy agrees in principle that Citizens Advice is a trusted third party and there is no reason to expect that it would be unable to provide a level of service at least equivalent to that Ofgem might have provided.
- 8.16 Given that, however, monitoring energy tariffs is not Citizens Advice's primary remit (and nor is it focussed on serving microbusiness customers), we strongly believe that a contingency should be in place in the event that Citizens Advice determines in future that it no longer has the resources or capacity to continue with the challenging task of keeping up to date with the expected proliferation of tariffs (including bespoke deals) and increased consumer traffic as result of the removal of the 'simpler choices' component of RMR. We consider it is also important that there is a similar body established for microbusinesses.
- 8.17 EDF Energy believes that Ofgem should be responsible for ensuring that a credible service is provided (including for microbusinesses) and assure the accuracy and integrity of the data, rather than have Citizens Advice rely on the Energylinx data<sup>6</sup>. In particular, we are concerned that Energylinx may not have access to some of the supplier-specific deals on rival PCWs, and therefore there will be no one site available to customers where they are able to access a whole of the market view.

***PCW-specific remedies proposed by the CMA in the domestic context (including in the context of RMR reform)***

Proposed remedies concerning the Prepayment AEC and the Domestic Weak Customer Response AEC

11.10 The remedies proposed to address part of the Prepayment AEC and part of the Domestic Weak Customer Response AEC and/or the associated detriment are as follows:

[...]

(c) An order on Gemserv to give PCWs access upon request to the ECOES database on reasonable terms and subject to satisfaction of reasonable access conditions.

(d) An order on Xoserve to give PCWs access upon request to the SCOGES database on reasonable terms and subject to satisfaction of reasonable access conditions.

(e) A recommendation to DECC to make the following changes to the current specifications of Midata phase two:

(i) Participation in Midata is mandatory for all gas and electricity suppliers.

(ii) The scope of Midata is expanded to include the following data fields: meter type, Warm Home Discount indicator, consumption data and time-of-use for those customers on Economy 7 meters or other time of use tariffs.

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<sup>6</sup> [redacted]

(iii) PCWs are given the ability to seek customer consent on the frequency with which they can access the customer's data through Midata; are required to present at least two options to a customer when seeking consent to access Midata (including one option concerning access on an annual or ongoing basis); and are given the ability to send updated tariff comparison information based on any subsequent access granted to a customer's Midata.

[...]

### **Gemserv and Xoserve to provide PCWs with data**

- 8.18 EDF Energy supports the CMA's proposal that PCWs be given access to the Electricity Central Online Enquiry Service ("**ECOES**") and Single Centralised On-Line Gas Enquiry Service ("**SCOGES**") databases to allow them to facilitate the switching process (PDR, paragraph 6.174). We support measures such as this, which allow any issues to be identified at an early point in the switching process and which will therefore help to reduce the rate of cancellations once the switching process is initiated (albeit, as noted by the CMA at PDR, paragraph 6.159, the erroneous transfer rate is actually quite low).
- 8.19 Restrictions on the use of the data would, however, have to be enforced so as to limit use to checking information on customer-initiated switches. We therefore support the CMA's restrictions on use of this data, specifically that use of the data would be upon request and upon satisfaction of reasonable access conditions and would be strictly limited to allow PCWs to check or obtain Meter Point Administration Number ("**MPAN**") and Meter Point Reference Number ("**MPRN**") numbers for customers seeking to switch supplier and to check other information provided by these customers against that held on the databases (PDR, paragraph 6.169). We note that the CMA realises the potential for usage by non-domestic TPIs (PDR, paragraph 6.183) and the potential benefit for microbusiness customers. However, we believe that equal consideration should be given to the potential risk of misuse by TPIs (with different operating models to PCWs) for marketing or targeting purposes. In our view, this provides a further rationale for the introduction of consistent TPI regulation across both domestic and non-domestic segments.

### **Making mandatory and broadening of scope and access to Midata**

- 8.20 EDF Energy fully supports the broadening of scope and access to Midata and believes this will facilitate better consumption based quotes (thus overcoming one of the current deterrents to switching).
- 8.21 We are therefore broadly in favour of the proposed changes to the Midata programme (PDR, paragraphs 6.105(c) and 6.210 et seq.) that will make participation in Midata mandatory for all gas and electricity suppliers, expand the scope of data fields used, and give PCWs increased access to more customer data, enabling PCWs to monitor the market on behalf of customers and advise them of potential savings.
- 8.22 EDF Energy does, however, have concerns over the management of third party access to data handled by the DCC from smart meters. This is especially the case with consumption data as there are potentially serious privacy implications. Consumption data could indicate whether a customer is at home or allow the inference of other household behaviour. Consequently, the availability of consumption data needs careful control, potentially through additional regulation.
- 8.23 In particular, EDF Energy believes that third parties should only obtain permission to look at previous consumption data when instigated by the consumer and permission should not be granted for further ongoing access to data by the third party without each time being prompted

by the customer. We note that the ICO Guidance on Direct marketing<sup>7</sup> (paragraph 86) states that "there is no fixed time limit after which consent automatically expires. However, consent will not remain valid forever. How long consent remains valid will depend on the context - the question is whether it is still reasonable to treat it as an ongoing indication of the person's current wishes". However, we believe that due to heightened privacy concerns around smart meter consumption data as stated above, this issue needs to be explicitly considered further. To control ownership of the DCC data, we believe that the data should not be sold on or transferred by one third party entity to another without direct permission from the customer. Again, further consideration will be required as to how this will be policed.

### **Responsibility for compliance of PCWs**

- 8.24 EDF Energy supports the CMA's determination that compliance by PCWs should be the responsibility of Ofgem, and not suppliers, and that Ofgem will have responsibility for the implementation, monitoring and compliance of the remedies recommended (PDR, paragraphs paras. 5.416, 5.418 and 6.39). We believe that it would be appropriate for PCWs to pay reasonable charges for access to the data so that the costs of managing compliance is not borne by suppliers, and also that fair contributions are made towards the costs of maintaining the data that they will be accessing.

### ***Removal of the Whole of Market Requirement in the Confidence Code and the introduction of a requirement for PCWs to be transparent over the market coverage they provide***

Proposed remedies concerning the RMR AEC

11.9 The remedies proposed to address the RMR AEC and/or associated detriment, as well as part of the Prepayment AEC and the Domestic Weak Customer Response AEC and/or associated detriment are as follows:

(a) A recommendation to Ofgem to:

[...]

(iii) remove the Whole of the Market Requirement in the Confidence Code and introduce a requirement for PCWs accredited under the 6 Confidence Code to be transparent over the market coverage they provide to energy customers

- 8.25 EDF Energy supports the removal of the Whole of the Market Requirement in the Confidence Code and the introduction instead of a requirement for PCWs to be transparent over the market coverage they provide (PDR, paragraph 6.105(a)). EDF Energy believes that the requirement to make the extent of market coverage clear must also apply to TPIs more generally (i.e. not exclusively to PCWs as suggested by the CMA) and should cover both domestic and non-domestic markets. We discuss this in more detail directly below.
- 8.26 However, consideration needs to be given to the impact that this will have on the effectiveness of the microbusiness price transparency remedy as customers may not be able to get a full market view in any single place if PCWs are not required to show all prices.

<sup>7</sup> Information Commissioner's Office, Direct marketing, October 2013.

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## **Accreditation and disclosure of commission - and EDF Energy proposal that remedy should extend to other aspects of TPI conduct and incentives (and not be limited to PCWs)**

- 8.27 EDF Energy believes that it is of fundamental importance that the CMA's eventual remedies improve trust in the role of TPIs generally, which will require greater transparency around their operations and incentives.
- 8.28 EDF Energy therefore continues to consider that, alongside the Standards of Conduct, all commercial TPIs (including not but limited to PCWs) should be accredited. The CMA's proposed remedy appears to apply only to PCWs that are accredited. All TPIs should clearly state if they are not providing whole of market view and show which suppliers are paying them a commission (or disclose how else their services are paid for). The disclosure obligations should not stop at commission alone. In EDF Energy's view, a simple way to convey this information would be through a 'Key Facts' document such as those used in financial services, setting out information including:
- Revenue received by the TPI for the deal from either the supplier or the customer.
  - Product specifics such as terms and conditions ("**T&Cs**") and pass-through costs.
  - Whether the price is fully fixed.
  - What relevant or suitable products were available to the TPI but were not shown to the customer.
  - Supplier specific customer service metrics.
  - TPI T&Cs such as cancellation fees, and whether exclusivity clauses exist preventing customers speaking directly to suppliers.
- 8.29 TPIs should also have to display their accreditation to the Ofgem Code of Practice and state that they are compliant with this remedy if implemented.
- 8.30 Fundamentally, we believe that it is essential that TPIs become subject to principles-based regulation through direct licensing, requiring them to treat customers fairly and transparently. This regulation and licensing should be the responsibility of Ofgem, as recognised by the CMA (see above), and should apply to all TPIs that transact a sale with a supplier on behalf of a customer.

### ***PCW-specific remedies/proposals that the CMA does not propose to take forward***

#### **Ofgem independent, information-only PCW**

- 8.31 EDF Energy supported the CMA's possible remedy for Ofgem to provide an independent PCW for domestic customers as one means of tackling the Domestic Weak Customer Response AEC.
- 8.32 We understand that the CMA has decided not to recommend such a PCW be created, largely because Citizens Advice has launched a credible alternative, namely a new domestic price comparison service operated as a white label solution with source data provided by Energylinx, and which is Confidence Code accredited (PDR, paragraphs 6.137 – 6.144).
- 8.33 EDF Energy supports this decision. There is no reason to believe that a service by Ofgem would improve on that provided by Citizens Advice and would be an unnecessary burden on the regulator. However, as stated above, we believe that a contingency should be in place in the event that Citizens Advice determines in future that it no longer has the resources or capacity to continue with the challenging task of keeping up to date with the expected proliferation of tariffs (including bespoke deals) and increased consumer traffic as result of the removal of the



'simpler choices' component of RMR. It is also essential that a solution is found that also works for microbusinesses.

**Link / direction to independent, information-only PCW**

- 8.34 In response to the CMA's possible remedy that Ofgem provide an independent price comparison service, EDF Energy submitted that commercial PCWs should be obliged to provide a link or direction to this independent service. Given that Citizens Advice is now intended to assume responsibility for providing an independent service, EDF Energy believes that it would be appropriate for commercial PCWs to provide a link (and possibly other information, such as targeted messaging in bills), as well as direct customers, to the Citizens Advice PCW or any future microbusiness equivalent.

***Suppliers to disclose to Ofgem specified information relating to 'Disengaged Domestic Customers' for purpose of this information being made available to rival suppliers for postal marketing; Ofgem to operate a cloud database to store the data and enter logistical agreements with suppliers***

11.10 The remedies proposed to address part of the Prepayment AEC and part of the Domestic Weak Customer Response AEC and/or the associated detriment are as follows:

[...]

(f) An order on gas and electricity suppliers requiring the disclosure to Ofgem, subject to certain use restrictions, of

(i) certain details (the Domestic Customer Data) of their domestic customers who have been on one of their standard variable tariffs (or any other default tariff) for three or more years (the Disengaged Domestic Customers), and

(ii) updated Domestic Customer Data every six months, for the purposes of a creating, operating and maintaining a secure cloud database containing the Domestic Customer Data and allowing rival suppliers to access and use the data for the purpose of postal marketing. The order would also require suppliers, prior to disclosing the Domestic Customer Data to Ofgem, to send a prescribed letter to each Disengaged Domestic Customer, explaining the proposed use of the customer's details, and including an opt-out mechanism for the domestic customer, at any time, to object to and prevent the proposed disclosure and use of their details.

(g) A recommendation to Ofgem to

(i) create, operate and maintain a secure cloud database for the purposes of holding the Domestic Customer Data;

(ii) hold the Domestic Customer Data;

(iii) enter into agreements with suppliers including, access to, and use restrictions concerning the Domestic Customer Data; and

(iv) provide access to the Domestic Customer Data by any rival supplier that has entered into such an agreement. [...]

- 8.35 EDF Energy is fully committed to promoting consumer engagement in this market, and we have a considerably lower proportion of domestic customers on SVTs than the c.70% of customers of the Six Large Energy Firms quoted by the CMA (PDR, paragraph 6.247). We see efforts to reduce the level of disengagement as beneficial for customers as well as an opportunity for EDF Energy to compete more effectively for the disengaged customers of our rivals.

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- 8.36 We agree with the CMA that a period of three years is an appropriate time at which to prompt customers on default tariffs, as it is unlikely that customers will be in a transition between tariffs at that point and will have become disengaged from the market.
- 8.37 We are concerned, however, that the CMA's proposed database programme could lead to poorly targeted mass 'spam', which further exacerbates the perceived effort to switch and confusion that is currently deterring some consumers from engaging, and furthermore risks undermining the significant efforts we have made to increase trust in our industry. In this way the database could increase rather than decrease engagement.
- 8.38 We are also concerned by the potential for the misuse of the customer information, which could have a dramatic impact on trust for the whole industry, extending beyond the targeted customer group and affecting wider engagement. It is possible that unscrupulous rival suppliers could send misleading communications to customers implying, for example, that the Government "requires them to switch". Customers have very real concerns over the privacy of their data, which should not be underestimated.
- 8.39 We note that, in addition to the majority of suppliers expressing reservations, the CMA records that Citizens Advice also expressed concerns about such a scheme, submitting that "the proposed remedy could facilitate unsolicited marketing" (as paraphrased by the CMA at PDR, paragraph 6.238).
- 8.40 In EDF Energy's view, a more effective and efficient alternative would be to use the initial letter (described as the "Opt-out Letter" in the PDR, paragraph 6.252) as a prompt to engage itself, by requiring existing suppliers to deliver specific prescribed messaging to the eligible customers co-branded with Ofgem, in a format properly trialled by Ofgem, which explains the benefits of switching, and the potential savings to be obtained, as calculated by Ofgem, as well as where to access information on service levels (see paragraph 8.5). This format for the 'opt-out' letter would be appropriate whether an opt-in or opt-out approach was adopted.
- 8.41 We have conducted a trial (see Appendix 3) which demonstrates that clear messages from a customer's own supplier can be highly effective; resulting in a level of response that considerably exceeds what would be expected from unsolicited letters by alternative suppliers.
- 8.42 We believe that customers should be given the option to opt-in to receiving information from other suppliers if they feel this would help their decision process, rather than given the option to opt-out. This process would also allow customers to be asked their communication preferences so that suppliers were able to contact them in a way that suits them, such as through e-mails or by phone as appropriate.
- 8.43 We strongly agree that Ofgem should enter into agreements with suppliers regarding access and use of the data on the database. Ofgem should consider restrictions that limit opportunities for the data to be misused, with access withdrawn where any supplier is judged to have not abided by the agreement.
- 8.44 Ofgem should also have regard for the customer experience when considering the arrangements for access and frequency. For example, we would expect that suppliers who are under restrictions on sales activity due to customer service issues would be limited in their access. We also believe there should be limits in the frequency by which suppliers may contact customers, as even those who have agreed to be on the database will not wish to be repeatedly contacted by the same supplier.
- 8.45 Ofgem should also have consideration for data security and how to limit the potential for the database to be shared or used inappropriately. We propose that rival suppliers who are given access to the database should not be permitted to retain the customer contact and consumption

information on a permanent basis, rather they should be required to delete it after using it for its intended purpose, or at the point the database is next updated and republished by Ofgem. This further protection would limit the opportunities for the information to be misused.

- 8.46 A combination of an effective prompt letter and contacts from alternative suppliers where requested will be an effective remedy for engaging some of the customers that are currently disengaged. Further action may be required, as we have proposed in paragraph 8.7, if Ofgem identifies that any particular customer group or groups to be failing to engage at the same level as the customer base generally. Where that is the case, Ofgem should work with relevant suppliers to explore further actions or approaches that may be more effective. For example, if there are certain regions, such as Scotland, where switching is less common, or if customers on a single fuel prove more difficult to engage, then new approaches to engaging those customers should be trialled and implemented.
- 8.47 As a final point, we note that the CMA has considered the French competition authority's successful application to require Engie to disclose details of its customers to other suppliers in France in the design of this potential remedy. It is our understanding that the requirement for Engie to make details of its customer base available to rival suppliers, and specifically on an opt-out basis (where customers that did not respond to Engie's letter informing them of the intention to share their data were assumed to consent to their data being shared), was imposed as an interim measure, only justified by the French competition authority due to the risk of serious and irreparable harm to competition. Indeed, Engie was suspected of using a resource inherited from its former national gas monopoly status to offer its customers on regulated tariffs deals on gas and electricity. Under the circumstances, we do not consider it to be a reasonable case study for the CMA to rely on in its design of appropriate measures for the UK market.

***Suppliers with over 50,000 domestic customers to make available their single-rate electricity tariffs to all domestic electricity customers on restricted meters, without this being conditional on meter replacement; and to remind these customers of their right to switch supplier or to a single-rate tariff, providing them with Citizens Advice contact details and providing Citizens Advice with information about such customers; supported by a recommendation that Citizens Advice become a recognised information provider to such customers***

11.10 The remedies proposed to address part of the Prepayment AEC and part of the Domestic Weak Customer Response AEC and/or the associated detriment are as follows:

[...]

(h) An order on gas and electricity suppliers with more than 50,000 domestic customers (and amendments to suppliers' standard licence conditions)

(i) requiring such suppliers to make all their single-rate electricity tariffs available to all (existing and new) domestic electricity customers on restricted meters, and

(ii) prohibiting such suppliers from making their single-rate electricity tariffs available to domestic electricity customers on restricted meters conditional upon the replacement of their existing meter.

(i) An order on gas and electricity suppliers (and amendments to suppliers' standard licence conditions) requiring suppliers to

(i) remind their domestic electricity customers on restricted meters, in their regular communications with them, that they have the option to switch supplier or to switch to a single-rate tariff without having to change their meter or incur replacement costs,

(ii) provide their domestic electricity customers on restricted meters contact details for Citizens Advice, and

(iii) provide, on a timely basis, Citizens Advice with the information it may reasonably require concerning customers on restricted meters in the format specified by Citizens Advice.

(j) A recommendation to Citizens Advice to become a recognised provider of information and support to domestic electricity customers on restricted meters.

[...]

- 8.48 EDF Energy agrees with the CMA's provisional conclusion that customers on restricted meters are likely to exhibit similarly weak engagement to domestic customers more broadly (PDR, paragraphs 3.143 and 6.317) and that this disengagement may be exacerbated by the additional barriers to accessing tariffs faced by certain of these customers (PDR, paragraph 3.146).
- 8.49 EDF Energy therefore supports the CMA's provisional finding that, in the case of customers on non-Economy 7 restricted meters, it is appropriate to supplement the CMA's general remedies designed to improve customer engagement with targeted remedies designed to remove any artificial restrictions on these customers accessing the full range of tariffs available to single rate customers.
- 8.50 EDF Energy notes that a significant proportion of its customers on non-Economy 7 restricted meters are already able to opt for a single-rate<sup>8</sup>. Of those customers that have meters where no single rate is currently available, [redacted] have a separate meter<sup>9</sup> on which they are able to access standard meter tariffs, while also benefiting from rates (for consumption through the restricted meter) that are lower than our cheapest fixed single-rate tariffs.
- 8.51 EDF Energy does not have any specific concerns about sharing the contact information of restricted meter customers with Citizens Advice other than general data protection issues. However, given the complexity of some of these meters and tariffs, and how they are often integral to hot water and heating functionality, it is important that customers receive the correct advice so that it does not negatively impact the functionality of the customer's system (and experience).

***Suppliers to ensure that the annual bills paid by prepayment customers (assuming a pre-determined consumption level) do not exceed a specified benchmark reference level, for a period until the end of 2020***

Proposed remedies concerning the Prepayment AEC and the Domestic Weak Customer Response AEC

11.10 The remedies proposed to address part of the Prepayment AEC and part of the Domestic Weak Customer Response AEC and/or the associated detriment are as follows:

[...]

(k) An order on gas and electricity suppliers (and amendments to suppliers' standard licence conditions) requiring suppliers to ensure that the annual bills paid by prepayment customers (assuming a pre-determined consumption level) do not exceed a specified benchmark reference level, for a period until the end of 2020.

<sup>8</sup> [redacted]  
<sup>9</sup> [redacted]

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- 8.52 EDF Energy previously expressed a number of concerns with respect to a wide price cap, and we note that many of our concerns have been taken into account by the CMA. In particular, we welcome the CMA's recognition that the imposition of a price cap presents "the potential for adverse consequences, particularly risks for the emergence of a long-term competitive outcome" (PDR, paragraph 4.116), and the CMA's view that, in the event a price cap is imposed, this should be for a transitional period only. (PDR, paragraphs 7.9, 7.20 and 7.172-7.173, with provision for a mid-term review discussed at 7.180.)
- 8.53 We also welcome the CMA's provisional finding that extending a price cap tariff across all SVT customers would be disproportionate and would, even during a transitional period, run excessive risks of undermining the competitive process, potentially resulting in worse outcomes for customers in the long run (PDR, paragraphs 4.125, 4.133 and 7.17).
- 8.54 While EDF Energy continues to have serious reservations in principle about the imposition of a price cap-type remedy, we recognise that there continue to be technical constraints in the PPM market limiting tariff availability (pending SMETS2 smart meter rollout) and that certain PPM customers face particular difficulties moving onto a credit meter.
- 8.55 EDF Energy agrees on balance that the introduction of a temporary regulated price cap for PPM meter customers may offer some short-term protection to customers who cannot switch pending the resolution of current technical constraints through SMETS2 smart meter roll-out. EDF Energy considers that the removal of the price cap should be linked to smart meter installation at an individual customer level rather industry level, so that customers who have a smart meter installed are able to benefit from the opportunities of the new infrastructure straightaway, rather than wait up to three years before they are able to do so.
- 8.56 EDF Energy agrees that the proposed hybrid approach of combining a benchmark with a cost matrix to set the PPM price cap is a viable approach. We do, however, have significant concerns about the methodology that the CMA has outlined both to set and then review the level of the cap on an ongoing basis. The approach needs to be suitable over the period to 2020 and to changes that might occur in that time e.g. a rise in wholesale energy costs.

### **Benchmark**

- 8.57 EDF Energy notes that price controls are normally based on costs of the regulated company that are determined by the regulator such that there is a common understanding of them. This allows the regulated company to create strategies to reduce costs. By using a third party's cost structure, as the CMA proposes to do in this case, the regulated firm will not derive the full benefit of "yardstick competition"<sup>10</sup>, especially in markets such as energy where there are a number of possible divergent competitive strategies that may not always lend themselves to equitable comparison.
- 8.58 The average of two mid-tier suppliers' DD tariffs as of 30 June 2015 is not a suitable benchmark for establishing a competitive price level. The cost base of these two rapidly expanding suppliers is not representative of a sustainable and achievable level for the industry as a whole over the medium term. The claimed PPM customer detriment, of about £300m, was calculated at a time when the difference in the length of energy hedges between OVO Energy and First Utility and other suppliers, resulted in lower costs. Had wholesale costs been rising rather than falling, the result would have been very different. Indeed, OVO Energy makes this explicit in its press release of 27 September 2015 regarding its financial results (significant losses) where it states "... OVO saw its customer numbers triple from 137,000 at the start of 2014 to 408,000 by year end, fuelled by a major brand campaign and *a responsive hedging strategy that enabled it to offer*

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<sup>10</sup> See Andrei Shleifer, "A theory of yardstick competition", Rand Journal of Economics, Vol. 16, No.3 Autumn 1985

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*highly competitive tariffs on the back of flat or falling wholesale gas and power prices.*" (emphasis added)<sup>11</sup>. See Appendix 1 for further comments on the "competitive benchmark" methodology.

- 8.59 The CMA dismisses the advantages of the shorter-term hedging costs of the suppliers on the assumption that if wholesale costs were rising then larger suppliers would raise prices despite their relatively lower energy costs. A review of the market when wholesale prices were last in a sustained period of increase would demonstrate that this assumption is false. In a rising wholesale market the larger suppliers would continue to compete with each other, and the CMA is incorrect to assume that the prices of the smaller and mid-tier suppliers are the only competitive constraint in the market. In previous periods of rising prices, smaller suppliers were not able to sustain large price differences, were not able to grow to the extent seen recently and indeed some failed as businesses as a result.
- 8.60 It is also important to consider the differences in customer types served by the benchmark suppliers and other suppliers. The cost to serve of customers who are engaged and predominantly on DD, as is the case in OVO Energy and First Utility, are very different from customers who require cash and cheque payment terms and who deal predominantly with their supplier over the phone rather than online. Also, although the two suppliers were fully obligated for the Energy Company Obligation ("**ECO**") at the time of the benchmark we believe it unlikely that they would have fully reflected these costs in their pricing, as they had only very recently achieved that status. As a general observation, faster growing suppliers benefit from the lag effect of the obligation being calculated on an annual basis, which results in the costs being spread over a larger number of customers that the obligation was originally based on.
- 8.61 EDF Energy would also highlight that differences in customer service could also be reflected in cost structures. For example, small and mid-tier suppliers have had notably low rankings in the Q4 2015 Citizens Advice Complaint League Table, which ranks energy suppliers in terms of externally escalated complaints. We note that four of the bottom six suppliers with a score of over 300 on the index used (with the bottom two scoring over 1,100) are small or mid-tier suppliers. In contrast, four of the Six Large Energy Firms make up the top five, with EDF Energy in first place with a score of 34.5. This reflects the success of our strategy set out at the beginning of 2015 to become industry leading and the introduction of our Complaints Improvement Programme. We are therefore disappointed that when stating that the sector is characterised by poor service, that the CMA has not yet recognised the considerable progress to improve service that has been made recently amongst the large majority of firms operating in the sector, nor provided a substantiated evidential basis for this viewpoint.
- 8.62 A broader benchmark is required to properly reflect a sustainable level of prices for the industry as a whole. We believe that the CMA has identified a suitable benchmark approach within the alternative price cap design. We propose the CMA retain the hybrid benchmark and cost matrix update approach, but use the alternative benchmark design to set the initial benchmark level. This alternative benchmark is more robust as it has the benefit of including all suppliers with more than 500,000 customers, which are subject to similar levy costs, and avoids the potential for bias that results from selecting only two suppliers as a benchmark. The risks identified by the CMA with the alternative benchmark design due to the time lag, perverse incentives and practicality are all overcome by retaining the cost matrix approach to updating the benchmark for future periods.

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<sup>11</sup> See "OVO Energy 2014 Financial Results & Trading Update" Press Release, September 2015. <http://tinyurl.com/zeld97>. Last accessed 6 April 2016.

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- 8.63 We believe that the CMA's assessment of the cost differentials in serving PPM customers requires further analysis. As the CMA acknowledge, the information provided by suppliers to date results in a broad range of calculated costs, reflecting the difficulty suppliers had in providing information in the format requested by the CMA. In particular, we would like to draw the CMA's attention to the potential for bias within the allocation of call centre costs for EDF Energy based on call volumes and call propensity. This is due to only capturing account data for c60% of our incoming calls which means that the allocation based on this data implicitly assumes the payment type split of all calls is the same as that of those captured automatically through our call handling system. Given the size of the cost, any bias in the volume of calls automatically identified will have a material impact on payment type differentials and further analysis is required. Additionally, while we accept that there is a lack of recent data relating to prepayment meter key fraud costs, we believe this requires further examination by the CMA rather than an assumption they are not material.
- 8.64 The CMA should also recognise that the current level of cost differential between payment types cannot be assumed to be constant in future. For example, we have previously raised with the CMA the need to ensure a fair allocation of the costs of the existing PPM infrastructure as the numbers of customers that are reliant on it decreases. If the price cap methodology does not allow for any increases in cost differentials between payment types above inflation, suppliers would be exposed to the risk of being unable to recover the relevant infrastructure costs. While not necessarily a differential impact between PPM and other payment types, the CMA does not appear to have considered these legitimate future costs in the setting of the cap.
- 8.65 We are not clear as to the basis for the £25 per customer per account that the CMA has calculated for headroom. The level appears to have been set on the basis of bringing the benchmark level up to the price charged to some PPM customers in some areas, rather than on an assessment of what level of headroom would allow competition between suppliers to continue, and incentives for customers to engage to be maintained in future. In order to ensure that the cap does not stifle competition, and that headroom is sufficient to address the risks of outturn costs differing from forecasts, more rigorous analysis is necessary. Importantly, we believe that the absolute level of headroom will need to vary for different consumption levels.

### **Cost Matrix**

- 8.66 The proposed approach to the updating of the price cap through a cost matrix has merit, although the current proposal would lead to some substantial and material costs being excluded and also inaccurate costs in a number of areas. In particular, there are substantial accuracy issues with using allowed revenues as the basis for cost updates.
- 8.67 We agree with the general principle for the calculation of the wholesale cost element, namely that the change in wholesale costs should be based on the change in costs reported for standard products via the ICIS index. To ensure that the approach adopted by the CMA is sustainable, it is essential that the process begins with an accurate view of the proportion of the June 2015 benchmark price that represents wholesale costs. Furthermore, we would strongly advise against these costs being taken as a single day's 'snapshot' of wholesale prices as it would also introduce a strong incentive on suppliers to hedge on that day, potentially pushing that day's prices up, as well as introducing exposure to the risk of market manipulation as has been experienced in other markets (e.g. LIBOR).
- 8.68 A method for calculating wholesale costs has already been established within the industry to calculate the reference price for baseload CfDs, using the average price for a season over a six month period. We believe that a mechanism that uses a similar principle to this should be used for the cost matrix.

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- 8.69 EDF Energy would strongly advise that customers are notified of price changes ahead of them coming into effect. In practice, this would mean the price cap being calculated in advance of the 1 April deadline with, we would suggest, sufficient time to give suppliers the opportunity to give customers 30 days' notice of the price change
- 8.70 The proposed approach of using allowed revenues for calculating transmission and distribution costs can be very inaccurate for individual customer types. Setting costs on this basis would lead to material inaccuracies (up to £35 per customer based on our analysis), as the allocation between customer groups can change substantially from year to year. Prices are published over a year in advance by DNOs, and a change in market rules has been proposed for transmission companies to increase how far in advance they publish prices (currently two months). These published charges would provide accurate costs for both electricity and gas and should be the basis for the cost matrix.
- 8.71 BSUoS costs are separate from the allowed revenues of the transmission companies, and have been rising in recent years. This substantial cost also needs to be included in the cost matrix, which could be based on National Grid's published forecast. This could be further improved if a proposed change to market rules is approved which would also mean that these prices are published in advance in future, and which could then be used in the cost matrix.
- 8.72 Independent cost forecasts by the Office of Budget Responsibility ("**OBR**") of the Renewables Obligation ("**RO**"), Feed-in Tariffs and CfDs would seem a sound basis for adjusting for changes in policy costs. The OBR forecast of the Capacity Market Supplier Charge must also be included because although this was zero at the time of setting the benchmark price, this will become a significant cost in future. There are uncertainties, however, over the outturn level of these costs, especially if changes in policy are made during the period of the price control. We would recommend that either headroom that properly reflects these risks is included or the ability to adjust the level of the price cap more frequently if there is a change in law. There is also a need to reflect changes in demand in the calculation of costs at the customer level. These changes can happen due to year on year variations and trends as well as due to policy decisions, such as to exclude certain industries from these costs for international competitiveness reasons.
- 8.73 It does not appear that the CMA has made an allowance for the costs of smart metering and other industry-wide infrastructure projects such as faster switching and half hourly settlement. These costs are expected to increase considerably over the period of the price cap, and would not be fully reflected in the initial benchmark set at June 2015. These must also be calculated and included.
- 8.74 The assumption that the level of electricity consumption is the same for both Economy 7 and standard meter customers is incorrect. Economy 7 customers have almost twice the consumption of standard meter customers, as confirmed by a recent publication by Ofgem<sup>12</sup> which shows clearly the differences in energy consumption between Economy 7 and standard customers. The CMA must take account of differences in consumption in the setting of the price cap.

### **Applicability and timeline**

- 8.75 The CMA has indicated through its reasoning that the technical constraints that limit tariff availability in the PPM market, as well as broader concerns relating to softened incentives for suppliers to compete for PPM customers, must affect the customer base of rival smaller suppliers as well as those of the Six Large Energy Firms. Given the underlying concern, the design of the

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<sup>12</sup> Ofgem, Typical Domestic Consumption Values – 2015 Decision letter, 28 May 2015.



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remedy and its relatively short-term nature, EDF Energy considers that the remedy should apply across all suppliers.

- 8.76 We note that the CMA have rejected the concept of derogations from the price cap on the basis that suppliers are able to challenge the final report if they feel the cap is not appropriate.
- 8.77 We consider this to be a disproportionate approach, which unnecessarily restricts innovation and tariff availability for customers and does not take into account how costs may evolve in the industry over the next few years. Longer-term fixed-rate tariffs may prove attractive to customers, particularly if wholesale costs become more volatile, but would not be permissible if the appropriate level exceeds the price cap.
- 8.78 We believe that where a customer wishes to actively choose a tariff that is above the cap (e.g. a long-term fixed-rate tariff), in a transparent and informed way, then suppliers should not be prevented from making that tariff available. A derogation process, monitored by Ofgem under Standards of Conduct, could ensure that any such offers genuinely differ from the tariffs available under a price cap.
- 8.79 We note that the CMA recommends that the timing of the removal of the price cap is kept under review in light of progress to roll-out smart meters to PPM customers at an industry level.
- 8.80 The price cap will make it difficult to introduce time-of-use tariffs and other tariffs perhaps not yet created which are made possible by the introduction of smart meter infrastructure for PPM, effectively putting on hold innovation in the PPM market until the price cap is removed. Suppliers will be wary, for example, of time-of-use tariffs which could lead to customers breaching the price cap if they use a greater number of higher priced units than anticipated. We also believe that it would not be possible for suppliers to justify to customers why they were on a restricted price cap when there were no technical constraints preventing them moving to an alternative smart PPM tariff.
- 8.81 Furthermore, we believe that the level of the price cap will not be appropriate for smart PPM customers including, as it will, an element of the costs for the legacy 'dumb' PPM infrastructure they no longer need or benefit from.
- 8.82 EDF Energy considers that the removal of the price cap should be linked to smart meter installation at an individual customer level rather industry level, so that customers who have a smart meter installed are able to benefit from the opportunities of the new infrastructure straightaway, rather than wait up to three years before they are able to do so.
- 8.83 The installation of a smart meter is a powerful prompt and incentive for customers to engage in the market and seek out a tariff that is suited to their circumstances. Retaining a price cap for these customers will severely weaken the prompt and may mean that the opportunity to engage them will be lost. The absence of a regulated price cap enforces the incentive to switch, and helps to overcome concerns expressed by the CMA that customers will lose the habit of switching if they do not do so in the period to 2020 under a price cap.
- 8.84 Tying removal of the cap explicitly to individual smart meter installations also provides a powerful incentive for suppliers to roll-out smart PPMs to customers as quickly as possible for those customers who would benefit from them the most.
- 8.85 EDF Energy does have some concerns that for customers who value the protection of a regulated tariff, the removal of that tariff may prove to be a disincentive for agreeing to a smart meter installation. However, we believe that suppliers will be offering customers who have smart meters installed attractive tariffs and that the removal of a regulated tariff will be another incentive for customers to engage in the market.

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8.86 In our view, the overall end date for the PPM price cap should remain as 2020, by which time most PPM customers will have had their smart meters installed and the price cap lifted. This date will then provide a further prompt for any customers remaining on legacy PPM meters and the price cap to engage in the market as well as an incentive to have a smart meter installed if they have not already done so. A review in 2020, as proposed by the CMA, would be appropriate to assess whether the installation of smart meters has fallen behind schedule and whether the deadline needs to be reviewed. We consider that this review should be undertaken by Ofgem, who are already monitoring the roll-out programme.

## Microbusiness Weak Customer Response AEC

### *Suppliers to disclose all available contracts to the 'Proposed Segment' and the prices of their out of contract and deemed contracts*

The Microbusiness Weak Customer Response AEC

11.11 The remedies package proposed to address the Microbusiness Weak Customer Response AEC and/or the associated detriment is as follows:

- (a) An order on gas and electricity suppliers (and amendments to suppliers' standard licence conditions):
  - (i) requiring suppliers to disclose the prices of all available acquisition and retention contracts to non-domestic customers falling within a defined category (the 'Proposed Segment') either through an online quotation tool made available on their website, or through one or more third party online platforms (and including a web link on their own website to direct non-domestic customers to such third party online platform(s));
  - (ii) requiring suppliers to disclose the prices of all their out of contract and deemed contracts on their websites;

[...]

### **Disclosure of prices**

- 9.1 EDF Energy supports, in principle, the CMA's proposal to require energy suppliers to disclose the prices of all available acquisition and retention contracts to a category of non-domestic customers, and that this should be either through an online quotation tool made available on their websites, or through one or more third party online platforms.
- 9.2 EDF Energy accepts that it may be more cost-effective for smaller suppliers to make prices available through PCWs rather than through their own quotation tools. However, we do not believe that it is unreasonable to expect all suppliers to comply with the requirement to provide direct-only prices through their own tools (or publication of rate cards). This is because, in our experience, the costs will not be as high as some of the estimates provided by the CMA (PDR, paragraphs 9.111 and 9.112). This is particularly the case if a third party such as Energylinx has provided a generic platform (as it has done in the past for the domestic residential market).
- 9.3 Additionally, the CMA should consider the implications of suppliers not having control over what prices customers are actually quoted by TPIs due to the uplifts in price to cover commissions that are sometimes applied to prices by TPIs. This means that the prices shown may not be the same as those that are available direct from the supplier. This demonstrates the need for consistency in regulation between suppliers and TPIs, and we note that this is a view shared by some major TPIs, as well as by suppliers.
- 9.4 EDF Energy agrees that simple online quotation tools improve the accessibility of prices and therefore customer engagement. While EDF Energy agrees with the CMA that an online tool would be the preferable route to access prices for most consumers on the basis that online tools would be most up to date (PDR, paragraph 9.39), these online tools should ideally still be supported by the publication of simple rate-cards. This would be for the benefit of those consumers who are reluctant to use a tool or otherwise engage in a process requiring them to input information, which can be the case if they are a time-poor microbusiness.
- 9.5 It is important that customers are able to compare prices and customer service metrics with consistent qualification criteria. This is necessary for the former as prices which initially may appear cheaper may have more restrictive T&Cs, such as exit fees and have additional pass-

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through costs. We consider that it would be relatively straightforward for suppliers and beneficial to customers if rate cards had to be produced for a simple defined set of products, such as 1, 2 and 3 year contracts for DD customers with average credit scores and no variable pass-through costs and a defined exit fee.

- 9.6 We believe that the term “all available” contracts (e.g. PDR, paragraph 9.44) needs clarification as this could be interpreted in different ways. In the SME market, suppliers offer a multitude of different prices for each contract type for a variety of reasons and situations. Examples of this include rollover prices for which there may be several active versions at any given time – but only one of which would be available to a specific renewing customer, based on their renewal date. Also, suppliers may have different prices for different channels, depending on their channel strategy. Some suppliers may even have a range of prices for each channel (particularly evident in the TPI channel), which could include discounts or uplifts on a base price to allow for negotiation or commission; or a price matrix model. To keep this as simple and accessible to customers as possible, we believe that this should refer to direct prices available, with a single price per contract for a given set of inputs.
- 9.7 We note the CMA’s intention to allow some element of negotiation to remain. This is, and will continue to be, an important feature of the microbusiness market and we welcome the additional flexibility this provides to suppliers and customers alike.
- 9.8 In order to assess the impact of this remedy, we believe that the CMA should, as part of the design phase, ask suppliers which prices they intended to publish under the remedy, and whether these are available to new and existing customers.
- 9.9 EDF Energy also supports the proposal to require suppliers to disclose the prices of all their out-of-contract (“**OOO**”) and deemed contracts on their websites (PDR, paragraph 9.80). It is worth noting that this is already required for deemed contracts.

#### **Definition of 'Proposed Segment'**

- 9.10 With respect to the customers covered, EDF Energy supports the CMA's efforts to identify a precise category of customers to which this remedy should apply (the 'Proposed Segment'), given diverging use of the term 'microbusiness' across the industry. It would be beneficial to customers, suppliers and third parties if the 'microbusiness' definition was amended accordingly to ensure that all the remedies are applied to a consistent and easily defined group of customers.
- 9.11 EDF Energy, however, believes that the appropriate group would be non-domestic customers with single meter points falling under profile classes 3 to 4. This is because very few microbusiness customers are on profile class 1 and 2 meters (less than [3<]%) of our SME customer base and mainly relating to sole traders and businesses run from home). In addition, there are complications in offering SME prices to these customers, such as VAT declarations. Including profile classes 1 and 2 in microbusiness quotation tools may result in domestic customers accessing these prices, and this would not be appropriate for a number of reasons due to different pricing strategies and different T&Cs.

#### **Timescale for implementation**

- 9.12 As many suppliers are already compliant with most of the requirements, we consider that a quicker implementation could be achieved for some elements than is proposed by the CMA, particularly with respect to the option to provide prices to PCWs. Therefore a phased approach may be more appropriate. In addition, some of the costs quoted appear to be excessive based on our experience. Given our concerns around TPI regulation that have been expressed above, it may be appropriate for the 12 month timeline to be consistent with a deadline for

implementation of a TPI Code of Practice for the non-domestic sector. This should be overseen and administered by Ofgem with an associated accreditation deadline.

***Prohibition of certain termination restrictions, exit fees and other unfavourable clauses in auto-rollover contracts and similar restrictions in out of contract and evergreen contracts***

The Microbusiness Weak Customer Response AEC

11.11 The remedies package proposed to address the Microbusiness Weak Customer Response AEC and/or the associated detriment is as follows:

(a) An order on gas and electricity suppliers (and amendments to suppliers' standard licence conditions):

[...]

(iii) prohibiting the inclusion of conditions in their existing and future auto-rollover contracts with microbusiness customers that:

- prohibit the microbusiness customer from giving a termination notice up to the last day of the initial fixed-term period;
- prohibit the microbusiness customer from giving a termination notice up to the last day of the fixed-term roll-over period; and
- impose a termination fee and/or no-exit clause for the roll-over period;

(iv) prohibiting the transfer of microbusiness customers that have given a termination notice during the rollover period of an auto-rollover contract to a higher priced contract during the notice period; and

(v) prohibiting the inclusion of a condition in their existing and future out-of-contract, and evergreen contracts with microbusiness customers that include termination fees.

(b) A recommendation to Ofgem to make any necessary minor consequential amendments to the suppliers' standard licence conditions.

[...]

9.13 EDF Energy supports the CMA's proposal to increase the time window during which microbusiness customers can give notice of termination to suppliers, and to prohibit suppliers from imposing termination fees and no-exit clauses on rollover, out of contract or evergreen customers (PDR, paragraph 9.155).

9.14 We also agree with the CMA's recommendation that microbusiness customers must be allowed to give a termination notice at any time up to the last day of their initial contract period, at any time during the rollover period regardless of whether the rollover period is fixed or non-fixed (PDR, paragraph 9.149) and that such customers should not be moved onto a more expensive contract during the notice period. We welcome the CMA's recognition that some notice period is required in order to protect supplier risk in respect of energy that suppliers have purchased in advance and we agree that 30 days strikes a reasonable balance.

9.15 EDF Energy welcomes the CMA suggesting a remedy that mirrors the market-leading approach that we took to the issue of auto-rollovers in Q3 2013 - our decision was taken on the basis of what was fairest for our customers.

9.16 Beyond those proposals suggested by the CMA, EDF Energy considers that there would be value in instituting a mechanism whereby Ofgem monitors the way suppliers engage with their disengaged customers to ensure that any change to a non-default tariff is as a result of active

engagement on the part of a customer, and not an automatic transfer. We acknowledge that this may be achieved through the ongoing Ofgem and CMA monitoring envisaged at PDR, paragraph 9.163 (albeit monitoring of compliance with the remedy/licence condition rather than supplier conduct more generally).

***Ofgem to establish a programme focused on information provided to microbusinesses***

The Microbusiness Weak Customer Response AEC

11.11 The remedies package proposed to address the Microbusiness Weak Customer Response AEC and/or the associated detriment is as follows:

[...]

(c) A recommendation to Ofgem to establish an ongoing programme to identify, test (through randomised controlled trials, where appropriate) and implement measures to provide microbusiness customers with different or additional information with the aim of promoting engagement in the microbusiness segments of the SME retail energy markets.

[...]

9.17 EDF Energy is broadly supportive of this proposal. Please see our detailed comments above with respect to the CMA's equivalent proposals in respect of domestic disengagement more generally, which we believe also apply in part to the microbusiness segment (noting that the potential savings shown in the jointly branded communication from Ofgem and the customer's own supplier will need to be calculated on a different basis).

9.18 There are, however, some further points specific to microbusinesses that need to be considered above and beyond those for domestic customers:

- Solutions that have been designed for domestic customers should not be applied to microbusinesses customers without specific testing of their impacts on microbusinesses. Any testing should undergo the same degree of rigour as suggested for the domestic sector.
- Microbusinesses may require different or additional information to engage, given the range of consumption and business types.
- Unlike the changes introduced as part of RMR relating to required information for domestic customers, we note that the changes introduced for non-domestic customers have been widely acknowledged as having a positive impact.

***Suppliers to disclose to Ofgem specified 'Microbusiness Customer Data' for purpose of this information being made available to rival suppliers for postal marketing; Ofgem to create and operate a cloud database to store the data and enter various logistical agreements with suppliers***

The Microbusiness Weak Customer Response AEC

11.11 The remedies package proposed to address the Microbusiness Weak Customer Response AEC and/or the associated detriment is as follows:

[...]

(d) An order on gas and electricity suppliers requiring the disclosure to Ofgem, subject to certain use restrictions, of (i) details of certain of their microbusiness customers that have been on a default contract for three or more years (the 'Microbusiness Customer Data'); and (ii) updated Microbusiness Customer

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Data every six months, for the purposes of creating, operating and maintaining a secure cloud database containing the Microbusiness Customer Data for the purpose of postal marketing.

(e) A recommendation to Ofgem to (i) create, operate and maintain a secure cloud database for the purposes of holding the Microbusiness Customer Data; (ii) hold the Microbusiness Customer Data; (iii) enter into agreements with suppliers including, access to, and use restrictions concerning the Microbusiness Customer Data; and (iv) provide access to the Microbusiness Customer Data by any rival supplier that has entered into such an agreement.

9.19 Please see our detailed comments above with respect to the CMA's equivalent proposals in respect of domestic disengagement more generally, which we believe apply equally to the microbusiness segment (with the exception of specific points raised in that section).

9.20 However, in addition:

- We note that it is proposed that data protection rules will not apply to businesses. We believe that the nature of many microbusinesses, such as sole traders and those who use their home as their business premise, mean that concerns over data protection still apply. Microbusiness customers should, like domestic customers, have the ability to opt-in to having their details included in the database.
- The criteria regarding a customer's ability to switch need to be clear in their prompt letter. Debt may restrict some customers from switching (and unlike for domestic customers, there is no DAP for the non-domestic sector), although we note that this is not the case for deemed customers.
- Encouraging deemed customers in debt to change supplier would have the unintended consequence of socialisation of debt risk across the industry, as the debt risk crystallises into bad debt when customers change supplier thereby making it harder to collect.
- The mix of customers falling into the proposed segment is very heavily weighted towards lower consuming microbusinesses. Based on our current customer portfolio, of those that would qualify for inclusion on this database, [3<] consume more than 30MWh, and [3<] consume less than 1MWh. For the latter group of customers, we consider that there may be understandable reasons for non or low engagement, such as very low potential savings and the passing through of costs to end users.
- The data quality may be poor for many of these customers. Suppliers do not have complete contact details for many deemed customers who have not signed a contract and so will not be able to provide this information to the database. We note that the CMA does not state who would be responsible for ensuring the accuracy of data, and updating the database in the case of returned mail etc. Our previous experience shows that match rates to external data such as Experian credit scores can be low, and decline with lower levels of consumption.

## Governance AEC

*DECC to initiate a legislative programme with a view to: deleting paragraph 1C from both sections 4AA of the Gas Act 1986 and 3A of the Electricity Act 1989; set up a process for Ofgem to comment publicly on relevant draft legislation and policy proposals*

### Governance AEC

11.12 The remedies package proposed to address the Governance AEC and/or the associated detriment is as follows:

(a) A recommendation to DECC to initiate a legislative programme with a view to:

(i) deleting paragraph 1C from both sections 4AA of the Gas Act 1986 and 3A of the Electricity Act 1989; and

(ii) set up a clear and established process for Ofgem to comment publicly, by publishing opinions, on all draft legislation and policy proposals which are relevant to Ofgem's statutory objectives and which are likely to have a material impact on the GB energy markets.

10.1 EDF Energy supports the CMA's proposals to: (a) revise Ofgem's statutory objectives and duties; and (b) set up a clear and established process for Ofgem to comment publicly, by publishing opinions, on all draft legislation and policy proposals which are relevant to Ofgem's statutory objectives and which are likely to have a material impact on the GB energy markets.

#### **(i) Revision of Ofgem's statutory objectives**

10.2 Broadly, EDF Energy supports the deletion of paragraph 1C from both sections 4AA of the Gas Act 1986 and 3A of the Electricity Act 1989. While we do not consider this should have been an issue for Ofgem, we agree that any confusion in the minds of Ofgem is problematic and needs to be addressed.

10.3 Specifically, we remain unconvinced that Ofgem's statutory duties impose a constraint in practice on Ofgem's ability to pursue competition-based policies by placing a priority on approaches that do not promote competition. However, we believe that there is a risk alternative approaches will turn out not to be in consumers' interests and so we therefore support the removal of the requirement for Ofgem to look at other options.

#### **(ii) Clear and established process for Ofgem to comment publicly on legislative and policy proposals**

10.4 EDF Energy supports initiatives that increase the transparency of regulatory decision-making in the industry. Therefore, we agree that Ofgem's views should be made public to increase the transparency of policy development and demonstrate that the doctrine of independent economic regulation is being upheld.

10.5 Further, we agree that an obligation to comment publicly on all draft legislation and policy proposals should be limited to legislation and proposals that are likely to have a material impact on the GB energy markets.

10.6 We see a vital role for Ofgem to provide independent, robust and trusted information on the operation of the markets it regulates. To perform this role, Ofgem must be able to act and publicly express its views independent of the Government. This could include Ofgem providing its own view of the cost impacts of Government policies, which would potentially be a useful role for the proposed Office of the Chief Economist.



***DECC and Ofgem to publish detailed joint statements concerning proposed DECC policy objectives that are likely to necessitate Ofgem interventions***

Governance AEC

11.12 The remedies package proposed to address the Governance AEC and/or the associated detriment is as follows:

[...]

(b) A recommendation to DECC and Ofgem to publish detailed joint statements concerning proposed DECC policy objectives that are likely to necessitate parallel, or consequential, Ofgem interventions, setting out (i) a proposed action plan for the regulatory interventions needed and responsibility for these, (ii) an estimated timetable, and (iii) where appropriate, a list of relevant considerations in designing the policy.

[...]

- 10.7 EDF Energy broadly supports this proposal, which we believe will enhance transparency of decision-making and clarity of reporting lines, both of which are important to avoid mixed or confused signals and restore consumer trust in this industry. Optimising the interaction between these different bodies should also encourage the development of the most robust regulation.
- 10.8 EDF Energy considers that while the remedy (and particularly the greater transparency it will bring) is helpful with regard to strengthening the recognition by Government of Ofgem's independence, it may not be sufficient on its own. We believe that the Government should signal the importance of regulatory independence in a variety of ways including, for example, via a Strategy and Policy Statement that describes regulatory independence as an intrinsic part of energy policy. In particular, we support the vision that is set out in the BIS "Principles for Economic Regulation"<sup>13</sup>, including the importance of having clarity of roles and responsibilities between Government and regulators.

***Ofgem to publish an annual State of the Market Report, create a new expert unit and modify the Six Large Energy Firms' licence conditions with respect to reporting requirements***

Governance AEC

11.12 The remedies package proposed to address the Governance AEC and/or the associated detriment is as follows:

[...]

(c) A recommendation to Ofgem to:

(i) publish annually a state of the market report (the 'State of the Market Report') which would provide analysis regarding issues such as (i) the evolution of energy prices and bills over time, (ii) the profitability of key players in the markets (e.g. the Six Large Energy Firms), (iii) the social costs and benefits of policies, (iv) the impact of initiatives relating to decarbonisation and security of supply, (v) the trilemma trade-offs, and (vi) the trends for the forthcoming year;

(ii) create a new unit (e.g. an office of the chief economist) within Ofgem, which would build expertise across the different areas of the energy markets with a view to publish annually the State of the Market Report; and

<sup>13</sup> Department for Business Innovation & Skills, Principles for Economic Regulation, April 2011.

(iii) modify the licence conditions of the Six Large Energy Firms' generation and supply licences by introducing requirements to:

- report their generation and retail supply activities on market rather than divisional lines;
- report a balance sheet as well as profit and loss account separately for their generation and retail supply activities;
- disaggregate their wholesale energy costs for retail supply between a standardised purchase opportunity cost and a residual element; and
- report prior year figures prepared on the same basis.

[...]

10.9 EDF Energy supports the recommendation that Ofgem publish an annual State of the Market Report, and that it creates a new unit with accountability for expert economic analysis. We also support the proposal to report generation and retail supply activities on market rather than divisional lines. It is important for the sector going forward that appropriate measures of profitability in the industry are used in order to reduce the type of misunderstandings and adverse press publicity about profitability that has been a feature of the market in the past, including ahead of the recent General Election. However, we strongly believe that the regulatory reporting requirements should apply to all firms (subject to a *de minimis* threshold) rather than be limited to the Six Large Energy Firms.

#### **(i) Annual State of the Market Report**

10.10 EDF Energy agrees with the CMA's recommendation to Ofgem to produce an annual State of the Market report to analyse the issues set out in the PDR. We would see this replace Ofgem's suspended Supply Market Indicator ("**SMI**"). We agree that there has been a lack of shared and accurate understanding across many stakeholders about, in particular, the factors that influence retail prices. This remains the case and is something which Ofgem has not sought to explain, even during this investigation<sup>14</sup>. Transparent and accessible information about retail price formation is central to the operation of a well-functioning market and is also an essential element in the democratic scrutiny of energy policy.

10.11 In analysing the evolution of energy prices, the profitability of key players in the market and the social costs and benefit of policies, as well as the other issues identified, it is vital that lessons are learned from previous attempts to provide information to stakeholders. There is a risk that any analysis will be insufficiently robust, and could itself lead to a distortion of the market (particularly if energy providers, initiatives or trends are singled out as having a precise impact). Therefore, it is crucial that independence is maintained and that sufficient resources are allocated to producing the State of the Market Report in an accurate, balanced and objective manner.

10.12 There is a balance to be struck between improving transparency in the interests of building trust, and the impact a State of the Market Report could have on commercial confidentiality, and the potential for Ofgem to inadvertently facilitate some form of coordination between suppliers. Careful consideration will need to be given to how certain categories of information are published to reduce this risk, and indeed whether it is appropriate to make public all data that is collected by Ofgem for the purposes of assessing the market.

<sup>14</sup> See for example "Ofgem's reply to the Daily Mail" Press Release, 27 January 2016. <http://tinyurl.com/gpophuk> Last accessed 6 April 2016.

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## **(ii) Creation of a new unit within Ofgem**

- 10.13 EDF Energy agrees that Ofgem is best placed to produce the annual State of the Market Report, and that a new unit should be created for this purpose. We support the CMA's view that a special unit, such as an Office of the Chief Economist, would strengthen the independence of the report and reduce the risk of confirmation bias. It is important that robust economic analysis becomes central to Ofgem's analysis going forward. We believe that this role would be substantially strengthened if the Office had independence from the Executive of Ofgem and instead reported directly to the GEMA.

## **(iii) Modification of the conditions of the Six Large Energy Firms' generation and supply licences**

- 10.14 EDF Energy supports the proposed recommendation to Ofgem to modify generation and supply licences in part. We support the proposal to report generation and retail supply activities on market rather than divisional lines, and agree that any such remedy should be implemented through licence conditions. However, we have concerns about the remaining proposals.
- 10.15 EDF Energy strongly disagrees that the proposed regulatory accounting requirements should be limited to the Six Large Energy Firms. We consider that the same requirements should apply to all generators and suppliers, subject to a *de minimis* threshold. Limiting the reporting requirements to just the Six Large Energy Firms would not be justified as it would provide only a partial view of the market - making the reports less useful in terms of understanding how the market is functioning and potentially missing an opportunity to encourage new entrants to the market.

### *Market segment reporting*

- 10.16 We agree that Ofgem should determine the market segments which should be reported on in accordance with the principles set out in Appendix 10.3, having regard to the regulatory burden on the Six Large Energy Firms. Sufficient time should be allowed before suppliers are required to report on the new basis as moving to a market segment approach is likely to require EDF Energy and other affected suppliers to make system alterations which could not be implemented immediately.
- 10.17 There are two areas highlighted in Appendix 10.3 that the CMA should provide greater clarity on:
- *Reporting of related parties' results* (PDR, Appendix 10.3, paragraph 5). EDF Energy prepares segmental statements in line with the guidelines provided by Ofgem. Our interpretation of these guidelines does not require us to consolidate the results of our interest in our Renewables business but we do present our share of the joint venture results. EDF Energy Renewables Holdings Limited is not a subsidiary of any EDF Energy group company. If the CMA would like such results to be included in segmental statements we recommend that the wording is changed in order to specify this.
  - *Costing using market products* (PDR, Appendix 10.3, paragraph 8c). In the case when bespoke products are created and costed on a market valuation, we would welcome clarity as to whether companies would then need to track a separate cost base for segmented accounts purposes only. While this does not currently impact EDF Energy, it has the potential to create high implementation costs for future innovative products, thus reducing the ability for suppliers to compete.

### *Balance sheet reporting*

- 10.18 EDF Energy has previously expressed the view that while balance sheets can be useful for understanding the profitability of a generation business, profitability of supply businesses should

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be assessed based on margins, and not through ROCE analysis based on balance sheet information. As the CMA has experienced during this investigation, there are multiple difficulties in determining how elements of the supply business should be considered on a balance sheet, and indeed we note that suppliers, the CMA and independent experts have not been able to agree on a valid approach. As such we find it difficult to envisage a balance sheet approach for reporting on supply businesses that all parties would agree as useful and accurate. If this measure were to be taken forward, EDF Energy would need to make significant and subjective changes to its current approach to reporting balance sheets in order for them to be used to understand profitability. Accordingly, it would be important that sufficient time was allowed before requiring balance sheets to be reported.

*Wholesale energy costs reporting*

10.19 EDF Energy does not support the separation of “opportunity” and “residual” wholesale costs for the retail supply business. It is not clear to us that this would provide Ofgem (or the wider public) with any useful information and, if in the public domain, would provide potential scope for misinterpretation that would unjustifiably damage customer trust. We do not believe that the CMA has described the benefits of this reporting sufficiently to justify the implementation costs it would bring, and the potential for misunderstanding.

10.20 Our objections fit into three main categories:

- *Potential impact on hedging*
  - EDF Energy strongly disagrees with the CMA’s description of the benchmark hedging strategies used to calculate the opportunity cost as that which would be carried out by a “prudent retail supplier”. Hedging strategies for supply are an inherent part of how we price our tariffs and manage risk. We currently purchase our energy requirements in advance for SVT customers [X] to smooth costs. This enables us to implement infrequent tariff changes that we believe are valued by this group of customers. In the event that we only purchased energy for our SVT customers on a month-ahead basis, this would require multiple tariff changes in a volatile market and affect our customers’ ability to budget. Current regulation mandates 30 days’ advance notice of increases to the SVT. This entails a direct cost and introduces a lag between changes in costs and the time when the price change becomes effective.
  - We recognise that, in mandating the proposed reporting, the CMA and Ofgem would not force suppliers to hedge any differently to how they do now. However, it is not difficult to imagine a scenario in which wholesale prices had fallen and the “residual” cost element represented a significant additional cost. Our experience (e.g. of Ofgem’s SMI) suggests that, in such a case, some commentators could misinterpret this as being the result of speculative activity, even though the reverse would in fact be true. In a rising market, the “residual” cost would be negative and would bring benefits to customers. However, it is unlikely that this would be highlighted by the media or consumer groups.
  - It is therefore possible that suppliers would begin to hedge their SVT customers in a similar way to the opportunity cost reporting, leading to much greater volatility for customers and further eroding trust in the market. Although most of the period of the CMA’s analysis has been characterised by declining global energy prices, if the analysis had included 2007/2008, the “prudent supplier” in question would be likely to either be bankrupt, or to have subjected its customers to monthly price changes of up to 17% (from September/October 2007).

- An alternative could be for Ofgem to model energy costs based on spot market prices (i.e. no forward hedging). Purchasing only in the spot market could not be characterised as a prudent hedging approach for a supplier as price volatility that could not be passed onto SVT customers could quickly lead to bankruptcy and because outturn wholesale prices would be very different if a supplier did try to hedge on this basis. This would, however, give Ofgem visibility of the difference between this benchmark and the costs generated by suppliers' actual hedging strategies.
- *Additional costs*
  - The CMA should not underestimate the operational overheads involved in implementing this remedy as proposed. Suppliers need to be able to change hedging strategies to react to market conditions and allow for innovation. If the "opportunity" cost is specified prescriptively (as seems to be the case), this would effectively entail maintaining parallel systems – one storing the hedges that we have actually carried out, and the other purely to maintain information for the segmental accounts. As well as significant up-front implementation costs, this would be likely to lead to a noticeable operational overhead (which could be as high as £0.5m-£1m/year for EDF Energy if a high level of precision is required). This could be mitigated if Ofgem were to calculate this cost itself based on product and customer data from suppliers.
- *Impact on innovation*
  - It may also stifle innovation because reporting the opportunity costs would be a significant hurdle to overcome in any new product or hedging strategy. Although the specific issues with SVTs are larger than for fixed-price products, even the reporting proposed for fixed-price products is likely to be an approximation that suppliers would not wish to replicate precisely in their processes. This is because this would lead to increased overheads from running a parallel system. As and when the RMR four tariff rule is lifted, we expect to see far more innovation in the retail supply market. We are concerned that any requirement to agree with Ofgem as to how such products should be reported may well slow down or stymie such innovation.

#### *Prior year information*

- 10.21 EDF Energy agrees that prior period comparatives should be reported based on the same accounting rules to facilitate a comparison. However, to carry out historic accounting assessments would impose a costly regulatory burden on suppliers. Therefore, we propose that this requirement operates going forward, but does not require suppliers to re-report on previous years where different reporting rules applied.

#### *Publishing data*

- 10.22 The CMA should consider if their envisaged outcomes are more likely to be achieved by this information being made available publicly or only to Ofgem. The benefits of this information being in the public domain would need to outweigh the risk of further erosion of trust that has been created in the past by misinterpretation and misreporting. If information is to be provided solely to Ofgem and confidentiality can therefore be maintained greater detail could be provided.

## Codes AEC

### *Recommendations to both DECC and Ofgem that they take a number of steps to improve the regulatory framework around industry codes*

#### Codes AEC

11.13 The remedies package proposed to address the Codes AEC and/or the associated detriment is as follows:

(a) A recommendation to Ofgem to:

- (i) publish a cross-cutting strategic direction for code development (the 'Strategic Direction');
- (ii) oversee the annual development of code-specific work plans for the purpose of ensuring the delivery of the Strategic Direction;
- (iii) establish and administer a consultative board that would bring stakeholders together for the purpose of discussing and addressing cross-cutting issues;
- (iv) initiate and prioritise modification proposals that, in its view, are necessary for the delivery of the Strategic Direction;
- (v) in exceptional circumstances, intervene to take substantive and procedural control of an ongoing strategically important modification proposal, as appropriate; and
- (vi) modify the licence conditions of code administrators to introduce the ability for the administrator to initiate and prioritise modification proposals that, in its view, are necessary for the delivery of the Strategic Direction or to improve the efficiency of governance arrangements.

(b) A recommendation to DECC to initiate a legislative programme with a view to:

- i) giving Ofgem the power to modify industry codes in certain exceptional circumstances; and
- (ii) making the provision of code administration and delivery services activities that are licensed by Ofgem and specifying that such licence conditions will include appropriate targets to incentivise code administrators to take on an expanded role to be able to deliver pursuant to the Strategic Direction.

- 11.1 EDF Energy supports the code governance remedies in part. While EDF Energy does not agree that the current industry code governance gives rise to an AEC through limiting innovation and causing the energy market to fail to keep pace with regulatory developments, we do strongly agree that the arrangements would benefit from reform so that the code modification processes benefit all market participants, particularly the smaller ones.
- 11.2 EDF Energy does not, however, support additional powers being given to Ofgem at the expense of input from stakeholders. In our view, the proposed remedies rely too greatly on Ofgem leading the overall strategy, development, implementation and process for code modifications. Such an increase in Ofgem's powers goes too far, risking unintended consequences in circumstances where the existing system is not fundamentally flawed. We do not believe that a case has been made for Ofgem to be provided with additional broad powers allowing it to unilaterally make modifications to industry codes in respect of the faster switching and settlement reforms. Increasing Ofgem's powers to implement changes without due assessment by experts in the industry could lead to sub-optimal changes being developed and further damage customer trust in the energy market.

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- 11.3 It is imperative that decisions taken by the regulator are of high quality, justified and accountable, in order to protect consumer interests and promote competition. The introduction of any additional powers should therefore be accompanied with appropriate checks and balances and procedural rights that are at least commensurate with those that are currently in place for other Ofgem decisions, such as licence modifications and code modification directions.
- 11.4 EDF Energy is concerned that the scope of the powers provided to Ofgem by the proposed legislation are broadly drafted. There is therefore a risk that such powers could be used to make changes that go beyond that which is required to ensure the successful implementation of the faster switching and settlement reforms, and the intent behind the granting of the powers in the first instance. We believe that the legislation needs to define precisely the policy intent behind the proposed new powers.

### **Strategic Direction**

- 11.5 EDF Energy supports the recommendation for Ofgem to publish a strategic direction setting out its expectations for the strategic development of the codes over the year to come, provided there is sufficient consultation with stakeholders in the process and that this is set within an overall longer-term strategy. A strategic direction would be helpful as it would allow tangible changes to be made to industry rules and could enable parties to develop such changes without detailed involvement from Ofgem.

### **Strategic work plans**

- 11.6 EDF Energy does not consider that Ofgem needs more powers to specify a work plan in relation to code changes. We are not persuaded that the publication of such work plans by Ofgem would necessarily improve the end result of code changes. We believe that the current process of Ofgem leading on the policy phase and industry leading the implementation phase is working without the need for Ofgem to issue code specific work plans.
- 11.7 We consider that a better way to improve the development of the codes would be for Ofgem to have greater oversight of the performance of code panels and to make a comparative assessment of their performance against their duties.

### **Consultative board**

- 11.8 EDF Energy supports the recommendation for Ofgem to create a 'consultative board' to bring stakeholders together for the purpose of discussing and addressing cross-cutting issues. This process would assist in improving Ofgem's engagement in the code modification process while appropriately allocating resources to the best placed bodies to drive forward those modifications. However, we note that greater, and more proactive, participation by Ofgem during working group meetings would also address some of these challenges.

### **Periodic review of the code regime**

- 11.9 EDF Energy believes that a wholesale review of the codes regime on a periodic basis by Ofgem would be helpful as the basis for simplifying codes and improving their efficiency. Periodic reviews would help ensure that opportunities to improve the codes regime were taken at the right time.

### **Powers for code administrators to initiate and prioritise code changes**

- 11.10 Ofgem already has the powers to direct bodies to raise/initiate code modifications that it considers to be important. We do not support providing new powers to code administrators to allow them to raise their own code modifications, except under direction from Ofgem. We also have concerns regarding the prioritisation of resources. It is often the case that the importance

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and nature of industry code changes are not fully understood until material work has taken place. While code administrators are likely to be experts in the codes themselves, they will not necessarily be experts in the drivers for a code modification or its impact on the market. In our view, it is therefore not clear that they are best placed to make these judgements (unless they have clear oversight from the industry and Ofgem).

### **Ofgem power to initiate and prioritise code modification proposals**

- 11.11 EDF Energy does not support a recommendation that Ofgem initiate and prioritise code modification proposals necessary for the delivery of the strategic direction, or for DECC to initiate a legislative programme to give Ofgem the power to modify industry codes. We do not consider that Ofgem needs greater powers in relation to code changes. If Ofgem is to publish a strategic direction as proposed, we consider that it is sufficient that the direction is taken into account in the code modification process. If Ofgem were to take such powers to raise and manage code modifications then we believe that adequate safeguards would be needed, e.g. low cost/burden appeal processes.
- 11.12 We are supportive of increased project management of code changes and their implementation where this is necessary. However, as we set out in our proposed Code Governance reforms in our response to the Notice of Possible Remedies, this can be achieved through greater oversight of the Code administrators and Code panels.

### **Ability for Ofgem to intervene in relation to strategically important modification proposals**

- 11.13 EDF Energy is supportive in principle of a backstop 'call in' power for Ofgem, provided such interventions are limited to exceptional circumstances and are subject to robust procedural and judicial safeguards.
- 11.14 However, it is not clear from the examples given that the CMA has justified why such a power is necessary:
- The first scenario consists of those issues so important for consumers that they should not be managed through an industry code process. We would highlight that the industry codes process is a construct derived from the licensing regime. If Ofgem considers that issues should not be within the codes regime, and instead should be held at the licence level, then it can make this change itself by altering the necessary licence.
  - The second scenario outlines an example where Ofgem considers that industry is taking too long to deliver a code modification. Again Ofgem, through its Significant Code Review process, has powers to require code modifications be raised and then have oversight of the timescales involved. While these timescales can be extended, approval from Ofgem is ultimately needed. Therefore we believe that Ofgem already have significant powers to ensure key reforms are delivered in a timely manner.

- 11.15 Overall, EDF Energy is very concerned about an "open-ended" power to make code changes and its impact on business planning and the long-term investment environment. We do not believe that there is evidence to support such a significant intervention in the governance of industry codes.

### **Making code administration and delivery services a licensable activity**

- 11.16 EDF Energy supports the proposal to make the provision of code administration and delivery services a licensable activity, subject to our concerns about the other proposed remedies in relation to code governance. We consider that the proposed reform is likely to increase accountability to Ofgem and improve best practice across Code administrators.



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## Appendix 1 - Competitive Benchmark

1. The purpose of this appendix is to provide our views on the competitive benchmark methodology used by the CMA to calculate customer detriment in the UK energy market.

### Competitive benchmark

2. The CMA's benchmark is based on a hypothetical supplier which it has created by combining data from two suppliers, OVO Energy and First Utility, identified by the CMA as being the most competitive in the markets. There are several aspects of the CMA's methodology that cause concern:

### Bias in the selection of suppliers for determining the efficient benchmark

3. The CMA says that OVO Energy and First Utility were selected because they are competing primarily through acquisition tariffs where competition is focused on price and where customers are acquired through PCWs. Therefore, the CMA argues, both OVO Energy and First Utility have relatively few inactive customers, which leads the CMA to expect their average price (or the "system" price) to be close to the competitive level. The CMA essentially considers that the average of OVO Energy and First Utility prices is the marginal price in the market. However, the CMA's approach is highly selective and has resulted in a benchmark which is not representative of all new entrants' prices, may be unsustainable for the Six Large Energy Firms, and may even be unsustainable for the two benchmark companies:
  - a. *The CMA's hypothetical benchmark price is not a representative market price* The CMA has created an artificial price which reflects the average of just two mid-tier suppliers at a single point in time and is therefore not representative of all market prices available to switchers, let alone the prices offered by new entrants. It is therefore an arbitrary price benchmark from a competition perspective. Switchers do not observe an average of just two suppliers' prices but, rather, consider all the available prices in the market and then switch on the basis of market wide information on price and quality preferences. We therefore consider that the relevant benchmark price should include a wider range of peer group companies and be set at the median price of all market tariffs, consistent with the CMA's alternative cap. Analysis by EDF Energy suggests that a price cap benchmarked to median market prices, excluding SVT, would result in affordable, but more market reflective, PPM tariffs. The benchmark tariff would also be updated using a suitable cost index to avoid the costly approach of sampling tariffs every six months. Such an approach would eliminate the influence of high SVT tariffs in the benchmark as well as reduce any uncertainty and instability associated with six monthly sampling.
  - b. *The CMA has selected a snapshot benchmark price* In selecting the prices of two suppliers at June 2015, the CMA's benchmark reflects a static snapshot of market prices, not a dynamically efficient market price. This goes against the conventional methodology used by UK regulators, such as Ofgem and Ofwat, whose approach has been to use data from all peer group firms in their benchmarking methodologies through the review period<sup>15</sup>. The models used by these regulators aim to identify firms operating at the efficient frontier but in order to do that, all peer group firms are included in the analysis and their costs and profits are evaluated over the entire review period. This enables

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<sup>15</sup> Ofwat, Ofgem and Ofcom have used benchmarking to evaluate the operating and capital efficiency of regulated network businesses in the absence of market comparators. Their techniques have included mathematical modelling such as data envelope analysis ("**DEA**") and stochastic frontier analysis ("**SFA**") as well as regression analysis.

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information from the whole peer group to be included in the analysis and focuses on dynamic efficiency.

The above concept can be generalised to the fact that costs in the industry tend to be stepped in nature i.e. the level of any economies of scale vary non-linearly with customer numbers. As such, the benchmark may have been set at a time of relatively high economies of scale i.e. just before a step-up in costs, which would make the benchmark unachievable for all companies in the market, including those on whom it is based.

- c. *Efficiency properties of peer-group benchmarking* Andrei Shleifer (1985)<sup>16</sup> initially proposed benchmarking for regulated businesses based on tournament-type regulation based on peer-group competition. Firms would be allowed to price at the group-determined average cost. Firms with costs below the average would profit based on the difference between their own costs and the average; firms with costs above the average would have incentives to become more efficient or continue to lose on each unit of production. This tournament would be conducted each period and there would be incentives for firms to raise their efficiency. Each firm would strive to lower its cost, in order to maximise its profit and, as a consequence, the average cost would be reduced. The advantages of this approach include a reduction in the overt influence of the regulator, the reliance on more accurate measures of group costs based on central tendencies, and the use of a simulated competition among the firms to reveal the potential for total cost reductions.
- d. *CMA benchmark does not reflect the peer group of the Six Large Energy Firms* The CMA's selection of just two mid-tier suppliers, with very different cost strategies and business characteristics, is not consistent with the approach of peer-group benchmarking. According to Shleifer, "the efficacy of using costs of comparable firms as indicators of a firm's potential is best illustrated for identical firms, which the regulator can expect to be able to reduce costs at the same rate. By relating the utility's prices to the firms identical to it, the regulator can force firms serving different markets effectively to compete."<sup>17</sup>
- e. *Different business strategies* The CMA has selected the two most aggressive and fastest growing competitors in the market who are sacrificing short to medium term profitability for customer acquisition. OVO Energy achieved 300% customer growth in 2014. First Utility has achieved 50% year-on-year market share growth<sup>18</sup>. These growth levels are unsustainable and suggest that the pricing of OVO Energy and First Utility may not be sustainable over the medium to longer-term. Additionally, the owners of First Utility have stated their intention "to exit" in 2016<sup>19</sup> which may lead to a greater risk appetite and lower desire for short term profit to achieve growth levels to justify a high valuation.

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<sup>16</sup> Andrei Shleifer, "A theory of yardstick competition", Rand Journal of Economics, Vol 16, No.3, Autumn 1985

<sup>17</sup> Ibid.

<sup>18</sup> First Utility, "Independent energy suppliers' market share grows by a staggering 50% year on year as Big Six continue to lose customers", 23 September 2015. <http://tinyurl.com/zwkojue> Last accessed 6 April 2016.

<sup>19</sup> Financial Times, "First Utility plans stock listing for early 2016", 21 July 2015. <http://tinyurl.com/zdfpgh> Last accessed 6 April 2016.

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## Poor financial performance of selected benchmark firms

4. OVO Energy has been persistently loss making during 2009-2014. According to the CMA, OVO Energy made a loss of £33m in 2014 (PDR, paragraph 3.195). OVO Energy attributed the losses to the costs of scaling up its management function as well as its rapid acquisition of many customers. This highlights the difficulty of comparing the current costs and profitability of OVO Energy, and using those as the efficient benchmark, when it is clear that OVO Energy's current business is highly unstable. First Utility has fared a little better. It was loss making between 2009-2012 and then achieved EBIT margins of 0.2% in 2013 and 1.9% in 2014. The CMA considers an EBIT margin of just under 1.5% consistent with a reasonable ROCE. By the CMA's own metric, the hypothetical benchmark is below the efficient level as, across the period used in the CMA's benchmarking analysis (2012-14), OVO Energy and First Utility made a combined EBIT margin loss of [£33m]. The average profitability of OVO Energy and First Utility is therefore well below the long-term equilibrium level of profit in an efficient market, and well below the level of return investors usually require to be willing to continue to invest in energy supply businesses.

## No adjustment for differences in customer characteristics

5. The CMA notes there may be some differences in customer characteristics that impact costs but have not explicitly controlled for these differences. The CMA considers that First Utility and OVO Energy customers are more engaged, and therefore more costly to serve than customers who do not frequently change supplier. On the other hand, the customers of the Six Large Energy Firms are more likely to be on the PSR, which entails higher costs. The CMA appears to consider that the exclusion of these factors will not introduce systematic bias in the results. Our analysis shows that customer characteristics significantly impact costs and explain a large portion of the differences in the costs between the Six Large Energy Firms and mid-tier suppliers.
  - a. *Cost differentials* The CMA says it has satisfied itself that OVO Energy and First Utility do not enjoy significant cost advantages relative to the Six Large Energy Firms. However, there are likely to be significant differences in costs between mid-tier suppliers and the Six Large Energy Firms. One factor is the relatively large number of DD payment customers of mid-tier suppliers compared with the Six Large Energy Firms. This greatly reduces bad debt risk and working capital costs for mid-tiers compared with Six Large Energy Firms. Mid-tier suppliers' IT costs are also significantly lower than the Six Large Energy Firms that have legacy IT systems. IT costs can also be affected by the investment cycle so that the costs can vary significantly from year to year. Mid-tier suppliers also have significantly lower obligations costs, which the CMA has not adjusted for in its methodology. For electricity sales, obligation costs are around twice as high for the Six Large Energy Firms than for First Utility<sup>20</sup>. For domestic gas sales, First Utility did not incur any obligation costs. Prior to 2015, OVO Energy and First Utility were only partially obligated under the ECO. The CMA recognises this and reported "while [First Utility and OVO Energy] prices may reflect some differences in their cost bases in earlier periods, their 2015 prices will reflect a similar cost base in terms of environmental obligations" (PDR, paragraph 3.177). However, we note that the direct approach to detriment relies on tariffs from 2012 onwards and so will reflect the mid-tier suppliers' lower cost bases. As far as we are aware, the CMA has not made any adjustment to the detriment figure to account for these differences in obligation costs.
  - b. *Different hedging strategies* The CMA acknowledges that the shorter term hedging strategy pursued by some mid-tier suppliers would, in a rising wholesale market, have

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<sup>20</sup> OVO Energy has not provided a figure for obligation costs.

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resulted in them incurring higher wholesale energy costs than the Six Large Energy Firms. But the CMA dismisses this argument by saying that if mid-tier suppliers raised their prices, then so would the Six Large Energy Firms, thereby relaxing the competitive constraint from mid-tier suppliers (PDR, paragraph 3.197). This line of reasoning ignores the fact that mid-tier suppliers have been attracting customers through very low one year fixed price offers which have been hedged by one-year contracts. The much larger, and more diverse, customer base of Six Large Energy Firms makes their hedging more complex and costly than the mid-tier suppliers<sup>21</sup>.

### **Exclusion of Utility Warehouse and Co-operative Energy from the benchmarking**

6. The CMA's rationale for excluding Utility Warehouse and Co-operative Energy is not particularly convincing. The CMA says that Utility Warehouse acquired the majority of its existing customers through a deal with RWE npower rather than through offering keenly priced tariffs. The CMA also notes that Utility Warehouse does not advertise its tariffs through PCWs where customers can compare but instead works in a partnership with independent distributors who receive a commission. Another reason is that Utility Warehouse provides bundled services (energy and telecoms), making it difficult for the CMA to compare their costs with other companies. We acknowledge that different business models make the cost benchmarking more complex. However, the CMA is principally concerned with price benchmarking in which case it should ideally include the prices of all products in the market that consumers consider in their switching decisions. The business models of Utility Warehouse and Co-operative Energy are equally valid (and maybe more sustainable) models of market entry and competition and therefore should ideally be included in any peer group average used in a benchmarking methodology.

### **Stability of the firms used in the efficient benchmark analysis**

7. One of the difficulties with benchmark analysis is that it can be highly unstable, with firms exhibiting varying levels of costs and profits through the period of analysis. An analysis of First Utility and OVO Energy suggests a high level of instability in costs and profits/losses in the period of analysis. The exclusion of one year can significantly affect results and the relative positioning of mid-tier suppliers and the Six Large Energy Firms. When the results of benchmarking vary significantly from year to year, its value and credibility is called into question. We consider that the CMA has not done sufficient analysis to test the robustness and sensitivity of its hypothetical benchmark.

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<sup>21</sup> See "OVO Energy 2014 Financial Results & Trading Update" Press Release, September 2015. <http://tinyurl.com/zeld97> Last accessed 6 April 2016.

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## Appendix 2 - Locational losses modelling

1. EDF Energy supports the principle of cost reflective charging and we agree that the absence of locational pricing for transmission losses could be a feature of the wholesale market rules that constitutes an AEC. We note that the CMA has commissioned analysis from NERA to support its provisional decision to implement locational charging for transmission losses. However, as we have outlined in our response, we do not believe that the modelling satisfies the standard of evidence required to conclude that there is a certain net benefit, and, importantly, to proceed directly to implementation.
2. Notwithstanding our reservations to date with respect to the proportionality, design and implementation of any remedy in this area based on the CMA's evidence, the intention of this technical annex is to set out in more detail a number of technical points to help the CMA translate NERA's results into a practical scheme to realise the potential efficiency gains, should it be minded to proceed with the introduction of locational pricing for transmission losses. These are material issues that the CMA should further consider, and address, in any planned scheme.

### EDF Energy's modelling

3. EDF Energy notes that the CMA invited parties, in parallel to NERA's work, to conduct their own analysis in the "Notice regarding assessment methodology for losses remedy – consultation on methodology and scenarios" (December 2015). In response EDF Energy has constructed a load flow and dispatch model, and investigated some different potential future scenarios to those modelled by NERA.
4. It is important to emphasise that the modelling and analysis we have undertaken is complementary to NERA's analysis of the long-term net welfare gains arising from cost-reflective charges for transmission losses. We have consistently supported the principle of cost-reflective charging for networks. In the context in which transmission losses cost around £300 million each year, around 10% of the £3000 million total charge for balancing services and transmission access, it is clearly worth asking what efficiency gains could arise from locational charges for losses.
5. NERA's modelling co-optimises investment in generation and network reinforcement over a 20-year period to provide an indicative answer to this question. Necessarily, modelling of this kind must use a crude representation of the network; it would be computationally time-consuming to calculate using a full power flow model. Using a 16-node model, as NERA does, which maps neither to the real nodes – of which there are about 944 – nor to the 14 Grid Supply Point ("GSP") Groups in which data for most distribution-connected generation and most demand is settled, means that the details of appropriate spatial averaging, for example, cannot be considered.
6. Furthermore, as we explain below, the mechanism by which the Balancing and Settlement Code ("BSC") uses Transmission Loss Multiplier ("TLM") to adjust delivery and offtake volumes does not map in a one-to-one way with the Marginal Loss Factor ("MLF") produced by a network model. Our concern is that a misunderstanding on this point has led the CMA to conclude erroneously that the allocation of 100% of losses to generation will sharpen the marginal incentive on generation to avoid losses. It will not; and furthermore will have undesirable side effects.
7. Power flow models calculate MLF by node, based on the electrical properties of the transmission network. EDF Energy's power flow model is a 944-node model, with representation of 1378 transmission links (overhead lines, cables etc.). The network topology and electrical properties

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are taken from National Grid's transport model used for incremental cost related pricing of transmission access (i.e. the ICRP model for TNUoS charges).

#### **A: Marginal loss factors over-recover losses**

8. The MLF for a node represents the ratio of the marginal value of electricity at that node relative to the equivalent value at a reference node due to different impacts on total variable losses on the network. The reference node is chosen arbitrarily, traditionally at Cowley in Oxfordshire. Assuming no transmission constraints, the MLF depends only on the marginal effect on variable transmission losses of an incremental change at that node relative to the reference node. Net injection at a node is the difference between generation (delivery) and demand (off-take). If additional generation or lower demand at a node increases losses relative to an equivalent change at the reference node (or "slack bus") then the MLF is less than one; if lower generation or additional demand at a node decreases losses at the reference node, the MLF is more than one.
9. The marginal Transmission Loss Factor ("**TLF**") for a node is the fractional change in total variable losses for an incremental change in flow at that node relative to an equivalent change at the reference node ( $MTLF = MLF - 1$ , equivalent to TLF in the BSC). Since losses vary with the square of the power flow ( $I^2R$ ) the marginal impact of an incremental increase in power flow is double the average impact of the flow over a range from zero. Therefore application of marginal TLF to net injections will represent double the actual variable transmission losses.
10. For changes in flow at a node which are small relative to the flow itself, marginal TLFs applied to those changes are a theoretically robust method of incentivising behaviour which optimises variable losses. However, for changes which are not marginal, marginal TLFs applied to the entire flow at a node will over-represent the actual impact on variable losses. The marginal TLF can be significantly different with and without a flow at a particular location. For example, application of marginal TLF to small changes in output of a large generator may be a reasonably accurate representation of the relative impact on total variable losses. But for larger changes, the original marginal TLF may no longer be valid, in which case inefficient responses are likely for large volumes. Exaggerated and inefficient response in either direction is possible. Theoretical accuracy depends on the size of flow changes relative to the flow itself, and the impact of the flow at that node relative to the system as a whole.
11. The residual over-recovery of variable losses resulting from application of marginal TLFs to the entire flow at each node can be re-distributed to all flows in proportion to their size, scaling up all injection and/or scaling down all offtakes. However, this does not correct for application of marginal factors to non-marginal amounts of flow.
12. More generally, the application of marginal TLFs determined for one particular pattern of flows to a different pattern of flows will misallocate the impacts on total variable losses.
13. For this reason, previous proposals to allocate transmission losses have used half-marginal (or average) TLF. This dilutes the marginal signal but could be considered a fairer basis for allocation of the actual variable transmission losses. **We urge the CMA to indicate urgently if its proposal is to follow P229 in using half-marginal TLF.**

#### **B: Allocation of losses between generation and demand will not sharpen the incentive on generators**

14. Actual total losses on the transmission network comprise variable losses, which depend relatively predictably on power flows, and other losses, sometimes referred to as "fixed", whose levels

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depend on factors other than simple power flows. Total losses are measured in each half-hour period by the difference between metered delivery and metered offtake. The BSC adjusts delivery and offtake volumes in each half-hour period to match each other, using volume multipliers (TLMs). The adjustment allocates total losses between delivery and offtake volumes in a given proportion, currently 45:55 respectively.

15. This adjustment (denoted in the BSC by TLMO+ and TLMO- offsets) determines the “balancing point” at which trading takes place. In essence, generation bears the cost of getting electricity from the station gate to the balancing point; and demand bears the cost of getting electricity from the balancing point to the grid supply point (“GSP”). Shifting the balancing point to the station gate (or indeed to the grid supply point) has an equal and opposite effect on the wholesale price and on the cost of losses for both generation and demand.
16. With two important exceptions, it makes no difference where the balancing point is located. Shifting the balancing point towards the station gate provides benefits for interconnector imports, which are not currently subject to transmission loss adjustments. This exacerbates the problem of regulatory arbitrage that is already a significant issue, creating distortions affecting interconnector flows. **Due to these distortions, and lack of any offsetting beneficial impact, we urge the CMA to reconsider its decision to shift the balancing point to the station gate.**
17. The second important exception relates to volumes sold forward in market hedging operations. These volumes were sold on the basis of trade at today’s balancing point, but if the balancing point is shifted before delivery then costs change with no corresponding change in wholesale price. **We therefore urge the CMA to give adequate notice of any shift to the balancing point, by pushing the introductory date back from October 2017 to beyond the market trading horizon, i.e. October 2018.**
18. We note that it is more usual for supply costs that cannot easily be firmly attributed to individual participants to be allocated as a tax on demand on the basis that consumers will ultimately pay and it avoids administrative process for producers. For example, the costs of the Renewables Obligation (“RO”), Feed-in Tariff (“FIT”) scheme, CfDs and the Capacity Market are recovered only from supplier imports. If these were charged to generation too, we could displace even more GB generation with imports.
19. Note also that losses within distribution are allocated to both exports and imports, but because most end-customer flows are offtakes (most delivery comes from the transmission system), most of the losses are allocated to offtake.
20. EDF Energy believes that any shift of the national balancing point for electricity should be undertaken in association with a review of losses more generally, including consideration of losses within distribution, losses due to interconnector flows, and losses in electricity systems in other inter-connected countries.

### **C: Impact of putting locational signals on demand**

21. Delivery and offtake volumes can be adjusted further by application of the TLF. It is important to understand that the application of TLF is a relative one, differentially affecting volumes at each node. The location of the balancing point is irrelevant to the impact of TLF: for generation at each node the volume adjustment up or down is relative to other generators, with zero net adjustment for generators as a whole; and for demand at each node similarly the volume adjustment up or down is relative to other nodes, with zero net adjustment for demand as a whole.

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22. However, it is not clear whether the CMA intends to apply TLF to offtake units. We are not clear whether the proposal to allocate all the costs of losses to generation literally means no transmission loss allocation to any demand, or whether it means that demand would collectively pay nothing, but with individual demands paying or receiving. We consider that there are two issues. Firstly, while most consumer demand may be fairly unresponsive to the loss signal, licence exemptable generation embedded in distribution systems usually reduces offtake under the BSC rather than appearing as explicit delivery, although the effect on transmission losses due to the change in flow at the transmission boundary is the same as if it were delivery. Also, the impact on losses of more active future demand response, particularly for system balancing, could be more significant. Not applying TLF to offtake units would lose the potential benefits of locational allocation of losses, and discriminate between licensed generators and other sources of generation and balancing energy. Secondly, to not apply TLF to units which are offtaking would require more significant modification of the BSC central systems than previous proposals, increasing implementation costs. **We request the CMA to clarify urgently whether it intends to apply TLF to offtake.**

**D: Spatial and temporal averaging of the loss factors should be kept under review**

23. We understand that the CMA's decision is to fix TLF in advance, using the results of a power flow model to indicate the average value applicable over a period, likely a year ahead. Furthermore, we assume that, like P229, the TLF for each delivery and offtake unit will be an average for the zone in which it is situated e.g. according to which of the 14 distribution regions the unit is located. This is a pragmatic position that reduces implementation costs significantly, and provides a stable signal to which dispatch decisions can respond. However, it must be recognised that the averaging inherent in this process significantly reduces the effectiveness of the marginal signals in optimising transmission losses with fuel cost efficiencies.
24. Our modelling indicates the variation of TLF within a GSP Group is typically larger than the variation between the averages for the GSP Groups (See Figure 1). This is because GSP Groups are large regions, with boundaries which do not closely reflect the electrical "distance" between nodes. For example, offshore wind nodes are associated with very high losses on the long undersea cables. Averaging these losses across all nodes within the GSP Group where the offshore cable connects would distort the marginal signal for other generators in that GSP Group. Furthermore, our modelling indicates that the variation through time, from hour to hour, is dependent particularly on the strength of wind generation, due to the strong impact on north-south power flows from predominantly Scottish wind generators (See Figure 2). **As intermittent onshore and offshore wind is expected to play an increasing role in the GB power system in the future, we urge the CMA to recommend that the spatial and temporal averaging of the TLF is kept under review by the industry.**
25. EDF Energy would welcome the opportunity to discuss the results of our analysis further if it would be helpful to the CMA.



Figure 1 - Raw marginal loss factors for GSP Group averages (dots) and 'best' and 'worst' nodes in group (bars) for a scenario with stronger north-south power flows.

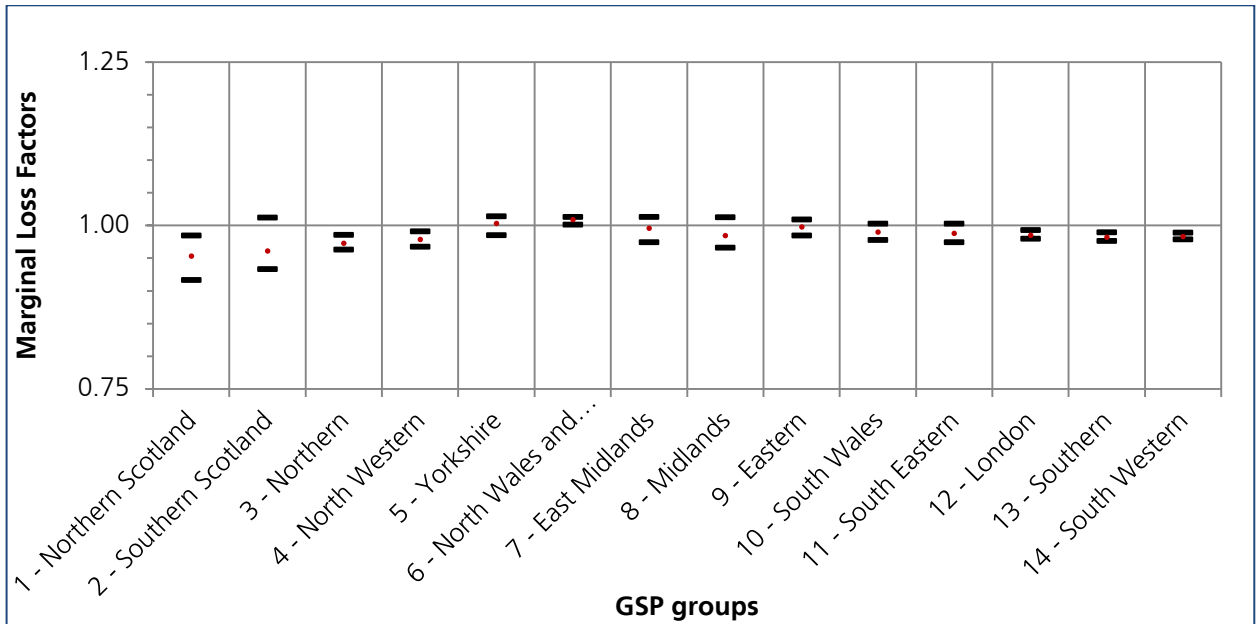
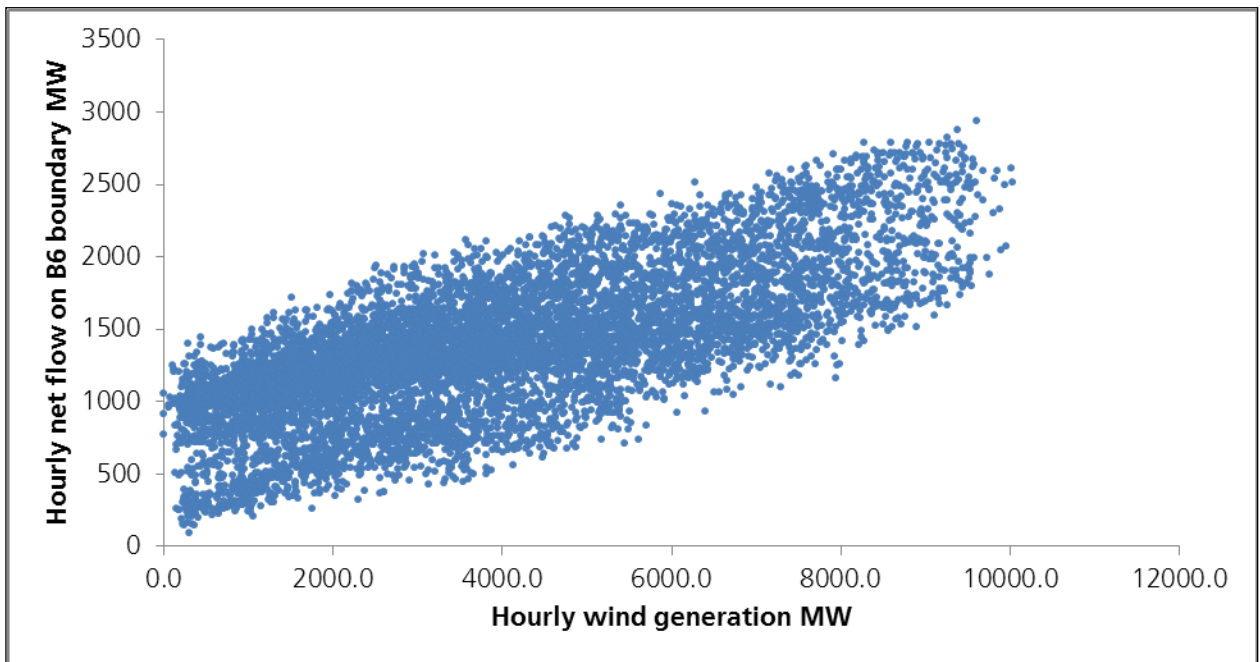
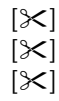


Figure 2 - Points mark hourly flows on the B6 boundary between the Scottish and English transmission networks as a function of the hourly wind output on the system. North-south flows are a key driver of transmission losses and hence MLF.



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## Appendix 3 - Results of EDF Energy's recent customer communications testing with Standard Variable Tariff customers



**EDF Energy**  
**April 2016**