Anticipated merger between SSE Retail and Npower, and the anticipated acquisition of material influence by Innogy over the Merged Entity

Decision on relevant merger situation and substantial lessening of competition

ME/6721/17

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 26 April 2018. Full text of the decision published on 21 May 2018.

Please note that [✂] indicates figures or text which have been deleted or replaced in ranges at the request of the parties for reasons of commercial confidentiality.

SUMMARY

1. The proposed transaction (the **Merger**) involves the anticipated merger between the domestic retail energy business of SSE plc (**SSE Retail**) and Npower Group plc (**Npower**) (forming the **Merged Entity**), and the anticipated acquisition of material influence by Innogy SE (**Innogy**), the current owner of Npower, over the Merged Entity. SSE Retail and Npower are together referred to as the **Parties**.

2. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that the Parties will cease to be distinct as a result of the Merger, that the turnover test is met and that, accordingly, arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

3. The Parties' main overlap is in the retail supply of electricity and gas (together, **energy**) to domestic customers in Great Britain (**GB**). Customer groups can be distinguished by tariff type, meter type and payment method. The CMA has assessed the impact of the Merger in the following frames of reference:

    a) the supply of electricity to domestic customers in GB;

b) the supply of gas to domestic customers in GB;

c) the supply of electricity to domestic non-Economy 7 restricted meter customers in GB;

d) the supply of electricity to domestic prepayment customers in GB; and

e) the supply of gas to domestic prepayment customers in GB.

4. The Six Large Energy Firms (**SLEFs**), which include the Parties, account for around 80% of the supply of energy to domestic customers in GB. The CMA found that, while recognising the growth and increasing constraint imposed by some small and mid-tier suppliers (**SAMS**) on SLEFS, there are substantial differences between the SLEFs and SAMS (eg in their customer base, customer preference and brand awareness). For this reason, the CMA believes that the Parties are more similar, and compete more closely with, the other SLEFs than with the SAMS.

5. The CMA assessed whether the Merger might raise competition concerns as a result of horizontal unilateral effects in the frames of reference set out above, and also assessed whether the Merger could give rise to coordinated effects. Finally, the CMA also considered the effect of the Merger on the vertical relationship between Npower and one of its wholesale customers.

6. The CMA considered two different theories of harm as part of its assessment of the horizontal unilateral effects of the Merger in the supply of electricity and/or gas in GB: (i) the loss of rivalry in the process by which suppliers, and particularly the SLEFs, set their Standard Variable Tariff (**SVT**) prices; and (ii) the loss of rivalry to attract new customers.

7. The CMA has found competition concerns in the supply of gas and electricity to domestic customers in GB as a result of a loss of rivalry in the process of setting SVT prices because:

a) As submitted by the Parties and shown in their internal documents, a key consideration for suppliers when setting SVT prices is the expected customer reaction, which is affected significantly by the timing and level of SVT price changes of rival SLEFs;

b) There is significant press and other commentator interest in SVT prices, which is strongly focussed on the SLEFs as the SLEFs have the vast majority of SVT customers;

c) Consistent with this, the main focus of the Parties' internal documents is the SVT prices of the other SLEFs – although the Parties consider the SVT prices of other suppliers, this is more limited;

d) For these reasons, each of the SLEFs, including each of the Parties, is constrained in its SVT price setting behaviour by the other SLEFs; and

e) Post-Merger, the removal of part of this comparative constraint could result in higher SVT prices among all the SLEFs than absent the Merger.

8. In coming to this conclusion, the CMA took into account the information and evidence received during the course of its investigation of the Merger, the findings of the CMA's recent Energy Market Investigation (**EMI**) and the ongoing work of Ofgem (including the State of the Energy Market Report).

9. The EMI found that:

a) competition was not working effectively for customers in the SVT segment;

b) a large number of households appear to remain unengaged from the market and on more expensive SVTs, despite many small and mid-tier suppliers competing for new customers with less expensive fixed term contract (**FTC**) tariffs; and

c) changes in SVT prices affect millions of households.

10. Ofgem told the CMA that "*in its Report the CMA found that even with six large suppliers the retail energy market was not delivering good outcomes for consumers. Notwithstanding the implementation of the remedies recommended by the CMA, we have concerns that with the reduction of the number of larger competitors from six to five competition in the market will be undermined.*"

11. The CMA believes that the Merger gives rise to a realistic prospect of a substantial lessening of competition (**SLC**) in relation to the supply of electricity and/or gas to domestic customers in GB. This is as a result of horizontal unilateral effects through the loss of rivalry in the setting of SVT prices. Given there are currently millions of customers on SVTs (with a significant proportion of these customers on SVT tariffs for more than three years)[1] despite the existence of cheaper FTC tariffs available, the CMA does not believe the

[1] Latest figures published by Ofgem suggest approximately 13 million non-prepayment meter SVT customer accounts, see paragraph 91.

constraints from FTCs to be sufficient to protect customers from any SVT price increase.

12. With respect to the effect of the Merger in the loss of rivalry to attract new customers, the CMA found that the Parties are not close competitors and they face constraints from both the other SLEFs and some of the SAMS. The CMA found that these constraints apply across GB, including in the Parties' former **PES** regions.[2] Consistent with this evidence, the CMA found that the Merger does not result in significant upward pricing pressure as a result of a reduction in competition for new customers. Therefore, the CMA has not identified competition concerns in relation to this theory of harm.

13. The CMA also has not found competition concerns in the supply of electricity to non-Economy 7 restricted meter customers given that Npower does not offer tariffs of this sort to new customers.

14. The CMA also has not found competition concerns in the supply of gas and/or electricity to domestic prepayment meter (**PPM**) customers in GB given the lack of closeness between the Parties and the availability of other suppliers, including the other SLEFs and some of the SAMS, particularly Utilita and Ovo Energy.

15. The CMA also considered whether the Merger could lead to competition concerns as a result of coordinated effects. The EMI found no evidence of coordination, and the CMA noted that the changes in the energy market since the EMI will have made coordination less likely. The CMA found that, even if the Merger might change some aspects of the market structure, which might enhance the ability of some parties to reach an understanding on the terms of coordination, this would not be either internally or externally sustainable given the increased differences between the SLEFs and, even if the Merged Entity and British Gas become more similar, the competitive pressure of other suppliers. Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of an SLC as a result of coordinated effects in relation to the supply of gas and/or electricity to domestic customers in GB.

16. Pursuant to its finding of competition concerns in the price setting of SVTs, the CMA could not exclude the possibility that the Merger may also raise competition concerns in relation to the vertical relationship between Npower and Utility Warehouse, given that the wholesale price paid by Utility Warehouse is set by reference to SVT prices and an increase in SVT prices may lead to the foreclosure of this competitor.

[2] Public Electricity Supply regions

17. Post-Merger, Innogy, the current owner of Npower who will acquire 34.4% in the Merged Entity, will not be operating at the retail level of the supply chain and so the CMA did not identify a horizontal theory of harm in relation to the acquisition of material influence by Innogy over the Merged Entity. Given the relevant shares of the Parties and Innogy at the retail and wholesale levels of supply respectively, the CMA has also not identified a credible vertical theory of harm in relation to this aspect of the Merger.

18. The CMA found that entry or expansion would not be timely, likely and sufficient to prevent the SLC identified by CMA, as there is insufficient reason to believe that the SAMS will become as prominent in the benchmarking process for setting SVT prices as the SLEFs in the foreseeable future.

19. The Parties have until 3 May 2018 to offer an undertaking to the CMA that might be accepted by the CMA. If no such undertaking is offered, then the CMA will refer the Merger pursuant to sections 33(1) and 34ZA(2) of the Act.

ASSESSMENT

Parties

20. SSE plc (**SSE**) is a listed, vertically integrated energy company, with electricity and gas activities in the UK and Ireland. Prior to the transaction, SSE will separate out its domestic retail activities[3] in GB to form SSE Retail.[4] In the financial year ended 31 March 2017, the UK turnover of SSE Retail was £ [✂].

21. Npower is a UK company, fully owned by Innogy**,** which is active in the retail supply of domestic and non-domestic gas and electricity and energy-related services in GB.[5] Innogy is a European energy group active in renewable energy generation, electricity and gas distribution, and the retail supply of energy. Innogy is listed on the Frankfurt Stock Exchange, and is majority owned (76.8%) by RWE AG (**RWE**).[6] In 2016, the UK turnover of Npower was £ [✂].

[3] SSE is also active in the supply of energy to small and medium-sized enterprises (**SMEs**) (including microbusinesses) and to industrial and commercial customers. SSE will not contribute these activities to the Merged Entity.
[4] SSE's business in Northern Ireland and the Republic of Ireland will also not be transferred to the Merged Entity.
[5] Npower has c. £ [✂] turnover generated from legacy non-domestic retail energy contracts with customers in Ireland, which will be transferred to the Merged Entity as part of the Merger. Npower is not currently competing for business in Ireland or Northern Ireland, and therefore these activities are not considered further.
[6] Innogy was formed through the restructuring of RWE, whereby the renewables, grid and retail divisions of RWE were de-merged from RWE's conventional power generation and trading activities.

Transaction

22. The anticipated transaction involves the creation of a new company (the Merged Entity), into which the Parties will contribute SSE Retail and Npower in exchange for shares in the Merged Entity.

23. At completion, the Merged Entity will be listed on the London Stock Exchange. Innogy will retain a minority shareholding (34.4%) in the Merged Entity, and SSE's shareholding of the Merged Entity (65.6%) will be distributed to its shareholders immediately,[7] leading to the exit of SSE from the domestic retail energy sector in GB. Innogy will retain its minority shareholding in the Merged Entity for at least 6 months.

24. The Parties confirmed to the CMA that the Merger is not subject to review by any other competition authority, including the European Commission.

25. The Parties submitted that the rationale for the Merger is "to create an efficient new independent retail energy supplier in Great Britain by combining the resources and experience of two established players in a new market model"; and the Merger is "expected to lead to substantial synergy potential". SSE internal documents describe the rationale for the Merger as being an opportunity to: improve earnings for SSE through the turnaround of Npower's supply business, significantly reduce the combined cost base, decrease SSE's capital expenditure through using Npower's new IT system, and offer an enhanced customer proposition though the application of SSE's management practices.

Procedure

26. The Merger was considered at a Case Review Meeting.[8]

Jurisdiction

27. As a result of the Merger, the enterprises of SSE Retail and Npower will cease to be distinct.

28. The CMA considered whether the 34.4% minority interest of Innogy in the Merged Entity would result in Innogy gaining material influence over the

[7] SSE will not be involved in the appointment of any members to the board of directors of the Merged Entity, other than for the transitional period to ensure that the composition of the Merged Entity board of directors is known at the time of closing of the transaction/listing of the Merged Entity on the London Stock Exchange (which will occur simultaneously).
[8] See Mergers: Guidance on the CMA's jurisdiction and procedure (CMA2), January 2014, from paragraph 7.34.

Merged Entity, and therefore in the creation of a further relevant merger situation.

29. The ability to exercise material influence is the lowest level of control that may give rise to a relevant merger situation.[9] When making its assessment, the CMA focuses on the acquirer's ability to materially influence policy relevant to the behaviour of the target firm in the marketplace. A finding of material influence may be based on the acquirer's ability to influence the target's policy through exercising votes at shareholders' meetings, together with, in some cases, additional supporting factors. Material influence may also arise as a result of the ability to influence the board of the target, and/or through other arrangements.[10]

30. Innogy's minority interest in the Merged Entity will:

a) allow it to unilaterally block special resolutions at the shareholder level, but not unilaterally pass any ordinary shareholder resolutions; and

b) give it the right to appoint a minority of the board of the Merged Entity (two directors if it has at least a 20% share of the Merged Entity or one director if it has a 10-20% share), but no ability either to veto or to take unilateral decisions at board.

31. The Parties submitted that, as a result of the transaction, Innogy will acquire material influence over the Merged Entity (including SSE Retail) via its interest in the Merged Entity.

32. On the basis of this evidence, the CMA believes that, as a result of the Merger, Innogy will acquire material influence over the Merged Entity.

33. The anticipated transaction therefore gives rise to two merger situations:

a) the creation of the merger between Npower and SSE Retail (ie Npower and SSE Retail will cease to be distinct), and

b) the acquisition of material influence by Innogy over the Merged Entity (ie Innogy and SSE Retail will cease to be distinct).[11]

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[9] See Mergers: Guidance on the CMA's jurisdiction and procedure, paragraph 4.14.
[10] See Mergers: Guidance on the CMA's jurisdiction and procedure, paragraph 4.16.
[11] The Parties submitted that the transaction gives rise to one single relevant merger situation, rather than two separate relevant merger situations, as the combination of Npower and SSE Retail occurs as part of a single, indivisible step in the overall transaction and therefore does not create a relevant merger situation in its own right. Footnote 17 of the Mergers: Guidance on the CMA's jurisdiction and procedure provides that, in certain limited circumstances, it may be appropriate to treat a single commercial transaction as giving rise to more than one relevant merger situation. CMA notes that, in this case, the combination of Npower and SSE Retail can qualify as a separate merger situation because the nature of the change in control is different for the two operations.

34. The UK turnover of each of SSE Retail and Npower exceeds £70 million, so the turnover test in section 23(1)(b) of the Act is satisfied in relation to each of the relevant merger situations identified above.

35. The CMA therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of two relevant merger situations.

36. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 28 February 2018 and the statutory 40 working day deadline for a decision is therefore 26 April 2018.

Background

The Energy Market

37. The electricity sector consists of generators, grid operators and distribution network operators who transport the electricity to end users, wholesale traders who trade electricity for half-hour periods at various moments in the future, a system operator (National Grid) and retail supply companies who sell electricity to end users. The value chain for gas operates in much the same way. SSE is active in most stages of the value chain in the UK, whereas Npower is almost exclusively active in retail supply (although its parent Innogy is active in renewable electricity generation in GB).

The CMA's Energy Market Investigation (EMI)

38. From 2014 to 2016, the CMA conducted an in-depth investigation into the energy market in the UK, including both the wholesale and retail markets (including supply to households and microbusinesses). In the EMI, the CMA found several features of domestic retail energy supply giving rise to adverse effects on competition, including:

    a) An overarching feature of weak customer response and lack of engagement, giving suppliers the ability to exploit their position through their pricing policies, including through price discrimination by charging their SVTs materially above a level that could be justified by cost differences.

    b) Specific features in the prepayment segment, reducing suppliers' ability and/or incentives to compete to acquire prepayment meter customers and to innovate by offering tariff structures for these customers' demands.

c) Specific aspects of the regulatory regime, including measures introduced under the Retail Market Review (**RMR**) reforms (eg the measure limiting the number of tariffs a supplier is able to offer to four), reducing suppliers' ability and/or incentives to innovate in designing tariffs to meet customers' demands.

39. Pursuant to the EMI, the CMA implemented or recommended a number of remedies to help address these concerns, including the withdrawal of certain aspects of the RMR reforms,[12] a remedy to enhance restricted meter customers' ability and incentive to engage in the market and to switch to other suppliers, some remedies to improve customer engagement generally, and a price cap to protect PPM customers for a transitional period. A number of these remedies have already been implemented. For instance, in November 2016, the rules which restricted suppliers to offering only four tariffs (the RMR 'Simpler Tariff Choices' rules) were lifted; and in April 2017, Ofgem introduced a price cap for PPM customers.

40. Ofgem has also recently introduced a number of its own reforms, including (i) a proposed single Central Switching Service (CSS) aimed at promoting faster and more reliable switching of tariff and supplier;[13] (ii) allowing suppliers to switch consumers onto new FTCs rather than SVTs at the end of their FTC period; and (iii) the repeal of various non-discrimination prohibitions.[14]

41. In addition, the Government has published a draft Bill (the Domestic Gas and Electricity (Tariff Cap) Bill) that, if passed, would require Ofgem to introduce a cap on SVTs and other default tariffs until 2020, with the possibility of it being extended to 2023 if necessary (the **Price Cap**).[15]

Counterfactual

42. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers, the CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the

[12] Ofgem also removed the non-price discrimination clause (Standard Licence Condition 25) allowing for regional pricing differences.
[13] The CSS would replace existing separate gas and electricity switching services, and would switch a customer's tariff or supplier within one working day. The necessary drafting of industry code requirements and licence conditions is planned to start during 2018, see Ofgem update on new switching arrangements
[14] Ofgem (September 2016), Modification of electricity and gas supply licences to remove certain RMR Simpler Tariff Choices rules
[15] The Government has introduced the Domestic Gas and Electricity (Tariff Cap) Bill, which is currently at the Committee stage in the House of Commons. Announcement available on the government's website

evidence available to it, it believes that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions.[16]

43. The Parties identified a number of recent or anticipated changes in the competitive conditions in the retail supply of energy, including the implementation of the remedies proposed in the CMA's EMI, technological advances (including smart meters and connected homes), further Ofgem reforms aimed at encouraging customer switching, and the proposed Price Cap. However, the Parties submitted that these changes should be considered in the competitive assessment, and did not propose that the CMA should adopt an alternative counterfactual to the prevailing conditions of competition.

EMI remedies and other regulatory measures

44. As set out in paragraph 39, a number of measures and regulatory changes have taken place since the EMI. At least some of these measures are beginning to have an effect. For instance, as a result of the introduction of the price cap for PPM customers, the market average price for a dual fuel prepayment customer fell by around £60 in April 2017.[17]

45. Several other measures are also still in the process of being implemented, including the creation of a database of disengaged customers (ie customers who have been on an SVT for more than three years) to allow rival suppliers to target them, and other measures (such as prompts and information on energy deals) aimed at increasing customer engagement, which Ofgem is currently trialling.

46. To the extent that the EMI remedies and other regulatory changes have been implemented, and their effect is reflected in the recent data that the CMA has used as part of its assessment, they will be included in the prevailing conditions of competition. For those remedies and measures not yet implemented, or where the effect has not yet been felt, there remains some uncertainty, both around the extent and nature of the effects and when they will be realised. For this reason, the CMA has not included them within its counterfactual. However, consistent with the Parties' submission, the CMA has considered these measures, where appropriate, in its competitive assessment.

[16] Merger Assessment Guidelines (OFT1254/CC2), September 2010, from paragraph 4.3.5. The Merger Assessment Guidelines have been adopted by the CMA (see Mergers: Guidance on the CMA's jurisdiction and procedure (CMA2), January 2014, Annex D).
[17] See Ofgem's State of the Energy Market Report at page 32.

Price Cap

47. In the same way as for the other measures not yet implemented considered above, there is considerable uncertainty around the proposed Price Cap. This uncertainty relates to its scope (eg which customers and tariffs it will cover), its timing (ie when it will be implemented), its duration, its level and its impact on competition. As currently proposed, it will be the responsibility of Ofgem to set the level of the Price Cap to protect and safeguard customers (which the CMA understands is the primary objective),[18] but also to protect competition. Specifically, the draft Price Cap Bill says that Ofgem should encourage supplier efficiency, enable effective competition between suppliers, maintain customer engagement and ensure efficient suppliers are still able to effectively finance themselves.[19]

48. At this stage, it is not clear to the CMA what the competitive landscape will look like after the Price Cap comes into effect. Therefore, for the purposes of its assessment of the Merger, the CMA has not included the implementation of the Price Cap in its counterfactual.

E.ON/RWE transaction

49. In reviewing mergers at phase 1, the CMA may be required to consider a merger at a time when there is the prospect of another merger in the same market (a parallel transaction).[20] The CMA is likely to consider whether the statutory test for reference would be met whether or not the parallel transaction proceeds (unless the parallel transaction can clearly be ruled out as too speculative).[21]

50. On 12 March 2018, E.ON and RWE announced they had reached an agreement, which includes the acquisition by E.ON of RWE's 76.8% stake in Innogy (**the E.ON/RWE transaction**). Pursuant to this transaction, E.ON will acquire control over Innogy's 34.4% shareholding in the Merged Entity (subject to any change in this shareholding by the time of the E.ON/RWE transaction).

51. The CMA considered whether the E.ON/RWE transaction may be a parallel transaction for the purposes of its assessment of the Merger.

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[18] See, for example, the summary of Bill referring to the intention that it protects households.
[19] Domestic Gas and Electricity (Tariff Cap) Bill, as introduced by the Secretary of State for BEIS on 23 February 2018, s. 1(6).
[20] See footnote 46 of the Merger Assessment Guidelines. This footnote explains that a parallel transaction is considered as part of the counterfactual on the basis that it would occur whether or not the merger takes place.
[21] See Merger Assessment Guidelines, paragraphs 4.3.5, 4.3.25, 4.3.26 et seq

52. The Parties submitted that, for the following reasons, it is currently not certain that the E.ON/RWE transaction will proceed and that, therefore, it must be considered as too speculative:

a) The E.ON/RWE transaction is conditional upon, inter alia, approval by the relevant antitrust and regulatory authorities. In particular, the E.ON/RWE transaction will be conditional upon clearance of the European Commission;

b) The E.ON/RWE transaction is not expected to complete until the end of 2019;

c) The voluntary public takeover offer period is currently expected to commence in early May 2018, following approval of the offer document by BaFin (the German Federal Financial Supervisory Authority). Closing of the public takeover offer period is not expected until the middle of 2019.

53. The CMA believes that there is currently a significant degree of uncertainty about both the timing and the outcome of the E.ON/RWE transaction and, therefore, in line with its previous practice,[22] it has assessed the Merger against the current conditions of competition (ie not reflecting the impact of the E.ON/RWE transaction).

Frame of reference

54. Market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the merger as it is recognised that there can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.[23]

[22] See, for instance, in its decision on the anticipated acquisition by BT Group plc of EE Limited (15 January 2016), the CMA found that it was not possible to pre-judge the outcome of the Commission's investigation of the Hutchison 3G / O2 transaction and hence to predict the impact that it would have on competition in markets relevant to BT/EE in the UK. The CMA therefore ultimately carried out its assessment of the merger against a counterfactual in which the level of competition is equivalent to the status quo excluding any effect of the Hutchison 3G / O2 transaction. Similarly, in its decision on the anticipated merger between NYSE Group, Inc. and Euronext N.V (9 October 2006), the Office of Fair Trading found that it was speculative to conclude that a parallel bid would satisfy all relevant shareholder and regulatory approvals and complete.

[23] Merger Assessment Guidelines, paragraph 5.2.2.

Overlaps and vertical relationships between the Parties

55. The retail supply of energy to end users is typically split into (i) domestic, (ii) SMEs, and (iii) industrial and commercial (**I&C**) customers. Given the Parties' activities overlap in the retail supply of energy to domestic households and not to other retail customers, the CMA took this as its starting point for its assessment of the Merger.

56. The Parties also overlap in the supply of energy home automation products, in particular in the supply of household smart thermostats.[24] SSE Retail sold [✂] of these units in 2016 and Npower sold [✂] units in the year to 31 March 2017. This represents a combined share of supply of [0-5]%, given total market sales of approximately [✂] units in 2016. Information submitted by the Parties indicates that there are many retail suppliers of energy home automation products in GB, and no third party raised concerns regarding the effect of the Merger in the supply of these products. Therefore, the CMA has not considered this overlap further.[25]

57. There is also a vertical relationship between the Merged Entity's activities in the retail supply of energy and both SSE's and Innogy's energy generation and trading operations in GB. However, the CMA notes that the EMI did not find any adverse effect on competition arising from vertical integration in the energy sector. Moreover, as a result of the Merger, the retail activities of SSE will be separated from its upstream generation and trading activities, reducing the extent of vertical integration.[26] Similarly, although Innogy will have influence over a larger retail business, its level of influence will be reduced to 34.4%. The CMA also found in EMI that Innogy/RWE's share of supply in the generation and trading of energy is less than [✂]. For these reasons, the CMA believes that the Merged Entity and Innogy would have neither the ability, nor the incentive, to foreclose any competing generator or retail supplier, nor to reduce wholesale market liquidity.[27] Therefore, the CMA has identified no plausible

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[24] The Parties also provide other energy-related services such as meter and metering services, Energy Company Obligation (**ECO**) services, and home products and services, but submitted they do not overlap in relation to these services because they are an ancillary part of supplying gas and electricity to customers, and either one or both of the Parties do not provide these services to third parties.
[25] There is also a vertical relationship between Innogy's wholesale supply of smart thermostats and the Merged Entity's downstream activities in the retail supply of smart thermostats. Given the small share of supply of both the Merged Entity in the retail supply of smart thermostats and Innogy in the wholesale supply, the CMA found that neither Innogy nor the Merged Entity will have the ability or incentive to foreclose either wholesale or retail suppliers of these products.
[26] The Merged Entity has entered into a transitional services agreement with SSE to provide hedging activity to meet its requirements, which is envisaged to last until around 2022, when the Merged Entity is expected to have developed its own capability or entered into third party agreements.
[27] EMI final report, appendix 7.1

theory of harm in relation to these vertical relationships, and it has not considered them further.

Product scope

58. The Parties overlap in the retail supply of energy to domestic customers.

59. The UK authorities have considered the retail supply of energy to domestic customers on a number of occasions,[28] including in the EMI,[29] and have generally distinguished between the supply of gas and electricity, given the material demand-side and supply-side differences in relation to these products.

60. The Parties submitted that the Merger should be assessed by reference to the retail supply of gas, electricity, and dual fuel separately, noting that they consider dual fuel as a key driver of competition. The Parties did not find it appropriate to further segment by type of tariff, meter or payment method.

61. The CMA has not received any evidence to indicate that the approach previously adopted by the CMA in relation to the distinction between the supply of gas and electricity as separate frames of reference is not appropriate in the present case.

62. The CMA may sometimes define relevant markets for separate customer groups if the effects of the merger on competition to supply a targeted group of customers may differ from its effects on other groups of customers, and require a separate analysis.[30] In this case, the CMA has considered three possible customer segmentations: by tariff, meter type and payment method.

Single and dual fuel tariffs

63. In previous decisions,[31] the Office of Fair Trading (**OFT**) considered whether to split energy supply into gas and electricity, or into gas, electricity and dual fuel, but did not conclude. More recently, in the EMI, the CMA did not define a separate market for dual fuel.

64. Dual fuel tariffs are an alternative to single gas and electricity tariffs for customers that use both gas and electricity. Therefore, the CMA considers that there is significant demand-side substitution between dual fuel tariffs and single

[28] For example see Anticipated acquisition by Telecom Plus plc of Electricity Plus Supply Limited and Gas Plus Supply Limited from Npower Limited (Telecom Plus 2013), Anticipated acquisition by Centrica of 20 per cent of Lake Acquisitions (Centrica/Lake Acquisitions 2009), and Anticipated acquisition by Npower Ltd of the electricity and gas businesses of Telecom Plus plc (Npower/Telecom Plus 2006).
[29] EMI final report, section 3
[30] Merger Assessment Guidelines, paragraph 5.2.5(c).
[31] See Telecom Plus (2013), par. 19, and Npower/Telecom Plus (2006), par. 11

gas/electricity tariffs. The CMA notes that dual fuel discounts offered by energy suppliers are not necessarily cost reflective, and energy suppliers can price discriminate between dual fuel and single fuel customers, but as the gas and electricity supplied under these tariffs is the same as under single tariffs, the option for both demand and supply side substitution remains.

65. Therefore, the CMA has assessed the effects of the Merger in relation to the retail supply of gas and electricity separately and has not considered dual fuel tariffs as a distinct frame of reference. However, the CMA did not have to reach a conclusion on the appropriate product frame of reference since, as set out below, its reference decision did not depend on the precise definition adopted.

Tariff type

66. Broadly speaking, there are two types of tariff:

    a) Variable tariffs, most importantly the SVT. These tariffs can be changed unilaterally by the retailer at any time, subject to 30 calendar days' notice,[32] although in practice suppliers tend to make SVT prices changes on an annual basis. At present, SVTs are generally 'default' tariffs, which customers switch onto when their FTC period comes to an end.

    b) FTC tariffs, which provide the customer with a fixed price for a given period. These are generally used as acquisition or retention tariffs, ie customers actively choose to switch to them.

67. The Parties submitted that it was not necessary for the CMA to assess the Merger by reference to tariff type.

68. In the EMI, the CMA noted that, although the product is essentially homogenous, "*all suppliers have consistently priced their SVTs at a premium to fixed term tariffs*", indicating that suppliers are able to price discriminate between 'less engaged' customers, with lower propensity to switch, on an SVT and 'engaged' customers, with higher propensity to switch, on a FTC tariff. However, the EMI emphasised that customers "*do not fall into discrete camps of 'engaged' and 'disengaged'*", and concluded that the two groups were not distinct enough to warrant separate markets.[33]

69. The CMA also notes that some suppliers now use an FTC tariff as a default tariff, and that others use variable tariffs (but not SVTs) as important acquisition tariffs. Therefore, the key distinction is between default tariffs (which are

[32] Standard Licence Condition 23.4 of the gas and electricity supply licences.
[33] EMI final report, chapter 3, par. 3.32-3.34.

referred to in this decision as SVTs)[34] and acquisition tariffs (which are referred to as FTC tariffs but may include some variable tariffs).

70. The CMA has not received any evidence to indicate that the approach adopted by the CMA in the EMI is not appropriate in the present case. Therefore, the CMA has taken into account the distinct competitive conditions for some of these customer segments in its competitive assessment but has not identified them as separate frames of reference.

Meter type

71. In the EMI, the CMA concluded that non-Economy 7 restricted meters[35] were a distinct segment, finding a more limited number of tariffs available to these customers compared with other customers.[36] The EMI also found that customers on dual-rate tariffs often pay a premium compared to what they would pay on a single-rate tariff,[37] which was indicative of limited substitutability.

72. In the present case, Price Comparison Websites (**PCWs**) told the CMA that tariffs for non-Economy 7 restricted meters were not typically part of their offer. Similarly, a number of competitors told the CMA that they could only supply new customers with such meters if they were willing to receive a single-rate tariff, or if they replaced their meter.

73. Customer data provided by Ofgem suggests that the number of non-Economy 7 restricted meter customers is falling. Data provided by the Parties supports this, (eg in December 2017, SSE Retail had approximately [✂] electricity customers on non-Economy 7 restricted meter tariffs, representing a reduction [✂] since the start of 2015). Moreover, pursuant to the EMI, the CMA introduced a remedy seeking to allow restricted meter customers to switch to single-rate tariffs, which took effect from 1 September 2017.

74. However, given the level of non-Economy 7 restricted meter customers who remain, and given that there could be some reluctance among customers with these meters to switch to single-rate tariffs, it appears there is a limited constraint on dual-rate tariffs from single-rate tariffs for these customers. For

[34] The term SVT also includes new tariffs that may be introduced by energy suppliers in response to the potential Government Price Cap that have similar terms to SVTs and to which customers will default to at the end of their FTC tariff.
[35] Restricted meters include any metering arrangement whereby a domestic customer's consumption at certain times and, in some cases, for certain purposes (eg heating) is separately recorded. These meters allow for customers to be charged lower rates for electricity used at times when overall demand is lower.
[36] EMI final report, par. 3.41.
[37] The EMI calculated that 67% of customers of the SLEFs on restricted meters in Q2 of 2015 paid more than they would have done on a single-rate bill (EMI final report, Appendix 9.5, par. 75-96, including table 4. For the Parties, the figures were [✂] (Npower) and [✂] (SSE).

these reasons, the CMA has assessed the effects of the Merger in relation to customers on non-Economy 7 restricted meters separately.

Payment method

75. The Parties and other energy suppliers offer different options for payment to their customers, including direct debit, standard credit and prepayment.

76. In the EMI, the CMA concluded that prepayment customers constitute a distinct market since there is a lower number of tariffs for these customers and less intense competition to win them. The CMA noted in the EMI final report that "*prepayment is not generally a choice on the part of the consumer*".[38] This suggests that customers with prepayment meters will not generally be able to switch to a different payment method in response to a price increase.

77. In the present case, some suppliers confirmed that not all tariffs were available to customers of all payment methods, particularly prepayment customers. Suppliers also noted that, for some tariffs, new customers could only start with direct debit payment terms.

78. The CMA has not received any evidence to indicate that the approach it adopted in the EMI is not also appropriate in the present case. Therefore, the CMA has assessed the effects of the Merger in relation to prepayment customers separately.

Conclusion on product scope

79. For the reasons set out above, the CMA has considered the impact of the Merger in the following product frames of reference:

    a) the supply of electricity to domestic customers;

    b) the supply of gas to domestic customers;

    c) the supply of electricity to domestic non-Economy 7 restricted meter customers;

    d) the supply of electricity to domestic prepayment customers; and

    e) the supply of gas to domestic prepayment customers.

[38] EMI final report, par. 3.37.

Geographic scope

80. The Parties submitted that, in line with previous decisional practice, the appropriate geographic frame of reference is GB. They said that the conditions of competition are similar across the regions of GB, and that the Merged Entity will continue to face competition from a large number of suppliers across all of these regions.

81. In past cases,[39] and in the EMI,[40] the CMA has considered the geographic frame of reference to be GB. In the EMI, the CMA noted that the regulatory regime, which determines many of the parameters of competition, applies equally across GB and that the SLEFs and the mid-tier companies, as well as many of the smaller suppliers, operate across all regions. However, the CMA notes that a regional geographic frame of reference has been considered in some past cases as a possibility, based on the SLEF's high shares of supply in their former incumbency areas.[41] In EMI, the CMA noted in its final report "*the particular constraints that might be disproportionately faced by customers in certain nations and regions*".[42]

82. In the present case, the CMA has found that the shares of supply of the Parties (and the other SLEFs) differ substantially by region, with higher shares in their former incumbency areas and lower shares elsewhere (see Table 3). However, as discussed below, there is little difference in switching rates, suggesting that the main cause of the differences in shares is the volume of disengaged customers who remain with their incumbent supplier rather than any significant difference in the extent of competition.

83. In its submissions to the CMA, Ofgem noted some differences in competitive conditions between different PES regions, as well as more generally between the remote areas of GB and more urban areas. For example, it said that "*most customers in the remote parts of Scotland are electricity only customers*", and that there are different levels and patterns of switching by region. Other third parties also pointed to regional differences in retail supply.

84. The CMA has considered whether energy suppliers in GB compete nationally or whether they compete on a regional basis. The CMA notes that the opportunities for regional variation in competition have increased significantly since the EMI, with no regulatory limits on suppliers' ability to offer tariffs and promotions regionally. The CMA has found that there are some differences

[39] Telecom Plus (2013), par. 21, Npower/Telecom Plus (2006), par. 11, Proposed acquisition of Economy Power Limited by E.ON UK plc (2005), par. 9.
[40] EMI final report, section 3
[41] See, for example, OFT decision Centrica/Lake Acquisitions (2009), par. 25.
[42] EMI final report, par. 3.45.

between energy suppliers in terms of their use of regional discounts (ie differences in tariffs which are not cost-reflective). Some suppliers said that they do not use such discounts, other suppliers have only recently started trialling them, and others (such as Scottish Power and EDF) said that they use them frequently. Several suppliers said that they had tariffs which were only available in one or a small number of regions. PCWs who run collective switches also told the CMA that they sometimes have different winners in different regions, either because the cheapest supplier did not bid in all regions or because of regional price differences between suppliers.[43]

85. Overall, on the basis of this evidence, the CMA believes that both demand-side and supply-side considerations, such as uniform product characteristics, similar switching costs and the prevalence of suppliers operating across the whole of GB, suggest a GB-wide frame of reference. However, the CMA notes that individual PES regions can play a prominent role in how suppliers think about competition, and regional pricing is becoming increasingly prevalent. Therefore, the CMA has taken into account differences in the competitive conditions at a regional level in its competitive assessment.

Conclusion on geographic scope

86. For the reasons set out above, the CMA has considered the impact of the Merger in a GB-wide frame of reference for all products.

Conclusion on frame of reference

87. For the reasons set out above, the CMA has considered the impact of the Merger in the following frames of reference:

a) the supply of electricity to domestic customers in GB;

b) the supply of gas to domestic customers in GB;

c) the supply of electricity to domestic non-Economy 7 restricted meter customers in GB;

d) the supply of electricity to domestic prepayment customers in GB; and

e) the supply of gas to domestic prepayment customers in GB.

[43] Differences in pricing, sales, advertising and marketing strategies by area is one of the points listed in the Merger Assessment Guidelines as suggesting that a regional market definition might be appropriate, see parargraph 5.2.23.

Competitive assessment

Background to the competitive assessment

88. Until recently, most households were served by one of six large energy suppliers – British Gas, who previously supplied gas to the whole of GB, and the five firms who are the successor companies to the former incumbent electricity suppliers in the 14 PES-regions (SSE, EDF, Scottish Power, E.ON and Npower).

89. The SLEFs' combined share of supply of domestic energy in GB has declined from approximately 95% in 2013 to around 80% in 2017. There are now ten mid-tier suppliers with over 250,000 customers, although they are still considerably smaller than the SLEFs.

90. The evidence suggests that there are a large number of 'sticky' or disengaged customers, who show little propensity to search between suppliers or switch suppliers. The EMI found that a weak customer response and lack of engagement "*gives suppliers a position of unilateral market power concerning their inactive customer base and that suppliers have the ability to exploit such a position through their pricing policies; through price discrimination by pricing their standard variable tariffs materially above a level that can be justified by cost differences*."[44]

91. Recent Ofgem data suggests that over 13 million non-prepayment customer accounts[45] are on SVTs, with over half of these accounts having been on SVTs for more than three years.[46] According to this data, SSE has 1.55 million customer accounts which have been on an SVT for over three years, and Npower 0.74 million such accounts. Ofgem has also noted the lack of engagement of a substantial number of customers. Ofgem's State of the Energy Market Report 2017 found that 58% of customers had never switched supplier or had switched only once, creating a large base of inactive customers.

92. In this context, the CMA has considered potential differences between the SLEFs and the SAMS.

[44] EMI final report paragraph 158.
[45] A 'dual fuel' customer account (ie where a customer takes gas and electricity from the same supplier) is counted as one account, rather than two separate accounts.
[46] Ofgem data on non prepayment customer accounts on SVTs, which only covers suppliers with over 250,000 customers.

93. The Parties submitted that evidence, including switching data, internal documents and Ofgem customer data,[47] shows that the SAMS are a key constraint on the SLEFs (including the Parties). The Parties also submitted that price is the most important factor (ie more important than the reputation and size of the energy supplier) for customers when choosing a new supplier, and that it is the SAMS which are driving competition on price.

94. While recognising the constraint imposed by some SAMS on the SLEFS, the CMA found that there are substantial differences between the SLEFs and SAMS, for the following reasons:

a) There are some customers who may not consider the SAMS as alternatives, because of brand recognition, perceptions about reliability or service, lack of awareness or information, or other reasons. For example, a survey carried out for the EMI found that around a quarter of customers who had shopped around in the previous three years had only considered the SLEFs.[48] This view was supported by some third parties: see paragraph 168 below.

b) The SLEFs have many long-standing customers who have rarely, if ever, switched suppliers, and hence large parts of their customer bases are on SVTs, which typically generate a higher margin than fixed tariffs. With only one exception, all the larger SAMS have a smaller proportion of customers on SVTs.[49]

c) Because of their large cohorts of disengaged, high margin customers, the SLEFs may have less incentive than the SAMS to prompt customer engagement.

d) The differences in the proportions of customers who are on SVTs compared to FTCs could allow the SLEFs to employ different marketing and pricing strategies (eg because they can recover common costs from SVT customers).[50]

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[47] The Parties submit that as seen in the Ofgem Customer Engagement Survey from September 2017, the primary factor a customer will consider when switching is saving money, but a number of other factors are also taken into account (eg customer service). Based on that survey, supplier, reputation and brand do not appear to be significant factors in customers' decision-making.
[48] See GfK NOP customer survey report, par. 135-136
[49] The CMA observes Utility Warehouse has a high proportion of customers on SVTs than the SLEFs, according to Ofgem data on non prepayment customer accounts on SVTs.
[50] Ofgem's State of the Energy Market Report, stated that "*less engaged consumers appear to allow suppliers to offer very competitive prices to engaged consumers and still make a profit*" (page 31). Ofgem estimates in this report that, if SVT prices were reduced so that they provided the same gross profit margin as fixed tariffs, suppliers would have made a 6% loss overall. The EMI also noted the relevance of the different types of customers (SVT and fixed) and the interrelationships between how the prices of these tariffs are set (see EMI final report chapter 8, page 399).

95. For these reasons, the CMA believes that the Parties are more similar, and compete more closely with, the other SLEFs than with the SAMS. The CMA has considered the competitive constraint from both the SLEFs and SAMS in its assessment below.

Horizontal unilateral effects

96. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or to degrade quality on its own and without needing to coordinate with its rivals.[51] Horizontal unilateral effects are more likely when the merging parties are close competitors.

97. The CMA assessed whether it is or may be the case that the Merger may be expected to result in an SLC in relation to horizontal unilateral effects in the frames of reference set out in paragraph 87.

98. Horizontal unilateral effects are more likely when price sensitivity of customers is low because any price increase will lead to fewer lost sales and therefore any costs of a price increase are lower.[52] The CMA notes that the significant number of disengaged customers (as noted above) suggests that many energy customers are relatively price insensitive.

Horizontal unilateral effects in the supply of electricity and/or gas to domestic customers in GB

99. The CMA has assessed two ways in which the Merger could result in higher prices or worse quality of service as a result of a reduction in rivalry in the supply of electricity and/or gas to domestic customers in GB:

    a) in the process by which suppliers, and particularly the SLEFs, set their SVTs;[53] and

    b) in the process by which suppliers set prices to attract customers.

[51] Merger Assessment Guidelines, from paragraph 5.4.1.
[52] Merger Assessment Guidelines, from paragraph 5.4.9.
[53] The CMA is considering whether the loss of rivalry leads to an increase in price as a result of horizontal unilateral effects and is not considering whether the removal of a comparator in the price setting process of SVT could lead to coordination. The CMA has considered potential coordinated effects arising from the Merger later in this decision.

Loss of rivalry in the setting of SVTs

100. The CMA has assessed whether the Merger may result in the ability and incentive to charge higher SVTs as a result of the removal of one of the SLEFs.

101. The CMA understands that SVT price changes typically occur around once per year, and most or all of the SLEFs will announce an SVT price change within a relatively short period of time. There are examples of more frequent SVT price changes, or a single supplier making a price change, but these are less common. The CMA notes that, one factor encouraging infrequent SVT price changes, is that price changes lead to SVT customers engaging with the market and possibly switching away.

102. The CMA considered: (i) the factors that the Parties consider when setting their SVTs, in particular the importance of the SVT prices of other suppliers and changes to these prices, and which suppliers are particularly important; (ii) the constraints on SVTs from FTCs; and (iii) the effect of the Merger.

Shares of supply

103. The Parties provided estimates of their shares of supply of SVT and non-SVT accounts in GB, as set out in Table 1.

Table 1: Shares of supply of SVT and non-SVT accounts in GB (by number of accounts, 2017)

	SVT accounts	Non-SVT accounts
SSE Retail	17.7%	10.0%
Npower	8.9%	12.1%
Combined	26.6%	22.1%
British Gas	34.4%	22.3%
E.ON	16.0%	10.8%
EDF	11.1%	13.6%
Scottish Power	7.3%	16.3%
SAMS	4.7%	15.0%

Source: Parties' submission based on Ofgem data

104. The CMA notes that the SLEFs together have over 95% of SVT accounts.

105. Ofgem data from January 2018 suggests that SSE has approximately 1.55 million non-prepayment domestic customers who have been on an SVT for more than three years, and Npower has 0.74 million such customers,[54] giving an estimated combined share of supply of such customers of 29% (increment 9%).[55] The data shows that 65% of SSE's SVT customers, and 63% of Npower's SVT customers, have been on those tariffs for more than three years, suggesting that disengaged customers make up the majority of their customers on these tariffs.

Factors considered in setting SVT prices

- *EMI*

106. During the EMI, the SLEFs told the CMA that the timing and size of changes in their SVT prices are driven by:

   a) changes in the cost base;

   b) the increased risk of losing customers when they increase prices; and

   c) other costs of changing tariffs (which are higher when prices are being increased due to regulatory requirements).[56]

107. In the EMI, the SLEFs also told the CMA that, when deciding on whether to change their SVT price, [✂].[57]

- *Parties' submissions*

108. The Parties submitted that:

   a) Wholesale costs are the most important driver of price changes, and consideration of the expected customer losses of any price change;

   b) Press coverage is a marginal element within a broader range of factors taken into account when assessing SVT price increases;

   c) Press coverage of an SVT price increase is typically focused on the impact of the change on the supplier's customers, and the benefit to

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[54] Ofgem data on non prepayment customer accounts on SVTs
[55] This may overstate the Parties' share slightly if suppliers with fewer than 250,000 customers have SVT customers for more than three years. The CMA does not believe that this effect will be material.
[56] EMI final report, paragraph 8.180
[57] EMI final report, paragraph 8.182.

customers of switching to FTCs, rather than comparing different suppliers' SVT prices;

d) There is a wide range of comparators available for SVT prices (not just the SLEFs), with increasing press coverage of the SAMS;

e) The Parties monitor many different SVT and FTC prices, including many of the SAMS, as shown in their internal documents;

f) The Parties are not relevant comparators to each other as shown by their internal documents; and

g) The Merged Entity will be a different and larger proposition in the market, and will attract more press attention (making an SVT price increase less likely).

109. SSE told the CMA that, when setting its SVT price, the factors it takes into account include:[58]

a) [✂];

b) [✂];

c) [✂];

d) [✂];

e) [✂].

- *Press coverage of SVT changes*

110. In response to the Parties' claims about press coverage (paragraph 108b-d), the CMA asked Ofgem to provide information on press coverage of SVT price change announcements between 1 January and 18 April 2018.[59] This information showed that the recent SVT increases from British Gas and EDF were covered extensively in the national press and were widely discussed on social media and other online sources. Despite a number of SVT increases from SAMS, only the increase by Bulb Energy received press coverage tracked by Ofgem, and only in one national newspaper (alongside energy specific publications).[60] Whilst the CMA notes the limitations of this analysis, it views it

[58] Parties' response to the Supplementary Issues Paper, par. 4.10(ii).
[59] This period included SVT increase announcements from British Gas and EDF, and changes made by E.ON, but was prior to the recent announcement by Scottish Power. Ofgem notes that it does not record all coverage of price increases and has not conducted a qualitative analysis of the information provided.
[60] The price increase by Utilita was also reported in the Guardian article on the Bulb Energy price increase.

as indicative that the majority of press coverage of SVT changes is focussed on the SLEFs.

111. The CMA also notes that almost all of the press coverage of EDF's SVT rise on 12 April 2018 referred to price rises by other SLEF suppliers, commenting for example that it followed the "steeper price rise announced by British Gas".[61] There was very little comment on the SVT prices of the SAMS.

112. The CMA also observed that the recent coverage of Scottish Power's SVT price increase by the BBC, the Guardian, the Times and Moneysavingexpert.com all put the price announcement and the price changes into the context of the recent changes by other SLEFs, with one article commenting it is "*the same percentage rise as British Gas announced earlier this month and higher than ones from E.ON and EDF... SSE and Npower are the only two other big energy firms yet to declare a price rise*".[62]

113. The Parties also submitted that, in reporting on the SVT increases of "major energy suppliers", uSwitch includes First Utility and Co-op Energy, while also flagging a number of the smaller SAMS.[63] The CMA reviewed this article, "*Gas and electricity price changes 2017*",[64] and found that it does list seven "*major energy suppliers*", five of which are SLEFs, and First Utility and Co-op Energy. With regard to other suppliers, it states that "*many smaller suppliers, including Octopus, Ecotricity, Bulb and Flow Energy, announced price rises*". Each of the seven large suppliers listed is a link to a uSwitch article about that supplier's price rise. The CMA noted that, for each of the SLEFs, the article places the price rise into the context of the other SLEFs, and no named SAMS.[65] The relevant pages for each of First Utility and Co-op Energy is only a short guide to that supplier and does not place them in the context of any other supplier. The CMA therefore believes that this is consistent with the CMA's view that SLEF SVT price changes are generally reported in the context of the other SLEFs.

114. On the basis of the evidence set out above, the CMA believes that press coverage of SVT price changes is primarily focused on the SLEFs, and frequently compares the changes and levels of the SLEFs' SVT prices.

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[61] The Times coverage "EDF energy price rises will hit more than 1 million households", 13 April 2018.
[62] Guardian coverage "Scottish Power raises energy bills for nearly 1m households"; BBC "Scottish Power to raise gas and electricity prices"; MSE "960,000 Scottish Power customers hit with June price hike"; and the Times "Price rise at Scottish Power prompts calls to 'ditch Big Six'", all from 20 April 2018.
[63] Parties' response to the Supplementary Issues Paper, par. 4.34.
[64] uSwitch website accessed on 25 April 2018.
[65] For example, the EDF price change on uSwitch says "Who else raised their prices in 2017? Along with EDF Energy, all of the big six energy companies raised their prices in 2017" and lists the percentage price rise for each of the SLEFs.

- *CMA’s analysis on factors considered in setting SVTs*

115. The CMA considers that all of the factors given by SSE (at paragraph 109) are tied to customer reactions and demonstrate the importance of other suppliers’ actions and propositions, either directly (eg relative pricing affecting customer losses), or indirectly (eg through the effects of press coverage and reputation).

116. The Parties’ internal documents confirm, as found in the EMI, that energy suppliers take many factors into account when setting SVT prices. In particular, costs are an important consideration, influencing both the timing and level of price changes. For all suppliers, SVT prices move broadly in line with wholesale costs. However, the Parties’ internal documents also confirm, consistent with the EMI, that, for a given cost level, the Parties consider a range of possible price points, demonstrating that other factors also have a significant influence on pricing.

117. The internal documents indicate that the main other factor considered is the number of customers the supplier can expect to lose (or gain) as a result of a price increase (or decrease). A key factor in this assessment is the positioning of any price increase against a broader market context, with particular focus on the behaviour of the SLEFs. The CMA found that both the Parties monitor and try to predict the SVT price changes of their major competitors, and the timing of the announcements of these changes.

118. The CMA found in the Parties’ internal documents that, [✂]. The CMA found that the [✂]. For example, one SSE document says that:[66]

    a) [✂]. The CMA found that this document focuses primarily on the SLEFS. Four mid-tier suppliers are listed in a table, but in a smaller font than the SLEFs and they are not ranked or mentioned in the text. This evidence suggests that the SAMS are not considered to be among the “main competitors” referred to in the quote above about SSE’s pricing strategy.[67]

    b) [✂].

    c) [✂].

    d) [✂].

[66] [✂]
[67] [✂]

119. Another SSE document discusses the level of its SVT and possible strategies for change, [✂]. With regards to its "SVT positioning", it presents a chart showing [✂].[68]

120. A further SSE document, which considers SSE's SVT price setting options, [✂].[69]

121. Two Npower documents refer to [✂].[70] [71]

122. The Parties submitted that the context of this and other documents shows that other factors also influence price and [✂].[72] The CMA acknowledges that other factors (notably costs) are important and that the decision on price is not tied directly to the price of any one competitor. However, the CMA believes that these statements show that the SLEFs are constrained in their SVT pricing behaviour by the SVT pricing behaviour of the other SLEFs. The CMA found no evidence to indicate that the SLEFs are constrained in a similar way, or to a similar extent, by the SVT pricing behaviour of the SAMS.

123. An example of this constraint between the Parties is a reference in [✂]'s documents to [✂].[73] [74]

124. The CMA believes that the high level of press coverage of the SLEFs' SVT changes (see paragraphs 110-114), and the consequent reputational impact of a change in SVT prices, also confirms that the SLEFs are an important comparator on one another with regard to their SVT pricing.

125. On the basis of this evidence, the CMA believes that comparative factors between the SLEFs are key to the Parties' expectations of how many SVT customers they will lose (either to other suppliers or to their own FTCs), and this analysis directly influences the SVT price changes which the Parties implement.

126. The effect of the removal of one of the Parties could be particularly significant if it is acting as a particular constraint on the other SLEF's SVT pricing. In this regard, the CMA notes that:

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[68] [✂]. This document was prepared as slides for a strategy retreat. The CMA is not aware of an [✂]. The Parties cite this document in their response to the Supplementary Issues Paper [✂].
[69] [✂]
[70] Both quotes from [✂]
[71] Both quotes from [✂]
[72] Parties' response to the Supplementary Issues Paper, par. 4.47.
[73] [✂]
[74] [✂]

a) SSE was reported by MoneySuperMarket as having the lowest percentage "*provider price increase*" in 2017 out of the five SLEFs who had increased their SVT prices by the time of the report;[75]

b) SSE announced a price freeze on its standard tariffs in November 2016, which the Guardian reported as "*piling pressure on rivals to follow suit*";[76] and

c) SSE had the lowest percentage price increase at the time of its SVT announcement early in the round of price increase in 2014.

Constraint on SVTs from FTCs

127. The Parties submitted that FTCs are driving competition for SVT customers. They said that the number of SVT customers has been declining consistently year on year due to increasing switching by SVT customers to FTC products. They said that FTC prices therefore constrain SVT prices. The Parties provided evidence that customers who switch from SVTs switch to a similar profile of products as those who switch from FTCs, and that this includes customers who have been on SVTs for more than three years.

128. The CMA recognises that, once a customer decides to switch, the majority of these customers switch to a FTC product. This includes customers on SVTs, and those who have been on an SVT for a significant amount of time. The CMA also notes that the number of customers who are engaged and switching is increasing, with further remedies (including the database remedy) set to continue this trend. However, there remains a significant number of customers in GB who are on SVTs and who are paying a far higher price for their gas and electricity than customers on FTCs (even from the same supplier). The CMA notes that, even while customer engagement is increasing, the gap in price between SVTs and FTCs remains.[77]

129. The CMA therefore believes that the constraint from FTCs is not sufficient to protect customers from increases in SVT prices. In particular, the significant gap which already exists between the FTC prices available and the SLEFs' existing SVT prices makes it implausible that a small increase in this gap would greatly influence certain SVT customers' decisions on whether to switch away from their SVT. In this way, it is implausible that FTC prices impose any significant constraint on SVT prices. Rather, it appears that increasing SVT

[75] British Gas froze its prices until August, see MoneySuperMarket website reporting.
[76] "SSE to freeze energy prices this winter", Guardian, 28 November 2016.
[77] Indeed, the EMI noted a widening gap in the prices of SVT and FTCs (see discussion at paragraph 9.86 and Figure 9.4 of the EMI final report), and the Ofgem State of the Energy Market Report 2017 suggests that this gap remains.

prices makes some customers engage with the market, and the size of the SVT change, both in absolute terms and relative to the other SLEFs' SVTs, and how it is reported, affects the number of customers that decide to switch away (or switch internally to a less expensive tariff from the same supplier).

Effect of the Merger

130. The evidence described above shows that the Parties monitor closely the SVT price changes of each other and the other SLEFs. It shows that changes made by these competitors can influence their price setting behaviour, as it directly influences the number of customers they expect to lose (or gain) as a result of a price rise (or reduction).

131. Although the CMA acknowledges that the Parties monitor the SVT prices of the SAMS, the CMA believes that the limited number of SVT customer accounts held by the SAMS (in aggregate less than 5%), the focus of the Parties on the SVTs of the SLEFs in their internal documents, and the focus of press coverage on the SVTs of the SLEFs indicates that the SAMS are not a significant factor in the Parties' SVT benchmarking process. The CMA has also found no evidence of an SVT price setting action of one of SAMS affecting the SVT price setting behaviour of one of the Parties.

132. On the basis of the evidence set out above, the CMA believes that the SVT price setting behaviour of the other SLEFs is a significant factor in the Parties' SVT price setting behaviour. The CMA has not found evidence to indicate that the Parties' SVT price-setting behaviour is a particular constraint on each other more than that of the other SLEFs, but rather that the SLEFs all monitor each other closely and act in their SVT price setting in light of each other's actions.

133. The CMA believes that a reduction of comparative constraints from five other SLEFs to four other SLEFs would reduce competition on SVT prices for all SLEFs.

134. A number of third parties raised concerns that the Merger could worsen the offering for customers of the Parties, particularly for those on SVTs, with one third party commenting that the CMA should "*pay special attention… [to] increased concentration of the SVT market*" and the potential for adverse consequences.

135. Ofgem told the CMA that "*it is probable that the [SVT] price charged to customers will be the higher of the two tariffs charged by SSE and Npower"* and that *"this transaction could influence other suppliers increasing prices, in particular, their default tariff prices*." This is one of the reasons, among others, that Ofgem raised concerns about the Merger.

136. The CMA also assessed whether customers switching from one Party's SVT to the other Party's FTCs, which could be recaptured post-Merger, might exacerbate the Merger's effect on SVTs. However, the CMA found that the Parties' SVT customer switching is similar to the switching in the whole market, discussed in paragraphs 154. The CMA found that switching between the Parties was relatively limited, with customers switching to other SLEFs and a wide range of SAMS, and therefore there was unlikely to be significant additional upward pricing pressure on SVTs from customer switching.

Conclusion on loss of rivalry in setting SVT prices

137. For the reasons set out above, the CMA believes that the Parties are important comparators to each other and to the other SLEFs in the process of setting SVT prices, meaning that the SVT pricing decisions of each of the Parties constrain the pricing decisions of all the other SLEFs (including the other Party). The removal of one such constraint could allow the Merged Entity and the other SLEFs to increase their SVT prices to a higher level than absent the Merger.

138. Accordingly, the CMA believes that the Merger raises competition concerns as a result of the loss of rivalry in the process of setting SVT prices for the supply of gas and electricity to domestic customers in GB.

139. The CMA notes that even a small change to current SVT prices could have a substantial impact on consumers given the millions of customers who could be affected. As an illustration of the scale of possible impact, even a 1% increase in SVT prices as a result of the Merger, for a "typical" annual bill of £1,135,[78] would equate to an increase of around £11 in the annual energy bill for each of the 13 million households currently on SVTs – ie an aggregate customer detriment of over £140 million per year. This is exacerbated by the fact that energy is a non-discretionary, price inelastic expenditure, and as shown by the finding in EMI and by evidence since (such as the number of customers that still remain on SVTs for more than three years)[79], many SVT customers are not engaged with the market and are therefore unlikely to respond to a price increase by switching tariff or supplier.

140. The CMA notes that any detriment to consumers through higher SVT prices could affect certain regions disproportionately to the extent that it affects some SLEFs more than others. For example, SSE has a large base of customers in its former PES regions who are on SVTs, the majority for more than three

[78] See Ofgem's Infographic: Bills, prices and profits, based on an average of dual fuel, direct debit and available paper tariffs from the six large suppliers at February 2017.
[79] See para. 91.

years. Moreover, given the relaxation of rules on regional pricing, suppliers are now able to price discriminate between regions, as many are doing or starting to trial. This flexibility may allow the Merged Entity (or other SLEFs) to alter SVTs in certain regions to the detriment of consumers in those regions, for example by setting SVT prices higher in regions with more disengaged customers.

Loss of rivalry to attract customers

141. When suppliers set prices, they compete to attract and retain customers. The CMA has assessed whether, Post-Merger, the Parties may set higher prices since some of the lost customers, who would have selected the other merging Party, will be recaptured.

142. To assess this theory of harm, the CMA has examined the closeness of competition between the Parties to attract (and retain) customers, focussing mainly on FTCs since the large majority of customers who switch supplier, or switch internally, move onto an FTC.

Shares of supply

143. The Parties provided estimates of their shares of supply of gas and electricity to domestic customers in GB, as shown in Table 2.

Table 2: Shares of supply of energy to domestic customers in GB (number of accounts, October 2017)

	Electricity	Gas
SSE Retail	[10-20]%	[10-20]%
Npower	[5-10]%	[5-10]%
Combined	[20-30]%	[10-20]%
British Gas	[20-30]%	[30-40]%
E.ON	[10-20]%	[10-20]%
EDF	[10-20]%	[5-10]%
Scottish Power	[10-20]%	[5-10]%
SAMS	[20-30]%	[20-30]%

Source: Parties' submission based on Cornwall Insight data[80]

144. The shares of supply of the Parties in their respective former PES regions are shown in Table 3.

[80] As with other share of supply information provided by the Parties, the data for calculating the shares is based on independent third party data collected by a specialist consultancy. Therefore, the CMA considers the shares to be accurate.

Table 3: Shares of supply of energy by PES region (by number of accounts, 2017)

	Former Npower regions			Former SSE regions		
Electricity	**Midlands**	**Northern**	**Yorkshire**	**Southern**	**South Wales**	**North Scotland**
Npower	[20-30]%	[10-20]%	[20-30]%	[5-10]%	[0-5]%	[0-5]%
SSE Retail	[5-10]%	[5-10]%	[5-10]%	[30-40]%	[40-50]%	[50-60]%
Combined	**[20-30]%**	**[20-30]%**	**[20-30]%**	**[40-50]%**	**[40-50]%**	**[60-70]%**
Gas	**Midlands**	**Northern**	**Yorkshire**	**Southern**	**South Wales**	**North Scotland**
Npower	[10-20]%	[10-20]%	[10-20]%	[5-10]%	[0-5]%	[0-5]%
SSE Retail	[5-10]%	[5-10]%	[5-10]%	[20-30]%	[30-40]%	[30-40]%
Combined	**[10-20]%**	**[20-30]%**	**[10-20]%**	**[20-30]%**	**[30-40]%**	**[40-50]%**

Source: Parties' submission based on Cornwall Insight data

145. The Parties submitted that their combined shares of supply cannot raise concerns on any possible frame of reference, whether GB-wide or at a PES-level, because in both cases either the combined shares of supply are well below 40% and/or they involve only a very small increment which would have no meaningful impact on competition. The Parties further stated that shares of supply fail to take account of the intense dynamic competition in the market, with the SLEFs experiencing rapid and considerable net customer losses while the SAMS collectively continue to achieve rapid gains.

146. The CMA considers that shares of supply in the energy market will not accurately reflect the dynamic of competition as they are significantly affected by the SLEF's high numbers of incumbent disengaged customers. Shares of supply therefore disproportionately represent a stock of customers rather than current customer preferences. The incumbency effect can also be observed in the Parties' regional shares of supply, particularly in electricity (which was the original source of the incumbency position).

147. However, the CMA notes SSE's high shares of supply in the Southern region, in South Wales and in North Scotland and has considered any specific regional differences in competition as part of its competitive assessment.

Closeness of competition

- *Parties' submissions*

148. The Parties submitted that switching data provides the best indication of competitive constraints. They submitted extensive customer switching data and said that it showed that the Parties are not close competitors, whether across GB, within any region or for any customer group. The Parties calculated an indicative GUPPI[81] based on the rates of switching between the Parties and plausible estimates of variable margin and said that the result was clearly too low to give rise to any horizontal unilateral effects.[82]

149. The Parties also highlighted that pricing data indicates a lack of closeness of competition, and said that their internal documents do not indicate that they are close competitors. The Parties noted that, in their documents, they do not mention each other more often than they mention numerous other suppliers, and they found no statements to suggest that the Parties compete more closely against each other than they do against other suppliers.

- *Switching data*

150. Table 4 sets out the results of the CMA's analysis of the switching data provided by the Parties, showing the overall switching between the Parties.

Table 4: Share of customers lost that go to the other Party (2015-2017)

	Electricity	Gas
Lost by Npower to SSE	[✂]	[✂]
Lost by SSE to Npower	[✂]	[✂]

Source: Customer data provided by the Parties

151. The CMA found that switching rates were broadly consistent for different tariff types and for those customers who chose standard credit or direct debit.

152. As shown in Table 4, and having reviewed more granular data taking account of region, tariff type and payment type over time, the CMA found that the switching rates between the Parties are consistently low, providing strong evidence that the Parties are not particularly close competitors.

[81] See chapter 5 of the CMA's retail mergers commentary.
[82] The Parties estimated, on the basis of conservative assumptions, that they would need to earn variable margins on their FTC tariffs of at least between [✂]% and [✂]% to generate a GUPPI of 5%.

153. The CMA observed slightly higher switching rates to SSE from Npower in SSE's former PES regions ([✂]), although still not at a level to indicate any particular closeness of competition, but found that the switching rates to Npower from SSE in these regions is lower than the overall rate of switching in the whole of GB.

154. The switching data also showed that, when engaging in the market, the Parties' SVT customers behave similarly to other customers,[83] with low switching rates between the Parties. The data showed that [✂] of Npower's electricity SVT customers that switched externally went to SSE, and [✂] of its gas SVT customers, while [✂] of SSE's electricity SVT customers that switched externally went to Npower, and [✂] of its gas SVT customers.

- *Pricing data*

155. The CMA also considered the ways in which the Parties compete for new customers and the tariffs they offer, as follows:

   a) Through a detailed analysis of data on the variable and fixed tariffs available in 2017,[84] the CMA found that the Parties are not particularly close competitors with regard to the tariffs they offer across all different customer segments. Although they do offer tariffs with the same characteristics, the tariffs the Parties offer are no more similar (in particular on price) than those offered by other competitors.

   b) In recent years, the Parties have focused on different acquisition channels for winning customers, [✂],[85] [✂].[86]

   c) In recent years, the pricing strategies of the Parties have been different, [✂], for the majority of the time, they have not been close competitors.

   d) The CMA found no evidence in the Parties' internal documents to indicate that they set their FTC prices with particular regard to the FTC prices of the other Party.

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[83] CMA analysis of data provided by the Parties, which used variable tariff customers as a proxy for SVT customers.
[84] Quarterly snapshot data on the tariffs available for subscriptions at that time was provided by uSwitch. This analysis allowed the CMA to evaluate the similarity of tariffs at different levels of usage rather than just based on an average household bills, allowing a more thorough assessment of closeness of tariffs.
[85] In 2017, Npower gained [60-70]% of its new customers through PCWs, while SSE gained [10-20]% of its new customers through this channel.
[86] In 2017, SSE gained [20-30]% of its new customers through collective switching, while Npower gained [0-5]% of its new customers through this channel. There were only two collective switching opportunities in 2016 and 2017 in which both Parties participated, both for iChoosr. Therefore, the CMA does not believe that either Party is a strong constraint on the other for collective switching opportunities.

- *Internal documents and third party submissions*

156. The Parties' internal documents show that they monitor many energy suppliers and track how their customers react to changes in the offerings of these other suppliers. The CMA found no evidence in the Parties' internal documents to indicate that the Parties consider each other to be close competitors for FTCs.

157. Some third parties (some PCWs and some competitors) noted that the Parties use similar pricing tactics and that there may be some periods where they compete closely with each other, in particular because they are both well-known brands. However, these third parties submitted no evidence to indicate that the Parties compete more closely with each other than with the other SLEFs, or with the larger SAMS. Almost all competitors who responded to the CMA did not identify the Parties as being particularly close competitors to each other for FTCs.

- *Conclusion on closeness of competition*

158. On the basis of this evidence, the CMA believes that the Parties are not particularly close competitors for FTCs, with low levels of customers switching between them, and a number of differences in their customer offering and strategy.

Competitive constraints

- *Parties' submissions*

159. The Parties submitted that, as shown by the switching data, they each face competition in FTCs from many other suppliers, and stronger competition from several other suppliers than from the other Party. The Parties highlighted that British Gas, as the market leader, provides a stronger constraint on both of the Parties than they impose on each other, and that the other SLEFs, First Utility, Ovo Energy and Utilita all provide strong competition, "*along with a host of other rapidly growing small and mid-tier suppliers*".

160. The Parties said that the switching data showed that the proportion of customers switching from each of the Parties to SAMS has been increasing year on year, and is now over 50%. The Parties added that customers who had previously been on SVTs for more than three years had similar switching preferences to other customers, with survey evidence suggesting that around half of these customers switched to one of the SAMS.

- *Switching data*

161. The CMA examined the switching data provided by the Parties and observed that each Party loses more customers to each of the other SLEFs than to the other Party, indicating that the other SLEFs impose a stronger competitive constraint on each of the Parties than they do on each other.

162. The switching data also shows that [over 50%] of the Parties' customers switching away between 2015-2017 switched to one of the SAMS, with a trend of switching to the SAMS rather than the SLEFs increasing over time. First Utility, Ovo Energy, Co-op Energy, Utility Warehouse and Extra Energy all impose a significant constraint on each of the Parties for new customers.

163. The CMA found similar results in the switching data at a regional level, and between customer types (eg long-term SVT customers).

- *Pricing data*

164. As mentioned above at paragraph 155, the CMA has found that the Parties generally pursue different pricing strategies, but there may be times when their FTCs are similar. However, even on these latter occasions the Parties submitted that there were a number of other suppliers with similar tariffs:[87]

    a) [✂].

    b) [✂].

- *Internal documents*

165. The internal documents provided by the Parties indicate that they both monitor a wide range of competitors, although some suggest that the Parties focus more on the developments of the other SLEFs rather than the SAMS.[88]

- *Third party submissions*

166. Ofgem told the CMA that the retail energy market is still concentrated despite the growth of the SAMS. On the basis of its findings in its State of the Energy Market Report 2017, Ofgem submitted that '*most of the competitive pressure exerted on the individual six large suppliers for the more dynamic segment of the market (typically non-default fixed-term tariffs) comes from the other large*

[87] [✂].
[88] See, for instance, [✂].

suppliers, with the small and mid-tier suppliers unable to act individually as significant competitive restraints'.

167. Ofgem also noted the findings of the EMI and concluded that '*even with six large suppliers, the retail energy market was not delivering good outcomes for consumers'*. Ofgem added that '[✂]*, we have concerns that, with the reduction of the number of larger competitors from six to five, competition in the market will be undermined.*'

168. The CMA noted that some customers switch to one of the SLEFs even when they are not the cheapest, possibly due to their greater brand recognition. One PCW told the CMA that some customers will not pick a lesser-known brand even if it is cheaper and that, if the price is the same, customers are more likely to switch to a SLEF. Another PCW commented similarly that "*a big brand will always have a slight pull*" if competing against a smaller supplier, possibly due to greater confidence in the supplier.

169. Although some third parties raised concerns about the sustainability of smaller suppliers in the long run, the CMA notes that many large firms with extensive experience in the energy sector have made recent investments in the GB market (including Shell's acquisition of First Utility and the entry of Engie (the French utilities company) and Vattenfall (the Swedish state-owned energy company)), suggesting that it is possible for at least some of the SAMS to operate effectively in the long term.

- *Conclusion on competitive constraints*

170. Notwithstanding that there are substantial differences between the SLEFs and the SAMS (see paragraphs 92 to 95), and the preference of some customers for SLEFs, the evidence set out above, in particular the switching data, shows that there exists strong competition to the Parties for new customers, both from the other SLEFs and from at least some of the SAMS.

171. The CMA has looked extensively at particular segments of the market based on region and tariff, and has not identified any segment where the strength of the remaining competitive constraint on the Merged Entity is particularly limited. In particular, the switching evidence set out above indicates that SVT customer switching is similar to switching in the whole market.

Conclusion on loss of rivalry to attract customers

172. For the reasons set out above, in particular the switching data showing to which alternative suppliers customers of the Parties switch when they leave, the CMA believes that, for new customers, the Parties are not close competitors, and

they each face significant constraints from both the other SLEFs and, to varying extents, from many of the SAMS.

173. This conclusion also applies in each of the Parties' former PES regions, and to customers switching both from FTCs or SVTs.

174. Therefore, the CMA believes that the Merger will give rise to only a limited loss of rivalry to attract customers and does not result in significant upward pricing pressure on FTC tariffs. Therefore, the CMA has not currently identified competition concerns in relation to this theory of harm.

Conclusion on horizontal unilateral effects in the supply of electricity and/or gas

175. For the reasons set out above, the CMA believes that the Merger raises significant competition concerns as a result of the loss of rivalry in the process of setting SVT prices.

176. Accordingly, the CMA believes that the Merger gives rise to a realistic prospect of an SLC in relation to the supply of electricity and/or gas to domestic customers in GB. This is as a result of horizontal unilateral effects through the loss of rivalry in the setting of SVT prices.

Horizontal unilateral effects in the supply of electricity to domestic non-Economy 7 restricted meter customers in GB

Parties' submissions

177. The Parties submitted that there is only limited overlap between the Parties in non-Economy 7 restricted meters due to Npower's small presence, and that this limited overlap is in steady decline. They stated that Npower does not offer multi-rate tariffs for new restricted meter customers, requiring new potential customers with non-Economy 7 restricted meters to switch to a single-rate or Economy 7 meter, and that this has been the case for at least the past four years.[89]

Shares of supply

178. Information submitted by the Parties indicates that, at December 2017, SSE Retail had around [✂] restricted meter customers in GB, while Npower had

[89] Npower estimates that it added [✂] new restricted meter customers across GB between January 2015 and December 2017, predominantly due to home-moves (ie where a customer moves into an address with a restricted meter that is currently supplied by Npower).

around [✂] non-Economy 7 restricted meter customers, representing shares of supply of [20-30]% and [5-10]% respectively.[90]

179. Ofgem expressed concern that the Merged Entity would have a significant degree of market power for these customers, particularly in remote geographic regions where there is limited choice of suppliers. Ofgem referred to its report '*The state of the market for customers with dynamically tele-switched meters'*,[91] noting that the Merged Entity would have a high share of supply in the restricted meters segment in [✂].

Closeness of competition

180. As stated above, Npower has a limited number of restricted meter customers. Moreover, it said that its restricted meter offering is highly unattractive for most customers, indicating that it does not compete effectively for restricted meter customers, and has not done so for several years.

181. The CMA's analysis of the Parties' switching data indicated that the number of non-Economy 7 restricted meter customers who switch to Npower is [✂] small (around [✂] customers per year),[92] and the proportion of customers who switch from SSE to Npower is [✂] limited. Between 2015 and 2017, only [✂] of the restricted meter customers switching away from Npower switched to SSE.

182. This evidence suggests that the Parties are not close competitors for restricted meter customers.

Competitive constraints

183. SSE submitted that it loses restricted meter customers to a large number of different suppliers, including all of the other SLEFs and many SAMS, including First Utility, Co-op Energy, Utility Warehouse, Extra Energy, Ovo Energy and Utilita. This applies also in its former PES-regions, including North Scotland.

184. The CMA noted that following the EMI remedy, non-Economy 7 restricted meter customers are now able to move to single-rate tariffs if desired. However, for those customers who do not wish to move to a single-rate tariff, and in line with its findings in the EMI, the CMA has found in the present case that customers with non-Economy 7 restricted meters do face fewer options and less

[90] The share of supply is based on the Parties' data. The CMA found some discrepancies in the classification of meter/ customer numbers between the Parties, but does not believe this would alter its conclusion on competition concerns for non-Economy 7 restricted meter customers.
[91] Ofgem report on the state of the market for customers with dynamically teleswitched meters.
[92] Npower submits that these customers are predominantly customers moving into a home with an existing Npower restricted meter tariff, and not new customers.

transparency in their choice of supplier and tariff than other customers. For example:

a) PCWs told the CMA that they tend not to list prices for these meter types, which makes it harder for non-Economy 7 customers to access and compare prices; and

b) Some competitors told the CMA that they are unable to offer dual-rate tariffs to non-Economy 7 restricted meters, with customers being required to change meter or to accept an Economy 7 tariff.

185. However, the evidence above indicates that there remain many alternative suppliers for the Parties’ restricted meter customers.

Conclusion on horizontal unilateral effects on restricted meter customers

186. For the reasons set out above, the CMA believes that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the supply of electricity to domestic non-Economy 7 restricted meter customers in GB.

Horizontal unilateral effects in the supply of electricity and/or gas to domestic prepayment customers in GB

Shares of supply

187. The Parties provided estimates for their shares of supply of electricity and gas to PPM customers, as shown in Table 5.

Table 5: Shares of supply for prepayment meters, by number of customers (GB, 2016)

	Electricity	Gas
SSE Retail	[10-20]%	[5-10]%
Npower	[5-10]%	[5-10]%
Combined	[10-20]%	[10-20]%
British Gas	[20-30]%	[30-40]%
E.ON	[10-20]%	[5-10]%
EDF	[10-20]%	[5-10]%
Scottish Power	[10-20]%	[5-10]%
Utilita	[5-10]%	[10-20]%
Ovo Energy	[0-5]%	[0-5]%
Other suppliers	[10-20]%	[10-20]%

Source: Parties' submission using Cornwall Insight and Ofgem data[93]

188. This data indicates that the Parties have a limited combined share of supply of PPM customers. In particular, Npower has a small share of supply of these customers, being the smallest of the SLEFs in this segment and smaller than at least one of the SAMS.

Closeness of competition

189. The Parties submitted that they are not close competitors for PPM customers, and provided detailed switching analysis showing that each Party loses only a small proportion of their PPM customers to the other Party.

190. The Parties also submitted that, owing to the PPM price cap (in place since 1 April 2017), it is no surprise that the tariffs they offer are similar, given that all suppliers are bunched just under the cap's level as they endeavour to cover their costs.

191. The CMA conducted its own switching analysis and found that switching between the Parties was significantly lower for PPM customers compared with

[93] These estimates are based on third party data sources, and consistent with other available data.

other customer types, with switching from Npower to SSE of between [✂]% for gas and/or electricity, and switching from SSE to Npower of between [✂]%. The CMA found that [✂].

192. This evidence suggests that the Parties are not close competitors for PPM customers.

193. The CMA noted that the introduction of the PPM price cap has led to a convergence of prices, with almost all suppliers (including the Parties) moving to prices just below the cap.[94] The CMA further examined the tariffs offered by the Parties by considering different levels of usage (as opposed to using Ofgem's assumptions about the energy usage of a typical household) and found them to be similar across usage levels. However, other suppliers' prepayment tariffs were also similar.

Competitive constraints

194. The Parties submitted that their shares of supply for PPM customers are falling over time, and that they lose customers to a large number of alternative suppliers, including the other SLEFs and the SAMS, in particular to Utilita and Ovo Energy, which specialise in serving PPM customers.

195. The CMA's switching analysis found that more PPM customers of the Parties switched to British Gas and Scottish Power than switched between the Parties. The CMA also observed that, in general, switching to other SLEFs from the Parties was lower for PPM customers than for other types of customer, driven by high levels of switching from both of the Parties to Utilita and Ovo Energy. These alternative suppliers win around [✂] PPM customers from each Party as the other Party does.

196. Only around half of the suppliers who are active in supplying energy in GB serve PPM customers, and the range of tariffs available to PPM customers is more limited than for other types of customer.[95] Moreover, some third parties raised concerns that the Merger may have a negative impact on vulnerable customers, some of whom are likely to be PPM customers (although no third party raised concerns with regard to PPM customers in particular).

197. Notwithstanding the fewer options available to PPM customers than to other customers, the evidence above indicates that there remain many alternative suppliers for the Parties' PPM customers.

[94] Analysis of this can be seen in Ofgem's State of the Energy Market Report at Figure 6
[95] For example, between June 2016 and June 2017, there were around 120 core tariff choices for direct debit customers, while there were only 30 choices for PPM customers. (Source: Parties submission)

Conclusion on horizontal unilateral effects in the prepayment market

198. For the reasons set out above, the CMA believes that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the supply of electricity and/or gas to domestic prepayment customers in GB.

Coordinated effects

199. Coordinated effects may arise when firms operating in the same market recognise that they are mutually interdependent and that they can reach a more profitable outcome if they coordinate to limit their rivalry.[96] A merger may raise competition concerns as a result of coordinated effects if it affects the market structure such that the conditions for sustaining coordinated effects are created or enhanced.

200. When assessing whether or not coordinated effects may arise as a consequence of a merger, the CMA has regard to whether (a) there is evidence of pre-existing coordination in the relevant market(s), (b) firms are able to reach and monitor the terms of coordination, (c) coordination would be internally sustainable, and (d) coordination would be externally sustainable.[97]

201. In the present case, the CMA considered whether the characteristics of the supply of electricity and/or gas to domestic customers in GB are conducive to coordination and whether the Merger will change the market structure such that the conditions for sustaining coordinated effects are created or enhanced. The CMA considered both whether the elimination of a SLEF could decrease complexity and increase the sustainability of coordination between the five remaining SLEFs, as well as whether the Merger could lead to coordination between the Merged Entity and British Gas, particularly whereby the two suppliers would coordinate to compete less strongly in different regions.

The EMI

202. The EMI assessed the possibility of tacit coordination between the SLEFs. Specifically, it considered the possibility that the SLEFs might coordinate prices using SVT price announcements.[98]

203. The EMI found that there was no evidence that price announcements were a mechanism used for tacit collusion. While it found some factors that may be

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[96] Merger Assessment Guidelines, paragraph 5.5.1.
[97] Merger Assessment Guidelines, paragraphs 5.5.4 and 5.5.9.
[98] EMI final report, par. 9.353-9.374 and Appendix 9.4.

conducive to collusion, such as transparent pricing and transparency on the suppliers to whom and from whom domestic customers are lost and gained, as well as similarity in cost structures and business models, it found many factors which indicated that coordination was unlikely. Specifically, it found that:

a) there were some differences in the business models of suppliers;

b) there would be short- to medium-term differences in energy costs reflecting differences in purchasing strategies; and

c) there were groups of domestic customers, including those subscribing to fixed-rate products, who were more price-sensitive than other customers.

204. With regard to coordination through price announcements in particular, the EMI found that:

a) Both the size and the timing of price announcements varied within and between rounds; and

b) No single supplier was consistently the first in announcing price changes.

Market structure

205. The Merger will change the structure of the market from a situation where British Gas is substantially larger than the other SLEFs to one where there are two large energy suppliers of similar size competing with three other SLEFs and many SAMS. Post-Merger, the Merged Entity and British Gas will have shares of supply of [20-30]% and [20-30]% respectively in electricity in GB, and [10-20]% and [30-40]% respectively in gas in GB.[99] E.ON, EDF and Scottish Power have continue to have shares of supply of between [10-20]%-[10-20]% for electricity and [5-10]%-[10-20]% for gas.

206. Ofgem submitted that the Merger could be seen as "*a movement from six large suppliers to two large suppliers of comparable size, with a sizeable fringe of medium and small suppliers*". Ofgem noted that, post-Merger, the Merged Entity and British Gas would together control around [40-60]% of domestic electricity and gas supply. Ofgem said that it believed the increase in market concentration resulting from the Merger, with the creation of two larger SLEFs, could create an environment that is more conducive to tacit collusion. Some

[99] Calculated using Cornwall Insight data for October 2017, submitted by the Parties.

smaller competitors also raised concerns that the change in the market structure as a result of the Merger could lead to coordinated effects.

Factors facilitating coordination

207. The Parties submitted that the factors identified by the EMI as making coordination less likely have become more pronounced since the EMI, further reducing the possibility of coordination. This includes the number of new suppliers who have entered the market with diverse business models and tariff offerings, increased customer engagement and use of PCWs reflecting increased price sensitivity, and the growth in the combined share of supply of the SAMS.

208. The CMA assessed the changes in the supply of domestic energy since the EMI and found that the majority of these changes have made coordination less likely than during the EMI. These changes include:

   a) The repeal of the RMRs (including the four-tariff rule) and the increase in the number of suppliers, which have decreased transparency on prices and terms and conditions.

   b) The increase in use of PCWs and collective switching and the increase in the number of suppliers (including niche suppliers), which has created a wider range of different business models.

   c) Barriers to entry and expansion have decreased as a result of the EMI remedies, and the shares of supply of the SAMS have continued to erode the shares of supply of the SLEFs, leading to less stability for the SLEFs in their market position.

   d) Customer switching and engagement has increased, with further remedies to be implemented to improve this further, leading to an increase in price sensitivity among customers.

209. Against these factors, the CMA noted that the shares of supply of the SLEFs have become more similar to each other since the EMI, including on a regional basis, since the incumbent’s share in each PES region has been falling.

210. Overall, the CMA believes that these changes since the EMI make coordination less likely than at the time of the EMI.

211. As in the EMI, the CMA has also found no evidence of pre-existing coordination.

212. Nevertheless, the CMA has considered whether the Merger may lead to changes in the market which might make it more susceptible to facilitating coordination.

External and internal sustainability of coordination

213. The CMA assessed whether, if the Merger were to facilitate reaching the terms of coordination, any coordination would be internally and externally sustainable.

214. The Parties submitted that coordination would not be internally sustainable because: (i) there would be little profit to be made due to the low switching figures, including between the Parties and British Gas; (ii) there would be no effective 'punishment mechanism' as customers who switch usually remain on their new tariff for a fixed term of at least six months; and (iii) it would be easy to deviate from the coordination by altering other aspects of their service offering, including customer service.

215. The Parties also submitted that coordination would not be externally sustainable, given the significant competitive constraints from over 60 other suppliers, as well as pressure from engaged customers.

216. Given the evidence submitted by the Parties and considered above, in particular the switching data, the CMA has concluded that:

   a) As to whether the five resulting SLEFs could more easily coordinate post-Merger, the Merger will make the large suppliers generally less similar to each other, with the Merged Entity considerably larger than three of its rivals in terms of total customers and SVT customers. Moreover, the Merged Entity's greater reliance on trading for its wholesale energy requirements also exacerbates the differences in business models and energy costs noted in EMI. Therefore, the Merger would not increase the internal sustainability of coordination.

   b) As to whether the Merged Entity and British Gas could more easily coordinate post-Merger, this would not be externally sustainable given the competitive constraints on these firms from the remaining SLEFs (for SVTs) and additional constraints from the SAMS (for FTCs).

Conclusion on coordinated effects

217. For the reasons set out above, the CMA believes that, since the EMI, which found no evidence of coordination, the changes in the energy market have made coordination less likely. Even if the Merger might change some aspects of the market structure, which might enhance the ability of some parties to

reach an understanding on the terms of coordination, this would not be either internally or externally sustainable given the increased differences between the SLEFs, even if the Merged Entity and British Gas become more similar, the competitive pressure of other suppliers.

218. Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of an SLC as a result of coordinated effects in relation to the supply of gas and/or electricity to domestic customers in GB.

Vertical effects

219. Vertical effects may arise when a merger involves firms at different levels of the supply chain, for example a merger between an upstream supplier and a downstream customer or a downstream competitor of the supplier's customers.

220. Vertical mergers may be competitively benign or even efficiency-enhancing, but in certain circumstances can weaken rivalry, for example when they result in foreclosure of the merged firm's competitors. The CMA only regards such foreclosure to be anticompetitive where it results in an SLC in the foreclosed market(s), not merely where it disadvantages one or more competitors.[100]

221. As discussed in paragraph 57, the CMA does not believe that the wholesale and generation activities of SSE and/or Innogy, and any vertical relationships between these firms and the Parties, will lead to a realistic prospect of an SLC.

222. In addition to these vertical relationships, Npower has an exclusive Supply and Services Agreement (**SSA**) with Telecom Plus for the supply of gas and electricity to Utility Warehouse, a mid-tier energy supplier. This agreement ends in [✂]. The CMA has considered whether, post-Merger, the Merger Entity could foreclose Utility Warehouse by increasing the price paid by Utility Warehouse under the SSA.[101]

223. The CMA's approach to assessing vertical theories of harm is to analyse (a) the ability of the merged entity to foreclose competitors, (b) the incentive of it to do so, and (c) the overall effect of the strategy on competition.[102]

224. Utility Warehouse submitted to the CMA that the Merged Entity would have the ability to increase the price paid based on the terms of the SSA and that it would also have the incentive given the recapture of lost customers by the Merged Entity and the increase in profit from the SSA. It also submitted the

[100] In relation to this theory of harm 'foreclosure' means either foreclosure of a rival or to substantially competitively weaken a rival.
[101] The price Utility Warehouse pays for energy is calculated as a discount to [✂] SVT prices of the SLEFs.
[102] Merger Assessment Guidelines, paragraph 5.6.6.

effect of this would be a reduction in its ability to compete effectively post-Merger.

Ability

225. The wholesale price paid by Utility Warehouse to Npower for electricity is based on [✂] the electricity SVT prices of the SLEFs. A similar [✂] applies to determine the gas wholesale price. Pre-Merger, Npower can affect these wholesale prices to some extent by varying its own SVT prices. However, after the Merger, the Merged Entity will have greater influence over these wholesale prices because it will control two out of the six inputs, rather than one.

226. Npower submitted that it would not have the ability to increase the price Utility Warehouse pays because the pricing arrangements are based upon an assumption that [✂]. However, the CMA has considered the legal consequences of the above clause to be unclear, in particular how the [✂] will be interpreted.

227. [✂], the CMA also found that it is not clear whether, given the precise form of the Merger, that clause will give Utility Warehouse [✂].

228. Therefore, the CMA believes that the Merged Entity might have the ability to increase the wholesale prices paid by Utility Warehouse, and that the Merger will increase that ability.

Incentive

229. Npower submitted that any increase in SVT prices would be highly unprofitable. It said that, when evaluating any increase in SVT prices, it considered a number of factors including its costs and likely customer losses, and this consideration would not change as a result of the Merger. Npower said that any effect on the wholesale price paid by Utility Warehouse through the SSA was not a factor in its setting of SVT prices.

230. The CMA considered the effects of the Merger on the incentives of the Merged Entity to raise its SVT prices in order to increase its wholesale prices to Utility Warehouse. The CMA found these effects to be small because:

    a) the size of the revenue the Merged Entity earns from the SSA is very small compared with the revenues it earns from its retail activities;

    b) If Utility Warehouse were to lose customers, the Merged Entity would lose wholesale revenue. The number of retail customers the Merged Entity could expect to recapture would be relatively small, given the Parties' proportion of all new customers won. Moreover, those new customers would join on an FTC with relatively low margins;

c) The CMA has seen no evidence in internal documents to indicate that pre-Merger the SSA is a consideration in Npower's SVT price setting behaviour.

231. Nevertheless, as noted above, the CMA has found competition concerns in relation to how the Merger may reduce the constraints on the SLEFs' SVT prices. Therefore, the CMA cannot exclude the possibility that the Merger could create an incentive to take actions which could, to some extent, foreclose Utility Warehouse. The incentive for the Merged Entity to increase its SVT prices would be driven by other factors (ie one less SLEF constraining its price setting) but the vertical effect would still be felt on Utility Warehouse.

Effect

232. Npower submitted that any increase in its SVT price would result in the wholesale price paid by Utility Warehouse being only marginally higher, and so would not result in a material effect on competition.

233. However, Utility Warehouse submitted that its ability to compete effectively would be reduced. It provided an analysis of the expected effect of a SVT price increase.

234. Given the factors mentioned above, the CMA expects that any Merger-specific SVT price rise faced by Utility Warehouse is likely to derive from the Merged Entity's other incentives to raise its SVT prices. However, any wholesale cost increase which is specific to Utility Warehouse would make it less able to compete effectively. Moreover, the CMA notes Utility Warehouse's differentiated business model, which involves a basket of utility services. This could cause any effect on Utility Warehouse with regard to its energy supply to have knock-on effects on the competitiveness of its basket of goods, though the materiality of such effects is unclear.

Conclusion on vertical effects

235. Pursuant to its finding of competition concerns in the price setting of SVTs, the CMA cannot exclude the possibility that the Merger may also raise competition concerns in relation to the vertical relationship between Npower and Utility Warehouse, given that the wholesale price paid by Utility Warehouse is set by reference to SVT prices and an increase in SVT prices may lead to the foreclosure of this competitor.

236. However, given the CMA's findings in respect of horizontal unilateral effects, it was not necessary for the CMA to conclude on whether the Merger raises significant competition concerns as a result of the supply relationship between Npower and Utility Warehouse.

Barriers to entry and expansion

237. Entry, or the expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases may mean that there is no SLC. In assessing whether entry or expansion might prevent an SLC, the CMA considers whether such entry or expansion would be timely, likely and sufficient.[103]

238. Given the concerns set out above, the CMA considered whether there was scope for one or more of the SAMS to become as prominent in the SVT price setting process as one of the Parties, and so replace the constraint lost by the Merger.

Parties' submission

239. The Parties submitted that barriers to entry and expansion in the supply of energy and gas in the UK are low, noting the relatively short timescale required to enter and the low cost. The Parties pointed to several new entrants from the past few years and said that these new entrants had collectively had significant success in attracting a high (and growing) proportion of customers. The Parties added that this trend is likely to continue.

240. The Parties stated that the ease of entry and expansion is evidenced by the growth of some mid-tier suppliers to represent around 2% of the market, and by ongoing investment in existing SAMS, eg Shell's recent acquisition of First Utility. The Parties also noted that there are now ten SAMS above the 250,000-customer threshold at which suppliers face additional regulatory obligations (eg the Warm Home Discount and ECO obligations).

Evidence from shares of supply and EMI

241. As mentioned above, the EMI found that many customers are disengaged from the retail energy market. It identified a number of barriers to engagement, which included barriers to accessing and assessing information, as well as switching costs. The CMA notes that customer disengagement may limit the number of

[103] Merger Assessment Guidelines, from paragraph 5.8.1.

customers who may switch, limiting the potential for energy suppliers to enter and expand.

242. Collectively, the SAMS have grown from a share of supply of energy in GB of around 5% in 2013 to nearly 25% in 2017. However, only six mid-tier energy suppliers in GB have a share of supply (both in electricity and gas) over 1%, and in all cases below 4%. All remaining small suppliers have a share of supply less than 1%. This suggests that although barriers to entry may be low, barriers to expansion might be more considerable. Many of the mid-tier suppliers, such as First Utility, Ovo Energy, Utility Warehouse and Utilita, have been active in the market for approximately 8 years or more, suggesting that their expansion has been slow.

243. The CMA also notes that, in recent years, there have been four exits by small domestic energy suppliers, including the recent exit of Future Energy in January 2018 and the exit of GB Energy in October 2016. This suggests that small suppliers might struggle to compete sustainably with the SLEFs.

Third party submissions

244. Ofgem told the CMA that the rate of growth of the SAMS is declining, with [✄]. Ofgem said that some suppliers who previously priced aggressively may now be trying to compete on other features, such as quality or innovation.

245. Several mid-tier competitors told the CMA that the additional obligations faced when a supplier reaches 250,000 customers triggers a significant increase in their marginal costs, which are hard to recover given the strong price competition for new customers from the SLEFs. These competitors said that at this point it becomes difficult for them to compete for new customers and to retain their current customers. Each of these competitors said that, for this reason, they are finding it hard to expand further.

246. Several third parties noted the recent exit of some small energy suppliers (ie GB Energy, Future Energy, Brighter Energy World and the Energy Deal).

CMA Assessment

247. On the basis of the evidence set out above, noting in particular the continued limited customer engagement and the significant marginal cost increase which affects mid-tier suppliers when they reach 250,000 customers, the CMA believes that it will take a considerable amount of time before any of the mid-tier suppliers grows to a similar scale to the SLEFs. This is supported by the trends in the shares of supply of each of the mid-tiers in recent years. Further, the CMA notes that, as the customers of mid-tier suppliers are, on average,

more engaged than those of the SLEFs, it will take them even longer to build up a sizeable number of SVT customers, which is relevant to the press coverage and public awareness of their SVT prices,[104] their likely prominence in the SLEFs' internal considerations, and their consequent constraint on the SLEFs' SVT price setting behaviour.

Conclusion on barriers to entry and expansion

248. For the reasons set out above, the CMA believes that, notwithstanding the number of new suppliers which have entered the supply of energy to domestic customers in GB in recent years, customer disengagement and higher costs arising from regulatory obligations (above a certain size) are significant barriers to expansion. Moreover, the small number of customers on SVTs with the SAMS means that these suppliers are unlikely to affect significantly the SVT price setting behaviour of the SLEFs for a considerable time.

249. Therefore, the CMA believes that entry or expansion would not be timely, likely and sufficient to prevent the SLC identified by CMA, as there is insufficient reason to believe that the SAMS will become as prominent as comparators in the benchmarking process for setting SVT prices as the SLEFs in the foreseeable future.

Third party views

250. The CMA contacted competitors of the Parties, around half of whom raised concerns about the Merger, particularly for SVT customers.

251. Ofgem also raised significant concerns on a number of aspects of the Merger, which have been discussed throughout the decision.

252. A small number of other third parties raised concerns. The CMA also contacted PCWs and consumer groups, none of whom raised concerns about the Merger.

253. Third party comments have been taken into account where appropriate in the competitive assessment above.

Decision

254. Consequently, the CMA believes that it is or may be the case that (i) arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and (ii) the creation of

[104] See paragraph 124.

that situation may be expected to result in an SLC within a market or markets in the UK.

255. The CMA therefore believes that it is under a duty to refer the Merger to Phase 2 as specified under section 33(1) of the Act. However, the duty to refer is not exercised[105] whilst the CMA is considering whether to accept undertakings[106] instead of making this reference. The Parties have until 3 May 2018[107] to offer an undertaking to the CMA.[108] The CMA will refer the Merger for a Phase 2 investigation[109] if the Parties do not offer an undertaking by this date; if the Parties indicate before this date that they do not wish to offer an undertaking; or if the CMA decides[110] by 11 May 2018 that there are no reasonable grounds for believing that it might accept the undertaking offered by the Parties, or a modified version of it.

Rachel Merelie
Senior Director, Delivery and Sector Regulation
Competition and Markets Authority
26 April 2018

[105] Section 33(3)(b) of the Act.
[106] Section 73 of the Act.
[107] Section 73A(1) of the Act.
[108] Section 73(2) of the Act.
[109] Sections 33(1) and 34ZA(2) of the Act.
[110] Section 73A(2) of the Act.