

ANTICIPATED MERGER BETWEEN THE DOMESTIC RETAIL ENERGY BUSINESS OF SSE PLC AND NPOWER GROUP PLC

Issues Statement

29 May 2018

The reference

1. On 8 May 2018 the Competition and Markets Authority (CMA), in exercise of its duty under [section 33\(1\)](#) of the Enterprise Act 2002 (the Act), referred the anticipated merger (the Merger) between the domestic retail energy business of SSE plc (SSE Retail) and Npower Group plc (Npower) for further investigation and report by a group of CMA panel members (the inquiry group).
2. The CMA must decide:
 - (a) whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and
 - (b) if so, whether the creation of that situation may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the United Kingdom (UK) for goods or services.
3. In this statement, we set out the main issues we are likely to consider in reaching our decisions, having had regard to all the evidence gathered to date including evidence set out in the CMA's document giving its reasons for deciding to refer the Merger for further investigation following the phase 1 assessment (the Reference Decision).¹ This does not preclude the consideration of any other issues which may be identified during the course of our investigation.
4. We are publishing this issues statement in order to assist parties submitting evidence to focus on the issues we currently envisage being relevant to our

¹ [The Reference Decision](#), 26 April 2018.

inquiry and to invite parties to notify us if there are any additional relevant issues which they believe we should consider.

5. Throughout this document, where appropriate, we refer to SSE Retail and Npower collectively as 'the Parties'.

Background

The transaction

6. SSE Retail and Npower are both involved in the supply of gas and electricity to domestic customers in Great Britain (GB). They are both former, pre-privatisation suppliers of electricity, and included in the Six Large Energy Firms (SLEFs), along with Centrica, EDF Energy, E.ON and Scottish Power. Other energy suppliers are referred to as small and mid-tier suppliers (SAMS).
7. The anticipated transaction involves the creation of a new company (the Merged Entity) as a result of the merger of SSE Retail and Npower. On completion of the anticipated transaction, innogy SE (innogy), Npower's parent company, will hold a 34.4% shareholding in the Merged Entity. SSE plc's 65.6% shareholding will be distributed to its shareholders, leading to the exit of SSE plc from the domestic retail energy sector in GB.

The Parties

8. SSE plc is a listed company on the London Stock Exchange. SSE plc is transferring its domestic retail energy supply, telecoms and energy-related services in GB to SSE Retail in anticipation of the transaction. Therefore, SSE plc's other business activities such as supplying energy to small and medium-sized enterprises (SMEs) will not form part of the transaction.
9. Npower is owned fully by innogy, a European energy group listed on the Frankfurt Stock Exchange that is active in renewable energy generation, electricity and gas distribution, and the retail supply of energy. innogy is in turn majority owned (76.8%) by RWE AG (RWE). Npower is part of innogy's retail business division and supplies electricity and gas to domestic and non-domestic customers and provides energy-related services in GB.
10. The Parties confirmed to the CMA that the anticipated transaction is not subject to review by any other competition authority, including the European Commission.
11. 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”.

Frame of reference

12. Market definition is a useful analytical tool, but not an end in itself, and identifying the relevant market involves an element of judgement. The boundaries of the market do not determine the outcome of the CMA’s analysis of the competitive effects of the merger in any mechanistic way. In assessing whether a merger may give rise to a SLC, the CMA may take into account constraints outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.²

Horizontal relationship and the phase 1 Decision

13. The Parties’ activities specifically overlap in the following areas:
 - (a) retail supply of energy (electricity and gas) to domestic customers in GB; and
 - (b) retail supply of energy home automation products to domestic customers.
14. However, as set out in the Reference Decision, given that there are many retail suppliers in the energy home automation market and the lack of concern on the part of third parties, the CMA decided not to consider this overlap further.³ Our focus is therefore to investigate the retail supply of energy to domestic customers.
15. As set out in the Reference Decision, the Parties submitted that the Merger should be assessed by reference to the retail supply of gas, electricity, and dual fuel separately. The Parties did not find it appropriate to further segment the product markets by type of tariff, meter or payment method.⁴
16. In the Reference Decision, the CMA considered the impact of the Merger in the following product frames of reference:
 - a) the supply of electricity to domestic customers in GB;
 - b) the supply of gas to domestic customers in GB;

² [Merger Assessment Guidelines](#) (CC2 (Revised)/OFT1254), September 2010, paragraph 5.2.2.

³ [The Reference Decision](#), paragraph 56.

⁴ [The Reference Decision](#), paragraph 60.

- 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.
17. The parties submitted that the appropriate geographic frame of reference was GB. The Reference Decision noted that SLEFs tend to have higher market shares in their historic areas which can affect how suppliers think about competition. However, it considered that a GB-wide frame of reference was appropriate in this case.

Approach in phase 2

18. We will use the frames of reference used in the Reference Decision as a starting point for our phase 2 investigation.

Vertical Relationship

19. In the Reference Decision the CMA recognised that there was a vertical relationship between the Merged Entity's activities in the retail supply of energy and both SSE plc's and innogy's energy generation and trading operations in GB.
20. In dismissing a theory of harm in relation to these vertical relationships, the Reference Decision noted that the CMA's Energy Market Investigation⁵ did not find any adverse effect on competition arising from vertical integration in the energy sector. In addition, the Reference Decision took into account that on completion, SSE Retail will be an independent entity separate from SSE plc. It also found that innogy's share of supply in energy generation and trading would not give the Merged Entity and innogy the ability or incentive to foreclose any competing generator or retail supplier, nor to reduce wholesale market liquidity. In light of these findings, we do not currently propose to explore this vertical relationship further.

Assessment of the competitive effects of the merger

21. Our role is to investigate whether the Merger may be expected to result in a substantial lessening of competition. We use theories of harm as a framework for this assessment, see paragraphs 31 to 46. However, this assessment is conducted with a view to the context of the sector in question, for example we

⁵ [CMA \(2016\) Energy Market Investigation Final Report](#).

may take into account whether there are other transactions occurring, whether there are other developments in the market and whether there may be previously identified concerns.

22. A merger that gives rise to an SLC will be expected to lead to an adverse effect for customers.⁶ Therefore, in assessing whether the Merger is likely to result in an SLC, we are concerned, in particular, with the interests of customers. Energy is a significant expense; the CMA's Energy Market Investigation noted that gas and electricity can be characterised as 'necessity goods', where the poorest 10% of the population spends almost 10% of total household expenditure on electricity and gas, while the richest 10% spends about 3%.⁷
23. In the Energy Market Investigation, the CMA identified "a combination of features of the markets for the domestic retail supply of gas and electricity in GB that give rise to an adverse effect on competition (AEC) through an overarching feature of weak customer response, which, in turn, gives suppliers a position of unilateral market power concerning their inactive customer base".⁸
24. As part of the Energy Market Investigation, the CMA put in place a package of remedies for domestic customers aimed at creating a framework for effective competition; helping customers to engage to exploit the benefits of competition; and protecting customers who are less able to engage to exploit the benefits of competition.⁹
25. It is in the context of the existing conditions of competition, taking account of the Energy Market Investigation's findings and the implementation of the remedies package, together with other market developments and information received, that the CMA will assess the anticipated effects of the Merger.

Counterfactual

26. We will assess the possible effects of the Merger on competition compared with the competitive conditions in the counterfactual situation (ie the competitive situation absent the merger). 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

⁶ [Merger Assessment Guidelines](#) (CC2 (Revised)/OFT1254), September 2010, paragraph 4.1.3.

⁷ [CMA \(2016\) Energy Market Investigation Final Report](#), Summary, paragraph 92.

⁸ [CMA \(2016\) Energy Market Investigation Final Report](#), Summary, paragraph 154.

⁹ [CMA \(2016\) Energy Market Investigation Final Report](#), Summary, paragraph 206.

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.¹⁰

27. The Parties identified¹¹ 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 Energy Market Investigation¹², technological advances (including smart meters and connected homes), Ofgem reforms aimed at encouraging customer switching, and the proposed price cap.¹³ There may be uncertainty over the extent to which these changes will occur, the timing, and the impact of them. The CMA will consider, on the facts available, whether an alternative counterfactual is appropriate, and whether any changes should instead be considered within the competitive assessment.
28. In reviewing mergers, 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).
29. 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).¹⁴ 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). At the moment, it is not certain whether the E.ON/RWE transaction will proceed, and the transaction will be conditional upon approval by the relevant antitrust and regulatory authorities, including clearance of the European Commission. In any event it is not expected to complete until the end of 2019.
30. We will consider whether any account should be taken of this anticipated transaction within the counterfactual or our analysis of the competitive effects

¹⁰ [Merger Assessment Guidelines](#) (CC2 (Revised)/OFT1254), September 2010, 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).

¹¹ [The Reference Decision](#), paragraph 43.

¹² For example, the creation of a database of disengaged customers (ie customers who have been on a standard variable tariff (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 (see [CMA \(2016\) Energy Market Investigation Final Report](#)).

¹³ 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. At this stage, we are unaware of the scope, timing, duration and level of the price cap and so its potential impact on the competitive landscape.

¹⁴ [E.ON and RWE joint press release](#), 12 March 2018.

of the Merger, taking account of any further information that becomes available.

Theories of harm

31. Theories of harm describe the possible ways in which an SLC could arise as a result of a merger and provide the framework for our analysis of the competitive effects of the Merger. We have set out below the theories of harm which we intend to investigate. However, we may revise our theories of harm as our inquiry progresses. Also, the identification of a theory of harm does not preclude an SLC being identified on another basis following further work by us, or the receipt of additional evidence.
32. We welcome views on all the theories of harm set out below.

A loss of rivalry in the setting of default tariff prices

33. In phase 1, the CMA considered whether the Merger may result in the ability and incentive to charge higher default tariff prices as a result of the removal of one of the SLEFs. Default tariffs are generally the tariffs customers pay when they have not made an active choice to change tariff.¹⁵ Since 2013 default tariffs have been standard variable tariffs (SVTs) and have had no end date, ie unless the customer opts to change tariffs or supplier they remain on this variable tariff.¹⁶
34. The CMA's Energy Market Investigation found that the market is characterised by a substantial group of inactive or disengaged customers who have not made an active choice regarding their energy supplier or tariff either recently or at all. These customers are on default tariffs and account for a significant proportion of the customers in the market. Ofgem reported that in April 2017, 58% of customers were on a standard variable tariff (the main default tariff, this is around 13 million customers) and 33% of customers have been on the same standard variable tariff for three years or more (around 8 million customers).¹⁷
35. Meanwhile, there is a smaller group of active and engaged customers who have made an active choice regarding their energy supplier or tariff and who are on acquisition tariffs (in recent years, typically a fixed term contract

¹⁵ For example, they are the tariffs customers are typically placed on when they first move into a new home and are the tariffs customers move on to at the end of a fixed term contract.

¹⁶ Although recently a number of suppliers have decided to end the use of SVTs as default tariffs.

¹⁷ [Ofgem, State of the energy market \(2017\) report \(October 2017\)](#), Figure 2.7. These figures exclude prepayment meter customers.

(FTC)). The Energy Market Investigation found that customers on acquisition tariffs made significant savings compared to those on default tariffs. For example, it estimated that dual fuel SVT customers of the SLEFs could have gained an average of £186 per year (equivalent to 17% of the bill) if they switched to the best available tariff.¹⁸

36. Suppliers can be expected to set default tariff prices with regard to a number of factors such as changes in their cost base, the risk of losing customers, and other costs of changing tariffs. The degree of customer switching following a supplier's default tariff price change may be determined by a number of factors such as the size of the price change relative to default tariff price changes announced by other suppliers, whether other suppliers have already announced a price change, the degree of publicity (eg news coverage) the price change is likely to attract, and the savings customers could make by switching to an acquisition tariff. Therefore, relative prices and how their pricing is perceived will be relevant to suppliers.
37. This theory of harm proposes that changes in default tariff prices may prompt switching and SLEFs need to balance the effects of price changes with any loss of customers. However, it is possible that price changes relative to other SLEFs are of primary importance, because these are most visible to customers and tend to be reflected in press coverage. Default tariff customers will therefore tend to respond to price changes depending on what other suppliers have already announced regarding default tariff price changes. We note that customers may also take into account the size of the savings they could make by switching to an acquisition tariff, although many customers have not switched despite the potential savings of doing so. This effect (the size of the supplier's default tariff price change relative to the price changes of the other SLEFs' default tariffs) may be relatively important, and so impact on SLEFs' price setting decisions.
38. The effect of the Merger could be to reduce the constraints on the Parties and other suppliers when setting their default tariff prices, leading to higher default tariff prices. For example, the reduction in the number of competing SLEFs might reduce the risk that a supplier loses default tariff customers because it announces a price which is out of line with those of the other suppliers.
39. On the basis of the evidence currently available to us, we propose investigating this theory of harm, ie considering whether a change in the number and identity of SLEFs could change how default tariff prices are set. To do so we are likely to consider:

¹⁸ CMA (2016) Energy Market Investigation Final Report, paragraph 8.252.

- (a) to what extent changes in default tariff prices prompt customer switching (to other tariffs or other suppliers), and in particular all the factors, and their relative importance, which determine the degree of customer switching following a default tariff price change;
- (b) the impact of SAMS' pricing on SLEFs default tariff pricing and customer retention;
- (c) the factors considered by suppliers, particularly the SLEFs, when setting their default tariff prices;
- (d) understanding the timing and size of past default tariff price changes by different suppliers, and how particular suppliers have responded depending on what other suppliers have done; and
- (e) understanding the factors which lead customers to engage with the energy market, in particular when a customer may not have engaged for some time.

Vertical effects: Foreclosure of Utility Warehouse resulting from an increase in Npower's wholesale price to Utility Warehouse

- 40. Npower has an exclusive Supply and Services Agreement (SSA) to supply gas and electricity to Utility Warehouse, a mid-tier energy supplier. The wholesale price paid by Utility Warehouse to Npower for energy is related to SVT prices of the SLEFs.¹⁹
- 41. This theory of harm considers whether the Merged Entity would have an incentive to raise SVT prices to increase its wholesale prices to Utility Warehouse. The Merger could change the relative assessment of the Merged Entity on the trade-off between its revenues from Utility Warehouse, a reduction in demand from any loss of Utility Warehouse customers, and the likelihood of picking up any Utility Warehouse customers who switch following a Utility Warehouse price rise.
- 42. At phase 1, the CMA found that it could not exclude the possibility that the Merger could raise competition concerns given that the Merged Entity would have the ability to increase the wholesale prices paid by Utility Warehouse and that any increase in SVT prices may lead to the foreclosure of Utility Warehouse. However, given its findings on horizontal unilateral effects, the Reference Decision did not conclude on this theory of harm.²⁰

¹⁹ [The Reference Decision](#), paragraph 222.

²⁰ [The Reference Decision](#), paragraph 235-236.

43. We therefore propose investigating this theory of harm. We are likely to consider:
- (a) whether the Merged Entity would have an ability to affect wholesale prices paid by Utility Warehouse given the contractual agreements;
 - (b) the impact on Utility Warehouse of a cost increase, and whether it has any ability to switch to alternative suppliers;
 - (c) whether the Merged Entity would have any credibly significant incentive to adjust prices given the size of the Utility Warehouse contract; and
 - (d) whether Utility Warehouse's business model (offering bundles of utility services) affects either the credibility of foreclosure or makes any such effect more or less important for competition.

Horizontal foreclosure of competitors as a result of cross-subsidisation

44. Ofgem's State of the Energy Market Report 2017 notes that prices paid for default tariffs are considerably above those offered to the typical fixed tariff (ie acquisition tariff) customers.²¹ Therefore, suppliers with substantial numbers of default tariff customers can potentially offer very competitive prices to engaged consumers while still making a profit overall. Concerns were raised during the phase 1 investigation that SLEFs could potentially use the profits from default tariff customers to cross-subsidise the acquisition tariffs they offer to active customers, and that potentially this could allow them to affect the growth of the SAMS and their incentive to innovate and to expand, reducing competition within the market. The Merger may then exacerbate this issue by increasing the size of the Parties' inactive customer base, increasing their ability to do this.
45. However, we note that:
- (a) The evidence received during the CMA's Energy Market Investigation and reviewed during the phase 1 investigation indicates that the SLEFs are not currently foreclosing entry through the use of this practice. In particular, it is the SAMS who generally have the lowest priced acquisition tariffs.
 - (b) Current prices appear to be financially sustainable for the SAMS. While some SAMS have exited the market recently, the overall number of

²¹ Ofgem, [State of the energy market \(2017\) report \(October 2017\)](#), page 31.

suppliers has continued to grow, albeit each of the SAMS individually continues to be significantly smaller than each of the SLEFs.

(c) At least in the short-run, if this practice is occurring, engaged customers selecting acquisition tariffs benefit from lower prices.

46. The CMA invites views on this theory of harm. For this theory of harm to be progressed, we would need evidence to demonstrate that as a result of the Merger the ability of the SAMS to compete would be likely to be reduced because they would be more likely to be partially or completely foreclosed.

Other theories of harm we are not minded to investigate

47. A number of other potential theories of harm were considered during the course of the phase 1 investigation or have been raised with us, but which we are not currently minded to pursue because there does not appear to be a realistic prospect that an SLC may be found. Should any party have reason for believing that we should investigate these theories of harm (or any new theories of harm), it should tell us and provide a reasoned submission.

48. The theories of harm we are not minded to investigate are as follows.

(a) A loss of rivalry to attract new customers with conventional meters via acquisition (fixed term contract) tariffs

Energy suppliers use acquisition tariffs to compete to attract new customers. An effect of this merger could be to reduce rivalry to attract new customers by reducing the number of competing suppliers. This effect would be more plausible where customers have relatively few close alternatives to the Parties, and the Parties are close alternatives to each other.

However, it was found in the Reference Decision that the Parties do not appear to be particularly close competitors to supply new customers: switching rates between them are consistently low²²; and the tariffs offered by the Parties are no more similar to each other than those offered by other competitors.²³

There are also a large number of alternative suppliers who currently compete to supply engaged/new customers and who would continue to constrain the Parties post-merger. For example, over half of all customers

²² [The Reference Decision](#), paragraph 152.

²³ [The Reference Decision](#), paragraph 155(a).

who switch away from the Parties move to one of the SAMS²⁴ who tend to offer the cheapest tariffs. Consequently, it appears likely that any reduction in rivalry to attract new customers following the Merger would not be significant.

(b) A loss of competition to supply restricted meter customers

Restricted meters record electricity usage at different times of day (or for different purposes separately). Customers with non-Economy 7 restricted meters face a limited range of tariffs and suppliers. However, Npower does not offer non-Economy 7 multi-rate tariffs for new restricted meter customers. Consequently, our current view is that the Merger will not have an effect on competition to supply these customers.

(c) A loss of competition to supply prepayment meter customers

Following the Energy Market Investigation, a temporary price cap on prepayment meter tariffs was introduced. Since then, prices have concentrated around the cap. The phase 1 investigation found that switching by prepayment customers between the Parties was limited, while prepayment meter customers have (in principle) the option to switch to the other SLEFs and a number of the SAMS. Given this, the fact that prices under the cap have converged, and that the existence of the prepayment price cap will currently ensure that any loss of competition following the Merger will not lead to higher prices for prepayment customers, we are not minded to investigate this issue further.

(d) Coordinated effects

Coordinated effects 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. The CMA's Energy Market Investigation did not find any evidence of explicit or tacit coordination. It found that some factors made coordination unlikely, including differences in energy costs between suppliers as a result of different purchasing strategies and the simultaneous presence of engaged and price-sensitive customers.

The Reference Decision noted some subsequent developments which have made coordination less likely including increased customer engagement and switching, and an increased number of suppliers, expansion of the SAMS and measures to reduce barriers to entry and

²⁴ [The Reference Decision](#), paragraph 162.

expansion. Therefore, we are not currently minded to investigate this theory of harm.

Countervailing factors

49. We will consider whether there are countervailing factors which are likely to prevent or mitigate any SLC that we may find. In particular, we intend to consider the constraint arising from possible entry and expansion, and the impact of any efficiency benefits. We are not currently aware of any other possible countervailing factors.

Entry and expansion

50. We will consider whether entry and/or expansion by existing SAMS can mitigate any initial effect of the merger on competition. In order to offset any SLC, entry and/or expansion would need to be timely, likely and sufficient.

51. To investigate this issue, we intend to look at:

- The history of entry, expansion and exit;
- The extent of the constraint from entry/expansion for different categories of customer and on different types of tariff;
- The barriers to entry and expansion including:
 - The challenges in raising public awareness;
 - The challenges in attracting new customers, such as:
 - Public perceptions of barriers to switching including costs and risks involved in switching;
 - Barriers to accessing and assessing information;
 - Customer disengagement; and
 - Reputational perceptions of unfamiliar suppliers;
 - Any challenges in retaining customers after initial acquisition tariff deals expire;
 - Whether regulatory requirements restrict the growth of SAMS (there may be significant additional obligations increasing costs when SAMS reach a 250,000-customer threshold); and
 - Any cost or service impacts of scale;

- The impact of:
 - technological advances (including smart meters and connected homes);
 - measures to promote customer switching including the remedies from the CMA's Energy Market Investigation and Ofgem's further reforms; and
 - the proposed price cap.

Efficiencies

52. We will examine any arguments made in relation to efficiencies arising from the Merger. In particular, we will examine whether any potential efficiencies are rivalry-enhancing and could be expected to offset any loss of competition.

Possible remedies and relevant customer benefits

53. Should we decide that the merger may be expected to result in an SLC in any market(s), we will consider whether, and if so what, remedies might be appropriate, and will issue a further statement.
54. In any consideration of possible remedies, we may have regard to their effect on any relevant customer benefits in relation to the Merger and, if so, what these benefits are likely to be and which customers would benefit.

Responses to the issues statement

55. Any party wishing to respond to this issues statement should do so in writing, by no later than **5pm on Tuesday 12 June 2018**. Please email SSE.Npower@cma.gsi.gov.uk or write to:

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