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Response to Issues Statement

1. Introduction

1.1 The Parties provide below their response to the Issues Statement, as published on the CMA's website on 29 May 2018 (the "**Issues Statement**").

1.2 The Transaction will result in significant customer benefits by creating a new independent energy retailer in GB, which will introduce a new market model for suppliers, combining the experience and expertise of two large suppliers with the focus and agility of a standalone retailer, allowing it to adapt to the rapid changes in the retail energy market.

1.3 With a dedicated Board and expert management team, MergeCo will be able to set its own strategy, make quicker decisions in reaction to developments and implement those decisions with greater agility.

1.4 The Transaction will combine the best of both Parties, bringing together SSE's strong legacy in customer service and cost efficiency with Npower's best-in-class IT platform and ability to introduce new products and tariff options for customers. MergeCo will also be able to operate on a reduced cost base, due to the significant synergies that will be realised through the Transaction (see paragraphs 6.2 to 6.8 below).

1.5 The Parties welcome the confirmation in the Issues Statement that the following concerns do not result in any realistic prospect of an SLC and that the CMA is not minded to investigate these theories of harm any further:

(i) **A loss of rivalry to attract new customers with conventional meters via acquisition (FTC) tariffs:** the Parties are not close competitors for new customers, switching rates between the Parties are consistently low, the tariffs offered by the Parties are no more similar to each other than those offered by other suppliers and there are a large number of alternative suppliers, including the SAMS, that compete to supply new customers and would continue to constrain MergeCo post-Transaction;[1]

(ii) **A loss of competition to supply restricted meter customers:** Npower does not offer non-Economy 7 multi-rate tariffs to new customers, so the Transaction will not have any effect on competition to supply these customers;[2]

(iii) **A loss of competition to supply PPM customers:** since the introduction of the temporary price cap, prices for PPM customers have concentrated around the

[1] Issues Statement, paragraph 48(a).

[2] Issues Statement, paragraph 48(b).

cap and the PPM cap will ensure that the Transaction will not lead to higher prices for PPM customers;[3] and

(iv) **Coordinated effects:** the EMI noted a number of factors that made coordination unworkable, including differences in the business models of suppliers, differences in energy costs between suppliers as a result of different purchasing strategies and the presence of engaged and price-sensitive customers. Since the EMI customer engagement and switching has increased, as has the number of suppliers and the share of supply of the SAMS. The increase in customer engagement and switching has been supported by the introduction of measures to reduce barriers to entry and expansion, all of which makes any coordinated theory of harm wholly implausible.[4]

1.6 The Parties support the indications in the Issues Statement that the CMA:

(i) will be taking the EMI remedies into account in the competitive assessment (as suggested at paragraph 25 of the Issues Statements); however, the Parties consider that these effects are now sufficiently certain and foreseeable that they should properly be taken into account in the counterfactual in addition to the competitive assessment (see Section 2 below);

(ii) will consider whether the counterfactual also ought to include the imminent SVT price cap (paragraphs 26 and 27 of the Issues Statement). In fact, for the reasons set out in Section 2 below, since there is no real uncertainty about the timing or likely effects of the price cap, this should now be taken into account in the counterfactual;

(iii) does not currently consider that the potential cross-subsidisation theory of harm has been evidenced at this stage (paragraphs 44 to 46 of the Issues Statement). As the Parties demonstrate in more detail in Section 5 below, this theory of harm is not plausible; and

(iv) acknowledges that there may be countervailing factors, including entry and expansion and/or efficiency benefits, that could prevent and/or mitigate any potential concerns, which the Parties set out in more detail in Section 6 below.

1.7 In relation to the other aspects of the analysis in the Issues Statement the Parties consider that:

(i) there is no basis on which the CMA should change its Phase 1 position that the potential E.ON/RWE transaction should not be taken into account in the counterfactual (see Section 2 below);

[3] Issues Statement, paragraph 48(c).

[4] Issues Statement, paragraph 48(d).

(ii) The Transaction does not give rise to any merger effect in relation to SVT pricing and there is no credible basis to consider that this unorthodox theory of harm will give rise to an SLC in practice (see Section 3 below); and

(iii) the Transaction will not result in MergeCo having either the ability or incentive to foreclose Utility Warehouse (see Section 4 below).

1.8 Except as otherwise defined in this response, references to defined terms in this response have the same meaning as in the Parties response to the Phase 1 Decision dated 30 May 2018 (the "**Initial Submission**").

2. Competitive assessment and counterfactual

There are no reasons to depart from the conclusion in the Phase 1 Decision that the E.ON/RWE transaction cannot be taken into account in the counterfactual and/or competitive assessment

2.1 As noted in the Initial Submission, the Parties welcomed the CMA's Phase 1 Decision finding that there was "*a significant degree of uncertainty about both the timing and the outcome of the E.ON/RWE transaction*" such that it was not possible to take account of the E.ON/RWE transaction in the counterfactual.[5]

2.2 The Parties also agree with the Issues Statement, which affirms this lack of certainty, noting that "*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 by the European Commission. In any event it is not expected to complete until the end of 2019*".[6]

2.3 The Parties' joint submission dated 15 March 2018 (the "**E.ON Submission**"), identified a number of reasons why the E.ON/RWE transaction is not sufficiently certain to be taken into account in the CMA's review of the Transaction.

2.4 The E.ON/RWE transaction involves two separate acquisition processes:

(i) the agreement between E.ON and RWE, announced on 12 March 2018, pursuant to which RWE will sell its 76.8% stake in innogy to E.ON (and make a payment to E.ON) in exchange for the transfer of a number of assets (see paragraph 2.1 of the E.ON Submission) (the "**Asset Exchanges**"); and

(ii) a voluntary public takeover offer by E.ON for the shares in innogy currently held by innogy's minority shareholders (see paragraph 2.2 of the E.ON Submission) (the "**PTO**").

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[5] Phase 1 Decision, paragraph 53.

[6] Issues Statement, paragraph 29.

2.5 For the reasons given in the E.ON Submission, and as a result of a number of developments since the E.ON Submission was prepared, the significant uncertainty about both the timing and the outcome of the E.ON/RWE transaction has increased.

2.6 This has recently been recognised by the joint reasoned statement issued by innogy's Executive Board and Supervisory Board on 10 May 2018 (the "**Reasoned Statement**"),[7] in which the innogy boards raised concerns that "*the complexity and the extended time horizon until the completion planned by [E.ON] constitute a considerable risk.*"[8]

Uncertainty as to the timing of the E.ON/RWE transaction

2.7 E.ON has indicated that it does not expect the PTO to complete until mid-2019.[9] Given the content of the Reasoned Statement, it must be considered that, even if the PTO were to complete (which, for the reasons set out below, is uncertain), a potential process of ensuring that the concerns raised by the innogy boards are properly addressed could be expected to put additional pressure on that timetable.

2.8 Since the completion of the Asset Exchanges is only intended to take place after the completion of the PTO, even if it is not conditional upon completion of the PTO, any delays to, or failure to complete, the PTO can be expected to affect the timing of the completion of the Asset Exchanges.[10]

2.9 In addition, the antitrust review process described below could also have a significant effect on the proposed timetable.

Uncertainty as to the outcome of the E.ON/RWE transaction

Antitrust and regulatory approvals

2.10 Both the PTO and the Asset Exchanges are conditional upon, *inter alia*, the approval by relevant antitrust and regulatory authorities.[11] The completion of the PTO and the Asset Exchanges are therefore subject to the timing of those reviews.

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[7] English translation of the Reasoned Statement available at https://iam.innogy.com/en/about-innogy/investor-relations/reasoned-statement

[8] Reasoned Statement, page 60.

[9] https://www.eon.com/en/about-us/media/press-release/2018/eon-and-rwe-two-european-energy-companies-focus-their-activities.html

[10] https://www.eon.com/en/about-us/media/press-release/2018/eon-and-rwe-two-european-energy-companies-focus-their-activities.html, which states that "*closing of the PTO is expected by the middle of 2019. The transfer of the renewable energy business from E.ON and innogy to RWE is to take place as soon as possible thereafter and could be completed by the end of 2019.*"

[11] See the E.ON press release (https://www.eon.com/en/about-us/media/press-release/2018/eon-and-rwe-two-european-energy-companies-focus-their-activities.html).

2.11 As set out in the E.ON Submission, the Parties understand that the European Commission is also expected to have jurisdiction over the Assets Exchange.[12] The offer document issued in relation to the PTO on 27 April 2018 (the "**Offer Document**") indicates that the Parties expect the PTO to also be subject to the review of the European Commission and, potentially, the CMA.[13]

2.12 The CMA cannot prejudge the outcome of the antitrust review of either the Asset Exchanges or the PTO, but, to the extent that the E.ON/RWE transaction raises any competition concerns, the CMA must consider that the most likely outcome is that those concerns will be addressed fully by the relevant antitrust authorities.

2.13 Such an approach would be consistent with the CMA's previous decisions on similar facts. In *BT/EE* the CMA carried out its Phase 2 assessment of the proposed merger against a counterfactual in which the level of competition was equivalent to that existing prior to the Hutchison 3G / O2 transaction (i.e. the *status quo* excluding any effect of the later announced transaction. This decision was taken on the basis that if any competition concerns were identified during the review of the Hutchison 3G / O2 transaction, such issues would be addressed through the imposition of remedies by the European Commission, thus restoring competition to the level before that merger.[14]

2.14 This was also the approach adopted in the CMA's recent Final Report on *21st Century Fox/Sky plc*, where the CMA did not take into account the separate proposed sale by Fox of certain assets to Disney in its analysis, since that Disney transaction "*will itself be subject to regulatory scrutiny, its terms may be varied as a result and it is unlikely to be completed until after the Secretary of State's decision on the Transaction. It is therefore uncertain whether, when or how the Disney transaction will be completed*."[15]

2.15 Given the above, it would not be appropriate for the CMA to consider what the final outcome would be from the antitrust reviews of the Asset Exchanges or the PTO.

2.16 The E.ON transaction is also potentially subject to a number of regulatory reviews (see, for example, paragraph 12.2 of the Offer Document, which lists a number of reviews to which the transaction is potentially subject). Given the very early stage of this transaction, it cannot be deemed that the E.ON/RWE transaction will receive all necessary approvals following those reviews.

Completion of the PTO

2.17 The Reasoned Statement provides that the innogy boards cannot conclusively assess whether the consideration offered by E.ON in relation to the PTO is fair; and/or whether

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[12] E.ON Submission, paragraph 4.1

[13] https://www.energyfortomorrow.de/download/companies/ma1007/ma1007offer/20180427_Offer_Doc.pdf, paragraph 12.1

[14] *BT Group plc and EE Limited*, paragraphs 7.7 to 7.18.

[15] *21st Century Fox, Inc and Sky Plc*, paragraph 13.

the E.ON/RWE transaction is in the best interests of innogy and the innogy minority shareholders.[16]

2.18 In reaching this conclusion, the Reasoned Statement notes "*with great concern the plans announced by [E.ON] to cut up to 5,000 jobs*" and a "*fear that innogy employees will suffer structural disadvantages in the course of an integration process as compared to the employees of the E.ON Group*."[17]

2.19 As a result, the Reasoned Statement concludes that it cannot support the transaction and the innogy boards do not issue any recommendation for the E.ON/RWE transaction to the minority shareholders in innogy.[18]

2.20 Given the lack of any recommendation for the PTO from innogy, the CMA cannot consider it to be certain that the PTO will complete.

E.ON walk away right

2.21 In addition to the conditions listed above, if innogy were to sell assets above an agreed value E.ON may be able to walk away from the Transaction.[19] This right only makes the completion of the E.ON/RWE transaction even less certain.

<u>Conclusion in relation to the E.ON/RWE transaction</u>

2.22 The Phase 1 Decision correctly identified significant uncertainty in relation to the potential outcome of the E.ON/RWE transaction in concluding that it would not form part of the counterfactual in relation to the CMA's assessment of the Transaction.

2.23 The CMA could only reach a different conclusion in Phase 2 where there has been a material change in circumstances. For all of the reasons set out above, any developments in relation to the E.ON/RWE transaction have only made the timing and outcome less certain.

2.24 The CMA must, therefore, adopt the same approach in relation to the E.ON/RWE transaction at Phase 2 as it did at Phase 1.[20]

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[16] Reasoned Statement, page 85

[17] Reasoned Statement, pages 85-86.

[18] Reasoned Statement, page 86.

[19] This condition is listed in the Offer Document at paragraph 13.1.6. Reuters has recently reported on this condition: https://uk.reuters.com/article/uk-rwe-results-e-on-innogy/e-on-can-walk-away-from-innogy-deal-if-too-many-assets-sold-rwe-idUKKCN1IG1LW.

[20] Particularly given the more stringent test for parallel transactions at Phase 2. See CC2/OFT124, Merger Assessment Guidelines, paragraph 4.3.26 and 4.3.27.

The effect of the EMI remedies, Ofgem initiatives and SVT price cap should be taken into account in the counterfactual and the competitive assessment

2.25 As set out in the Initial Submission, there have been a range of regulatory remedies stemming from the EMI and other Ofgem initiatives implemented in relation to the domestic retail energy market recently and more are being introduced in the near future.[21] The CMA must take the effects of these remedies and initiatives (including the reasonably likely future effects) into account when considering the Transaction and they should be included in the CMA's counterfactual for the reasons set out below.

2.26 The CMA's guidance notes that: "*The description of the counterfactual is affected by the extent to which events or circumstances and their consequences are foreseeable, enabling the Authorities to predict with some confidence*."[22] Since many of the remedies described in paragraph 4.21 of the Initial Submission have already been implemented their effects are already sufficiently foreseeable to be included in the counterfactual. Moreover, given the forward looking nature of merger control assessment, those measures that will imminently come into force are likewise sufficiently foreseeable within the meaning of the CMA's test and therefore should also be considered as part of the counterfactual.

2.27 This would be consistent with the CMA's legal obligation to implement remedies which would be effective following the EMI, so the CMA must assume that the remedies are effective and/or will be effective in the near future (or at the very least in the timespan considered by the CMA in its assessment of the Transaction).

2.28 It would moreover be consistent with the CMA's publicly stated position that the remedies will have – and are already having – a significant and positive impact on the domestic retail energy market and consumers.[23] The CMA has stated that "*[o]ur remedies package will revitalise the energy market, intensify competition between energy companies to bear down on costs, ensuring customers can make informed decisions about the range of options open to them and encouraging the development of smarter regulations that work in consumers' interests*."[24] That the remedies will have – and are already having – a significant and positive impact on the domestic retail energy market and consumers is also supported by Ofgem which, following initial trials of its Cheaper Market Offers Letter ("**CMOL**") initiative, said that the "*results showed that the CMOL increased switching rates*".[25] Reporting to BEIS on the remedies, the CMA noted that

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[21] See paragraphs 4.21 to 4.30 of the Initial Submission.

[22] CC2/OFT1254, Merger assessment guidelines, paragraph 4.3.2.

[23] See paragraphs 4.23 and 4.27 of the Initial Submission.

[24] *CMA, Modernising the Energy Market (June 2016),* paragraph 47.

[25] Ofgem, Cheaper Market Offers Trial: Research Results

certain trials had "*increased switching rates in some cases by a factor of four*", a result described as representing a "*huge transformational effect*".[26]

2.29 Furthermore, in relation to the now imminent SVT price cap, any previous uncertainty surrounding this measure at the time of the Phase 1 Decision is no longer relevant. The test for including the cap in the counterfactual, as set out at paragraph 2.26 is clearly met now, since:

(i) the price cap is progressing through the advanced stages of the legislative process and is expected to be introduced imminently; and

(ii) Ofgem has indicated its intention to bring the cap into effect by winter 2018 and therefore it is reasonably foreseeable that the price cap will have a significant impact on SVT price setting and will therefore affect the competitive analysis. [✂]

2.30 The second reading of the Bill took place in the House of Lords on 22 May 2018 with the committee stage set to commence on 12 June 2018 and has cross-party support in both houses of Parliament.[27]

2.31 Paragraphs 4.41 to 4.45 of the Initial Submission set out in detail the steps that have been taken to advance the imminent introduction of the SVT price cap. As previously noted, Ofgem is working on the assumption that the legislation will be coming into force in the summer of 2018: it aims to take a decision on the level of the cap by autumn 2018, with the cap coming into effect before the end of 2018.[28]

2.32 In addition, the effects of the SVT price cap are foreseeable. As explained in paragraph 4.47 of the Initial Submission, all currently available evidence indicates that the price cap will become the principal yardstick against which suppliers set their SVT prices in the future. Note that if suppliers set their SVT prices by reference to the cap, then the whole basis of the theory of harm in paragraphs 36 and 37 of the Issues Statement will not be applicable.

2.33 Given the imminent introduction of the price cap and its foreseeable effects, the impact of the price cap must therefore be taken into account in the counterfactual.

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[26] Business, Energy and Industrial Strategy Committee, Oral evidence: Pre-legislative scrutiny of the draft Domestic Gas and Electricity (Tariff Cap) Bill, HC 517, 12 December 2017, at Q57. Available at https://www.eprg.group.cam.ac.uk/wp-content/uploads/2018/01/S.-Littlechild_BEIS-oral-evidence-Dec-2017.pdf.

[27] Claire Perry MP, Minister for Energy and Clean Growth, has noted that it is "*refreshing*" that all parties have committed to getting the Bill through the House of Lords effectively and that the aim is be in "*good shape by the summer recess*". Also at the Second Reading, Labour MP Dr Alan Whitehead noted: "*The Committee is united on our endeavour this afternoon. We want to finish our deliberations, get the Bill passed as speedily as possible, and have it on the statute book by the summer—hopefully the early summer—so that Ofgem can execute it.*"

[28] Ofgem, Update on our plans for retail energy price caps, 6 March 2018 (available at https://www.ofgem.gov.uk/system/files/docs/2018/03/update_on_our_plans_for_retail_energy_price_caps.pdf). See also Ofgem, Default Tariff Cap: Policy Consultation Overview document, 25 May 2018 (available at: https://www.ofgem.gov.uk/system/files/docs/2018/05/default_tariff_cap_-_policy_consultation_-_overview.pdf).

3. The Transaction will not result in a loss of rivalry in the setting of default tariff prices

3.1 The Issues Statement indicates that the CMA intends to consider "*whether a change in the number and identity of [the larger suppliers] could change how default tariff prices are set*."[29]

3.2 The factors identified in the Issues Statement at paragraph 39 do not include the most relevant element of any possible theory of harm, namely whether there is a merger effect (i.e. whether the Parties constrained each other's SVT prices pre-Transaction). It is essential that the CMA has that point foremost in its mind when considering the potential relevance of the other points raised in the Issues Statement. For the reasons set out in paragraphs 5.40 to 5.86 of the Initial Submission, there is clearly no merger effect as regards the Parties' SVT pricing.

3.3 The Parties responded to this unorthodox theory of harm, which was initially set out in paragraphs 100 to 140 of the Phase 1 Decision, in detail in their Initial Submission and demonstrated that the theory of harm is untenable since:

(i) there can be no loss of SVT pricing rivalry as a result of the Transaction, since comparisons between suppliers' SVT prices do not drive customer switching;

(ii) SVT prices are constrained by the desire to balance a need to pass on changes in costs with an increased rate of customer losses, so any SVT price changes are driven by changes in costs;

(iii) there is no scope for the Transaction to have any merger effect on SVT prices, since, *inter alia*:

(a) the Parties are not important comparators either to each other or across the larger suppliers more generally;

(b) the relativity between the Parties' SVT prices does not drive customer losses and SVT price changes will continue to be reported in the media and other public commentary on the same basis, namely through comparisons with the cheapest FTC offers available;

(c) MergeCo's strategy and the realisation of the synergy benefits as a result of the Transaction are more likely to drive its SVT prices down, not up (see paragraphs 6.2 to 6.8below); and

(d) the imminent SVT/default tariff price cap will remove any residual concerns the CMA may have in relation to the setting of SVT prices (see paragraph 2.32 above).

[29] Issues Statement, paragraph 39.

3.4 Since the Parties' Initial Submission responded to this theory of harm in significant detail, this response will focus on the areas the Issues Statement has identified for further consideration.[30]

3.5 The Parties note the following key points, which provide important context for considering this SVT pricing theory of harm:

(i) SVT price changes are infrequent events – since 2014, the Parties have each only increased their SVT prices twice and decreased them three times;[31]

(ii) the position of SVTs is diminishing in importance, with suppliers considering a range of 'default tariff' options, for example, SSE has already announced that it will no longer automatically roll customers onto SVTs at the end of the FTC term – customers on a default tariff cannot be assumed to behave the same as SVT customers (see, for example, Figure 3.1 below for the effect of end of product mailings on customer switching); and

(iii) the price cap and the EMI regulatory remedies and other Ofgem initiatives will have a significant effect on the way in which SVTs are set and SVT customers behave in the future.

3.6 In addressing those points, the Parties will also respond to the way in which the CMA has articulated the theory of harm in the Issues Statement to the extent that its analysis appears to have progressed from the way in which the theory of harm was set out in the Phase 1 Decision.

FTC prices, not the SVT prices of other suppliers, are a major driver of switching both following an SVT price increase and generally

3.7 The Issues Statement requests further details on:

(i) "*the factors which lead customers to engage with the energy market, in particular where a customer may not have engaged for some time*";[32] and

(ii) "*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*".[33]

3.8 The Parties have therefore considered below the factors that drive customer engagement, noting in particular that it is FTC pricing that cause customers to switch (and

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[30] Issues Statement, paragraph 39.

[31] See paragraph 5.18 of the Initial Submission, subsequent to which SSE announced an SVT price increase to take effect from 11 July 2018.

[32] Issues Statement, paragraph 39(e).

[33] Issues Statement, paragraph 39(a).

the SVT prices of other suppliers have no such effect either generally or following an SVT price increase). The Parties then provide their response to the specific elements identified in the Issues Statement.

Factors that lead customers to engage with the energy market

3.9 As set out at paragraphs 4.14 to 4.18 of the Initial Submission, the energy market is seeing significant and continued growth in customer engagement. Customer engagement is driven primarily by price-related factors.

Price-related factors

3.10 Surveys of customers consistently show that price is the most important factor driving customer switching decisions.[34] For example, in SSE's leavers' survey, as set out in Figure 3.1 below, four of the five most significant reasons given for switching relate to price (e.g. due to the end of a tariff or offer, a bill increase or, more generally, a sense that the customer is paying too much). Similarly, in Npower's leavers' survey, shown in Figure 3.2 and Figure 3.3 below, between [✂] and [✂] of Npower's SVT leavers cite price as a reason for switching.

Figure 3.1
[✂][35]

Figure 3.2
[✂][36]

Figure 3.3
[✂][37]

3.11 Factors that highlight the absolute price that customers are paying and the savings that can be made by switching to an FTC appear to be particularly important triggers for customer switching.

3.12 For example, in Ofgem's Customer Engagement Survey, set out in Figure 3.4 below, three of the top five reasons for switching relate to receiving communications from their own

[34] Although these surveys focus on switching, many customers are engaged with the energy market without switching.

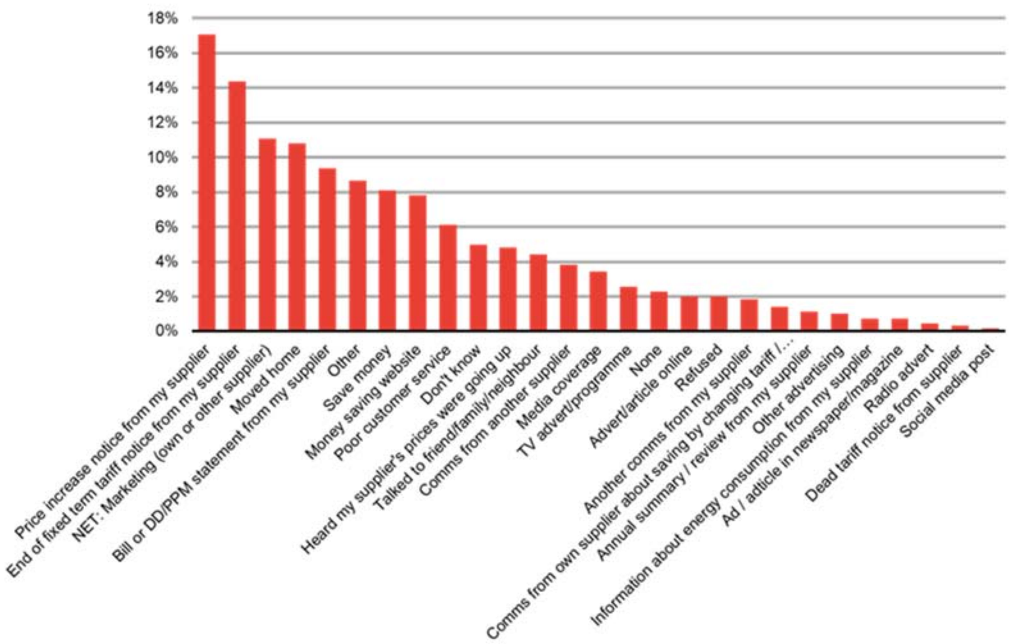
[35] [✂]

[36] [✂]

[37] [✂]

supplier about price.[38] Receiving a price increase notice from their supplier is the most common reason (cited by 17% of switchers) followed by an end of fixed term tariff notice (cited by 14% of switchers). A further 9% of switchers cite receiving a bill or direct debit/payment statement from their supplier as a trigger for switching. The Parties note that bills and other payment statements that customers receive from their own supplier (including the mandatory SVT price increase notification letter, as discussed at paragraph 3.42 below) will only mention that current supplier's own prices (SVT and FTC) and will not mention the SVTs of other suppliers.

Figure 3.4
Ofgem Customer Engagement Survey 2017 – Main reasons for switching supplier



Source: Frontier analysis of Ofgem Customer Engagement Survey 2017[39]

3.13 In addition, there is strong evidence that customer engagement, including switching from SVTs, is driven by the price of FTCs (see the Initial Submission at paragraph 5.13). Low FTC prices increase the financial gains from switching, making customers more likely to compare tariffs and suppliers and more likely to complete a switch after making such a comparison. Data from the CMOL initiative, data provided by a PCW and reviewed by

[38] This is based on the responses of customers that had switched supplier in the past 12 months. Since switching data shows that almost all customers switch onto an FTC, this analysis does not consider separately customers who have both switched in the past 12 months and that are currently on an SVT.

[39] Q161. "And thinking about the last time you Switched supplier, what were the main reasons that caused you to do that?"; Weighted base for respondents that had switched electricity or gas supplier in the past 12 months: n=703 across all respondents.

Ofgem, and customer surveys all suggest a positive relationship between customer switching and the savings available from switching to an FTC.[40]

3.14 By way of example, Ofgem's Customer Engagement Survey 2016, see Figure 3.5 below, finds that a larger proportion of customers are willing to switch when the potential saving from switching are larger.[41]

Figure 3.5
Respondents willing to switch for a specified minimum amount of money

Source: Frontier analysis of Ofgem Customer Engagement Survey 2016[42]

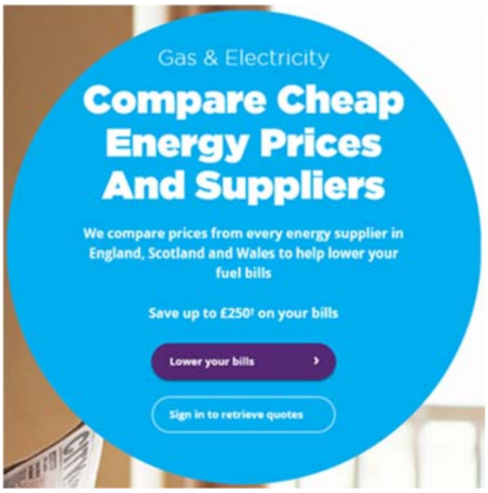
3.15 It is therefore unsurprising that PCWs, with their economic incentives to promote customer switching, focus their marketing on bringing the possible savings from switching to customers' attention (see Figure 3.6 below). PCW marketing is an important driver of customer switching, cited as a reason for switching by 23% of SSE's SVT leavers and 27% of SSE's SVT leavers with a tenure of more than three years (see Figure 3.1 above).

[40] Ofgem, Default Tariff Cap: Policy Consultation, Appendix 11 - Headroom, pages 15-17.

[41] Ofgem's 2015 Customer Engagement Survey gives similar results. This question was not asked by Ofgem in the equivalent 2017 survey.

[42] Q17/Q137. "Minimum amount of money would have to save to encourage switching gas or electricity supplier per year"; Figures for all respondents that provided an estimate (i.e. not those who refused or answered "don't know" or "it's not all about the money"); Weighted base for respondents that provided an estimate: n = 3,894 for Total; n = 1,795 for SVT; and n = 1,484 for Never Switched. (Including all respondents n = 5987 for Total; n = 2,841 for SVT; and n = 2,689 for Never Switched).

Figure 3.6
Current banner on MoneySupermarket.com[43]



3.16 In addition, as described at paragraph 2.28 above and in paragraph 4.21 of the Initial Submission, the EMI regulatory remedies and other Ofgem initiatives are already making customers more aware of price and the savings available from switching. Those remedies and initiatives continue to be implemented, that effect must be expected to continue.

3.17 Beyond those Ofgem-led initiatives, the Parties have also taken a number of additional steps to ensure that their customers are engaged and aware of the FTC prices available to them:

(i) [✂] and

(ii) [✂]. As mentioned above, SSE has also announced that it will no longer be automatically rolling customers onto SVTs at the end of their FTC term.[44]

3.18 Customer surveys suggest that media attention is a minor factor in driving customer engagement. The Ofgem Customer Engagement Survey 2017 found that 3.4% of respondents noted media coverage of suppliers in general as a reason for switching, 2.6% cited a TV advert/programme, 2.0% referenced an advert/article online, and 0.7% identified an advert/article in a newspaper/magazine.

3.19 Neither Npower's nor SSE's leavers' surveys report customer responses that mention the media (see Figure 3.1, Figure 3.2 and Figure 3.3 above) consistent with Npower and SSE not considering this to be an important factor when designing their surveys (and, in the case of Npower, when updating their survey questions each quarter). When considering the verbatim responses of Npower's leavers during the survey, it is clear that the media has very little influence over a customer's decision to switch.[45] Of the [✂] Npower leavers

[43] Accessed on 8 June 2018.

[44] [✂].

[45] The analysis focuses on Npower's four 2017 surveys because Npower changed its SVT price in March 2017.

surveyed in 2017, only [✂] mentioned any of the terms “media”, “TV”, “news”, “press” or “papers” during the survey.[46] [47] These mentions frequently arise in the context of the media highlighting the benefits of switching and/or the savings that can be made.

SVT prices of the other larger suppliers

3.20 In contrast, it is clear from the Parties’ switching data[48] and from the surveys described above that the SVT prices of other larger suppliers have no effect on customer engagement.

3.21 The Parties’ switching data shows that very few customers choose to switch onto an SVT (see paragraph 128 of the Phase 1 Decision and paragraphs 5.11 to 5.13 of the Initial Submission). One should therefore not expect the SVTs of the other suppliers to have any effect on the level of customer engagement.

3.22 When asking about customer engagement, none of the Ofgem, SSE or Npower surveys report customer responses that mention the SVT prices of other suppliers (see Figure 3.1 to Figure 3.4 above). Npower and SSE therefore did not consider this to be an important factor when designing their surveys. Moreover, the same review of Npower’s verbatim responses as described at paragraph 3.19 above showed that of the [✂] that mentioned media-related terms during the survey only [✂] ([✂]% of the total surveyed) mentioned hearing about Npower or another supplier’s SVT price in the media before leaving Npower.

3.23 In addition, the SVT prices of other suppliers have no relevance to any of the initiatives implemented by Ofgem or the Parties and therefore are not driving the significant and continued growth in customer engagement. As a result, there is no basis upon which the CMA’s remaining theory of harm could be found to adversely affect customer engagement.

<u>The extent to which changes in SVT prices prompt customer switching</u>

3.24 The Issues Statement requests information about the extent to which an SVT price change will prompt customer switching and the factors that will affect the degree of customer switching post-SVT price change.[49]

Levels of customer switching post-SVT price change

3.25 The effect of an SVT price change can be seen in the Parties’ switching data. In particular, Figures 5.1 and 5.2 of the Issues Statement (reproduced below as Figure 3.7 and Figure

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[46] [✂]

[47] The [✂] includes cases where the key words are at the start of a word (e.g. newspaper). It excludes cases where the key word occurs in the middle of a word (e.g. immediately), mentions of key words in contexts unrelated to the media or energy supply, and where the interviewer mentions the key word.

[48] See Section 2 of the Supplementary Issues Paper Response and Section 17 of the Issues Paper Response.

[49] Issues Statement, paragraph 39(a).

3.8) demonstrate that, while the Parties are experiencing a continuous loss of SVT customers at an increasing rate, the rate of loss (to internal FTC products and externally) picks up immediately following an SVT price increase.

Figure 3.7
[✂][50]

Figure 3.8
[✂][51]

3.26 Figure 3.7 and Figure 3.8 above show that, although both Parties experience spikes in losses following an SVT price increase, there is also a significant quantity of customer switching that occurs on an ongoing basis. For example, in 2017, the two months around their respective SVT price increases accounted for roughly [✂] of the Parties' total losses for the year, demonstrating that the majority of losses occur on an ongoing basis outside of these SVT price increases.[52]

3.27 The Parties must also take this ongoing switching by SVT customers into account when setting their SVT prices, since the full impact of the SVT price change will be felt beyond the immediate spike in customer losses and is therefore only one of a wider range of considerations.

It is the size of the savings available and the absolute level of the SVT price change that drives the level of customer switching post-SVT price change

3.28 In asserting that "*relative prices and how their pricing is perceived will be relevant to suppliers*", the Issues Statement lists a series of factors that the CMA considers may affect the level of customer switching following a price increase, citing "*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.*"[53]

3.29 It is not clear from the Issues Statement what source was used to identify those potential factors and the Parties do not consider it is an accurate reflection of either the factors they or their customers take into account or the relative importance of those factors.

3.30 The list of factors identified in the Issues Statement places undue emphasis on the relative size of the SVT price change and does not take full account of the fact that an

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[50] [✂]

[51] [✂]

[52] Between March and April 2017, SSE experienced [✂] and [✂] of total yearly losses for electricity and gas respectively. Similarly, between February and March Npower recorded [✂] and [✂] of total yearly losses for electricity and gas.

[53] Issues Statement, paragraph 36.

SVT price increase will make customers aware of the savings available from switching either because:

(i) the absolute level of the SVT price increase also increases the savings that customers can achieve by switching to an FTC; or

(ii) it will otherwise act as a prompt to customers to consider whether they can save by switching to an FTC.

3.31 Evidence from observing customer behaviour around price increases suggests that the degree of customer switching following a price increase is primarily determined by the absolute size of the price increase, and not the relativity with regards to the other larger suppliers.

3.32 This can be seen from uSwitch Insight data, which shows [✂].[54] The increase in comparisons following a price increase announcement provides a measure of the extent of customer engagement triggered by each price rise,[55] and therefore allows an analysis of the factors that cause customer engagement to be higher or lower. Annex 1 of this response contains additional detail about this analysis.

3.33 Comparing the increases in customer engagement observed following the different price announcements over this period suggests that customer behaviour is determined most notably by the size of the price increase. This is evident from Figure 3.9 below, which shows that:

(i) the highest absolute SVT price increases were typically associated with particularly high increases in customer engagement;

(ii) for each supplier, the higher absolute SVT price increase observed in 2017 were associated with a larger increase in customer engagement than the lower SVT price increases in 2018; and

(iii) the larger increase in customer engagement in 2017 for each supplier occurred irrespective of whether a supplier's SVT price increase was higher than that of larger another supplier.

Figure 3.9
[✂][56,57]

[54] The uSwitch Insight data [✂].

[55] [✂].

[56] [✂]

[57] [✂]

3.34 This is consistent with the CMA's finding in the Phase 1 Decision that customers' decisions are being driven by the potential savings available in the market by switching to FTCs and also with the wider evidence on customer behaviour, as described further in paragraphs 3.61 to 3.63 below:

(i) when surveyed, customers indicate that they are motivated to switch by the potential savings available in the market (i.e. to FTCs), and that their willingness to switch consistently increases as the savings increase;

(ii) as set out at paragraph 3.21 above, the vast majority of customers (including SVT customers) switch onto an FTC when they change tariff, meaning that the most relevant price to customers' switching decisions is the price of FTCs rather than any comparison between suppliers' SVT prices.

3.35 In addition, Figure 3.9 shows that higher absolute price changes are associated with a greater increase in customer engagement, even when the price increase relative to that of the other larger suppliers is lower. For example, British Gas' SVT price increase in 2017 was 7.4% but was towards the lower end of the larger suppliers' SVT price increases. In contrast, British Gas' SVT price increase in 2018 was lower (5.5%), but was one of the highest increases by the larger suppliers. [✄] the number of comparisons triggered by British Gas' SVT price increase announcement in 2017 was [✄] the equivalent in 2018 – with an estimated impact of [✄] observed in 2018. This suggests that comparisons between other suppliers' SVT prices is not of "*primary importance*" to determining the customer response to SVT price changes.[58]

3.36 If one of the Parties were to put through an SVT price increase that was significantly above the cost pressures in the market (and therefore likely out of line with other SVT price increases), they would expect this to trigger a lot more customer switching; however, this will primarily be due to the additional savings available from switching to an FTC as a result of that SVT price increase.

Factors considered by the Parties when forecasting customer losses following an SVT price change

3.37 Given the fact that SVT price changes result in significant customer losses, it is necessary for the Parties to attempt to forecast the level of customer losses likely to result from any proposed SVT price change.

3.38 The Parties provided details of how they forecast the potential levels of customer losses in their respective responses to the Market Questionnaire (see paragraph 6.12 of Npower's response and paragraph 10.3 of SSE's response).

[58] *C.f.* Issues Statement, paragraph 37.

3.39 The SVT price change itself is a major driver, given the prompt that it creates for customers to consider how much they can save from switching. Beyond this, key factors considered by the Parties include [✂][59] [✂].

3.40 The Parties base this assessment on previous experiences of customer behaviour following SVT price changes. Such analysis is difficult, however, due to the infrequency of SVT price changes (as noted above, the Parties have each only announced two SVT price increases and three SVT price decreases since 2014) and the fact that the rate of SVT customer losses is accelerating as ever more customers engage in the market. The Parties therefore treat the forecasts as indications of the potential effect of the SVT price change rather than precise estimates.

Role of press coverage in customer switching post-SVT price change

3.41 In assessing the likely factors that drive customer switching following an SVT price change, the Issues Statement places significant emphasis on the role of the press. In particular, the Issues Statement suggests that "*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*."[60]

3.42 This is not the case. The most visible price information available to SVT customers when SVT prices are increased are the details set out in the price increase notification letters that suppliers are obliged to send directly to customers.[61] That letter will not contain details of any other suppliers' prices (either SVT or FTC), but instead includes details of, *inter alia*:

(i) the level of the SVT price increase;

(ii) the cheapest similar tariff offered by the supplier at the time; and

(iii) the cheapest overall tariff offered by the supplier at the time.[62]

3.43 Even if the CMA were to only consider what is visible to customers in press and other media coverage, it is not correct to suggest that the relative SVT price changes between the larger suppliers "*tend to be reflected in press coverage*".[63]

3.44 As the Parties have explained in detail in previous submissions, the focus of any media (and broader public) commentary is not on the relative size of the SVT prices (or of SVT price changes) of the larger suppliers, but rather a clear focus on the effect the SVT price

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59 [✂]

60 Issues Statement, paragraph 37.

61 See Npower's response to Question 14 of its Market Questionnaire and SSE's response to Question 13 of its Market Questionnaire.

62 See, for example, the Supplementary Issues Paper Response, paragraph 3.16 and Annex 1.

63 Issues Statement, paragraph 37.

increase will have on customers (in terms of the absolute level of the increase) and the benefits that customers can secure by switching to FTCs.[64]

Relevance of announcements of other suppliers

3.45 The Issues Statement also suggests that SVT and default tariff customers will "*tend to respond to price changes depending on what other suppliers have already announced regarding default tariff price changes*."[65]

3.46 In fact, as explained at paragraph 5.76 *et seq* of the Initial Submission and paragraph 3.39 above, both Parties expect to face significant additional customer losses where they are the first supplier to announce an SVT price increase, since such an announcement is likely to result in additional press and media attention.

3.47 The Parties' analysis of this effect only applies to the first supplier to announce an SVT price increase and neither of the Parties' analyses of customer losses consider any effect on the level of customer losses based on the relative timing of announcements between suppliers provided that the announcement is not made first.

3.48 To the extent that the first supplier to announce an SVT price increase faces additional customer losses, the Transaction cannot be expected to have any effect. The Transaction cannot be expected to reduce the level of media and public commentary given to an SVT price increase and clearly will not make it more likely that a supplier can avoid being the first to announce an SVT price increase.

3.49 Moreover, evidence on customer behaviour (above at paragraph 3.20 *et seq*) shows no indication that the size of the SVT price increase relative to the other suppliers is an important factor in determining the customer response in terms of switching.

3.50 Given the above, there is no reason to consider that the SVT prices of other suppliers have any relevance to a customer's decision to switch following an SVT price change and, therefore, no reason for the CMA to conclude that the Transaction will result in a loss of 'rivalry' between SVT prices.

When setting SVT prices, the Parties take into account a range of factors, the most important of which is changes in costs

3.51 The Parties have considered below the request in the Issues Statement that the CMA would like to understand:

(i) "*the factors considered by suppliers, particularly the SLEFs, when setting their default tariff prices*";[66] and

64 Supplementary Issues Paper Response, paragraphs 4.14 to 4.27 and the Initial Submission paragraphs 5.68 to 5.76.

65 Issues Statement, paragraph 37.

66 Issues Statement, paragraph 39(c).

(ii) "*the impact of SAMS' pricing on SLEFs default tariff pricing and customer retention*".[67]

Factors considered by the Parties when assessing any potential SVT price increase

3.52 The Parties have provided detailed descriptions of the way in which they assess SVT price increases in both the Initial Submission (at paragraphs 5.16 to 5.39) and their responses to the Market Questionnaire (see, for example, Npower's response to Questions 6 to 21 and SSE's responses to Questions 5 to 18).

3.53 The Parties therefore do not propose to set out their SVT pricing behaviour again in this response, but note that:

(i) as the Phase 1 Decision recognises "*costs are an important consideration [when setting SVT prices], influencing both the timing and the level of price changes*" and "*[f]or all suppliers, SVT Prices move broadly in line with wholesale costs*";[68]

(ii) it is in the context of those costs changes (and the impact such changes have on their respective budgets and plans), as well as the significant customer losses that result from any SVT price change (see Figure 3.7 and Figure 3.8 above) that the Parties consider the appropriate level for any change in SVT price, taking into account a number of factors;

(iii) one such factor is the broader political context, which is taken into account particularly in relation to the timing of any SVT price change announcement. By way of example:

(a) [✂];

(b) [✂];

(iv) SSE and Npower have different approaches to SVT pricing (see paragraph 5.48 of the Initial Submission); and

(v) as the Phase 1 Decision notes in respect of SVTs "*the decision on pricing is not tied directly to the price of any one competitor*."[69]

3.54 The CMA's theory of harm appears to be based upon the fact that one such factor is whether the Parties consider that they will adequately be able to demonstrate that the change in SVT prices is justified and, within that analysis, one factor is the Parties' monitoring of the costs of the other suppliers.

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67 Issues Statement, paragraph 39(b).

68 Phase 1 Decision, paragraph 116.

69 Phase 1 Decision, paragraph 122.

3.55 In assessing this theory of harm, and determining whether the Transaction will result in an SLC in relation to SVT pricing, however, it is necessary to place that analysis in the context of the numerous other factors considered by the Parties, including:

(i) the other factors that the Parties consider are likely to affect the level of customer losses as discussed at paragraph 3.39 above; and

(ii) the other reference points the Parties use for assessing whether a proposed SVT price change will be seen as cost-reflective, such as Ofgem's supplier costs index and changes to the PPM cap (see paragraph 5.25 of the Initial Submission); and

(iii) the imminent introduction of the SVT price cap and the ongoing implementation of the EMI remedies and Ofgem initiatives as discussed at 2.25 *et seq*,

none of which will be adversely affected by the Transaction. These factors will, therefore, continue to be highly relevant for MergeCo to take into account when assessing any future SVT price changes.

3.56 Moreover, as set out at paragraphs 5.43 to 5.61 of the Initial Submission, neither of the Parties are important comparators to each other within that analysis. As a result, the Transaction will not result in the removal of any current constraint on either Party in relation to SVT pricing.

<u>Impact of SAMS' pricing on SVT price setting</u>

3.57 It is not clear from paragraph 39(b) of the Issues Statement whether the CMA intends to consider the effect of the SAMS' SVT or FTC pricing. The Parties have therefore considered both below.

Impact of SAMS' SVT pricing

3.58 As described at paragraph 5.26 of the Initial Submission, the Parties seek to monitor the publicly available costs of all suppliers in order to determine the likely cost pressures on those suppliers that may result in changes to their SVT prices.

3.59 Since the obligation to publish consolidated segmental statements ("**CSS**"), which contain the most detailed publicly available information on other suppliers' costs, only applies to the larger suppliers, much of the Parties' analysis of cost pressures is focused on the larger suppliers. The Parties consider, however, that the changes in the larger suppliers' costs are a good indicator cost pressures in the market generally and, therefore, can be used by the Parties as a proxy for the SAMS' cost pressures.

3.60 In addition, the Parties continuously monitor the SVT pricing decisions of the SAMS and, where relevant, take those decisions into account in their SVT pricing analysis alongside similar information about SVT pricing decisions of the larger suppliers (see Figure 5.6 and paragraph 5.51 of the Initial Submission).

Impact of SAMS' FTC pricing

3.61 Since the SAMS impose a significant competitive constraint in relation to FTCs (see paragraph 170 of the Phase 1 Decision), SAMS' FTC prices are likely to have a significant effect on customer switching (as discussed at paragraph 3.34 above), which explains the significant proportion of the Parties' SVT customers that are lost to the SAMS (see Figure 3.10 and Figure 3.11 below).[70]

Figure 3.10
[✂]

Figure 3.11
[✂]

3.62 As explained in the Initial Submission at paragraph 5.13 and in detail at paragraphs 3.10 to 3.19 above, a variety of sources provide strong evidence that customer switching, including switching from SVTs, is driven by the price of FTCs.

3.63 Indeed, the customer behaviour observed at paragraph 3.33 suggests that the absolute prices are more important in determining engagement than the relativities between the larger suppliers' price changes. This is consistent with customers being motivated to switch by the existence of cheaper FTC prices, since higher absolute SVT price increases tend to be associated with increases in the gap between FTC and SVT (see Figure 3.9 above).

The Transaction will not result in any merger effects, since the Parties are not important comparators for each other, or any other supplier, in setting SVT prices

3.64 The Issues Statement notes that:

(i) the CMA would also like to understand "*the timing and size of past default price changes by different suppliers, and how particular suppliers have responded depending on what other suppliers have done*";[71] and

(ii) the Transaction may "*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*

[70] While the Parties are not able to determine whether these customers are switching onto the SAMS' FTCs or SVTs, since, as described at paragraph 3.21 above, when customers change tariff, the vast majority of customers switch onto an FTC, it must be expected that these customer losses are being driven by SAMS' FTC offers

[71] Issues Statement, paragraph 39(d).

that a supplier loses default tariff customers because it announces a price which is out of line with those of the other suppliers."[72]

3.65 As set out at paragraph 3.2 above, in order for the Transaction to result in an SLC, the CMA must demonstrate that it will result in any merger effect. For the reasons set out below, this is not the case:

(i) the Parties are not important comparators for each other in relation to SVT pricing; and

(ii) for the avoidance of doubt, the Parties are also not important comparators for any other supplier.

3.66 Given the CMA's request at paragraph 39(d), the Parties have provided details of previous SVT price increases by all of the larger suppliers in Annex 2 of this response.

The Parties are not important comparators for each other's SVT prices

3.67 As the Parties demonstrated at paragraphs 5.43 to 5.61 of the Initial Submission, the Parties are not important comparators for each other's SVT pricing decisions.

3.68 In particular, the Parties have very different approaches to SVTs, with [✂], while [✂].[73]

3.69 Each Party's internal documents further support the fact that the other Party is not an important comparator for its SVT pricing decisions (see paragraphs 5.49 to 5.52 of the Initial Submission) and, as demonstrated at paragraphs 5.55 to 5.59 of the Initial Submission, the three SSE pricing decisions identified in the Phase 1 Decision as potentially affecting Npower's SVT pricing had no such effect.

3.70 There is therefore no basis on which the Parties could be considered a significant constraint on each other's SVT pricing and, therefore, the Transaction cannot result in any merger effect.

The Issues Statement wrongly suggests that the Transaction will make it easier for other suppliers to increase SVT prices

3.71 The Transaction will also have no effect on the SVT pricing decisions of other suppliers since in light of the factors that drive customer engagement and switching, as described at paragraphs 3.9 to 3.50 above, the number of competing suppliers (including the number of larger suppliers specifically) cannot be expected to affect customer losses or create increased scope for higher prices.

3.72 Furthermore, as demonstrated above, there is no evidence that pricing in line or out of line with the other larger suppliers' SVT prices has any bearing on losses, nor should

[72] Issues Statement, paragraph 38.

[73] See Initial Submission, paragraph 5.48.

there be any expectation that there would be a correlation given what matters to customers.

3.73 Even if, however, there were a dynamic by which customer losses would increase if a supplier were to be "out of line" with the other suppliers, it is not clear how the Transaction would reduce that risk and therefore lead to higher SVT prices.

3.74 In order to have such an effect on SVT pricing, the Transaction would need to result in the removal of an important reference point for determining whether an SVT price is "out of line", which is clearly not the case. The most likely reference point would appear to be the cheapest SVT.

3.75 Even if only considering the larger suppliers, neither Npower nor SSE have been the cheapest at any point in the last three years outside of the periods mid-SVT price change rounds when prices are more transient (see Figure 3.12 below, which replicates Figure 5.5 of the Initial Submission).

Figure 3.12
[✂][74]

3.76 As a result, post-Transaction, the cheapest SVT price (currently E.ON) would remain in the market and therefore, even under the CMA's theoretical approach to SVT pricing, there can be no concern that the Transaction will change the way in which suppliers will set their SVT prices.

3.77 To the extent that, despite the arguments set out above, the CMA has any concerns about the way in which suppliers may set their SVT prices post-Transaction, as set out at paragraph 2.32 above and paragraphs 5.87 to 5.95 of the Initial Submission, any such concern must fall away given the effect the imminent price cap will have on SVT pricing.

Conclusion on the CMA's SVT pricing theory of harm

3.78 The Issues Statement identifies two potential ways in which the Transaction may adversely affect SVT pricing, namely:

(i) the visibility of relative SVT price changes, including in the press, which drives customer switching; and

(ii) the potential reduction in the risk of being "out of line" on SVT pricing.

3.79 For the reasons set out above (and in the Initial Submission), neither of these concerns can be sustained.

[74] [✂]

3.80 First, SVT prices of other competitors are not the most visible information available to customers, who are provided with significant pricing information about their own supplier in the mandatory price notification letters following an SVT price increase.

3.81 Even if only considering what customers see in public commentary, this does not focus on the relative SVT price changes in the market, but rather the effect the SVT price change has on the customer and, as a result, the significant benefits to customers if they were to switch to an FTC.

3.82 The Transaction will have no effect on the ability of the press and other public commentators to report on both of those elements and, therefore, to the extent that press coverage affects a customer's decision to switch, it will continue to do so post-Transaction.

3.83 Second, the Transaction does not give rise to any merger effect in relation to the SVT pricing decisions of the Parties, since neither Party is an important comparator for the other in setting its SVT price.

3.84 Similarly, neither of the Parties are important comparators for any other supplier in setting their SVT prices. Even if, therefore, there were a benefit to suppliers avoiding their SVT prices being "out of line" from the other larger suppliers, the Transaction would have no impact in this regard.

3.85 As a result, the Transaction cannot be expected to result in an SLC in relation to SVT pricing.

4. The Transaction will not result in the foreclosure of Utility Warehouse

4.1 The Issues Statement suggests that this theory of harm is based upon whether the Transaction could "*change the relative assessment of [MergeCo] 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*."[75]

4.2 The Parties have responded below to this theory of harm and the areas identified in the Issues Statement for further consideration in two sections, as follows:

(i) Whether MergeCo would have the ability to foreclose Utility Warehouse:

(a) Paragraph 43(a): "*whether [MergeCo] would have an ability to affect wholesale prices paid by Utility Warehouse given the contractual agreements*"; and

(b) Paragraph 43(b): "*the impact on Utility Warehouse of a cost increase, and whether it has any ability to switch to alternative suppliers*.

[75] Issues Statement, paragraph 41.

(ii) Whether MergeCo would have the incentive to foreclose Utility Warehouse:

(a) Paragraph 43(c): "*whether [MergeCo] would have any credibly significant incentive to adjust prices given the size of the Utility Warehouse contract*"; and

(b) Paragraph 43(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*."

MergeCo has no ability to foreclose Utility Warehouse

4.3 The current pricing arrangements contained in the Supply and Services Agreement between Npower and Utility Warehouse (the "**SSA**") are based on [✂].[76]

4.4 [✂].

4.5 [✂]. As set out at paragraph 44.7(i) and (ii) of the Issues Paper Response, [✂]:

(i) [✂][77]; and

(ii) [✂].

4.6 [✂].

4.7 In the unlikely event that the pricing arrangements under the SSA [✂].[78]

4.8 The Phase 1 Decision indicated that [✂].[79] [✂].[80]

4.9 [✂]:

(i) [✂]

(ii) [✂].

4.10 [✂].

4.11 [✂].

[76] See paragraph 44.2 and footnote 174 of the Issues Paper Response for details.

[77] [✂]

[78] See the Issues Paper Response, paragraph 44.7(iii).

[79] Phase 1 Decision, paragraph 227.

[80] See the Issues Paper Response, paragraph 44.9, citing an Npower document that states [✂]

MergeCo will have no incentive to foreclose Utility Warehouse

4.12 Even if [✂], MergeCo would have no incentive to foreclose Utility Warehouse [✂].

4.13 Post-Transaction, SVT prices will continue to be constrained for the reasons set out in Section 3 above and, since the pricing [✂] is based on [✂] SVT prices, [✂]. This is clear from the fact that:

(i) MergeCo's SVT customer base ([✂] million for electricity, and [✂] million for gas[81]) is far larger than Utility Warehouse's customer base ([✂] million for electricity and [✂] million for gas[82]);

(ii) [✂];

(iii) the value of each customer lost from MergeCo is far higher than the potential gain to MergeCo from Utility Warehouses losses, since:

(a) MergeCo would only recapture a very small proportion of any customers lost by Utility Warehouse. Combined, the Parties gained only roughly [✂] and [✂] electricity and gas customers from Utility Warehouse in 2017 respectively,[83] compared to estimated losses from Utility Warehouse of around [✂] and [✂] electricity and gas customers respectively.[84] This suggests that more than [✂] of any customers displaced from Utility Warehouse would not be recaptured; and

(b) any customers re-captured by MergeCo are likely to be captured onto an FTC product, with a low margin [✂].

4.14 It is therefore clear that the losses from such a strategy would far outweigh any potential gains from MergeCo re-capturing a Utility Warehouse customers.

4.15 There is no reason to consider that Utility Warehouse is a close competitor for either of the Parties currently (see the limited switching between them as set out at 4.13 above). Utility Warehouse's business model does not affect this analysis, [✂].

Conclusion on the Utility Warehouse theory of harm

4.16 For the reasons set out above, MergeCo would have neither the ability nor the incentive to foreclose Utility Warehouse. In particular:

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[81] Based on the Parties' Response to Q8 of the CMA's RFI dated 13/12/2018. Customer numbers are as per 31 December 2017.

[82] Based on Cornwall Insight data for 31 January 2018.

[83] Based on the Parties Response to Q10 of the CMA's RFI dated 13/12/2018. Gains reported are totals for 2017.

[84] Based on reported churn of 1% per month quoted in Utility Warehouse's Half Yearly report (see https://s3-eu-west-1.amazonaws.com/whitepapers.utilitywarehouse.co.uk/Half%20Yearly%20Report%20September%202017%20FINAL.pdf), and the Cornwall Insight data estimate of their customer base during 2017.

(i) [✂];

(ii) [✂]; and

(iii) MergeCo would, in any event, have no incentive to foreclose Utility Warehouse given [✂] and the fact that Utility Warehouse is not a close competitor to either Npower or SSE currently and therefore MergeCo cannot expect to recapture a large number of customers from Utility Warehouse or benefit more generally from Utility Warehouse exiting the market.

4.17 More generally, post-Transaction, any SVT price increase by MergeCo must also take into account the broader political context of such a decision as discussed at paragraph 3.53(iii) above, the effects of which far outweigh any possible benefit that might be achieved through adopting any such foreclosure strategy.

5. The Transaction will not result in the foreclosure of competitors as a result of cross-subsidy

5.1 The Issues Statement correctly sets out three conditions in paragraphs 45(a)-(c) that would need to be met for the cross-subsidy theory of harm to hold. The facts demonstrate that none of these conditions is satisfied so there can be no credible concern relating to cross-subsidy.

5.2 The Issues Statement correctly notes that the larger suppliers are not currently foreclosing the entry of SAMS by cross-subsidising their acquisition tariffs and, in fact, it is the SAMS that are driving FTC pricing with the lowest priced FTC tariffs.[85] This position, based on overwhelming evidence gathered at Phase 1, is fully supported by the Parties. As noted in the Issues Paper Response, SAMS are dominating the top 20 cheapest tariffs on uSwitch, with the larger suppliers' ranking worsening over time.[86]

5.3 As set out in Figure 23.1 of the Issues Paper Response, offers from larger suppliers are worsening over time relative to the SAMS. It therefore cannot credibly be said that the larger suppliers are directing the pricing strategies of the SAMS – as explained at Section 21 of the Issues Paper Response, the larger suppliers are reacting to the SAMS' pricing in order to remain competitive.

5.4 Indeed, [✂].

Figure 5.1
[✂][87]

[85] Issues Statement, paragraph 45(a).

[86] See paragraph 23.3 of the Issues Paper Response.

[87] [✂]

5.5 Similarly, [✂].

Figure 5.2
[✂][88]

5.6 The Parties agree with paragraph 45(b) of the Issues Statement that "*current prices appear to be financially sustainable for the SAMS*." SAMS have continued to grow over the past few years and there is no evidence to suggest that this growth will not continue going forward. Indeed, the Parties consider it highly likely that there will continue to be sizeable new entry into the retail energy supply market in the next three years, as there are a large number of potential entrants that could enter the market quickly and easily (as described in detail in paragraphs 22.5 to 22.8 of the Merger Notice and in the Parties' responses to question 16 of the CMA's section 109 notice of 8 May 2018, submitted on 18 May 2018). In particular, the Parties note that Ofgem has issued supply licences to significantly more companies than are currently active in the market, including 15 new domestic energy supply licences in the last three months alone and 72 new supply licences granted in the last 15 months.[89]

5.7 The year-on-year growth in the number of SAMS since 2013 demonstrates that SAMS have entered the market on a sustainable basis. Although four small suppliers have exited in the last seven years, this cannot suggest that the SAMS as a whole struggle to compete sustainably. The CMA acknowledges as much in its Phase 1 Decision, noting that the entry of over 50 new suppliers in the market in recent years includes a number of large, well-financed companies such as Shell (First Utility), engie and Vattenfall.[90] These firms are well-resourced and experienced in energy markets and would be unlikely to have made such investments if they did not view their investments as sustainable.

5.8 The Parties also agree with paragraph 45(c) of the Issues Statement that current low prices benefit consumers. However, the Parties disagree with any suggestion that this is a short-run situation. The Parties set out in detail in the Issues Paper Response how the SAMS have gained share at the expense of the larger suppliers. In 2013, collectively the SAMS accounted for just c.[✂] of dual fuel supply, but within just five years the SAMS have rapidly grown to achieve a combined share of supply of [✂] in dual fuel (as of January 2018), up over ten percentage points from [✂] two years ago. This growth in share of supply has been gained entirely from the larger suppliers and is evidence of very significant competition.

5.9 In particular, as noted in the Initial Submission, the growth of the SAMS has been increasingly strong over the last 12 months. Between January 2017 and January 2018, the SAMS made net additions of [✂] customer accounts in electricity and [✂] customer

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[88] See [✂].

[89] https://www.ofgem.gov.uk/licences-industry-codes-and-standards/licences/notices/licences-granted-notices.

[90] Cornwall Insights, Small and medium suppliers serve more than a fifth of households (24 January 2018). https://www.cornwall-insight.com/newsroom/all-news/small-and-medium-suppliers-serve-more-than-a-fifth-of-households and Cornwall Insight Domestic Market Share Survey Q118, page 6.

accounts in gas, an increase of [✂] and [✂] with respect to the net additions achieved in the previous year.[91] This accelerating growth is illustrated in Figure 5.3 below, which shows the evolution of net gains of SAMS' electricity and gas customer accounts respectively over time.

Figure 5.3
[✂]

5.10 As noted in the Initial Submission, the accelerating growth of the SAMS also appears to have had an increasing impact on the Parties, with both Parties experiencing significantly higher net customer losses in 2017 than 2016.[92]

5.11 The above trend is expected to continue. This is currently, and will continue to be, a significant benefit for consumers and will continue to encourage switching and engagement. As noted in the Initial Submission, low FTC prices increase customers' financial gains from switching, making them more likely to compare tariffs and suppliers and more likely to complete a switch after making a comparison. As set out in paragraphs 3.10 to 3.19 above, FTCs play a key role in driving the high levels of switching.

5.12 The Parties cannot currently either partially or completely foreclose the SAMS and there is no basis upon which to suggest that the Transaction will not have any effect on their sustainability. This is clear from the significant and sustained growth of the SAMS over the last few years.

6. Countervailing factors

6.1 Even if the CMA were to conclude that there is an SLC, contrary to the evidence and the Parties' submissions, there are strong countervailing factors that would prevent any negative impact on customers.

The Transaction will generate a number of efficiencies and synergy benefits, which will result in benefits to customers

6.2 [✂].

6.3 As noted previously, the Transaction is expected to result in significant synergies that would not be achieved by either Party on a standalone basis. These synergies are key in ensuring that MergeCo can maintain a low cost to serve, which will be further supported by SSE's existing understanding of cost control and efficiency.[93]

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[91] Cornwall Energy, January 2018.

[92] See paragraph 4.11 of the Initial Submission for details of the quantum of SSE and Npower customer losses in 2017.

[93] See the Parties' response to Question 5 of their respective version of the CMA's Request for Information (8 May 2018).

6.4 The position as to benefits to customers, potential synergies and efficiencies arising from the Transaction is [✂][94] [✂]. These synergies will allow MergeCo to operate with a lower cost to serve and to pass savings on to consumers.

6.5 [✂]:

(i) [✂];

(ii) [✂];

(iii) [✂];

(iv) [✂]; and

(v) [✂].

6.6 [✂].

6.7 [✂].

6.8 [✂].

There has been consistent and successful entry and expansion

6.9 As explained in more detail in the Merger Notice, the Parties' responses to the CMA's Request for Information dated 8 May 2018 and in their responses to the Financial Questionnaire Part I, barriers to entry in the retail markets for the domestic supply of gas and electricity are very low. In particular, regulatory barriers are low, prior industry experience is not required for a successful entrant, start-up costs are low, the required supply licences can be obtained quickly, easily and cheaply and there are no barriers to entry in terms of patents or know-how.[95]

6.10 The lack of regulatory or licensing barriers to entry is most clearly demonstrated by the rapid increase in the number of domestic suppliers. Ofgem reports that the number of active suppliers has increased in the last three years by 42 suppliers, from 27 suppliers in December 2014 to 69 suppliers in December 2017, with 17 active suppliers entering the market in 2017 alone.[96]

6.11 A number of examples of major new entrants since 2015 (i.e. those with more than 5,000 accounts for a single fuel and 10,000 accounts for dual fuel) were provided in Table 21.1 of the Parties' responses to the Financial Questionnaire Part I. From this table, it is clear

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[94] Provided to the CMA as Annex FQ 002.

[95] See sections 21 and 22 of the Merger Notice, the responses to Questions 15 and 16 of the CMA's Request for Information dated 8 May 2018 and the responses to Section E of Part I of the Financial Questionnaire.

[96] https://www.ofgem.gov.uk/data-portal/number-active-domestic-suppliers-fuel-type-gb.

that there can be no suggestion that new entrants have any difficulty in attracting new customers.

6.12 In addition, of the suppliers that were considered new entrants a few years ago, most have gone on to grow their customer numbers significantly. As noted above, SAMS now collectively account for [✂] of domestic energy accounts and [✂] of domestic dual fuel accounts (as at 31 January 2018).[97] Moreover, ten SAMS now have more than 250,000 customer accounts, with Bulb Energy surpassing this number in December 2017.[98] This sustained growth is evidence of the fact that new entrants are able to retain customers.

6.13 As set out in the Parties' response to Question 19 of the Financial Questionnaire, the Parties estimate that small suppliers have a net cost benefit giving them capability to offer tariffs at a discount compared to larger suppliers.[99] This cost benefit is comprised of exemptions from regulatory obligations such as the Warm Home Discount scheme, Energy Company Obligation ("**ECO**") obligations, reduced obligations in administering the smart meter rollout, and exemption from the obligation to accept all types of payment methods.

6.14 Suppliers with fewer than 250,000 energy accounts are exempt from ECO obligations, while suppliers with 500,000 energy accounts or more have full ECO obligations. Suppliers with between 250,000 and 500,000 energy accounts benefit from a taper relief band which gradually increases their share of the obligation as their supply volumes increases up to 500,000 customer accounts, which is designed to avoid a "cliff edge" for newly obligated suppliers. Suppliers with less than 500,000 energy accounts therefore benefit from a reduction in their total cost obligations.

6.15 However, it is clear that the step up in regulatory costs described above has not posed a barrier to suppliers expanding if they choose to do so. For example, as shown in Figure 6.1 below, Ovo Energy experienced steady growth to [✂], at which point it passed the threshold of 250,000 energy accounts. Rather than hindering Ovo Energy's expansion, its growth was even more pronounced over the course of [✂] after it passed this threshold, surpassing 500,000 energy accounts in [✂]. As at 31 January 2018, Ovo Energy had [✂] energy accounts.[100]

Figure 6.1
[✂]

[97] Cornwall Insight Domestic Market Share Survey Q118, page 6.

[98] Bulb Energy only entered the market two years ago, but has grown from 5,000 customer accounts in January 2016 to more than 250,000 customer accounts by December 2017. https://www.cornwall-insight.com/newsroom/all-news/small-and-medium-suppliers-serve-more-than-a-fifth-of-households.

[99] See paragraph 19.1 of the Npower Response to Part I of the Financial Questionnaire for details of the quantum of the cost benefit and discount.

[100] Cornwall Insight Domestic Market Share Survey Q118, page 11.

6.16 In addition to the above, there is also no evidence that new entrants have any significant challenges in raising public awareness. For example, SAMS have engaged in the following recent advertising and promotional campaigns:

(i) First Utility's 2016 campaign which ran across TV, outdoor, press, social and digital;

(ii) OVO Energy's 2018 campaign which includes print ads, out of home, digital, social, below the line and PR, as well as a cinematic TV spot. OVO Energy is also an official sponsor of SweetSpot's cycles races (which includes the Tour of Britain);

(iii) Robin Hood Energy ran a local advertising campaign in Nottingham and sponsored Gloworm Festival in 2016;

(iv) Octopus Energy is an official sponsorship partner of Arsenal FC;

(v) Utilita is an official sponsorship partner of Rangers FC and Aston Villa FC; and

(vi) Good Energy is the official energy partner of Eden Sessions, a series of concerts taking place at the Eden Project in 2018.

6.17 As a result of these sorts of advertising and outreach activities, [✂] of SSE's leavers who do not use a PCW (and therefore may be most expected to rely on advertising campaigns by individual suppliers) switch to one of the SAMS. A new entrant could easily engage in similar promotional activities. In addition, the advertising spend of PCWs will indirectly raise awareness for new entrants.

6.18 It is also worth noting that SAMS in fact hold a number of competitive advantages over larger energy suppliers, enabling them to compete aggressively on the market. For example, SAMS are generally more agile than larger competitors and are free from the constraints of legacy costs and systems.

6.19 Finally, the imminent implementation of the SVT price cap will not negatively affect the ability of new entrants to compete and new entrants are likely to benefit from the various EMI remedies and Ofgem measures just as much as existing suppliers, if not more so. These measures are designed to increase customer engagement, the success of which has already been acknowledged by the CMA.[101] As more and more consumers start to engage, they will look to switch onto the cheapest tariffs available, and new entrants will be able to take advantage of this to grow their customer base.

[101] The CMA has recently noted that certain trials had "*increased switching rates in some cases by a factor of four*", a result described as representing a "*huge transformational effect*" - Business, Energy and Industrial Strategy Committee, Oral evidence: Pre-legislative scrutiny of the draft Domestic Gas and Electricity (Tariff Cap) Bill, HC 517, 12 December 2017, at Q57. Available at https://www.eprg.group.cam.ac.uk/wp-content/uploads/2018/01/S.-Littlechild_BEIS-oral-evidence-Dec-2017.pdf.

7. Conclusion

7.1 The Parties welcome the fact that the CMA does not intend to reopen the theories of harm that have been established as not resulting in a realistic prospect of an SLC in the Phase 1 Decision. Given the evidence provided by the Parties on these points, which demonstrate the fact that those theories are not substantiated, it would have served no useful purpose to reconsider these issues.

7.2 For the reasons set out in this response, the Parties consider that, when the evidence is considered fully,[102] the outstanding concerns identified in the Issues Statement similarly do not result in an SLC, particularly when assessed against the relevant counterfactual for this Transaction, which involves the ongoing implementation of the EMI remedies and other Ofgem initiatives and the imminent introduction of the SVT price cap.

7.3 The Transaction will not give rise to an SLC in relation to SVT pricing since there will be no merger effect on SVT pricing, given the fact that the Parties are not important comparators for each other or other suppliers in setting SVT prices. Moreover:

(i) customer engagement and switching is driven by the price they pay and the savings available from switching to FTCs, with the SVT prices of other suppliers (and any comparisons between such SVT prices) having no similar effect;

(ii) relative differences between SVT prices of suppliers are also not a relevant factor for media and other public commentary on SVT price changes, so to the extent that such public reporting has any effect on customer switching, that will not be affected by the Transaction; and

(iii) the imminent SVT price cap will, in any event, remove any residual concerns in relation to the setting of SVT prices.

7.4 There can be no concerns about the potential foreclosure of Utility Warehouse. In particular:

(i) **MergeCo will have no ability to foreclose Utility Warehouse**: the SSA [✂]; and

(ii) **MergeCo also has no incentive to foreclose Utility Warehouse**: any such SVT price increase would [✂] and switching data demonstrates that Utility Warehouse is not a close competitor to either of the Parties currently, so MergeCo cannot expect to recover those losses through recapturing customers from Utility Warehouse (particularly since any such recapture will be onto an FTC).

7.5 The Transaction will not result in the foreclosure of competitors through cross-subsidy. As the Issues Statement recognises, the larger suppliers are not currently foreclosing the entry of SAMS and, in fact, the SAMS are driving FTC prices. The Transaction will have

[102] The Parties recognise that, given the very late stage in the process at which the SVT point was raised the CMA did not have sufficient time to consider the evidence at Phase 1.

no effect on this dynamic and there will continue to be fierce competition for new customers, as recognised in the Phase 1 Decision.

7.6 To the extent that the CMA has any concerns about these theories of harm, the Transaction will result in real customer benefits including through the creation of a more customer focused supplier and through the passing on of the synergies generated from the Transaction. In addition, the increasing entry and growth of the SAMS must be expected to continue, ensuring that MergeCo will continue to face a significant competitive constraint post-Transaction.

Annex 1
uSwitch Insight Analysis

[✂]

Annex 2

Historic Price Increases

[✂]