SSE RETAIL/NPOWER ANTICIPATED MERGER INQUIRY

Summary of hearing with E.ON held on 22 June 2018

Competition in the market

1. E.ON said that there were a lot of competitors in the market including both larger companies and small and medium sized energy firms (SAMs). E.ON said that they had lost a significant portion of customers to the SAMS.

2. E.ON explained that some SAMs benefitted from lower costs as well as inherent advantages through, for example, their exemption from the ECO and WHD obligations, as well as other inherent advantages in terms of customer mix and not having to bear legacy costs and therefore were able to offer lower prices. Some SAMs targeted more affluent customers who were less costly to deal with as charges were recovered from them regularly via direct debit. They also required less customer support as they would serve themselves online.

E.ON shift away from standard variable tariff

3. E.ON explained that, in September 2017 it had announced the intention to begin (from a later date) moving its standard variable tariff (SVT) customers who had smart meters installed to a new fixed term default tariff at a discount to the SVT. E.ON's view was that fixed term tariffs improved customer engagement as they prompted customers to research alternatives as they were aware that their contracts were coming to an end.

4. E.ON explained that their fixed default tariff prices were set lower than their SVTs and also benchmarked against competitors' default fixed tariff rates.

5. E.ON explained that their fixed default tariff prices would be reviewed regularly and would reflect changing costs at the point of contract renewal for customers. Therefore they could be more responsive to changes in wholesale and other costs and vary more frequently than SVTs as the market moved.

E.ON said that their acquisition fixed tariffs would typically be intended to remain at prices lower than their default tariffs.

Proposed tariff cap on SVTs

6. E.ON suspected that the proposed cap on SVTs would have two effects based on their observations of the prepayment price cap; prices would start to converge at the cap and switching would be reduced. In prepayment accounts, switching had reduced by a third.

7. E.ON explained that the level of the price cap was likely to affect how they price their fixed tariffs. A price cap that was low might put upward pressure on the price of fixed tariffs to be able to compensate for the potential losses they would be making from the low SVT price they would be restricted to. Whether there would be price competition for default tariffs would depend on the level of headroom allowed, i.e. where the price cap was set relative to efficient costs.

Customer engagement

8. E.ON said that switching between different tariff schemes within the same energy company and between companies had increased significantly in general. E.ON said that they had had a net increase in the number of customers in the first quarter of 2018.

9. E.ON said that customer engagement had improved since the remedies of the CMA's Energy Market Investigation (EMI). This was also evidenced by E.ON's reduction in the number of SVT customers. E.ON explained that more customers were leaving SVTs and choosing cheaper fixed tariffs instead. The effects of the engagement measures were still working through.

10. E.ON also attributed the increased customer engagement to actions it had taken in its communications with customers, e.g. that it had simplified its letters to customers communicating that their fixed term contracts were coming to an end and that they would be put on more expensive default SVTs. This prompted customers to search for alternatives.

11. E.ON said that engaged customers tended to switch from SVTs to fixed acquisition tariffs, and they did not compare SVTs. Many customers utilised price comparison websites to switch.

12. E.ON explained that customers were also prompted to switch due to negative experiences with customer service.

Setting prices

13. E.ON explained that it first took into consideration its changing costs in determining whether to update its SVT pricing.

14. E.ON explained that up to 80 percent of costs are largely out of the six large energy firms' (SLEFs')[1] control. These costs comprised things such as wholesale energy costs, transmission and distribution costs, and meeting the costs of social and environmental legal obligations, such as ECO and the costs of renewables. The remaining costs, which make up around 20 percent, were operational costs, including costs of dealing with customers and other support functions and profit margin, . E.ON had undertaken cost reduction programmes to address this area. The wholesale energy costs that had to be recovered might be influenced by hedging strategies.

15. E.ON explained that they also took into account the way the media, other stakeholders and competitors might react to any price announcements. These were significant factors as price announcements could lead to substantial losses in customers, especially if they were the first SLEF to raise their price.

16. Whilst all SLEFs needed to increase their SVTs to recover cost increases, the first SLEF to announce a price rise tended to suffer the most losses. Media coverage of the first SLEFs to raise prices tended to be greater. Therefore, the timing of raising prices was considered carefully. While this encouraged waiting to see if others might move first, delaying a price rise could necessitate then imposing a higher one, which could itself generate adverse publicity.

17. E.ON said that customers are informed via letter of both price increases and decreases.

18. E.ON said that prices may vary from region to region, recognising regional differences in supply costs.

The merging parties

19. E.ON observed that SSE had on a few occasions been the first SLEF to announce price rises. E.ON observed that SSE had not been particularly aggressive with their fixed rate tariffs.

[1] Centrica, EDF Energy, E.ON, RWE, Scottish Power, and SSE.

20. E.ON said that Npower was believed to have high costs and to have suffered from poor customer service in the past.

Effects of the anticipated merger

21. E.ON said that there was enough competition in the market to constrain the merged entity.

22. E.ON explained that SSE and Npower might be able to reduce their costs through synergies which would in turn make them more competitive which E.ON would expect particularly to manifest itself in prices of fixed term tariffs.

23. E.ON said that they did not believe the anticipated merger would have an impact on the way they set their SVTs as the market would only have one less competitor, making little difference. Prices were mainly determined by cost pressures and SLEFs were generally constrained by a number of different factors and not the SVT prices of any individual SLEF.

24. E.ON said that customer engagement may improve as a result of the merger as the merged entity would have a better ability to serve customers and respond to their demands quicker.

E.ON acquisition of Innogy

25. E.ON explained that, subject to EU Commission approval, when E.ON acquires Innogy, the UK unit of E.ON will transfer its renewables business to RWE.

26. E.ON said that the remainder of the E.ON UK unit would remain independent and treat the merged entity comprising SSE Retail and Npower as a competitor.

27. E.ON explained that the UK unit would not have access to E.ON SE’s plans for the merged entity, being a 34.4 percent stakeholder in that company.

28. E.ON said that they were in the pre-notification stages with the EU Commission and would not complete the notification stage before the summer break.

29. E.ON said that they were also involved in a number of investigations with local regulators in relation to the acquisition of Innogy in some other EU member states.

Cross-subsidisation of fixed or acquisition tariff customers from SVT profits

30. E.ON said that they did not see that new entrants coming into the market had any problem competing with the existing players, given that there were around 70 suppliers who had entered the market and the market share of SAMs had significantly increased in the last five years.

31. E.ON observed that smaller energy firms had certain cost advantages in that they were not burdened with the obligation to supply Warm Home Discount and meet certain environmental objectives.

Other theories of harm

32. E.ON said that they believed the CMA was correct in not being minded to investigate the loss of rivalry to attract new customers with conventional meters via fixed tariffs, to supply restricted meter customers and to supply prepayment meter customers and the likelihood of coordinated plans.