SSE RETAIL/NPOWER ANTICIPATED MERGER INQUIRY

Summary of hearing with ScottishPower held on 15 June 2018

Competition in the market

1. ScottishPower opined that the energy retail market was highly competitive with 70 new entrants offering highly competitive prices to a range of customers. Small and mid-tier suppliers' (SAMs) share of the market had increased from under 5% to approximately 20% over the past five or six years. There were currently 10 mid-tier suppliers active in the market. A number of these SAMs were also growing in size.

2. ScottishPower told us the reason the SAMs had not grown at a faster pace was because they needed more time to ensure that they had the correct infrastructure to sustain a larger customer base. It told us another reason behind slow growth could be the fact that there had been little consolidation amongst the SAMs.

3. ScottishPower told us its strategy had not been affected by the anticipated merger. The key focus was competition against smaller suppliers.

4. ScottishPower said the anticipated merger of RWE and E.ON would increase market concentration but on the basis of what was currently known about the proposals would not be expected to significantly change competition, in particular competition from the smaller competitors would still be strong.

Standard variable tariffs and the potential effect of the anticipated merger

5. ScottishPower stated the number of standard variable tariff (SVT) customers in the UK was falling and now only constitutes [✄]% of ScottishPower's nonprepayment customers. ScottishPower explained this could in part be attributable to the remedies introduced by the Competition and Market Authority's (CMA's) Energy Market Investigation (EMI) which contributed to a high number of customers being switched to default fixed tariffs.

6. ScottishPower opined that competition in the SVT market would not be affected by the merger. The main competition for SVT comes from the fixed tariff market, which an increasing number of customers had switched to.

ScottishPower shift away from SVT

7. ScottishPower said that moving customers to a default one-year fixed tariff rather than an SVT default tariff was advantageous as it meant better opportunities to engage with customers and to encourage them to consider a competitive fixed tariff, leading to better customer retention. A [✂] portion of ScottishPower's customers who have defaulted to SVT tended to switch away to other suppliers in the 12 months following a maturity.

8. ScottishPower said letters sent out in relation to the end of a fixed tariff period were more likely to prompt customer engagement. These were stronger prompts for customers to switch than those from communications to customers about SVT price changes. ScottishPower explained that this was because letters to fixed tariff customers contained a hard date stating when the fixed period will end and by which a decision had to be made.

Proposed tariff cap on SVTs

9. ScottishPower opined that a tariff cap may inhibit customers from switching as they would subscribe to the perception that a regulator approved tariff is the correct price and there was nothing to be gained from switching.

10. ScottishPower told us the level of competition would depend on the level of the price cap. The higher the cap, the more headroom there would be to compete on price.

11. ScottishPower said there was aggressive competition currently in the market involving lowering tariffs, including fixed term acquisition tariffs. The prices often, in ScottishPower's view, reached a loss-making level. ScottishPower explained that if there was a cap on SVTs, acquisition tariffs would be less likely to decrease to gain customers. This was because lower loss-making acquisition tariffs would not be compensated for by higher SVTs as they would be capped. Hence, it was likely that all types of tariffs would converge at or close to the price cap.

Effects of the anticipated merger on customers in Scotland

12. ScottishPower said the merger would have no specific effect on customers in Scotland. It explained that SSE had brand loyalty in some areas of Scotland where it was the historic provider. ScottishPower selectively competed in

some of these areas, one approach had been to deploy sales staff in shopping centres. It said that it was more economical to target competition in larger cities.

13. ScottishPower said Npower did not appear very active in Scotland.

Customer engagement

14. ScottishPower explained that customer switching was generally dependent on the ease of switching. In practice this concerned how many clicks the customer would have to carry out online before switching.

15. ScottishPower said it was also important to understand what triggers and motivates a switch. This was usually price and price differentials.

16. ScottishPower told us that from its experience, the majority of customers were engaged given the high proportion of switching to fixed tariffs witnessed. It was only a minor portion of customers that were disengaged, and this portion was decreasing in size.

17. ScottishPower said price comparison websites (PCWs) were good at mobilising customers around points in time when providers had large portions of their customers' fixed tariff contracts ending. This prompted customers to carry out price comparisons.

18. ScottishPower said the ability to offer a greater range of differentiated tariffs and increased freedom in simplifying letters to prompt customers to switch enabled by the EMI had improved customer engagement, contributing to increased switching between both tariffs and energy suppliers.

Setting prices

19. ScottishPower explained that, in making a decision to change SVT or fixed tariff prices, it considered changes in costs, its objectives in terms of customer growth and retention, and what other market players were doing. In considering the actions of other market players, attention was paid to their price changes to gauge how the public might react to ScottishPower's own proposed price changes.

20. ScottishPower said it looked at the actions of competitors of all sizes.

21. ScottishPower told us it was usually concerned with the potential for current SVT customers to switch away in reaction to negative publicity. The press regularly communicated with ScottishPower asking for the reasons as to why tariffs had not gone down when those of their competitors had. Public

perception on what a fair price was could be very much determined by what the press said should be the appropriate price, often based on the lowest price in the market.

22. ScottishPower said it wanted their SVT prices to be [✂] of the 'Big Six' SVTs available in the market.

23. ScottishPower explained that when it decided to implement an exact price change, it would announce it the next day. The implementation of a price increase would be approximately six weeks from the decision. This also included 30 days' notice of the price change that had to be communicated to customers, as required by Ofgem's rules. Price decreases can be done more quickly.

24. ScottishPower told us it was risky to be the first to announce a price rise. ScottishPower had announced a 19% price rise in 2011 and none of the other six large energy firms (SLEFs)[1] had raised prices till approximately eight weeks later. During that period ScottishPower lost [✂] customers. ScottishPower said in a situation with fewer SLEFs, it would be even more risky to be the first mover in terms of raising price.

Barriers to entry

25. ScottishPower said the merger would not raise barriers to entry because there would still be a very large number of competing players in the market and one less competitor was unlikely to alter the behaviour of those competitors. ScottishPower explained that some of the SLEFs had made losses in retail and therefore any merger could be aimed at reducing their losses by becoming more efficient as opposed to tying up customers to the detriment of competitors.

Utility Warehouse

26. ScottishPower said there were many alternatives available to Utility Warehouse for accessing wholesale energy and it would not therefore expect the merger to adversely affect Utility Warehouse as they could switch to an alternative energy management service provider.

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

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

27. ScottishPower said cross-subsidisation was unlikely to be employed by SSE and Npower post-merger to foreclose competitors by heavily subsidising fixed tariffs to acquire new customers.

Restricted, prepayment and conventional meter customers

28. ScottishPower said it did not feel there were any competition issues in relation the supply of restricted meter, prepayment meter and conventional meters customers via acquisition tariffs.

Coordinated effects

29. ScottishPower said it did not see any coordinated effects in the market given the large number of customers that the SLEFs have lost in the last few years.