CMA
Competition & Markets Authority

Anticipated merger between SSE Retail and Npower

Provisional findings report

Notified: 30 August 2018

The Competition and Markets Authority has excluded from this published version of the provisional findings report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂]. [Some numbers have been replaced by a range. These are shown in square brackets.] [Non-sensitive wording is also indicated in square brackets.]

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Summary

1. On 8 May 2018 the Competition and Markets Authority (CMA) referred the anticipated merger between the domestic retail energy business of SSE plc (SSE) (SSE Retail) and Npower Group Limited[1] (Npower) (the Merger) for an in-depth phase 2 investigation. The CMA is required to address the following questions:

   (a) whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and

   (b) if so, whether the creation of that situation may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the United Kingdom (UK) for goods or services.

2. Competition is the process of rivalry over time between businesses seeking to win customers' business by offering them a better deal. An SLC occurs when rivalry is substantially less intense after a merger than would otherwise have been the case, resulting in a worse outcome for customers (through, for example, higher prices, reduced quality or reduced choice).[2]

The merging companies

3. The main overlap between SSE and Npower (together the Parties) is in the retail supply of electricity and gas (together, energy) to domestic customers in Great Britain (GB). The Merger brings together the third and sixth largest players in GB domestic energy supply.[3]

4. SSE is a listed company with generation, network transmission and distribution and retail activities in the UK and Ireland. Prior to the Merger, SSE will separate out its activities in the retail supply of electricity and gas to domestic customers in GB, as well as its telecoms and energy-related services to form SSE Retail.

5. Npower is a UK company, fully owned by innogy SE (innogy), which is active in the retail supply of domestic and non-domestic gas and electricity and energy-related services in GB. innogy is a European energy group active in

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[1] The terms of reference named Npower Group plc. However, this business was re-registered as Npower Group Limited with effect from 22 May 2018, we therefore for the purposes of our provisional findings report refer to Npower Group Limited as one of the Parties.
[2] Quick guide to UK merger assessment (CMA18), paragraph 3.1.
[3] Measured by number of customer accounts excluding pre-payment accounts.

renewable energy generation, electricity and gas distribution, and the retail supply of energy. innogy is listed on the Frankfurt Stock Exchange, and is majority owned (76.8%) by RWE AG (RWE). Npower has an exclusive wholesale 'supply and services agreement (the Wholesale Agreement) with Telecom Plus for the supply of gas and electricity to Utility Warehouse, a mid-tier energy supplier.

The Transaction

6. On 8 November 2017, innogy and SSE entered into an agreement to transfer Npower and SSE Retail into a new company (the Contribution Agreement) referred to as MergeCo (the Transaction). The Parties told us that MergeCo would be a standalone retail business with its own dedicated board of directors and specialist management team.

7. The Parties said that immediately following the Transaction (expected to be the last quarter of 2018 or the first quarter of 2019), MergeCo will be admitted to the premium listing segment of the Official List and to trading on the main market of the London Stock Exchange (LSE). We refer to the Transaction and the listing of MergeCo as the Merger.

8. Under the Parties' Agreement, innogy will receive a 34.4% equity stake in MergeCo, which innogy will be required to hold for at least six months; and SSE's stake of 65.6% will be distributed to its shareholders immediately following the Transaction.

Relevant merger situation

9. We are required to decide whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation. Section 23 of the Enterprise Act 2002 (the Act) provides that a relevant merger situation is created if:

   (a) two or more enterprises cease to be distinct; and

   (b) one or both of the 'turnover test' or 'share of supply test' is (are) satisfied.[4]

10. The Contribution Agreement is that SSE Retail and Npower will be brought under common control, and the new entity, MergeCo, will be listed on the

[4] Section 23 of the Act provides that the value of the turnover in the UK of the enterprise being taken over must exceed £70 million ('turnover test') or, in relation to the supply of goods or services, as a result of two or more enterprises ceasing to be distinct, at least one quarter of all such goods or services which are supplied or acquired in the UK or a substantial part of the UK are supplied by or to one and the same person ('share of supply test').

LSE. The CMA is accordingly satisfied that on completion of the Merger the enterprises of SSE Retail and Npower will cease to be distinct.

11. Based on evidence from the Parties we are also satisfied that the turnover test is met.

12. Accordingly, we are satisfied that a relevant merger situation has been created.

The market context

13. There were 72 energy retailers supplying domestic customers in GB (as of March 2018). These consisted of the Six Large Energy Firms (SLEFs) and 66 small and mid-tier suppliers (SAMS), mainly active in the supply of both electricity and gas.[5] The SLEFs (or 'large energy firms') comprise SSE and Npower, along with British Gas (now part of Centrica plc), E.ON UK plc (E.ON), EDF Energy plc (EDF), and Scottish Power Ltd (ScottishPower). The SLEFs were former monopoly providers of gas (British Gas) or regional electricity companies.

14. In recent years, there has been significant entry and expansion by new suppliers in the domestic energy retail supply markets. In 2017 the SLEFs' combined market share was just under 80% of domestic customers in GB (for both electricity and gas), having declined from a combined market share of around 95% in 2013.

15. Suppliers typically offer a range of tariffs, for single and dual-fuel customers, including tariffs for those customers with prepayment meters or restricted meters (which charge different rates for energy at different times of day, such as Economy 7 tariffs). In general, tariffs can be divided into two types.

    (a) Acquisition tariffs – these are tariffs offered to new customers or existing customers choosing a new tariff. They are usually fixed-term contracts (FTCs) which are sold at a fixed price for a fixed period, eg one, two or three years. They may have 'exit fees' where a customer chooses to leave the tariff before the fixed time period has expired.

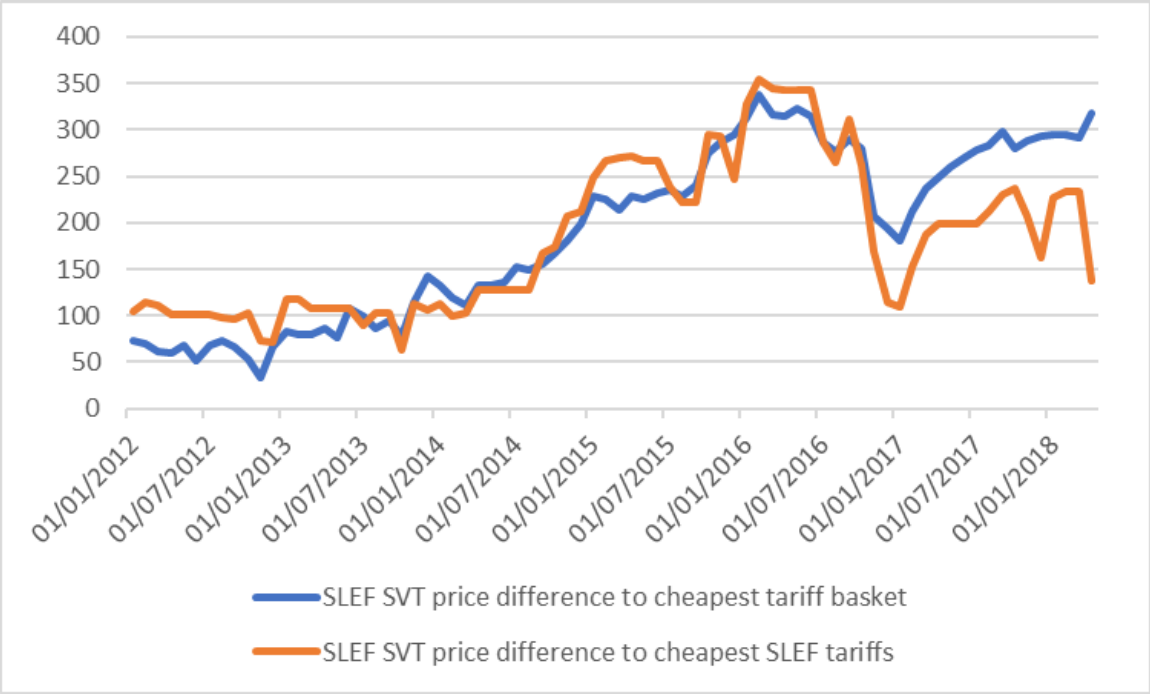
    (b) Default tariffs – these apply where a customer has not chosen a specific tariff. For example, on expiry of an FTC a customer will generally be rolled onto a default tariff if they do not make an active choice of alternative

[5] Number of active domestic suppliers by fuel type (GB), Ofgem (March 2018).

tariff. Default tariffs are usually standard variable tariffs (SVTs); these continue indefinitely, vary in price over time and do not have 'exit fees'.

16. Acquisition tariff prices tend to be substantially cheaper than default tariff prices. Figure 1 shows the difference in annual costs for a typical household on the average SVT of the SLEFs compared to the cheapest tariffs offered by any of the SLEFs (orange line), or compared to the cheapest tariffs offered by any supplier (blue line). The annual cost savings from switching away from an SVT to one of the lowest priced acquisition tariffs increased from 2012 to early 2016, fell back in 2016, and have increased again from early 2017. In recent months, the best acquisition tariffs offered by the SAMS have been considerably cheaper than those offered by the SLEFs.

Figure 1: Comparison of SLEF's SVT price differences to cheapest tariffs



Source: Retail price comparison by company and tariff type: Domestic (GB), Ofgem (July 2018).

17. The CMA conducted an in-depth review of the energy market in GB between 2014 and 2016 (the Energy Market Investigation (EMI)).[6] The EMI found, among other concerns, an overarching market feature of weak customer response.[7] It estimated that customers had been paying around £1.4 billion on average per year too much as a result of the problems it found, over the

[6] See EMI final report (24 June 2016).
[7] EMI final report (24 June 2016), paragraph 9.283.

period 2012-2015.[8] This was largely because around 70% of domestic customers were on more expensive default SVTs despite competitively priced acquisition tariffs being on offer.[9] This 'weak customer response' was the result of customers' limited awareness of and interest in their ability to switch energy supplier, actual and perceived barriers to accessing information and the existence of actual and perceived barriers to switching.[10]

18. Following the EMI, the CMA put in place a package of remedies. Among its remedies to improve domestic customer engagement, the CMA recommended:[11]

(a) the creation of an Ofgem-controlled database of 'disengaged customers' on default tariffs, which could allow rival suppliers to prompt these customers to engage in the retail energy markets (the 'Database remedy'); and

(b) the establishment by Ofgem of a programme to provide customers (directly or through their own suppliers) with information to prompt them to engage (the 'Prompt to engage remedy').

19. Ofgem is in the process of implementing these two remedies. In addition, Ofgem intends to initiate a Switching Programme (expected to be launched in April 2020[12]) to provide for faster and more reliable switching, including switching by the end of the next working day after a request.

Improvements in customer engagement

20. Rates of customer engagement have increased since the EMI and continue to do so. The number of customers on SVTs has declined from 70% of domestic customers at the time of the EMI[13] to 57% by October 2017 (excluding prepayment customers).[14]

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[8] This was equivalent to around £50 per household per year. Residential households spend an average of around £1,123 per household on gas and electricity each year (State of the energy market 2017 report, Ofgem (31 October 2017), page 6).
[9] EMI final report (24 June 2016), paragraph 102.
[10] We refer to the situation where customers do not consider or believe they cannot act on exploring the market to seek alternative suppliers and tariffs as disengagement. Such customers are likely to find themselves on default tariffs and will not have switched recently or at all.
[11] EMI final report (24 June 2016), paragraph 13.7.
[12] Transitional phase plan, Ofgem.
[13] Over two-thirds of domestic customers were on SVTs (Ofgem Retail Energy Markets in 2015).
[14] At October 2017, split between those SVT accounts held for more than three years (34%) and those held for less than three years (23%).(Number of non-price protected domestic customer accounts by supplier: Standard variable, fixed and other tariffs (GB), Ofgem (January 2018).

21. There has also been a gradual increase in customer switching rates since late 2014. For example, Ofgem's 2017 'State of the energy market' report found that in June 2017, 16% of customers had switched supplier in the previous 12 months, an increase from 11% in 2015 and the highest level of customer switching since August 2011.[15]

22. The proportion of customers switching to the SAMS has also increased over time. In 2015, just over [✂]% of gas and electricity customers leaving the Parties switched to one of the SAMS; by 2017, this had increased to over 50%. The number of SAMS has continued to increase, and their market share from around 5% in 2013 to around 20% in 2017. In addition, a significant proportion of customers switch internally (ie remain with the same supplier, but on a different tariff).

Measures to protect customers

23. While engagement is increasing and consequently many more customers are benefitting from lower priced acquisition tariffs, many customers are still not engaging with the market and as a result are paying higher prices. Measures have therefore been put in place, or are proposed, to protect such customers.

24. In addition to its recommendations outlined in paragraph 18, the CMA also put in place a price cap on prepayment meter tariffs (PPM Price Cap) in April 2017, which is due to expire at the end of 2020. On 2 February 2018, Ofgem extended the PPM Price Cap to a further one million vulnerable customers receiving the Warm Home Discount (WHD).[16] The CMA has committed to review the price cap with reference to the extent of smart meter roll-out in early 2019 and could potentially recommend to Ofgem that the duration of the prepayment price cap be extended.

Our findings

Market definition

25. Our provisional conclusion is that the appropriate markets for the purposes of this investigation are:

    (a) the supply of electricity to domestic consumers in GB; and

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[15] State of the energy market 2017 report, Ofgem (31 October 2017).
[16] Extend the PPM safeguard tariff for Warm Home Discount consumers. Under the WHD, large energy suppliers are required to provide bill rebates, worth £140 in 2017/18, to low-income and vulnerable households (Warm Home Discount).

(b) the supply of gas to domestic consumers in GB.

26. In practice, the conditions of competition are similar for gas and electricity and in our competitive analysis it has not been necessary to distinguish between them.

Counterfactual

27. We assess the possible effects of the Merger on competition compared with the competitive situation that would have prevailed absent the Merger (ie the counterfactual situation). That is, the counterfactual acts as a benchmark against which to assess the competitive effects of the Merger.

28. The Domestic Gas and Electricity (Tariff Cap) Act 2018 (the Default Tariff Cap Act) received Royal Assent and entered into law on 19 July 2018.[17] It requires Ofgem to impose a price cap on all 'standard variable' tariffs and 'default rates' for the supply of energy under domestic supply contracts (the Default Tariff Cap).

29. Ofgem will review the level at which the Default Tariff Cap is set at least every six months. The cap will apply to 2020 and can then be extended annually for, at most, a further three years. Ofgem is required to carry out a review (with the first review to take place in 2020, and then for each year the Default Tariff Cap period is extended) into whether conditions are in place for effective competition for domestic supply contracts, before making a recommendation to the Secretary of State on whether the cap should be extended.

30. There is an expectation that the Default Tariff Cap will be set at a level that is lower than the prevailing SVT prices of each of the larger suppliers. Ofgem, in its May 2018 consultation document, stated that the objective of the Default Tariff Cap would be to protect current and future consumers on SVTs or other default tariffs, and therefore, it expected that consumers on default tariffs paying the highest prices would make 'significant savings' under the cap.[18]

31. We are satisfied that it is likely the Default Tariff Cap will be in place by the end of this year. However, predicting whether the Default Tariff Cap will be extended beyond 2020 is very difficult. Ofgem has responsibility for conducting an annual review of the market and making its recommendations to the Secretary of State on whether the Default Tariff Cap should be extended. Currently, it is unknown how Ofgem will assess whether to recommend to the Secretary of State an extension of the Default Tariff Cap,

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[17] See Victory for consumers as cap on energy tariffs to become law, BEIS (19 July 2018).
[18] Default Tariff Cap: Policy Consultation Overview document, Ofgem (25 May 2018).

or how the Secretary of State might make a decision in response to the recommendation. As such, we can only foresee with any degree of certainty that the cap will be in place for the initial two-year period. Therefore, our provisional view is that the relevant counterfactual should take into account a price cap on default tariffs until 2020.

32. In relation to the CMA's remedies under the EMI, while these measures are not yet operational, all of the orders and undertakings required to implement these remedies have now been put in place. Therefore, we considered that the EMI remedies associated with such orders and undertakings should be taken into account in our counterfactual and competitive assessment. Similarly, we have also taken into account the initiatives that have already been introduced by Ofgem to increase consumer engagement. However, the exact form and impact of the EMI remedies and Ofgem's initiatives are currently unknown, and therefore, it is our provisional conclusion that their level of effectiveness in increasing consumer engagement cannot yet be gauged with any certainty.

33. We provisionally found that the current conditions of competition, taking account of the Default Tariff Cap and EMI remedies where appropriate, represent the appropriate counterfactual

34. Finally, we considered whether any account should be taken of the proposed E.ON/RWE transaction.[19] Our provisional view is that we should not take into account the possible impact of this transaction in the counterfactual as both the likelihood that this transaction will complete and the outcomes of any antitrust and regulatory reviews are uncertain.

Competitive assessment

35. We assessed the effects of the Merger on competition in the supply of electricity and gas to domestic customers in GB.[20] Our competitive assessment distinguishes between acquisition tariffs and default tariffs. However, we note that there is a relationship between these two types of tariffs, particularly since many customers switch between default and acquisition tariffs (whether actively or otherwise), and the SLEFs will consider both when developing their competitive strategy and pricing. We also considered the implications of the Merger on Npower's wholesale supply agreement with Utility Warehouse (the Wholesale Agreement).

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[19] See E.ON and RWE: two European energy companies focus their activities, E.ON and RWE (12 March 2018).
[20] Our function is to assess whether or not an SLC arises as a result of this Merger between SSE Retail and Npower, it is not an investigation into the state of the market and we do not have powers to address any non-Merger specific issues.

Effects of the merger on competition in acquisition tariffs

36. We found that the Parties are not particularly important constraints on each other in acquisition tariff competition. Specifically, there is relatively low level of customer switching between the Parties (less than 10% of each Party's customers who switch supplier, switch to the other Party). Additionally, there are a large number of alternative suppliers, including the SLEFs and the SAMS, that offer many acquisition tariffs which collectively will constrain the Parties following the Merger. This is illustrated by the fact that over half of the Parties' customers who switch supplier, switch to one of the SAMS and the SAMS tend to offer the lowest priced acquisition tariff prices. Although we found evidence that some customers had a preference for one of the SLEFs (or for a supplier with a recognised brand name more generally) we found no significant barriers to switching once customers are engaged.

37. Therefore, in light of the limited switching between the Parties, and the range of alternative suppliers and tariffs available to customers we do not consider it likely that the Parties could profitably increase the prices of their acquisition tariffs as a result of the Merger.

Effects of the merger on competition in default tariffs

38. We then looked at the effects of the Merger on competition in default tariffs. Nearly all of the Parties' default tariff customers are on SVTs and, therefore, our analysis focussed on possible effects on SVTs.

39. We noted that SVT customers are likely to be disengaged and when they become engaged, nearly all customers who switch will choose acquisition tariffs. Therefore, there is no competitive rivalry between the Parties in relation to attracting customers to SVTs.

40. Consequently, we considered whether the Merger might reduce the competitive constraints faced by the Parties in setting SVT prices, depending on the extent of customer switching from one Party's SVT to the other Party's acquisition tariffs. As noted at paragraph 36, customer switching in general between the Parties is low and we found that this was also true for the Parties' SVT customers. Therefore, customer switching between the Parties is unlikely to create an incentive for the Parties to increase SVT prices following the Merger.

41. We also considered the factors which prompt changes to SVT prices, the constraints the SLEFs face when adjusting SVT prices and how these

constraints could be affected by the Merger.[21] We found that the main driver for all of the SLEFs, in deciding on changes to their SVTs, is changes in their costs. This applies to both the timing and magnitude of such price changes. Because all the SLEFs face similar cost drivers, they are all likely to experience pressure to change prices at around the same time which leads to 'rounds' of price changes. We have also found that the SLEFs monitor the SVT price changes of the other SLEFs and take this into account when deciding their own SVT price changes.

42. We found that the main constraint on suppliers when adjusting SVT prices is that any SVT price change increases the likelihood that their customers will become engaged and switch, either to an alternative supplier's acquisition tariff (external switching), or to the supplier's own lower priced and lower margin acquisition tariffs (internal switching). SVT price changes prompt an increase in SVT customer switching above and beyond the underlying rate of SVT losses which the SLEFs experience throughout the year.

43. We found that this increase in customer switching arises because SVT customers receive a number of prompts to engage when SVT prices change. Some of these prompts originate from the supplier, for example the notification of a price increase or the receipt of a higher bill. They also include external prompts from the media (which includes the press and other market participants such as price comparison websites).[22] In this regard, we received evidence that the SLEFs consider how their proposed SVT price change will be perceived in the wider market context. This leads the SLEFs to consider the positioning of their proposed SVT price change relative to those of the other large energy firms, despite the fact that customers do not generally switch directly between these tariffs.

44. We found that the SLEFs tend to anticipate that they are likely to suffer more SVT losses if they announce a price increase which is larger than the increases of the other large energy firms.

45. Accordingly, we received evidence of the Parties seeking to predict the likely timing and magnitude of price announcements of the other large energy firms and seeking to limit their price increase, so as not to be an outlier, and/or estimating higher customer losses if their price increase is out of line with

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[21] In our analysis we focussed on the SLEFs' SVTs because of the evidence that they have a considerably greater number of customers on default tariffs than other suppliers, the SLEFs' SVT price announcements are more prominent than those of the other suppliers and we received evidence that each of the SLEFs pays particular attention to the likely timing and magnitude of SVT price changes by the other large energy suppliers when setting their own SVT prices.

[22] Media prompts can arise through a variety of forms of communication such as newspapers, television programmes, on-line consumer websites or through price comparison websites advertising and contacting potential customers.

those of the other large energy firms. We have also observed examples of the Parties adjusting their planned default tariff price changes in response to announcements by the other large energy firms. We refer to this behaviour as 'benchmarking'.

46. The SLEFs also expect to suffer increased SVT customer losses in response to a SVT price announcement if they are the first of the SLEFs to announce a change. The Parties, the other large energy firms and consumer groups told us that this is because the first supplier to announce is likely to receive significantly more media attention than would otherwise have been the case. Such media attention can not only have an immediate effect on customer switching but can also have wider adverse reputation effects.

47. Overall, we found that if one of the SLEFs announces a bigger price increase than the other large energy firms, or is the first SLEF to announce, it is likely to receive increased media interest and scrutiny. This media interest is likely to draw particular attention to that supplier, alerting its own customers more than those of other SLEFs, and this is likely to result in increased engagement and possible switching by its SVT customers.

48. Therefore, we considered whether a reduction in the number of large energy firms (from six to five) as a result of the Merger, and hence the number of relevant comparators they may benchmark against, would reduce any constraints on, first, the size, and second, the timing of any price changes of SVTs.

Benchmarking constraint on the size of SVT price changes

49. Our theory of harm is that the Merger, by reducing the number of large energy firms and therefore eliminating an important comparator, and/or by eliminating a particular important comparator for the other large energy suppliers, might reduce the benchmarking constraint on the size of SVT price changes. We noted that a change in the benchmarking constraint could affect the pricing of any of the SLEFs, not just of the Parties.

50. Although we received evidence showing that suppliers do consider the positioning of their SVT price relative to the SVT prices of the other large energy firms, we found no indications that the SVT price changes of SSE are of any more importance to Npower than the price changes of any of the other large energy firms (or vice versa). There are no indications that either of the Parties is seen as a particular price leader, nor that any of the other large energy firms regard either of the Parties as particularly important when setting their own SVT prices.

51. Rather, each of the SLEFs seeks to position its SVT price appropriately relative to the range of SVT prices offered by the other SLEFs. Currently each of the SLEFs positions its SVT price with reference to the SVTs of the other five large suppliers; we expect that following the Merger each of the remaining large suppliers will continue to pay regard to the SVT prices of the other four large suppliers. We consider it unlikely that a reduction in the number of comparators faced by each of the large suppliers from five to four would have a significant impact on the constraints faced by each of the large suppliers in setting their SVT prices. Consequently, we do not expect that the Merger will significantly change the likelihood that a supplier will announce a price change which is out of line with the range announced by the other suppliers.

52. Additionally, when suppliers consider SVT price changes, they take into account a number of factors, of which the impact of cost changes and the effect of the price change itself on customer retention are the most important. These other factors will be unaffected by the Merger and will continue to determine the Parties' (and other suppliers') pricing following the Merger to the same extent as before.

53. In summary, our provisional view is that the Merger is unlikely to substantially lessen competition, in respect of the benchmarking effect on default price levels, for the following reasons:

(a) we consider that the reduction in the number of large energy firms from six to five will not significantly change how they benchmark their price levels. In other words, the Merger will not significantly change the likelihood that a large supplier would announce a price change which is out of line with the range of price changes announced by the other large suppliers, as there will be sufficient comparators post-Merger;

(b) the Parties do not assign any particular significance to the other Party in benchmarking, and neither of the Parties appears to have a price leadership role (in timing or level) or to have prompted the other SLEFs to reconsider their proposed SVT price changes; and

(c) a number of other factors, such as cost changes and the effects of the price change itself on customer switching, play a more important role in the SLEFs' determination of the size of SVT price changes. These factors will not be affected by the Merger and will continue to determine the large energy firms' SVT prices following the Merger.

Effects of the Merger on the timing of the SLEFs' SVT price changes

54. As noted in paragraph 46, where one of the SLEFs is the first to increase its SVT price, there is likely to be an increase in its customer losses. This firm can seek to reduce its chances of being the first-mover by delaying its price change announcement in the hope that the delay will allow another supplier to announce first. However, such a delay is likely to be costly since potential increases in revenue are likely to be foregone.[23]

55. We have considered the possibility that the Merger may create incentives for each of the SLEFs to announce SVT price increases earlier. The Merger could do this because, by reducing the number of large energy firms, the Merger reduces the benefit to each firm of delaying their price announcement. This is because with fewer large energy firms setting a SVT, there is less chance that another large supplier will announce first. If the probability of gaining benefits by delaying a SVT price announcement is decreased, this may create an incentive for suppliers to announce SVT price changes earlier. If, post-Merger, the large suppliers brought forward price increases, even if only by a few days or weeks, this could have a substantial effect on customers given that the incentives would apply to the other large suppliers and given the number of customers involved.

56. The evidence suggests that the costs of delaying a price announcement are significant (in terms of lost profit) while the benefit of avoiding being the first of the SLEFs to announce a price change (if another SLEF announces a price change first in the period of delay) is relatively modest. This indicates that, while the Parties might prefer not to be the first of the SLEFs to announce, they currently have a relatively small incentive to delay price changes in order to achieve this. This is especially so given the uncertainty as to whether a delay will allow the Parties to avoid being the first of the SLEFs to announce.

57. Our review of the Parties' internal documents shows that relatively little consideration is given to this trade-off when deciding on the timing of an SVT price change. Moreover, the effects of the Merger on this decision is likely to be small, since there will continue to be four (rather than five) other large suppliers who could be the first to announce a price change.

58. Therefore, we have provisionally concluded that the Merger will not lead the large suppliers to announce SVT price increases earlier because:

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[23] A supplier may decide that a delay will then require a higher price announcement, to offset the revenue otherwise foregone. But this large price rise will further increase the risk of customers switching. We received evidence from a number of suppliers discussing the costs associated with delaying price announcements.

(a) the costs of delaying a price increase in order to see if another one of the SLEFs increases price first are high. Meanwhile, the benefits of avoiding the first-mover costs of an increased loss of SVT customers (and therefore, the potential benefits of delaying a price increase) are relatively small. This suggests that the possibility of delaying a price announcement in the hope of avoiding being the first supplier to announce plays only a limited role in a supplier's decision regarding the timing of a price announcement;

(b) consistent with this, our review of the Parties' internal documents indicates that the potential to delay price announcements in order to avoid being the first supplier to announce plays only a limited role in decisions regarding the timing of price announcements; and

(c) further, the effect of the Merger on any incentives to delay price announcements in order to avoid being the first of the large suppliers to announce is likely to be small since there will continue to be four other large suppliers who could announce following a delay.

Impact of the Merger on the Utility Warehouse Wholesale Agreement

59. We also considered whether the Merger could create an incentive on MergeCo to increase the wholesale price for Utility Warehouse, either to foreclose Utility Warehouse (totally or partially), or to increase MergeCo's profits from the Wholesale Agreement.

60. The wholesale price paid by Utility Warehouse to Npower is set by reference to the SVT prices of all the SLEFs. Pre-Merger, Npower can affect the wholesale price by varying its own SVT price. After the Merger, MergeCo will have greater influence because it will control the SVT price of two of the six inputs used to calculate the wholesale price.

61. Our provisional view is that we do not consider that MergeCo would have an incentive to totally or partially foreclose Utility Warehouse:

(a) regarding total foreclosure, the profit that MergeCo would lose from the Wholesale Agreement, in the event that it foreclosed Utility Warehouse, would be greater than the increased profit that MergeCo could expect to gain from Utility Warehouse customers switching to MergeCo; and

(b) regarding partial foreclosure, the Merger may slightly increase the profitability of partially foreclosing Utility Warehouse. However, we have found that the additional revenue from such a strategy would be small. In addition, in order to engage in a partial foreclosure strategy, MergeCo would have to significantly raise its own SVT prices, which would lead to

additional customer losses and consequently significantly reduce profitability. Therefore, in our view it would not be profitable for MergeCo to partially foreclose Utility Warehouse and as such MergeCo would not have an incentive to do so.

62. We also considered whether the Merger would create incentives for MergeCo to increase Utility Warehouse's wholesale price in order to increase its profit from the Wholesale Agreement. However, we found that this was unlikely to be the case. While MergeCo would have to implement a smaller SVT price increase than Npower to achieve a given increase in Utility Warehouse's wholesale price, it would have to implement this SVT price increase across a significantly larger customer base. As a result, MergeCo's foregone profits may be similar to those of Npower's prior to the Merger. Consequently, it is our provisional view that this effect is not likely to provide a greater incentive (than already applies) for MergeCo to increase SVT prices with the specific intention of increasing Utility Warehouse's wholesale price.

63. Consequently, our provisional conclusion is that the Merger is not likely to lead to the foreclosure of Utility Warehouse, nor any substantial incentive for MergeCo to increase the wholesale price it charges Utility Warehouse. Additionally, we note that the Default Tariff Cap is likely to restrict any such possibility while it is in place.

Other considerations

64. We have also considered the possible effects of the Merger on:

(a) service quality;

(b) price leadership in regard to default tariffs, specifically by British Gas and MergeCo; and

(c) the Parties' ability to use profits from default tariff customers to offer low acquisition tariff prices which could then detrimentally affect the growth of the SAMS and their incentives to innovate.

However, we did not find evidence that the Merger would diminish competition for these reasons, and so our provisional view is that the Merger is not likely to give rise to an SLC as a result of these.

65. Additionally, we have considered the relevance of a number of potential mitigating factors which have been put to us by the Parties, namely the Default Tariff Cap (which can be expected to constrain the pricing of default tariffs while it is in place), the possibility of entry and expansion, and possible efficiencies from the Merger. As we have provisionally concluded that the

Merger is not likely to give rise to an SLC, we did not need to reach a view on the impact of these potential factors.

Provisional conclusion

66. We have provisionally concluded that the proposed Merger may not be expected to result in a substantial lessening of competition in the supply of electricity to domestic customers in GB and the supply of gas to domestic customers in GB.

Provisional findings

1. The reference

1.1 On 8 May 2018 the Competition and Markets Authority (CMA),[24] referred the anticipated merger between the domestic retail energy business of SSE plc (SSE) (SSE Retail) and Npower Group Limited[25] (Npower) (the Merger) for further investigation and report by a group of CMA panel members (the inquiry group).

1.2 The CMA must decide:[26]

(c) whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and

(d) if so, whether the creation of that situation may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the United Kingdom (UK) for goods or services.

1.3 This requires that the CMA assesses what effect the Merger will have on competition, which is the process of rivalry over time between businesses seeking to win customers' business by offering them a better deal. An SLC occurs when rivalry is substantially less intense after a merger than would otherwise have been the case, resulting in a worse outcome for customers (through, for example, higher prices, reduced quality or reduced choice).[27]

1.4 Our terms of reference, along with information on the conduct of the inquiry, are set out in Appendix A.

1.5 This document, together with its appendices, constitutes our provisional findings. Further information, including submissions from SSE and Npower (together the Parties) and summaries of evidence from third parties can be found on our website.[28]

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[24] In exercise of its duty under section 33(1) of the Enterprise Act 2002 (the Act).
[25] The terms of reference (see Appendix A) named Npower Group plc. However, this business was re-registered as Npower Group Limited with effect from 22 May 2018, therefore, for the purposes of our provisional findings report we refer to Npower Group Limited.
[26] In exercise of its duty under section 36(1) of the Act.
[27] Quick guide to UK merger assessment (CMA18), paragraph 3.1.
[28] See the SSE Retail/Npower merger inquiry case page.

2. The market

2.1 This section is structured as follows:

(a) overview of the structure of the electricity and gas markets (see paragraphs 2.2 to 2.15);

(b) description of the retail energy products offered to customers in Great Britain (GB) (see paragraphs 2.16 to 2.26);

(c) overview of the energy retailers within the energy sector and their market shares for gas and electricity (see paragraphs 2.27 to 2.43);

(d) summary of the regulatory and policy framework that governs the energy market (see paragraphs 2.44 to 2.48); and

(e) summary of the CMA's Energy Market Investigation (EMI) findings and remedies[29] (see paragraphs 2.49 to 2.53).

The market structure overview

2.2 This section considers the physical supply chain that delivers electricity and gas (together 'energy') to customers and then the financial flows and market arrangements that support competition in the energy markets.

Physical supply chain in electricity and gas

2.3 At a high level, there are some strong similarities between the supply chains for electricity and gas:

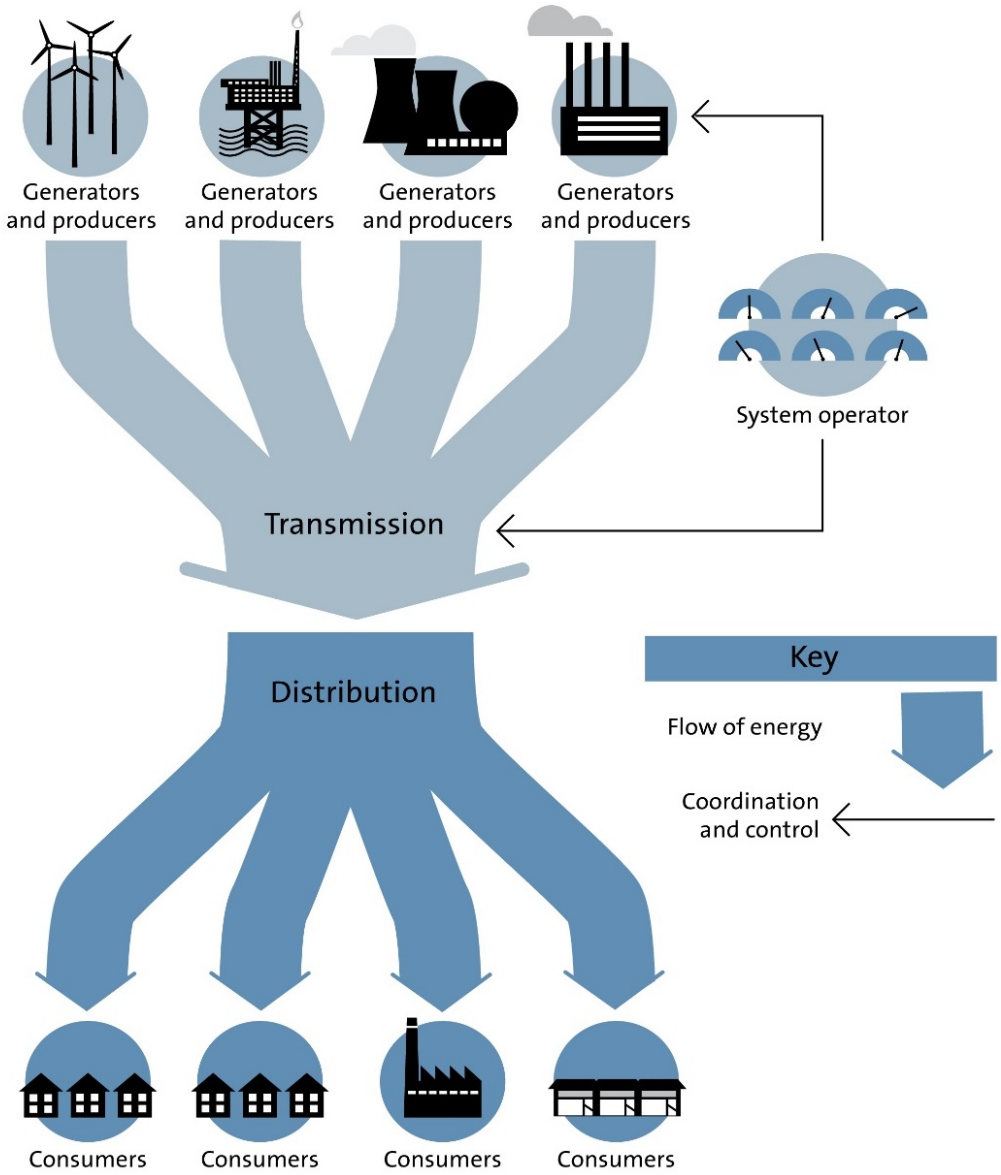
(a) In the electricity sector, different types of generation technology (eg coal, gas, nuclear or renewable) generate electricity, which is transported to customers via high-voltage transmission lines and low-voltage distribution lines.

(b) In the gas sector, gas from different sources (eg from offshore fields in the North Sea, imports via interconnectors from other countries or imports in the form of Liquefied Natural Gas (LNG)) are transported to customers via high-pressure transmission pipes and low-pressure distribution pipes.

[29] EMI final report (24 June 2016).

2.4 Figure 1 illustrates at a high level, the basic flow of energy to customers in both the electricity and gas sectors.

Figure 1: Physical supply chain in electricity and gas



Source: EMI final report (24 June 2016), Figure 2.1.

Transmission and distribution

2.5 GB is divided into electricity and gas distribution areas which were determined by the physical layout of the distribution and transmission network. This geographic segmentation of the supply of electricity and gas to domestic customers and small and medium-sized enterprises (SMEs) continues to a certain extent today with network costs varying across regions.

2.6 Public electricity suppliers (PES) were the 14 electricity companies created in GB when the electricity market was privatised following the Electricity Act 1989. These companies were subsequently split between distribution network operators and separate supply companies following the Utilities Act 2000.

2.7 In relation to electricity distribution, there are 14 licensed distribution network operators in GB which are owned by six different groups,[30] and there are eight gas distribution networks owned by four companies.[31]

2.8 In both electricity and gas, transmission and distribution are natural monopolies: it is cheaper to have producers and customers connected via a single network rather than multiple networks.

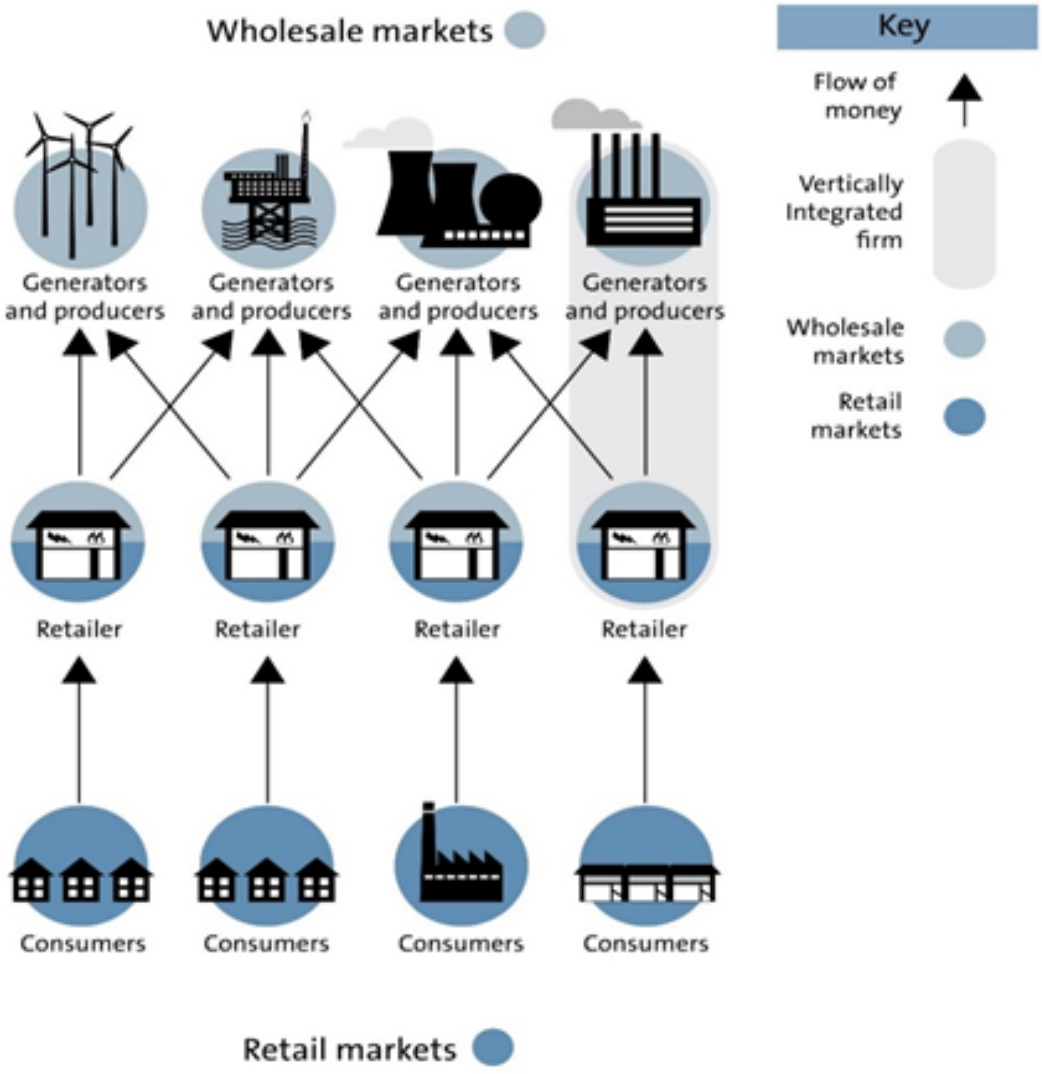
2.9 The energy retailers do not appear in Figure 1 above, as they have no role in the physical delivery of electricity and gas to the end-customers. Their role is focused on commercial and financial transactions – they are responsible for procuring energy in the wholesale energy markets, selling it to customers through a variety of tariffs and carrying out metering and billing functions as set out below.

Financial flows and market arrangements

2.10 The financial flows and market arrangements between the generators and producers (upstream) and energy retailers (downstream) are shown in Figure 2. The electricity generators and gas producers and importers compete to sell to energy retailers in the wholesale markets, and energy retailers compete to sell to consumers in the retail markets.

[30] Electricity North West Limited, Northern Powergrid, SP Energy Networks, SSE, UK Power Networks and Western Power Distribution (GB electricity distribution network, Ofgem).
[31] Cadent Gas Ltd, Northern Gas Networks Limited, Scotia Gas Networks Limited and Wales & West Utilities Limited (GB gas distribution network, Ofgem).

Figure 2: Financial flows and market arrangements



Source: EMI final report (24 June 2016), Figure 2.2.

2.11 The trading for electricity and gas in wholesale markets can take place bilaterally or on exchanges. Contracts can be struck over multiple timescales, from several years ahead to on-the-day trading. Gas is financially settled and balanced on a daily basis as it can be stored and electricity is financially settled on a half-hourly basis.

2.12 Retail markets provide the strongest point of commonality between gas and electricity, since the products are often sold together by energy retailers through a bundled tariff called a 'dual fuel' tariff. Moreover, the regulatory regime applying to retail functions generally applies equally to electricity and gas.

Metering and billing in retail markets

2.13 Most electricity and gas meters used in households do not communicate information directly to the supplier and are designed to be read infrequently. These meters are referred to as 'dumb' meters. These dumb meters are further categorised as 'credit as opposed to prepayment' meters and 'single-rate as opposed to restricted' meters.[32]

2.14 In contrast 'smart' meters record information on energy use which is transmitted directly to energy retailers and customers can track usage through in-home display units.

2.15 The current prevalence of dumb meters influences the form in which retail competition takes place for electricity and gas. We consider the roll-out of smart meters in Section 3.

Retail energy products

2.16 This section provides an overview of customer demand for energy, together with the main types of energy payment options and tariffs that are offered to domestic customers in GB.

Customer demand for energy

2.17 Energy is a necessity and if demand for electricity and gas is not satisfied instantaneously, the impact on customers and the cost to suppliers may be severe. As a result, the regulations governing energy supply ensure that domestic customers generally receive a continuous supply of gas and electricity, whether or not they have made an active choice of supplier, tariff or payment method.[33] The Office of Gas and Electricity Markets (Ofgem) appoints a supplier of last resort for failed suppliers to ensure continuity of supply to the failed suppliers' customers.[34]

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[32] Restricted meters include any metering arrangement whereby a domestic customer's consumption at certain times and, in some cases, for certain purposes (for example, heating) is separately recorded. These meters allow for customers to be charged lower rates for electricity used at times when overall demand is lower. These meters include Economy 7 meters (which track usage separately depending on if it's daytime or night-time; the rate paid is usually cheaper at night than during the day).
[33] Cutting off households from electricity and gas supply is a step that can be taken only in extreme circumstances, which are prescribed by legislation. Schedule 2B to the Gas Act 1986 and Schedules 6 and 7 to the Electricity Act 1989 provide for suppliers' rights to discontinue supply in certain situations. Exercise of these rights is subject to further restrictions in suppliers' Standard Licence Conditions.
[34] Guidance on supplier of last resort and energy supply company administration orders, Ofgem (21 October 2016).

2.18 Electricity and gas are a significant expenditure for many households. The poorest 10% of the population spend 8.1% of total household expenditure on electricity and gas, while the richest 10% spend 2.4% of total household expenditure on electricity and gas. For the poorest 10%, expenditure on energy is the fifth highest item of expenditure, after housing (net), food and non-alcoholic drinks, recreation and culture, and transport.[35]

2.19 Gas and electricity are homogeneous products in that an energy customer's consumption is entirely unaffected by the choice of retailer.

Types of payment method

2.20 Domestic customers may pay for their gas and electricity using one of three types of payment method: direct debit; standard credit; and prepayment.

2.21 Most domestic customers pay by direct debit and are on a credit single-rate dumb meter, although we note that by the end of 2020 all domestic customers will have the choice to be transferred to smart meters.[36]

2.22 Customers do not usually have a choice between standard credit and prepayment. All customers with (dumb) prepayment meters must pay by prepayment. Prepayment meters are generally installed where a customer has a poor payment history or in specific types of accommodation such as holiday homes and student accommodation.

Energy tariffs

2.23 Energy tariffs are structured as 'two-part' tariffs, ie customers pay a daily standing charge for supply of electricity or gas, and a per unit charge based on their level of consumption.[37] Some of the energy retailers offer tariffs with a zero daily standing charge.

2.24 Customers can choose to purchase gas and electricity individually ie 'single fuel' tariffs, or they may purchase both forms of energy in combination as a 'dual fuel' tariff.

2.25 Electricity tariffs are generally one of two types:

(a) Acquisition tariffs – these are tariffs offered to new customers or existing customers choosing a new tariff. They are usually fixed-term contracts

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[35] Household expenditure, ONS (financial year (FY) ending 2017).
[36] See Smarter Markets Programme, Ofgem.
[37] As a result of this, an energy customer will need to have a reasonable estimate of his/her annual level of consumption of electricity or gas in order to make comparisons between tariffs with different standing charges and unit rates.

(FTCs) sold at a fixed price for a fixed period of time, eg one, two or three years. They may have 'exit fees' where a customer chooses to leave the tariff before the fixed time period has expired. Some suppliers also offer variable acquisition tariffs.

(b) Default tariffs – these apply where a customer has not chosen a specific tariff. For example, on expiry of an FTC, a customer will generally be rolled onto a default tariff if they do not make an active choice of alternative tariff. Default tariffs are usually standard variable tariffs (SVTs) – these tariffs continue indefinitely, vary in price over time and do not have 'exit fees'. Following recent regulatory changes by Ofgem, some suppliers are beginning to utilise 'default FTCs', typically one-year fixed rate tariffs with no exit fees, after which customers will then be rolled onto a further default FTC.

2.26 Default tariff prices are significantly higher than acquisition tariff prices (see Figure 16). Ofgem's 2017 'State of the energy market' report noted that since the EMI 'price differences between variable tariffs and fixed tariffs have widened'.[38]

Energy retailers

Introduction

2.27 In this section we provide an overview of the energy retailers; first setting out some key characteristics of SSE Retail and Npower, before outlining the market size, details of the major suppliers, entry, market shares and customer profiles.

Key characteristics of SSE Retail and Npower

2.28 Table 1 sets out some key descriptive statistics for SSE Retail and Npower (see Section 4 for a more detailed overview of the Parties).

[38] State of the energy market 2017 report, Ofgem (31 October 2017), page 6.

Table 1: Descriptive statistics for SSE Retail and Npower

	SSE Retail		*Npower*	
Number of customers (million, April 2018)*	3.091		2.280	
Proportion of customers on SVTs (%)*	69		44	
	Gas	*Electricity*	*Gas*	*Electricity*
Revenue (£m, 2017)	1,408	2,403	944	1,431
Number of accounts (million, year end 2017)†	3.913	2.591	2.670	1.906
Market shares (%, Q1 2018)	11	14	8	9

Source: SSE Consolidated Segmental Statement (CSS) for the year ending 31 March 2018, page 2; RWE – UK Generation & Npower Supply CSS for the year ending 31 December 2017, page 5; Retail Market Indicators, Ofgem.
Notes:
* Excludes prepayment customers.
† Where a customer has a dual fuel contract, this is counted as two separate accounts.

Market size

2.29 Residential households spend around £30 billion on gas and electricity each year, an average of around £1,123 per household. Businesses, charities and public bodies spend an additional £20 billion each year.[39]

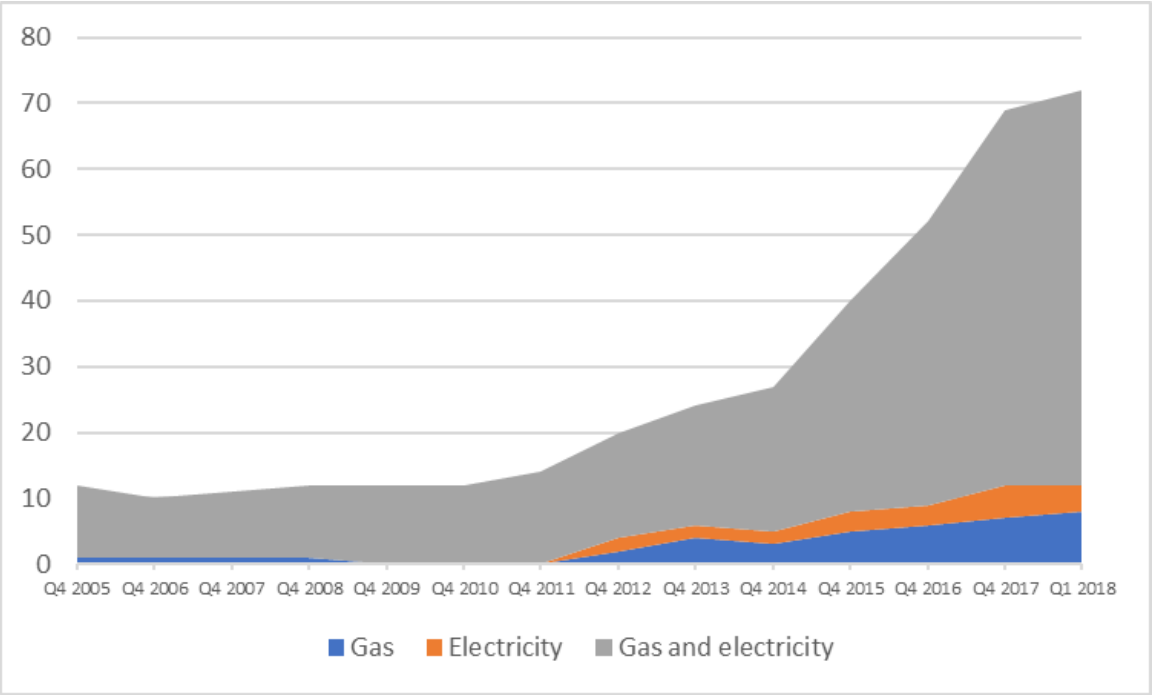
Overview of domestic energy retailers

2.30 As of March 2018, there were 72 energy retailers supplying domestic customers in GB (see Figure 3). There are 60 energy retailers supplying both electricity and gas, eight energy retailers supplying gas only and four energy retailers supplying electricity only.[40]

2.31 In recent years, there has been significant entry and expansion by new suppliers in the domestic energy retail supply market. The total number of suppliers in the domestic energy market increased considerably in the last two years compared with 40 suppliers in December 2015. There were 20[41] new domestic energy retailers during 2017 and in the first quarter of 2018, there were three new energy retailers.

[39] State of the energy market 2017 report, Ofgem (31 October 2017), page 6.
[40] Number of active domestic suppliers by fuel type (GB), Ofgem (March 2018).
[41] Excluding three supplies (Brighter World Energy, Future Energy and GB Energy), that had ceased trading.

Figure 3: Number of active domestic energy retailers by fuel type (GB), Q4 2005 – Q1 2018



Source: Number of active domestic suppliers by fuel type (GB), Ofgem (March 2018).

2.32 There are Six Large Energy Firms (SLEFs) and 66 small and mid-tier suppliers (SAMS), mainly active in both electricity and gas.

(a) The SLEFs (or 'large energy firms') are British Gas (now part of Centrica plc), E.ON UK plc (E.ON), EDF Energy plc (EDF), Npower, Scottish Power Ltd (ScottishPower) and SSE. These firms are the former monopoly providers of gas (Centrica) and electricity (E.ON, EDF, Npower, ScottishPower and SSE) to GB customers.

(b) The largest energy retailers within the SAMS for domestic energy are First Utility, Ovo Energy, Utilita and Utility Warehouse.

2.33 Historically, all of the SLEFs were vertically integrated in respect of electricity (ie active in both generation and retail) while Centrica was also vertically integrated in respect of gas (ie active in both upstream production and retail). However, in recent years some of the SLEFs have separated their generation and retail activities.[42] Both ScottishPower and SSE also have interests in electricity transmission and gas and electricity distribution.

[42] E.ON has now de-merged its conventional power stations (coal, gas and hydro) from its retail and renewables operation, which implies a large degree of vertical separation. innogy SE (innogy) was formed through the restructuring of RWE AG (RWE) whereby the renewables, grid and retail divisions of RWE were de-merged from RWE's conventional power generation and trading activities. SSE is carrying out an internal reorganisation that

Domestic energy retailer market shares

2.34 Together, the SLEFs' combined market shares as of Q1 2018 accounted for just under 80% of domestic customers in GB (for both electricity and gas), having declined from a combined market share of around 95% in 2013.[43] The SAMS increased their market share over this period from 5% to over 20%. The Merger is bringing together the third and sixth largest domestic energy suppliers in GB.[44]

Market shares in retail electricity supply

2.35 Figure 4 below shows the domestic electricity market shares of the SLEFs and the SAMS between Q1 2006 and Q1 2018.

(a) The market share of each of the SLEFs has fallen between Q1 2006 and Q1 2018, although during this period British Gas' and SSE's market shares first increased until 2013 and 2011 respectively before steadily decreasing. E.ON's and Npower's market shares decreased the most while the market shares of the other SLEFs reduced marginally.

(b) The Merger brings together the second and sixth largest players in GB domestic electricity supply. Npower's share of the domestic electricity market has fallen steadily from 15% in Q1 2006 to 9% in Q1 2018, while SSE's share has decreased from 16% in Q1 2006 to 14% in Q1 2018, having peaked at 20% in Q1 2009.

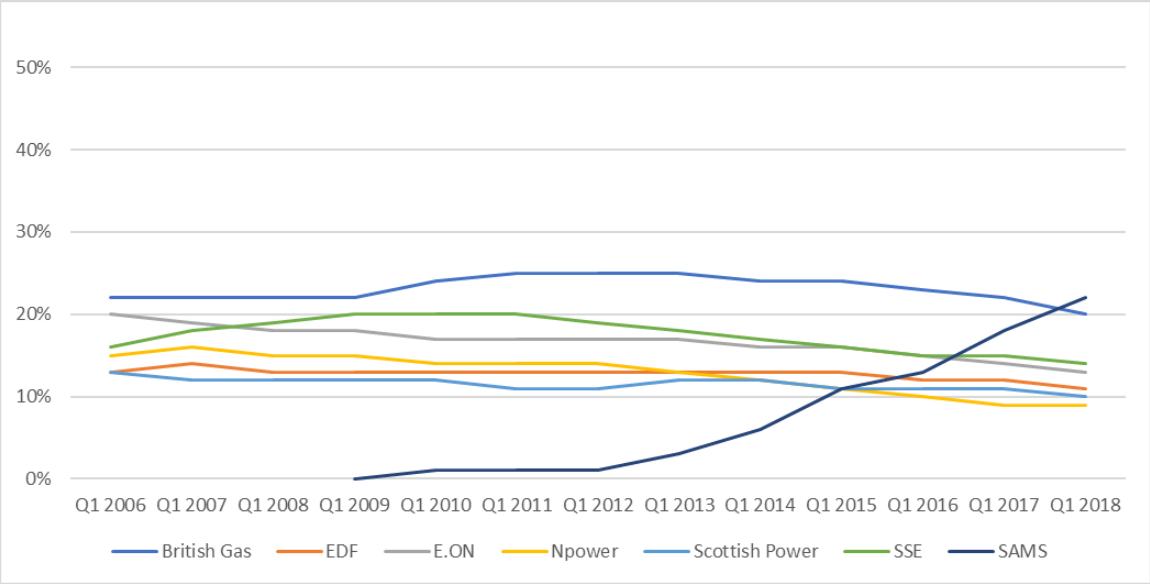
(c) The combined market share of all of the SAMS increased over the last five years to above 20% in Q1 2018. Among the SAMS, First Utility and Ovo Energy hold the largest share with 3% each, which is relatively low when compared to the 9% market share of the smallest of the SLEFs (Npower).

will separate the domestic retail energy supply businesses that SSE will contribute to MergeCo (the new merged entity resulting from the Merger) from the non-domestic energy supply businesses it will retain.

[43] Market shares from the number of meter points on the electricity and gas distribution networks.

[44] As measured by the number of customer accounts (counting dual fuel customers as having two accounts).

Figure 4: Domestic electricity supply market shares in GB by energy retailer, Q1 2006 – Q1 2018



Source: Electricity supply market shares by company: Domestic (GB), Ofgem (March 2018).

Market shares in retail gas supply

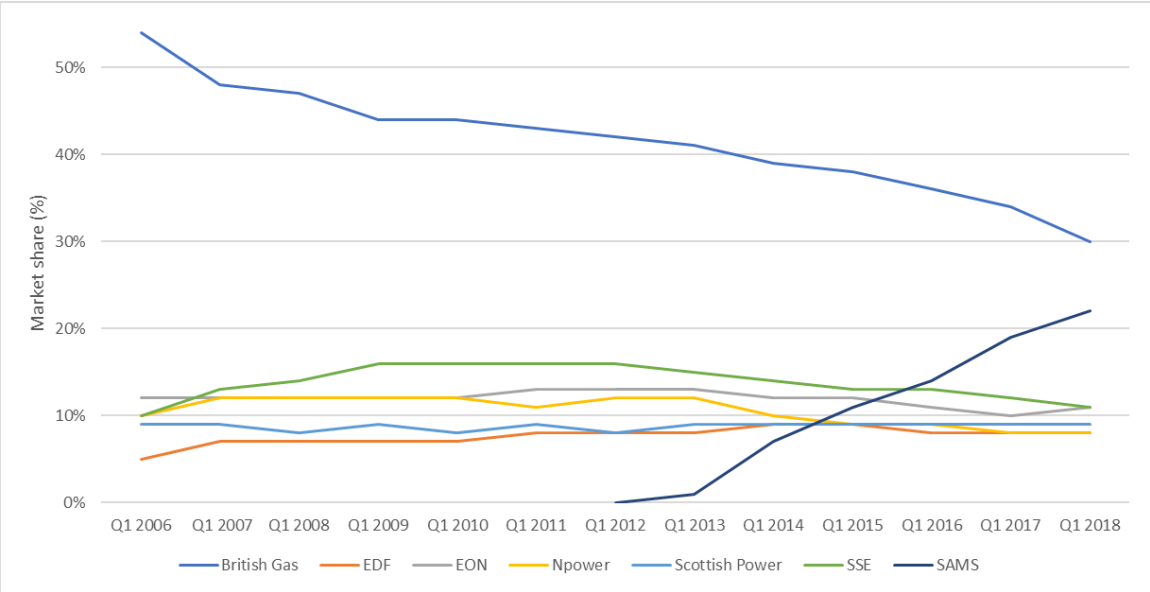
2.36 Figure 5 below shows the retail gas market shares of the SLEFs and the SAMS between Q1 2006 and Q1 2018:

(a) British Gas' market share has fallen consistently from 54% in Q1 2006 to 30% in Q1 2018. EDF's and ScottishPower's market shares have remained relatively stable, while the other SLEFs' market shares have reduced marginally.

(b) The Merger brings together the second (equal) and fifth (equal) largest players in GB domestic gas supply. Npower's share of the domestic gas market has reduced from 10% in Q1 2006 to 8% in Q1 2018, peaking at 13% in Q1 2013. SSE's share increased consistently from 10% in Q1 2006 peaking to 16% in Q1 2012, before declining to 11% by Q1 2018.

(c) The combined market share of all of the SAMS increased over the last five years to above 20% in Q1 2018. Among the SAMS, First Utility and Ovo Energy hold the largest share with 3% each, which is relatively low when compared to the 8% market share of the smallest of the SLEFs (Npower).

Figure 5: Domestic gas supply market shares in GB by energy retailer, Q1 2006 – Q1 2018



Source: Gas supply market shares by company: Domestic (GB), Ofgem (March 2018).

Regional shares of supply

2.37 The shares of supply of SSE Retail and Npower in their respective former PES regions are shown in Table 2. In some of their former regions, the Parties have higher market shares, such as the former SSE regions of Southern and South Wales, and especially North Scotland. We consider whether conditions of competition differ regionally and whether there are regional markets in paragraphs 7.26 to 7.34.

Table 2: Shares of supply of energy by PES region (by number of accounts, 2017)*

%

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

Source: Parties' submission based on Ofgem data.
*The customer data distinguishes between dual fuel, electricity or gas customers eg a customer who has both electricity and gas connection from a supplier are counted as two different customer accounts.

Growth of the SAMS

2.38 The lower acquisition tariff prices offered by the SAMS has resulted in an increase in their collective market share from 5% in 2013 to over 20% in Q1 2018. As noted above, among the SAMS, First Utility and Ovo Energy hold the largest shares with 3% each.

2.39 As the collective market share of the SAMS has increased, the market shares of each of the SLEFs has fallen (see Figure 4 and Figure 5 above).

2.40 Given that a significant number of customers have not switched supplier recently and the increase in the SAMS market share, the SAMS' share of switching customers gained is greater than their market share of all customers. This is illustrated by the Parties' aggregate switching data which shows that in 2017 over half of customers who switched away from each of the Parties switched to one of the SAMS (see Table 14); the proportion of customers switching to the SAMS has increased over time, rising from just over [✂]% in 2015.

SLEFs customer profiles

2.41 Figure 6 below shows the number of non-prepayment domestic customers of the SLEFs by tariff type at March 2018 compared with October 2017 (in which dual fuel customers are counted as one customer account).

(a) Across the SLEFs, SVT customers comprise 57% of households (11.1 million out of 19.8 million households) compared to 59% in October 2017.

(b) FTC customers comprise 41% (8.2 million) of households, compared with 39% (8.2 million) in October 2017, with 1% (0.2 million) of customers now on a 'default FTC'.

(c) The remaining 2% (0.35 million) of customers are on 'other non-SVTs'.[45]

2.42 SVT customers are split between 35% (6.9 million) who have been on a SVT for more than three years (36% (7.7 million) in October 2017), and 21% (4.3 million) who have been on a SVT for less than three years (23% (4.8 million) in October 2017).

[45] 'Other non-SVTs' is a supply contract with an indefinite length that does not have a fixed-term applying to the terms and conditions and has also associated rewards schemes, bundles or added services.

2.43 The proportion of non-prepayment domestic customers on the various tariffs varies significantly across the SLEFs. As of March 2018:

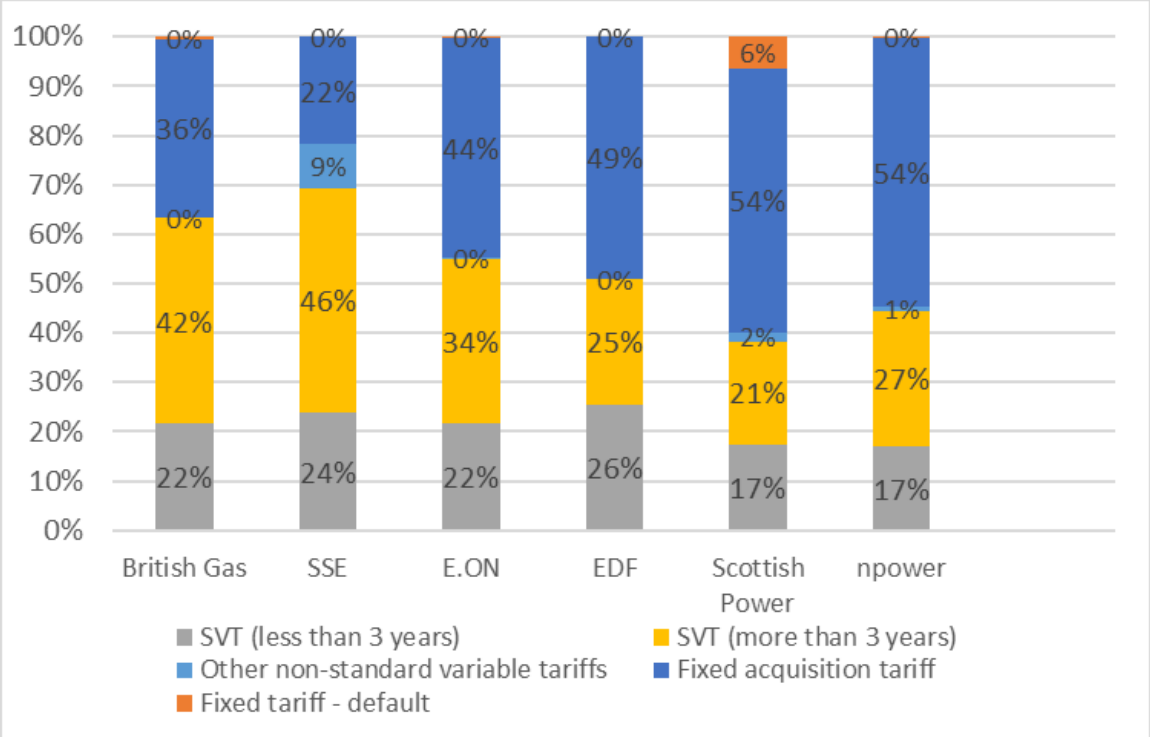
(a) SSE has the highest proportion of SVT customers at 69% (2.1 million), followed by 63% (3.9 million) for British Gas, 55% (1.8 million) for E.ON, 51% (1.4 million) for EDF, 44% (1.0 million) for Npower and 38% (0.9 million) for ScottishPower;

(b) SSE has the lowest proportion of FTC customers at 22% (0.7 million), followed by 36% (2.2 million) for British Gas, 44% (1.4 million) for E.ON, 49% (1.3 million) for EDF, 54% (1.3 million) for ScottishPower and 54% (1.2 million) for Npower;

(c) ScottishPower has the largest proportion of customers on 'default FTC' at 6.4% (0.15 million), followed by 0.4% (27,000) for British Gas, 0.4% (12,000) for E.ON and 0.2% (4,000) for Npower; and

(d) SSE has the highest proportion of other non-SVT tariff customers at 9% (0.3 million), followed by 2% (42,000) for ScottishPower, 1% (24,000) for Npower and 0.3% (10,000) for E.ON.

Figure 6: Number of non-prepayment domestic customers, as of April 2018



Source: Number of non-price protected domestic customer accounts by supplier: Standard variable, fixed and other tariffs (GB), Ofgem (April 2018).
Note: 'Other non-standard variable tariff' supply contracts with an indefinite length that does not have a fixed-term applying to the terms and conditions and has also associated rewards schemes, bundles or added services.

Regulatory and policy framework

2.44 The regulatory and policy framework governing the energy sector in GB is set out in UK and European Union (EU) legislation, licences, and industry codes.

Ofgem and the current regulatory framework

2.45 Ofgem is responsible for the economic regulation of the gas and electricity sectors in GB. In broad terms, this involves price regulation of those segments of gas and electricity that are natural monopolies – namely, transmission and distribution – and developing rules and regulations that shape the nature of competition in wholesale and retail markets.

2.46 Ofgem exercises its functions through granting licences and determining the content of Standard Licence Conditions, which themselves require compliance with detailed industry codes, which set out the rules for operating in the relevant markets.

Licences

2.47 Under the Gas Act 1986 and Electricity Act 1989, certain activities concerning gas and electricity can only be carried out with a licence. These are the primary means by which Ofgem regulates and enforces obligations placed on the relevant operators in the gas and electricity sectors. Ofgem also has powers to impose enforcement orders and, since 2014, customer redress orders.

Codes

2.48 Industry codes define the terms under which the industry participants can access the electricity and gas networks, and the rules for operating in the relevant markets. Licensees are required to comply with specified industry codes in accordance with the terms and conditions of their licences.

Energy Market Investigation

2.49 The EMI was an in-depth review of the energy market in GB between 2014 and 2016 conducted by the CMA. The investigation made a number of findings in respect of retail domestic energy markets, including that an overarching feature of weak customer response gave rise to an adverse effect on competition (AEC) (the Domestic Weak Customer Response AEC), that in turn gave energy suppliers a position of unilateral market power in respect of

their inactive customer base.[46] The CMA observed that 70% of domestic customers were on more expensive 'default' SVTs despite competitively priced FTCs being available.[47]

2.50 The CMA found that this 'weak customer response' was the result of:

(a) Customers' limited awareness of and interest in their ability to switch energy supplier, which arose in particular due to the homogeneous nature of the product and the role of traditional meters and billing practices which customers found confusing and unhelpful.

(b) The existence of actual and perceived barriers to accessing and assessing information, resulting from the complexity of bills and tariff structures and, in some cases, a lack of confidence in and access to price comparison websites (PCWs[48]).

(c) The existence of actual and perceived barriers to switching.

2.51 The CMA found that the barriers to accessing and assessing information and to switching were particularly significant for customers with prepayment and restricted meters.

2.52 The CMA also identified that certain features of the markets for the domestic retail supply of gas and electricity in GB, relating specifically to the prepayment segments, gave rise to an AEC (the Prepayment AEC). These features, in combination, reduced retail suppliers' ability and/or incentives to compete to acquire prepayment customers and to innovate by offering tariff structures that meet customers' demand.[49]

Remedies in the EMI

2.53 The CMA put in place a package of remedies to address the AECs it found. These remedies are described below and Section 3 includes details and progress on the remedies that are being implemented:

Domestic Weak Customer Response AEC remedies

(a) Requiring suppliers to give Ofgem details of all customers who have been on their default tariff for three or more years, to be put on a secure

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[46] EMI final report (24 June 2016), paragraph 9.283.
[47] EMI final report (24 June 2016), paragraph 102.
[48] PCWs compare prices and features for a particular consumer goods and service from various companies, these companies pay commission to the PCW for any sale through their websites.
[49] EMI final report (24 June 2016), paragraph 9.476.

database under Ofgem control for the purposes of allowing customers to be prompted with personalised offers, highlighting the savings from switching.[50]

(b) Recommending the introduction of an Ofgem-led programme of prompts designed to identify, test and introduce measures to promote customer engagement via new/additional information, eg changes to information on bills, including information on cheaper tariffs available across the market.

(c) Recommending various measures to enhance PCWs ability to improve engagement by allowing them to play a more active role in helping customers find the best offers for them and reducing the actual and perceived barriers associated with switching.

(d) Recommending various changes to the regulatory framework to stimulate more vigorous competition between suppliers.

Prepayment AEC remedies

(e) Introducing a temporary safeguard price control to protect approximately four million customers on prepayment meters,[51] whose options were more limited, and who experienced heightened features of the Domestic Weak Customer Response AEC, which would reduce their bills by a total of £300 million a year. This prepayment meter price cap (the PPM Price Cap) was introduced on 1 April 2017 and will remain in place until at least 31 December 2020, and could be extended on an annual basis to 2023.

Restricted meter AEC remedies

(f) Ordering all retail suppliers with more than 50,000 domestic customers to make all their single-rate electricity tariffs available to all domestic electricity customers on restricted meters,[52] without being conditional on replacement of their existing meters. In addition, this remedy requires all suppliers to provide restricted meter customers with further information and prompts to facilitate switching. The CMA recommended that Citizens

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[50] EMI final report (24 June 2016), paragraphs 11.65 and 13.11.
[51] Prepayment meters are not generally a choice on the part of the customer, all customers on prepayment meters must pay by prepayment. Prepayment meters are generally installed where a customer has a poor payment history or in certain types of rented accommodation and premiums paid by dual fuel SVT prepayment customers were about £75–£80 per year (EMI final report (24 June 2016), paragraph 105).
[52] The EMI found that customers on restricted meters faced higher barriers to access information, and that customers faced actual and perceived barriers to switching supplier and/or tariff for restricted meter customers (EMI final report (24 June 2016), paragraph 150).

Advice becomes a recommended provider of information and support to domestic electricity customers on restricted meters.

3. Customer behaviour

3.1 Understanding customer behaviour is important in understanding the nature and extent of competition, and to assess the potential effects of the Merger. This is particularly so given the findings of the EMI on 'weak customer response'. In this section, we consider evidence relating to customer behaviour and in particular:

(a) evidence regarding the level of customer engagement in the energy sector and recent trends in these levels (see paragraphs 3.5 to 3.12);

(b) evidence regarding the different stages of customer engagement (see paragraphs 3.13 to 3.29);

(c) measures to increase customer engagement – this includes a summary of the findings of Ofgem's recent trials which aim to increase levels of customer engagement (see paragraphs 3.30 to 3.37) (for further details see Appendix B), and

(d) measures to protect customers – this includes an outline of the measures that the government is putting in place to protect disengaged customers (see paragraphs 3.38 to 3.49).

3.2 A number of different measures of engagement (and disengagement) have been used in analysing customer behaviour in the energy market, and there is no single measure that reflects fully the nuances of engagement. For example, in its 2017 consumer engagement survey, Ofgem defined a respondent as having engaged in the past 12 months if they had searched for or switched tariff or supplier.[53] In the EMI, for the purposes of the Database Remedy, the CMA defined 'Disengaged Domestic Customers' as those who had been on their supplier's default tariff for three or more years.[54]

3.3 These different measures of engagement and disengagement are useful in exploring the various different dimensions of the issue. We have therefore not found it necessary to settle on a single definition of the term engagement (or disengagement). Throughout this report when we refer to customer engagement and disengagement, we are distinguishing between those

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[53] In 2017 GfK NOP Ltd (GfK) undertook a survey of 4,001 energy customers for Ofgem (GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 6).
[54] EMI final report (24 June 2016), paragraph 11.64.

customers who have recently considered whether they are on an appropriate tariff and have chosen a supplier and tariff accordingly, from those who have not.[55]

3.4 Since disengaged customers are those who have not actively considered their choice of energy supplier, these customers will typically be on default tariffs. However, it is not necessarily the case that all default tariff customers are disengaged. For example, an otherwise engaged customer may be on a default tariff temporarily following a home move or having come to the end of a fixed term acquisition tariff. Alternatively, some customers (usually those with low consumption levels) may find that a default tariff is the best tariff for them.

Levels of and recent trends in customer engagement

3.5 It is clear that a significant proportion of customers are engaged in the energy market. Ofgem's 2017 consumer engagement survey found that 41% of customers had 'engaged in the energy market' in the past 12 months.[56] Similarly, Ofgem's 2017 'State of the energy market' report found that in June 2017 almost 17% of customers had switched supplier in the previous 12 months.[57]

3.6 It is also apparent that customer engagement has increased since the EMI. Figure 7 shows that there was:

(a) A gradual decline in the rate of customers switching supplier between 2010 and late 2014. The EMI identified a number of potential reasons for this decline including the prohibition of regional price discrimination, the end of door step selling and the introduction of a number of changes following Ofgem's Retail Market Review.[58]

(b) A notable spike in customers switching supplier in November 2013. This followed four of the SLEFs making price increase announcements within 14 days of each other in October 2013.

(c) A gradual increase in customers switching supplier since late 2014 such that customer switching has now returned to the level seen prior to

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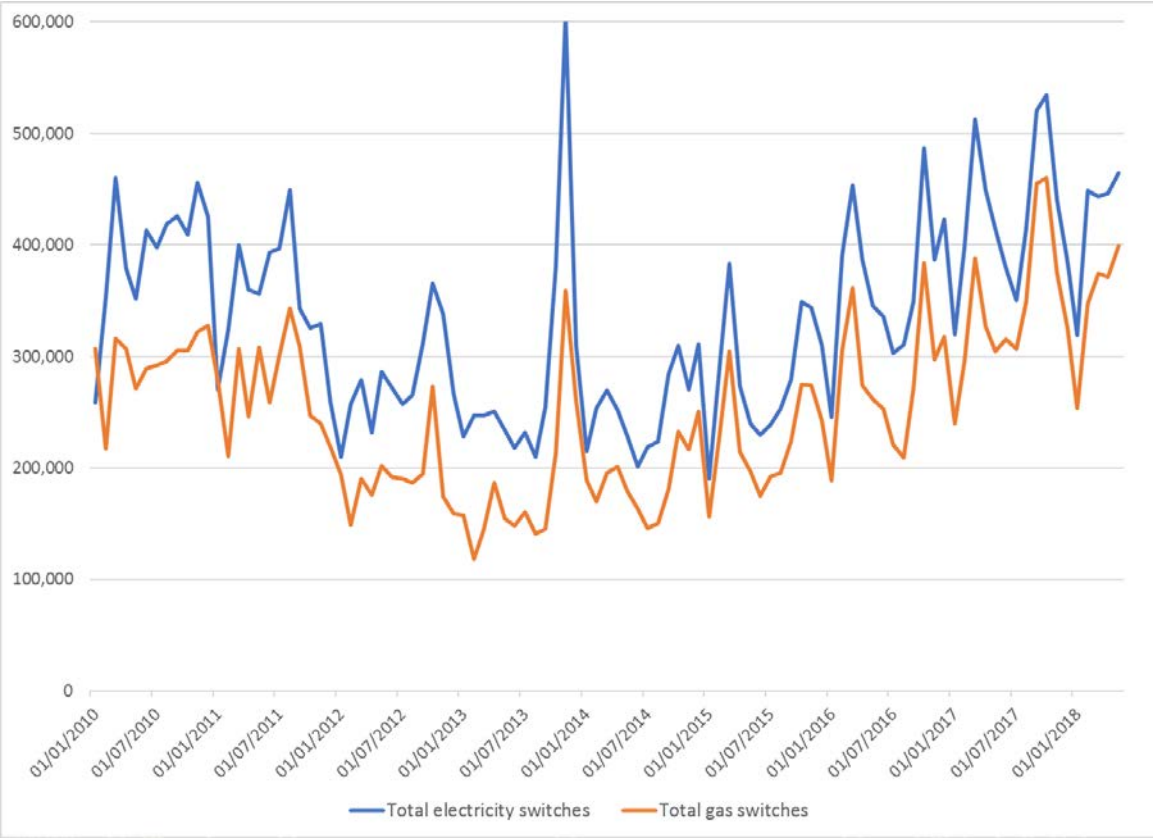
[55] In other words, disengagement is the situation where customers do not consider (or believe they cannot act on) exploring the market to seek alternative suppliers and tariffs.
[56] As noted above, engagement in this context was defined as having switched supplier, changed tariff or compared tariff with their own or other suppliers in the past 12 months (GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 1).
[57] State of the energy market 2017 report, Ofgem (31 October 2017), page 25.
[58] EMI final report (24 June 2016), paragraphs 8.142 and 11.139.

2011.[59] As noted above, Ofgem's 2017 'State of the energy market' report found that in June 2017 16% of customers had switched supplier in the previous 12 months, an increase from 11% in 2015 and the highest level of customer switching since August 2011.[60]

Figure 7: Number of customers switching supplier per month, Q1 2010 – Q2 2018



Source: Number of domestic customers switching supplier by fuel type (GB), Ofgem (July 2018).

3.7 The increase in the proportion of customers switching supplier has assisted the growth of the SAMS, who have increased their market share from around 5% in 2013 to over 20% in Q1 2018.

3.8 However, despite these increases in customer switching, there continue to be a significant number of disengaged customers. As Ofgem has noted 'despite increasing engagement, a large proportion of consumers remain unengaged'.[61]

[59] This is consistent with Ofgem's 2017 consumer engagement survey. As noted above, 41% of respondents had switched supplier, changed tariff or had compared suppliers or tariffs in the past 12 months. This compares to 37% of respondents in the 2016 survey and 34% in 2014 (GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 9).
[60] State of the energy market 2017 report, Ofgem (31 October 2017), page 25.
[61] State of the energy market 2017 report, Ofgem (31 October 2017), page 26.

3.9 For example, while 41% of customers engaged in the past 12 months,[62] 59% of customers did not. In addition, each of the SLEFs has a substantial proportion of customers who have been on SVTs for three or more years (between 21% and 46% of their customer base),[63] indicating that many default tariff customers have been on these tariffs for a significant period of time. As noted above, while a default tariff may be the best tariff for some customers, this is likely to be a relatively small percentage.[64]

3.10 We have not undertaken a full assessment of the potential gains from switching. However, we note that the difference between the average SLEF SVT price and the cheapest acquisition tariff on the market is approximately £300 per year, suggesting that customers on SLEFs' SVTs could likely make substantial savings by switching tariff and/or supplier. We therefore consider it likely that the majority of those customers who have been on SLEFs SVTs for three or more years could be considered disengaged.

3.11 Once a customer becomes engaged, it is also not necessarily the case that they will remain consistently engaged thereafter. There is a spectrum of engagement from those customers who engage regularly to those who are entirely disengaged, and some who engage in the market at one point in time can become disengaged again at a later date. For example, a significant proportion of customers rollover onto a default tariff at the end of an acquisition tariff (ie the customer has engaged in the past but does not engage immediately following the end of their acquisition tariff).

3.12 In their submissions, suppliers set out the proportion of customers they expect to rollover onto their default tariff at the end of an acquisition tariff's fixed term with current estimates ranging from marginally over 20% to marginally over 40%.[65] However, we do not have clear evidence relating to how long these customers remain on default tariffs, and therefore the extent to which these customers could be considered to be no longer engaged in the energy market.

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[62] GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 1.
[63] As of July 2018 (see Retail Market Indicators, Ofgem).
[64] This is also reflected in the evidence that the vast majority of customers gained by the Parties are switching to an acquisition tariff (see Appendix H).
[65] Npower's evidence indicates that, for its current conventional meter acquisition tariffs, it assumes that between [✂]% and [✂]% of customers will transition to a default tariff at the end of the contract's fixed term depending on the fixed term tariff in question. SSE submitted that [✂]% of its FTC customers transition to SSE's SVT at the end of an FTC. ScottishPower submitted that default rates at tariff maturity was [✂]% for contracts which matured in 2017. E.ON submitted that for FTCs maturing in 2017 the proportion of customers reverting to E.ON's default SVT was [✂]%. However, [✂] in Q1 2018 the equivalent figure was [✂]%.

Stages of customer engagement

3.13 We have received a wide range of evidence regarding the reasons for customer disengagement, the prompts which lead customers to engage and the factors which determine a customer's choice once they decide to engage with their choice of tariff or supplier.

3.14 In this section, we consider the following stages that previously disengaged customers may undergo when engaging with the market, and consider each one in turn:

(a) customers' awareness of their ability to switch tariff or supplier;

(b) reasons for customer disengagement;

(c) specific triggers of engagement; and

(d) drivers of choice once a customer has decided to engage with the market.

Customers' awareness of their ability to switch tariff or supplier

3.15 Many customers are aware of their ability to switch supplier, although a not insignificant minority continue to be unaware of their ability to do so. In Ofgem's 2017 consumer engagement survey, 86% of respondents were aware that they could switch supplier.[66]

3.16 In addition, 77% of customers were aware that they could switch tariff with their current supplier.[67] Even among those who had never switched, seven in ten were aware of their ability to switch supplier, tariff or payment method.[68]

Reasons for customer disengagement

3.17 There are a number of factors that affect the willingness of some customers to engage with their choice of energy tariff or supplier.[69] These include:

(a) a lack of awareness of potential savings which can be made by switching tariff or supplier;[70]

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[66] GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 46.
[67] GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 46.
[68] GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 47.
[69] These factors are consistent with those identified in Npower's research exploring the drivers of disengagement in SVT customers. It identified [✂].
[70] For example, Cheaper Market Offers Letter Trial, Ofgem (summer 2017), paragraph 1.4.

(b) that potential savings might not materialise or might not be as significant as expected;[71]

(c) concerns that the switching process might go wrong leading to a customer being billed twice or the customer being cut-off;[72] and

(d) customers are happy on their current tariff, or see it as being 'good enough'.[73]

3.18 Some of these factors are likely to apply more to switching supplier (such as customers' concerns that they may get cut-off), while others are likely to apply equally to customers considering switching tariff with the same supplier (eg a lack of awareness of potential savings).

3.19 These factors explain why a substantial number of customers continue to be disengaged despite the significant potential benefits available if a customer switches supplier or tariff. As we discuss in paragraphs 3.30 to 3.37 below, efforts are being made to reduce the barriers to switching that exist (for example, through the implementation of the EMI remedies[74] and Ofgem's Switching Programme[75]).

Specific triggers of engagement

3.20 In light of the above we have considered what prompts customers to begin to engage with their choice of energy supplier or tariff. The evidence illustrates that a range of factors prompt customers to engage (see Appendix B) including:

(a) Communications from suppliers, eg fixed term tariff notices, price increase notices or bills and statements.[76]

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[71] 28% of respondents to Ofgem's 2017 consumer engagement survey expressed a concern that costs might increase and 20% of respondents expressed a concern that they might not save as much as they thought (GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 52).
[72] The possibility of being billed twice was referred to by 14% of respondents and the possibility of being cut-off was referred to by 10% of respondents (GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 52).
[73] See Appendix B.
[74] EMI final report (24 June 2016).
[75] See Switching Programme: Outline Business Case, Ofgem (12 February 2018).
[76] For example, supplier communications were the most frequently cited prompt by respondents to Ofgem's 2017 consumer engagement survey (GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 56). Npower also provided evidence that its customer call volumes increased a few days following its SVT price announcement (while volumes immediately after the announcement were only slightly above the average) and this is consistent with the receipts of price change notification letters prompting increased customer engagement.

(b) Media coverage which encourages customers to consider switching supplier, eg at the time of an SVT price change announcement. The role of the media in encouraging customer switching is discussed in the Parties' submissions,[77] the Parties' internal documents,[78] and submissions from third parties.[79] We note that media coverage can refer to a wide range of activities including press coverage and advertising by PCWs and competitors.

(c) Poor customer service which leads customers to consider switching supplier.[80]

3.21 In relation to paragraph 3.20(b), the Parties submitted that media attention to price changes does not have a meaningful impact on customer engagement and is a significantly less important prompt for engagement than supplier communication. To support this submission the Parties referred to a number of surveys in which customers cited supplier communications more frequently than media coverage as their prompt for customer engagement.

3.22 We note the following:

(a) We have some doubts about the ability of customers to accurately recall precisely what prompted them to engage with the energy market at such a fine level of detail, especially when it may be some time after the event and when they are likely to receive multiple prompts simultaneously.[81]

(b) As noted above, the evidence from suppliers indicates that media coverage is a significant factor which can prompt increased customer engagement.

3.23 Therefore, we do not agree with the Parties' submission that media coverage does not have a meaningful impact on customer engagement. SVT price increases result in both communications from suppliers and an increase in media coverage. In our view, the evidence shows that both supplier

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[77] For example, SSE stated that '[✂]' (Parties Initial Submission (response to CMA phase 1 decision) (30 May 2018), paragraph 5.39 (iv)).
[78] See Appendix F for evidence of the consideration the Parties give to the likely media reaction when setting SVT prices. We have also received evidence that the media can prompt increased customer engagement at other times. For example, [✂] internal documents discuss the effect of a TV programme by Martin Lewis on customer switching and engagement.
[79] For example, [✂] noted that being the first large supplier to announce an SVT price increase 'will have the impact of significant media coverage resulting in customer losses'. [✂] also noted 'that being the first supplier to announce a price rise leads to disproportionate customer losses as a result of negative media coverage'.
[80] For example, respondents to [✂] mentioned [✂] as reasons for leaving [✂].
[81] This is consistent with the observation in Ofgem's 2017 consumer engagement survey that a fixed term tariff notice was a commonly cited prompt by customers who had switched for the first time in the last 12 months (ie former SVT customers) (see GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 56) but this is not a prompt which is received by SVT customers, and so was irrelevant to default tariff customers at the time of the survey.

communications and media coverage prompt customer engagement. However, as we discuss further in Appendix B we have not received evidence which allows us to identify precisely which of these two factors is more important in prompting the increase in customer engagement.

3.24 The evidence mentioned in paragraph 3.20 and Appendix B concerned the factors which prompt customers in general to engage with their choice of energy supplier. The evidence we have received indicates that broadly the same factors lead previously disengaged customers to engage with their choice of energy supplier. As we discuss in paragraphs 8.23 to 8.30 and Appendix H, SVT price increases prompt material increases in engagement by SVT customers. Therefore, such events likely lead many previously disengaged customers to engage with their choice of energy supplier.

3.25 As discussed in paragrgraphs 3.26 to 3.29 below, evidence indicates that once a customer is engaged, the primary motivation for switching is to benefit from lower acquisition tariff prices and that an engaged customer is more likely to switch the larger the potential savings available. However, this is not the same as what motivates a customer to engage in the first place. We have not received clear evidence[82] that the precise price difference between SVT and acquisition tariff prices has a significant effect on the level of customer engagement (at least not given the current extent of the differences in these prices).

Drivers of choice once a customer has decided to engage with the market

3.26 Once a customer has decided to engage, price is the main driver of their choice. For example, Ofgem's 2017 consumer engagement survey asked customers who had engaged in the market in the last 12 months what their priorities had been when doing so. 91% of respondents stated that price (in some form) was a priority. The next most important factor for those who had engaged in the past 12 months was the possibility of getting better customer service which was a priority for only 9% of respondents.[83]

3.27 Likewise, the EMI survey found that price was the most important driver of choice, with 81% of survey respondents identifying factors relating to 'cost/tariff/price/rate' as important to them.[84] The EMI survey found that other factors, such as convenience, quality and value added or bundled services,

[82] For example, [✂] and despite the increase in customer engagement and expansion of the SAMS the difference between SVT and acquisition tariff prices appears to have increased in recent years.
[83] GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 55.
[84] EMI final report (24 June 2016), paragraph 8.12 and Appendix 9.1.

were important to some customers.[85] However, these were not as important as price-related factors.

3.28 An online Energy Satisfaction Survey conducted by Which? in 2017 showed that price was the main driver of a customer's choice of supplier, but also that customers considered a range of other factors to be important, such as a belief they would receive a better service, their supplier was recommended by energy experts and the good reputation of the supplier (see Appendix B).

3.29 We also received some evidence which indicates that a supplier's brand is a relevant consideration in the choice of supplier for at least some customers. For example, some customers may value switching to an established brand (such as one of the SLEFs). In particular:

(a) although the Parties do not generally offer the most price competitive tariffs (see Appendix G) they continue to attract significant numbers of customers to their acquisition tariffs (see Appendix H);[86]

(b) a substantial proportion ([✂]%) of the Parties' customers who switch externally switch to one of the other SLEFs despite the fact the SLEFs do not generally offer the most competitively priced tariffs;[87]

(c) in Ofgem's 'Cheaper Market Offers Letter Trial' only 7% of the tariffs on the letters were from the SLEFs but the SLEFs gained 38% of the customers who switched;

(d) suppliers choose to make investments in their brands and to maintain their brand recognition;[88] and

(e) customer survey evidence indicates that a supplier's brand is a relevant factor in the choice of supplier for at least some customers (see Appendix B).

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[85] EMI final report (24 June 2016), paragraphs 8.15–8.18 and Appendix 9.1.
[86] This is also reflected in the substantial proportion of internal switching observed in the Parties' switching data. This indicates a preference to switch to a familiar supplier despite the offer of larger savings by other suppliers.
[87] This is illustrated by Ofgem's comparisons of pricing across suppliers (see Cheapest tariffs by payment method: Typical domestic dual fuel customer (GB), Ofgem (July 2018)).
[88] For example, SSE described to us how it had 'spent a lot of time and effort recently trying to create a national brand'.

Measures to increase customer engagement

3.30 In this section, we focus on the principal measures to increase customer engagement relating to smart meter roll-out, domestic customer prompts (including the SVT database) and Ofgem's Switching Programme.

Smart meter roll-out

3.31 As part of government policy for upgrading the UK's energy system, in 2009 it required energy suppliers to roll-out the offer of smart meters to all domestic customers by 2020 to better match energy supply and demand.[89]

3.32 Ofgem is leading the Smart Metering Implementation Programme. It expects consumer benefits from smart meters to include lower energy consumption, load shifting from peak periods, improved consumer experience and engagement, easier switching between suppliers and reduced carbon emissions.[90]

3.33 In 2017, just under five million smart meters were installed, and with around nine million smart meters rolled-out to date, energy retailers are around one-fifth of the way to full smart meter roll-out (see Table 3 below).

Table 3: Domestic meters operated by large and small energy suppliers (December 2017)

Meters operated as at 31 December 2017	*Smart Meters*	*Smart-Type Meters*	*Traditional Meters*	*All Meters*
Large suppliers	8,762,500	813,600	36,879,500	46,455,500
Small suppliers	213,200	141,200	3,092,700	3,447,100
Large and small suppliers	8,975,700	954,800	39,972,200	49,902,600

Source: Smart Meters: Quarterly Report to end December 2017, Department for Business, Energy & Industrial Strategy (BEIS) (27 March 2018), Table 1, page 11.

Domestic customer prompts

3.34 Ofgem has established a dedicated customer engagement team to implement the EMI's domestic customer prompt remedies (which came into effect between December 2016 and April 2018). This includes the creation of an Ofgem-controlled database of disengaged customers on default tariffs and the establishment by Ofgem of a programme to provide customers with information to prompt them to engage.

3.35 Since late 2016, Ofgem has undertaken a number of randomised controlled trials to test the effectiveness of potential interventions aimed at increasing

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[89] See policy paper 2010 to 2015 government policy: household energy (updated 8 May 2015).
[90] See Smart Metering Implementation Programme – Prospectus, Ofgem (July 2010).

customer engagement. (Appendix B summarises Ofgem's engagement trials in more detail.) These were:

(a) Database Remedy – Under this trial, rival suppliers were able to send six marketing letters to customers who had been on a default tariff for three or more years;

(b) Best Offers Letter – Under this trial Ofgem wrote to customers, presenting three cheaper tariffs to them;

(c) Cheaper Market Offers Letter – Ofgem undertook a randomised controlled trial to explore whether sending customers a 'Cheaper Market Offers Letter' increased customers' engagement with the domestic energy markets;

(d) Check Your Energy Deal – In this trial, customers who had been on a default tariff for three or more years were told that they were on an expensive tariff and were shown cheaper deals and routes through which they could switch to these deals; and

(e) Active Choice Collective Switch – This trial was designed for a group of customers who had been on default tariffs for three years or more to negotiate a collective switch tariff.

3.36 Ofgem qualitative research from the trials above found that there was an increase in engagement for customers and that the letters prompted some customers to look on PCWs, or call their supplier to negotiate a cheaper tariff. Ofgem found that having an offer from a SLEF on the letter was not correlated with customers' propensity to switch, although it noted that some customers value switching to a brand they recognise. It also noted that a lack of brand awareness was a barrier to switching to small suppliers for some customers.

Switching Programme

3.37 Ofgem is to initiate a Switching Programme (expected to be launched in April 2020[91]) to provide for faster and more reliable switching, including switching by the end of the next working day after a request. The reform package is aimed at improving industry processes, creating new central systems, and harmonising gas and electricity switching arrangements.[92]

[91] See Switching Programme: Transitional Phase High Level Plan, Ofgem (February 2018).
[92] See Switching Programme: Outline Business Case, Ofgem (12 February 2018).

Measures to protect consumers

3.38 In this section we focus on recent measures to protect consumers relating to the PPM Price Cap, social and environment schemes and the forthcoming Default Tariff Cap. These measures are motivated by the perception that a significant number of customers in particular groups are currently unable or feel unable or unwilling to engage and switch provider and tariff to take advantage of competition, due to a variety of barriers, or that competition is not working well for them.

PPM Price Cap

3.39 The PPM Price Cap is one of the remedies introduced following the EMI and is due to expire at the end of 2020 when the smart meter roll-out is expected to have been completed. The linking of the PPM Price Cap to the smart meter roll-out reflected the expectation that smart meters will help to increase prepayment customer engagement and address weak customer response.

3.40 The CMA has committed to review the PPM Price Cap with reference to the extent of smart meter roll-out in early 2019. The CMA could remove the PPM Price Cap prior to the end of 2020 to the extent that the smart meter roll-out proceeds more rapidly than originally expected. In contrast, if smart meter roll-out is delayed, the CMA may recommend to Ofgem that the duration of the PPM Price Cap be extended beyond the December 2020 deadline.

3.41 In February 2018, Ofgem extended the CMA's PPM Price Cap to a further one million vulnerable customers receiving the Warm Home Discount (WHD).[93] The PPM Price Cap is set at £1,089 per year and is due to rise to £1,136 per year for dual fuel customers in October 2018.[94]

Social and environment schemes on energy retailers

3.42 Ofgem delivers social and environmental programmes on behalf of government. These programmes include renewable heat and electricity, energy efficiency and fuel poverty. The following are the main schemes for social and environmental obligations:

(a) Government-funded benefits to customers not paid by energy retailers, such as:

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[93] See Decision to extend the PPM safeguard tariff to those consumers in receipt of Warm Home Discount, Ofgem (7 December 2017).
[94] See Ofgem increases level of safeguard tariff due to higher wholesale costs, Ofgem (7 August 2018).

(i) Winter Fuel Payments – a cash transfer, initially introduced in 1997, to households containing someone over the female state pension age. In 2017/18 the payment is £150, rising to £300 if someone is aged 80 or over.[95]

(ii) Cold Weather Payments – another form of cash transfer, introduced in 1986, to vulnerable households to meet the cost of higher energy bills in periods of cold local weather. The payment is currently £25 following every seven-day period in which temperatures are forecast to fall below 0°C. Eligible households include those in receipt of a range of means-tested benefits with older people, young children or disabled people.[96]

(b) Government-funded support for renewable energy generation such as the renewable heat incentive.

(c) Social support schemes that energy companies (and therefore customers) are required to fund such as:

(i) The WHD which came into force in 2011. It puts an obligation on energy suppliers with more than 250,000 customer accounts, to provide bill rebates, worth £140 in 2017/18, to low-income and vulnerable households.[97] WHD is to be extended between 2019 and 2020 by reducing the customer account threshold from 250,000 to 150,000, with the aim that this would increase customer choice of suppliers. The lower threshold for suppliers to participate in the scheme should mean that 97% of the consumer energy market would be covered.[98]

(ii) The Energy Company Obligation (ECO) introduced in 2013 requires large energy companies (those with more than 250,000 customers) to support domestic energy efficiency through measures such as improved insulation.

(d) Support for renewable energy generation that energy companies (and therefore customers) are required to fund. These include 'Contracts for

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[95] See Winter Fuel Payment – payments and rates.
[96] See Cold Weather Payment.
[97] See Warm Home Discount.
[98] See Households with smaller energy suppliers to benefit from £140 Warm Home Discount on their energy bills, BEIS (15 June 2018).

Difference',[99] the 'Renewables Obligation'[100] and small-scale 'Feed-in Tariffs'.[101]

Default Tariff Cap

3.43 Below, we provide background information on the forthcoming price cap on default tariffs (the Default Tariff Cap) that will be imposed and the timetable for its implementation by Ofgem.

Background information on the Default Tariff Cap

3.44 The Domestic Gas and Electricity (Tariff Cap) Act 2018 (the 'Default Tariff Cap Act') received Royal Assent and entered into law on 19 July 2018.[102]

3.45 Under the Default Tariff Cap Act, the Gas and Electricity Markets Authority (GEMA)[103] is required to:[104]

(a) modify the 'standard supply licence conditions', as soon as practicable after the Default Tariff Cap Act is passed, to include conditions that impose a price cap on all 'standard variable rates' and 'default rates' for the supply of energy under domestic supply contracts, where:

(i) 'standard variable rate' means a rate or amount charged for the supply of energy under the contract that is not fixed for a period specified in the contract; and

(ii) 'default rate' means a rate or amount charged for the supply of energy under the contract that applies if the customer under the contract fails to choose an alternative rate;

(b) protect existing and future domestic customers who pay standard variable and default rates by means of the Default Tariff Cap. In so doing, it must have regard to:

(i) the need to create incentives for suppliers to improve their efficiency;

(ii) the need to set the cap at a level that enables suppliers to compete effectively for domestic supply contracts;

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[99] See policy paper Contracts for Difference, BEIS (updated 11 September 2017).
[100] See Renewables Obligation (RO), Ofgem.
[101] See Feed-in Tariffs (FIT), Ofgem.
[102] See Victory for consumers as cap on energy tariffs to become law, BEIS (19 July 2018).
[103] Ofgem's governing body is GEMA.
[104] Default Tariff Cap Act, sections 1(1), 1(4),1(6), 6(1), 7(1), 7(2) and 7(3).

(iii) the need to maintain incentives for domestic customers to switch to different domestic supply contracts; and

(iv) the need to ensure that suppliers who operate efficiently are able to finance activities authorised by the licence;

(c) review the level at which the Default Tariff Cap is set, at least every six months; and

(d) carry out a review (with the first review to take place in 2020, and then for each year the Default Tariff Cap period is extended) into whether conditions are in place for effective competition for domestic supply contracts, as part of which, it must consider the extent to which progress has been made in installing smart meters (for use by domestic customers).

3.46 In relation to exemptions from the Default Tariff Cap, the Default Tariff Cap Act states that:[105]

(a) the Default Tariff Cap would not apply to domestic customers who benefit from the PPM Price Cap (under the EMI remedies);

(b) the Default Tariff Cap 'may' not apply to:

(i) vulnerable domestic customers who benefit from another price cap imposed by GEMA; or

(ii) SVTs which apply only if they are chosen by domestic customers if, or to the extent that, the SVTs support the production of gas or the generation of electricity from renewable sources.

3.47 Under the Default Tariff Cap Act, the Default Tariff Cap expires on 31 December 2020, unless on recommendations from Ofgem, the Secretary of State publishes a statement to the effect that the conditions are not yet in place for effective competition for domestic supply contracts. In which case, the Default Tariff Cap can be extended for a further year (up to three times), until 31 December 2023 (at the latest).[106]

3.48 In addition to the above, if the Default Tariff Cap is removed, GEMA is required under section 9 of the Default Tariff Cap Act, to undertake a review (and then take action if necessary) into domestic energy suppliers' pricing

[105] Default Tariff Cap Act, section 3.
[106] Default Tariff Cap Act, section 8.

practices, and whether any protection should be provided to certain categories of domestic customers[107] on SVTs and default tariffs from 'excessive charges'.[108]

3.49 On 16 August 2018, Ofgem published an open letter to stakeholders stating that it aimed to launch its statutory consultation on the associated licence conditions and publish its policy decision in early September 2018, and reiterated its intention to have the Default Tariff Cap in force by the end of 2018.[109] At the time of this report, Ofgem has not yet published the statutory consultation which outlines its latest thinking on the design of the Default Tariff Cap.

Summary

3.50 There is a wide spectrum in terms of customers' levels of engagement. Some customers engage regularly, while others do not actively consider their choice of energy supplier, often remaining on their suppliers' default tariffs for long periods of time despite the opportunity to save money by switching tariff or supplier.[110] In addition, customers who engage in the market at one point in time can become disengaged again at a later date.

3.51 Overall, the levels of engagement in the market and switching have been increasing over recent years. The percentage of customers who have engaged in the market in the previous 12 months has increased from 34% in 2014 to 41% in 2017 (defined as having switched supplier, changed tariff or compared tariff with their own or other suppliers in the past 12 months). Likewise, the number of customers switching supplier has increased steadily over the same period, reaching 16% of customers in the 12 months leading up to June 2017. At the start of 2014, approximately 200,000 electricity and gas customers switched supplier per month; by the start of 2018, this figure had increased to approximately 400,000 customers per month.[111]

3.52 The market share of the SAMS has increased in line with these trends: the SAMS collectively had a market share of approximately 5% in 2013, and this had increased to over 20% in Q1 2018. The increasing number of suppliers

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[107] For example, whether there are domestic customers who will suffer an excessive tariff differential where on the termination of fixed rates the customers move to standard variable or default rates, and whether customers who appear to GEMA to be vulnerable by reason of their financial or other circumstances are in need of protection.
[108] Default Tariff Cap Act, section 9.
[109] Open letter to stakeholders 'Update on retail price protection', Ofgem (16 August 2018).
[110] As noted above, a supplier's default tariff may be the best tariff for some customers, however this is likely to be the case for only a limited set of customers.
[111] See Figure 7 above.

that has emerged over this period has also led to an increase in customer choice.

3.53 In assessing the evidence relating to drivers of engagement, it is useful to consider the different stages that customers undergo when engaging:

(a) Awareness of ability to switch: There is a high level of awareness among customers that they can switch supplier (see paragraphs 3.15 and 3.16).

(b) Barriers to engagement: A number of factors appear to put customers off engaging, including a lack of awareness of the potential savings, a fear that savings may not materialise, concerns around the switching process and a feeling that their current tariff and/or supplier is good enough (see paragraphs 3.17 to 3.19).

(c) Triggers of engagement: Both supplier communications and media appear to be significant triggers of engagement. In addition, poor customer service can drive customers to engage (see paragraphs 3.20 to 3.25).

(d) Drivers of choice: Price is the key driver of a decision to switch and the choice of tariff and supplier, although other factors such as customer service and brand also appear to be important to some customers.

3.54 A range of initiatives is being introduced intended to increase engagement in the market such as the roll-out of smart meters, measures to prompt customers on default tariffs to switch and changes to bring about faster and more reliable switching. A Default Tariff Cap is also being introduced to protect those customers who still do not engage, and is due to be in place until at least 2020. This is in addition to the PPM Price Cap which is already in place. There are also a further range of social and environmental programmes designed to benefit vulnerable customers in particular.

3.55 The evidence therefore points to a market undergoing a transition. As set out in more detail in Section 6, we expect that in the absence of the Merger, these increasing trends in switching and engagement would continue.

4. The companies

4.1 This section provides an overview of the Parties and their financial background.

SSE

Background

4.2 SSE plc (SSE) is listed on the London Stock Exchange (LSE) and is a constituent of the FTSE 100 Index.[112] SSE was formed by the merger of Southern Electric[113] and Scottish Hydro Electric[114] in 1998.

4.3 SSE has three principal business areas:[115]

(a) Wholesale – using turbines to convert energy from gas, oil, coal, water and wind to generate electricity; trading in wholesale energy markets; and managing energy contracts.

(b) Networks – transmitting and distributing electricity and gas to homes and workplaces.

(c) Retail – supplying electricity and gas and related services to households and organisations.

4.4 SSE Retail will transfer to the new merged entity resulting from the Merger (MergeCo) and comprises the domestic retail energy supply, telecoms and energy-related services businesses operating in GB only:

(a) SSE Electricity Limited (Retail OpCo: domestic electricity supply business) – supply of electricity to domestic households.

(b) Southern Electric Gas Limited – supply of gas to domestic households and the shipping of gas for customers supplied.[116]

(c) SSE Home Services Limited – provision of domestic boiler and electrical wiring insurance products and boiler installation services.

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[112] See London Stock Exchange.
[113] Southern Electric was formed in 1948 to distribute electricity in Southern England and was floated in 1990 as one of 12 England and Wales regional electricity companies (RECs) owning the local electricity distribution networks and monopoly retail operations but no power generation assets.
[114] Scottish Hydro Electric managed hydroelectric construction and then took control of the generation, distribution and retail supply chain in the north of Scotland. It was privatised as Scottish Hydro Electric in 1991. In Scotland, the electricity industry was privatised on a vertically integrated basis, unlike England and Wales where the RECs (for example Southern Electric) initially owned no power generation assets.
[115] SSE plc Annual Report (2017), page 4.
[116] Shipping involves buying gas from producers, arranging for it to be conveyed to supply points via the National Transmission System (NTS) and selling it to gas suppliers.

(d) SSE Retail Telecoms Limited – provision of landline telephony and broadband services to domestic customers.[117]

(e) SSE Energy Solutions Limited – installation of energy saving measures in domestic properties and the management of third parties delivering Energy Company Obligations (ECO's).

(f) SSE Metering Limited – provision of legacy and smart metering services across GB to energy suppliers in both domestic and business markets including data collection, installation and asset maintenance.

SSE domestic supply business financial information

4.5 This section sets out SSE's domestic gas and electricity supply revenue, cost and profits, broken down by the various segments of business for the last three years ending 31 March 2015, 2016 and 2017, as shown in Table 4.[118]

Table 4: SSE domestic gas and electricity supply revenue and cost

£m

	FY2015 (2015/16)		*FY2016 (2016/17)*		*FY2017 (2017/18)*	
	Gas	*Electricity*	*Gas*	*Electricity*	*Gas*	*Electricity*
Total revenue	1,592	2,377	1,458	2,297	1,408	2,403
Total cost	(1,408)	(2,305)	(1,235)	(2,252)	(1,255)	(2,258)
EBITDA	184	72	222	45	153	145
Depreciation and Amortization	(4)	(5)	(3)	(4)	(15)	(23)
EBIT	181	67	220	41	138	122
Profit margin	11%	3%	15%	2%	10%	5%
Total EBIT	248		261		260	
Total EBIT margin	6%		7%		7%	

Source: SSE CSS for the year ending 31 March 2016, page 2; SSE CSS for the year ending 31 March 2017, page 2; and SSE CSS for the year ending 31 March 2018, page 2.
Notes:
1. The revenue and units are expressed in SSE's financial year (consistent with the CSS) and therefore 2016 = 2016/17.
2. SSE operates on an April-March financial year.
3. White label products such as M&S and Ebico are accounted for in the same way as non-white label products.

4.6 Electricity revenue has increased by 1% in the last 3 years and gas revenue has decreased by 12%.

(a) In the case of electricity, the flat revenue is the result of a combination of declining account numbers (see Figure 8), [✂] in average revenue per account (see Table 6), and a decrease in consumption volume (see Table 5).

[117] SSE Enterprise Telecoms operate a 13,700km private telecoms network and 15 data centers in the UK (see SSE website: About Us).
[118] SSE's non-energy businesses are consolidated in the overall domestic business. The average revenue from non-energy business contributes approximately [✂]% of the consolidated domestic business revenue, and [✂]% of consolidated earnings before interest and taxes (EBIT).

(b) In the case of gas, the fall in revenues has been driven by the decline in account numbers (see Figure 8) and decrease in consumption volume (see Table 5), while the average revenue per account has [✂] (see Table 7).

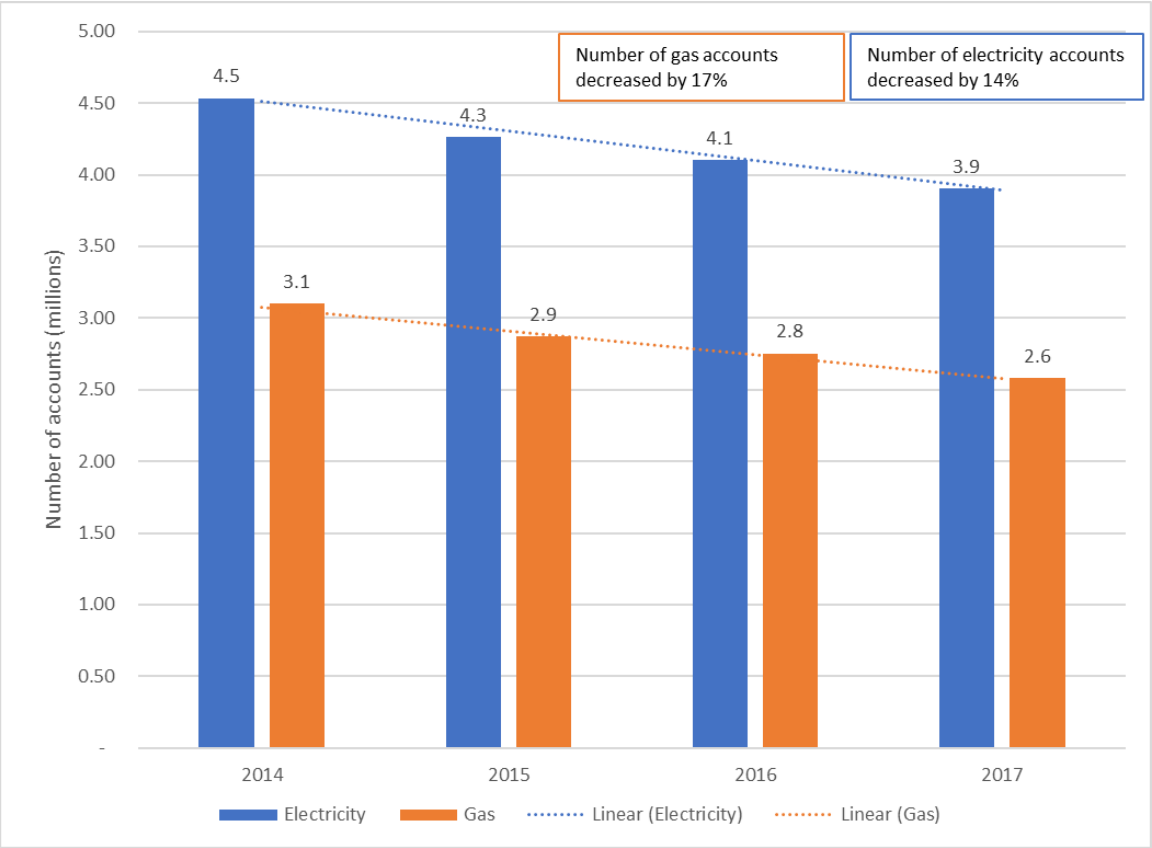
4.7 The combined electricity and gas profit (EBIT)[119] has increased in three years from £248 million to £260 million. This has mainly been driven by electricity profits which increased from £67 million in FY2015 to £122 million in FY2017. The profit for gas increased from £181 million in 2015 to £220 million in FY2016 before falling to £138 million in FY2017.

4.8 The combined profit margin has remained stable between 6% and 7%. The profit margin for electricity fell from 3% to 2% before increasing to 5% as of FY2018. The profit margin for gas increased from 11% to 15% before falling to 10% in FY2018.

4.9 Figure 8 shows the average number of SSE's domestic accounts for electricity and gas in the last four years.[120] The number of accounts decreased by 0.63 million (or 14%) for electricity and 0.52 million (or 17%) for gas from 2014.

[119] EBIT as a percentage of revenues.
[120] The customer data distinguishes between dual fuel, electricity or gas customers ie a customer who has both electricity and gas connection from SSE is counted as two different customer accounts.

Figure 8: SSE average number of domestic accounts for electricity and gas



Source: SSE CSS for the year ending 31 March 2015, page 2; SSE CSS for the year ending 31 March 2016, page 2; SSE CSS for the year ending 31 March 2017, page 2; and SSE CSS for the year ending 31 March 2018, page 2.
Note: Average customer numbers account (CSS definition).

4.10 Table 5 shows the customer consumption volumes for the last three years. SSE told us that the changes in consumption levels is due to a combination of decreases in the number of accounts and weather.

Table 5: SSE customer consumption volume for domestic supply customers

	2015	*2016*	*2017*
Electricity (TWh)	16.0	15.5	14.8
Gas (mth)	1,214	1,207	1,208

Source: SSE CSS for the year ending 31 March 2016, page 2; SSE CSS for the year ending 31 March 2017, page 2; and SSE CSS for the year ending 31 March 2018, page 2.

Revenue performance per tariff type

4.11 SSE's domestic gas and electricity supply revenue from Table 4 is reproduced in Table 6 and Table 7 by tariff type (SVT and FTC) for electricity and gas. The tables also show the number of accounts by tariff type which we have used to calculate an average revenue per account per year.

4.12 Table 6 shows that the SVT proportion of total electricity revenue has [✂] from [✂]% in FY2015 to [✂]% in FY2017. This trend is similar to the [✂] in

proportion of SVT accounts from [✂]% in 2015 to [✂]% in 2017.[121] However, the average revenue per account on SVT has [✂] by [✂]% in the last three years compared with a [✂]% [✂] in revenue per account on fixed term tariff.

Table 6: SSE domestic electricity supply revenue by tariff type

	FY2015 (2015/16)	*FY2016 (2016/17)*	*FY2017 (2017/18)*
SVT	[✂]	[✂]	[✂]
FTC	[✂]	[✂]	[✂]
Total electricity revenue (£m)	**2,366**	**2,280**	**2,388**
SVT	[✂]	[✂]	[✂]
FTC	[✂]	[✂]	[✂]
Total electricity accounts (million)	**4.3**	**4.1**	**3.9**
SVT	[✂]	[✂]	[✂]
FTC	[✂]	[✂]	[✂]
Average revenue per account (£)	**553**	**554**	**612**

Source: SSE.

4.13 Table 7 shows that the SVT proportion of total gas revenue has [✂] from [✂]% in FY2015 to [✂]% in FY2017. This trend is similar to the [✂] in proportion of SVT accounts from [✂]% in 2015 to [✂]% in 2017. However, the average revenue per account on SVT has [✂] over the last three years compared with a [✂]% [✂] in revenue per account on fixed term tariff.

Table 7: SSE domestic gas supply revenue by tariff type

	FY2015 (2015/16)	*FY2016 (2016/17)*	*FY2017 (2017/18)*
SVT	[✂]	[✂]	[✂]
FTC	[✂]	[✂]	[✂]
Total gas revenue (£'m)	**1,592**	**1,447**	**1,408**
SVT	[✂]	[✂]	[✂]
FTC	[✂]	[✂]	[✂]
Total gas account (million)	**2.9**	**2.8**	**2.6**
SVT	[✂]	[✂]	[✂]
FTC	[✂]	[✂]	[✂]
Average revenue per account (£)	**553**	**524**	**545**

Source: SSE.

[121] This proportion is based on number of accounts data, which counts a customer who has electricity and gas connection from the same supplier as two different customer accounts. The number of customers presented in Section 2 are based on number of non-prepayment domestic customers, which counts a customer who has electricity and gas connection from the same supplier as one customer.

Npower

Background

4.14 Npower is a wholly-owned subsidiary of innogy SE (innogy), which is 76.8% owned by RWE AG (RWE).[122] innogy is listed on the Frankfurt Stock Exchange. Npower is the holding company for the Npower retail group.

4.15 Npower supplies electricity and gas (through its subsidiary licensees) to domestic and non-domestic customers and provides energy-related services in GB. Npower is not currently active in domestic retail energy supply in either Northern Ireland or the Republic of Ireland.[123]

4.16 Npower categorises its business activities into three segments. Npower also has some management, corporate and support functions that sit behind these activities.[124]

(a) Home and Business – which is concerned with the retail supply of electricity and gas to domestic customers and small business customers.

(b) Npower Business Solutions – which is concerned with the retail supply of electricity and gas to medium and large businesses and industrial and commercial customers.

(c) Energy Services – which is concerned with the provision of certain energy-related services to customers, such as metering, gas boiler installation and services, electrical installation and home insulation, among others.

4.17 The total number of domestic accounts for the year ending 31 December 2017 was 4.6 million split between 2.7 million for electricity and 1.9 million for gas.[125]

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[122] The UK retail and generation arm of RWE traces its history back to National Power, one of the three England and Wales electricity generation companies formed during the privatisation of the UK electricity industry in 1990. Npower built a vertically integrated business through the acquisition of the supply businesses of three RECs – Midlands, Yorkshire and Northern as well as Independent Energy and Calortex.
[123] Npower has a small number of legacy non-domestic retail energy supply contracts in Ireland, which will also be transferred to MergeCo.
[124] The customer data distinguishes between dual fuel, electricity or gas customers ie a customer who has both an electricity and gas connection from Npower is counted as two different customer accounts.
[125] RWE – UK Generation & Npower Supply CSS for the year ending 31 December 2017, page 5.

Npower domestic supply business financial information

4.18 This section sets out Npower's revenue, cost and profits, broken down by its various segments of business for the last three years ending 31 December 2015, 2016 and 2017 as shown in Table 8.[126]

4.19 Npower introduced a new Systems Applications Products (SAP) information technology (IT) billing system in 2011 and in 2013 it acknowledged to Ofgem that it was having problems with its billing system. Between September 2013 and December 2014, Npower issued over 500,000 late bills and some customers also received inaccurate bills.[127] Due to this process and system-related problems in residential customer billing, it suffered financial losses during these periods.[128] Npower told us that it started a recovery and transformation program, which led to improved customer service performance, and resulted in a stable SAP IT system that is scalable to support the combined business.

Table 8: Npower domestic gas and electricity supply revenue and cost

£m

	FY2015 (2015/16)		*FY2016 (2016/17)*		*FY2017 (2017/18)*	
	Gas	*Electricity*	*Gas*	*Electricity*	*Gas*	*Electricity*
Total revenue	1,105	1,447	1,011	1,385	944	1,431
Total cost	(1,158)	(1,530)	(1,007)	(1,472)	(965)	(1,460)
EBITDA	(53)	(83)	4	(87)	(21)	(29)
Depreciation and Amortization	(18)	(19)	(29)	(38)	(30)	(36)
EBIT	(71)	(102)	(25)	(125)	(51)	(65)
Profit margin	-6.4%	-7.0%	-2.5%	-9.0%	-5.4%	-4.5%
Total EBIT	(173)		(150)		(116)	
Total EBIT margin	-7%		-6%		-5%	

Source: RWE – UK Generation & Supply CSS for the year ending 31 December 2015, page 4; RWE – UK Generation & Supply CSS for the year ending 31 December 2016, page 2; and RWE – UK Generation & Npower Supply CSS for the year ending 31 December 2017, page 5.
Note: Npower operates on January-December financial year.

4.20 Electricity revenue has decreased by 1.1% in the last 3 years and gas revenue has decreased by 14.6%.

(a) In the case of electricity, the flat revenue is the result of a combination of declining account numbers (see Figure 9), change in the average revenue per account (see Table 10) and change in the consumption volume (see Table 9).

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[126] Npower's non-energy businesses are consolidated in the overall domestic business. The average revenue from non-energy business contributes approximately [✂]% of the consolidated domestic business revenue. The average EBIT from non-energy business contributes approximately £[✂] compared to an average loss of £146 million for domestic electricity and gas supply.
[127] See Npower to pay £26 million for failing to treat customers fairly, Ofgem (18 December 2015).
[128] See Measures to further boost financial strength approved; 2015 earnings targets achieved, RWE official investors statement (8 March 2016).

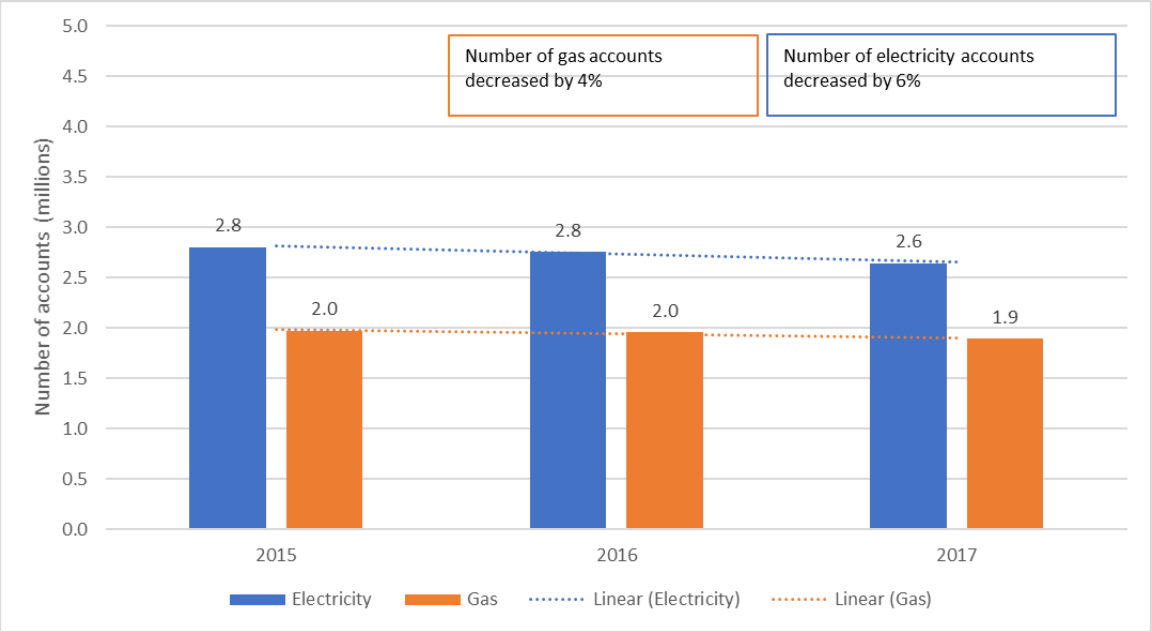
(b) In the case of gas, the fall in revenues has been driven by the decline in account numbers (see Figure 9) and a decrease in consumption volume (see Table 9) while the average revenue per account has been broadly flat (see Table 11).

4.21 The combined electricity and gas loss (EBIT) has reduced in the last three years from a loss of £173 million to a loss of £116 million as of FY2017. This has mainly been driven by a reduction in electricity losses which decreased from £102 million in FY2015 to £65 million in FY2017, however losses increased to £125 million in FY2016. The losses for gas has decreased from £71 million in FY2015 to £25 million in FY2016 before increasing to £51 million in FY2017.

4.22 The combined profit margin has improved from a loss of –7% in FY2015 to a loss of –5% in FY2017. The profit margin for electricity fell from a loss of –7% to –9% before improving to a loss of –4.5% as of FY2018. The profit margin for gas improved from a loss of –6.4% to –2.5% before decreasing to a loss of –5.4% in FY2018.

4.23 Figure 9 shows the year end number of domestic accounts for electricity and gas in the last three years.[129] Since 2015, the number of electricity accounts has decreased by 0.16 million (or 6%) and the number of gas accounts has decreased by 0.08 million (or 4%).

Figure 9: Npower average number of domestic accounts for electricity and gas



Source: Npower.

[129] The customer data distinguishes between dual fuel, electricity or gas customers ie a customer who has both electricity and gas connection from Npower is counted as two different customer accounts.

4.24 Table 9 shows the decrease in customer consumption volumes for the last three years.

Table 9 Npower customer consumption volume for domestic supply customers

	2015	*2016*	*2017*
Electricity (TWh)	10.3	9.9	9.6
Gas (mth)	964	952	935

Source: RWE – UK Generation & Supply CSS for the year ending 31 December 2015, page 4; RWE – UK Generation & Supply CSS for the year ending 31 December 2016, page 5; and RWE – UK Generation & Npower Supply CSS for the year ending 31 December 2017, page 5.

4.25 Table 10 shows the average domestic electricity revenue per account. The average revenue per account has increased in 2017 compared to 2015 after decreasing in 2016.

Table 10: Npower average electricity revenue per domestic account

	2015	*2016*	*2017*
Total electricity revenue (£m)	1,447	1,386	1,426
Total electricity accounts (million)	2.8	2.8	2.6
Average revenue per account (£)	**516**	**503**	**539**

Source: Npower.

4.26 Table 11 shows that the average domestic gas revenue per account has decreased in the last three years.

Table 11: Npower gas supply revenue per domestic account

	2015	*2016*	*2017*
Total gas revenue (£m)	1,105	1,011	944
Total gas accounts (million)	2.0	2.0	1.9
Average revenue per account (£)	**560**	**516**	**499**

Source: Npower.

Utility Warehouse relationship

4.27 Npower currently supplies wholesale energy and related services to Utility Warehouse.[130] In November 2013, Utility Warehouse and Npower entered into an exclusive 20 year wholesale 'supply and services agreement' (the 'Wholesale Agreement'), which is set to run until [✂] 2033.

4.28 Under the terms of the Wholesale Agreement, the wholesale prices for electricity and gas that Utility Warehouse pays are based on a discount to [✂] SVT price of the SLEFs:

[130] We understand that this agreement includes wholesale energy and network costs.

(a) **Electricity**: [✂] SVT price of the SLEFs is calculated as [✂] of the SLEFs' SVT prices.

(b) **Gas**: [✂] SVT price of the SLEFs is calculated as [✂] of the SLEFs' SVT prices.

5. The merger and relevant merger situation

5.1 This section sets out:

(a) the details of the proposed transaction;

(b) the Parties' transaction rationale; and

(c) our jurisdiction.

The proposed transaction

5.2 We set out below the details of:

(a) the structure of the proposed transaction;

(b) the timings and conditions precedent for completion; and

(c) MergeCo's future operations and management.

Structure of the proposed transaction

5.3 On 8 November 2017, innogy and SSE entered into an agreement (the 'Contribution Agreement') to transfer certain businesses into a new company (MergeCo) (the 'Transaction').

5.4 Under the Contribution Agreement, innogy and SSE agreed to transfer the following businesses into MergeCo:

(a) innogy will transfer its wholly-owned subsidiary, Npower, which is active in the retail supply of electricity and gas to domestic and non-domestic customers in GB, as well as in the supply of certain energy-related services in GB; and

(b) SSE will transfer its businesses which are active in the retail supply of electricity and gas to domestic customers in GB, as well as its telecoms and energy-related services businesses in GB (together, SSE Retail).[131]

5.5 The Parties told us that MergeCo would be a standalone retail business with its own dedicated board of directors and specialist management team.

5.6 Immediately following completion of the Transaction (expected to be the last quarter of 2018 or the first quarter of 2019), MergeCo will be admitted to the premium listing segment of the Official List[132] and to trading on the main market of the LSE. We refer to the Transaction and the listing of MergeCo as the Merger.

5.7 Under the Contribution Agreement:

(a) innogy will receive a 34.4% equity stake in MergeCo, which innogy will be required to hold for at least six months (the customary minimum period for larger shareholders in capital market transactions); and

(b) SSE's stake of 65.6% will be distributed to its shareholders immediately following the Transaction, by way of SSE declaring a dividend *in specie* to its shareholders to be satisfied by the transfer of SSE Retail to MergeCo and the issue of MergeCo shares to SSE's shareholders on a pro rata basis.

5.8 The Parties told us that as a result of the Merger, innogy would acquire 'material influence over SSE Retail' via its interest in MergeCo, but would not have 'de facto control' over MergeCo (or SSE Retail). innogy's CEO at the time of the Transaction's announcement on 15 November 2017, stated that innogy would not own the shares in MergeCo in the long-term.[133]

5.9 Figure 10 below shows the ownership structure of MergeCo at completion.

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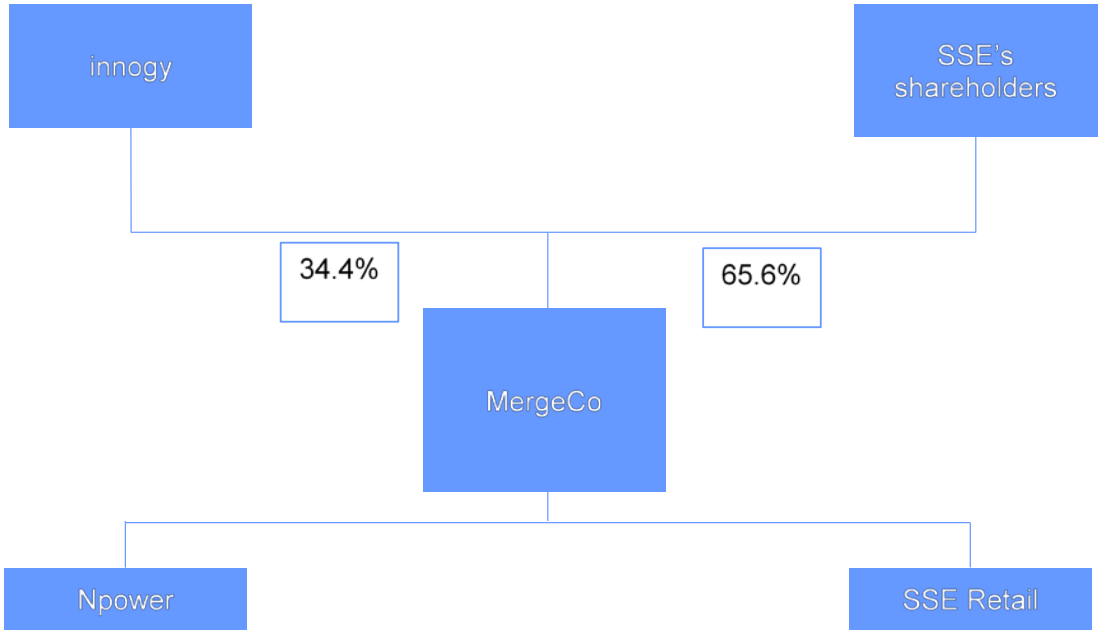
[131] Both innogy and SSE will retain their wholesale energy (ie electricity generation, gas production and import, and energy trading) activities. For the avoidance of doubt, SSE will retain its businesses in Northern Ireland and the Republic of Ireland, as well as its non-domestic customer businesses.
[132] The Official List is the definitive record of whether a company's securities are officially listed in the UK (see the Financial Conduct Authority (FCA) website).
[133] See Innogy to exit British retail JV with SSE in long-term – CEO, Reuters (15 November 2017).

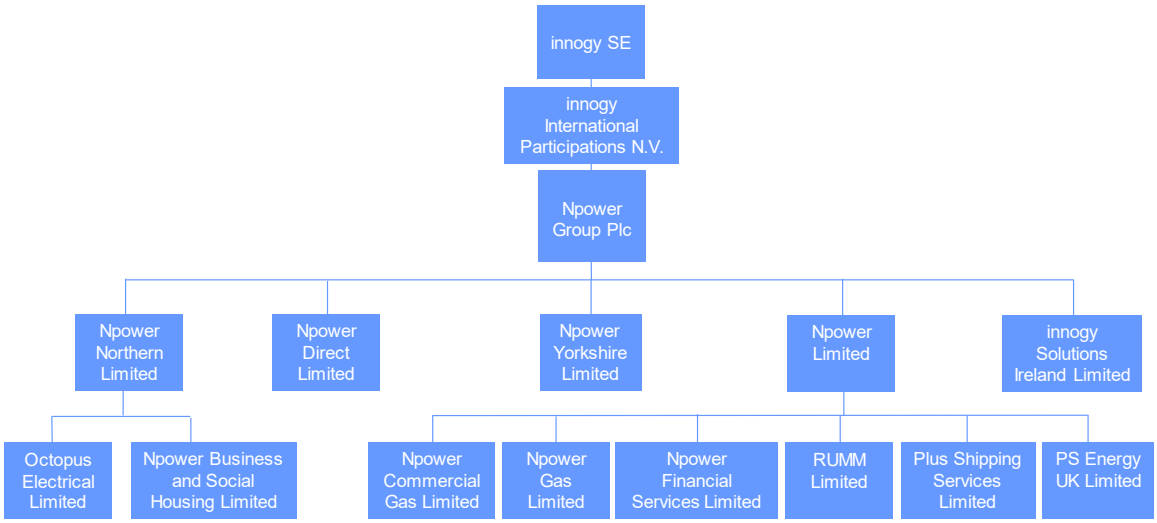
Figure 10: Ownership structure of MergeCo on completion



Source: Parties.

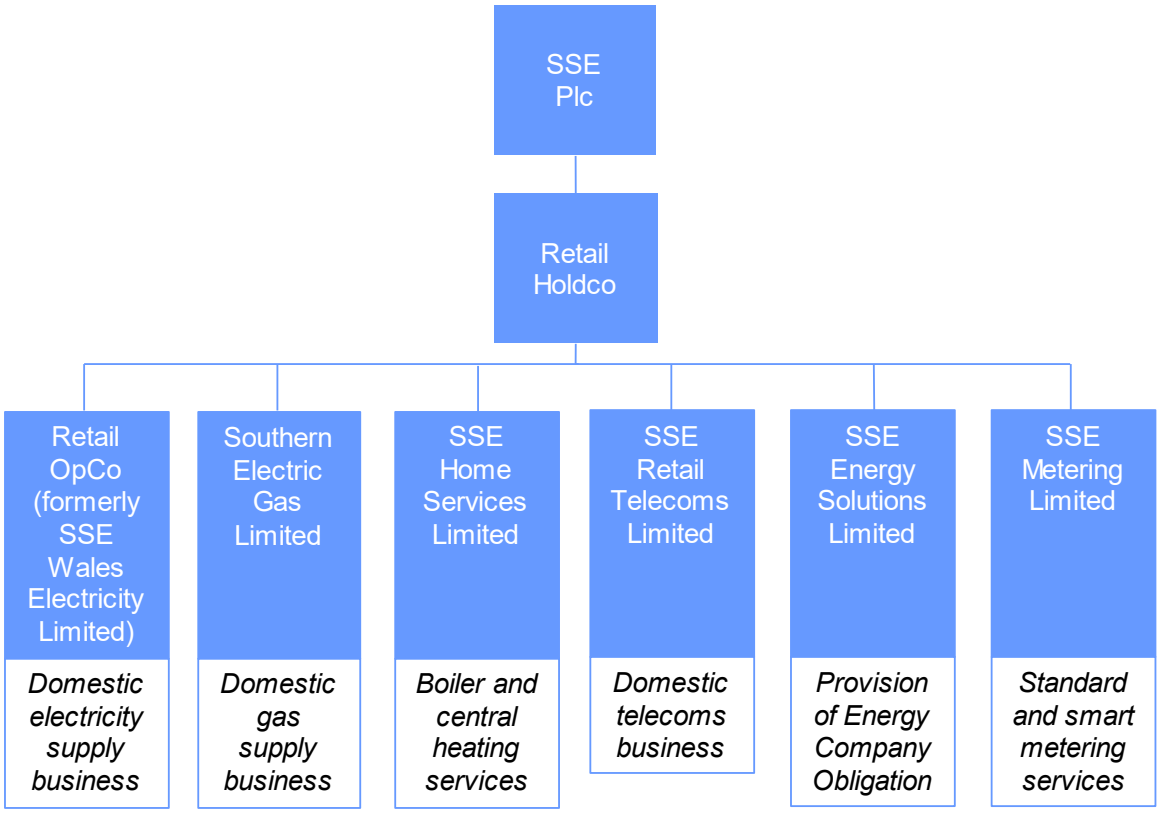
5.10 Figure 11 and Figure 12 below present the respective business contributions to MergeCo by innogy (ie Npower) and SSE (ie SSE Retail, shown as 'Retail Holdco').

Figure 11: innogy contribution to MergeCo – Npower



Source: Parties.

Figure 12: SSE contribution to MergeCo – SSE Retail



Source: Parties.

Timings and conditions precedent for completion

5.11 The Parties told us that the Merger was expected to close in the last quarter of 2018 or the first quarter of 2019. The Contribution Agreement provides for a long-stop date of 30 June 2019.

5.12 Under the Contribution Agreement, completion (of the Transaction) is conditional upon the satisfaction of various conditions, including:

(a) approval from the CMA;[134]

(b) Ofgem not proposing material modifications to, or replacement of, the supplier licences held by Npower or SSE Retail;

(c) SSE Class 1 shareholder approval (obtained on 19 July 2018);

(d) innogy supervisory board approval (obtained on 13 December 2017); and

[134] The Parties have received confirmation from the European Commission that the Merger is not subject to the EU Merger Regulation.

(e) receipt of the necessary approvals from the Financial Conduct Authority (FCA) and the LSE for admission to the LSE and the publication of MergeCo's prospectus.

MergeCo's future operations and management

5.13 We set out below the Parties' submission in relation to MergeCo's:

(a) future operations; and

(b) management.

MergeCo's future operations

5.14 The Parties told us that MergeCo would be 'focused entirely on strategic and operational developments in retail energy supply in GB, including the competitive and regulatory environment', and 'also have the ability to access and allocate its own capital, allowing day-to-day decision making to be more closely aligned with a retail-focused strategy'. The Parties added that this would 'facilitate the delivery of greater benefits to all stakeholders going forward, including customers and employees'.

5.15 The Parties told us that MergeCo would 'continue to supply energy and provide energy and infrastructure services to non-domestic customers throughout the UK and Ireland and to domestic customers in Northern Ireland and Ireland'.

5.16 In relation to MergeCo's branding, the Parties told us that:

(a) the Npower brand would transfer to MergeCo on completion; and

(b) SSE's branding for domestic retail energy would be licensed to MergeCo for three years following completion.[135]

5.17 On 27 June 2018, SSE's shareholder circular concerning the Transaction stated that 'immediately following the Transaction customers of MergeCo will not see any immediate change to the brand under which their energy is supplied', but that MergeCo was 'expected to develop and operate under a new brand' (which had yet to be developed) in due course.[136]

[135] For some SSE branding relating to non-domestic supply, the Parties told us that this would transfer to MergeCo and be licensed back to SSE for three years following completion.
[136] SSE shareholder circular for the Transaction (27 June 2018), page 11.

5.18 SSE told us that both the Npower and SSE brands would continue to remain in place until MergeCo was rebranded, and that the current intention was for MergeCo to adopt a new brand [✂] its listing. SSE added that to avoid any 'unnecessary disruption to customers', the working assumption was that the new brand would be launched [✂] it started the process of migrating data from the 'legacy' systems to a single SAP system, which was expected to commence [✂] MergeCo's listing.

MergeCo's management

5.19 The Parties told us that MergeCo would be a 'standalone retail business', with its own dedicated board of directors and specialist management team. The Parties added that since MergeCo would be subject to the UK Listing Rules, it must demonstrate that it would 'be carrying on an independent business as its main activity'. The Parties told us that in order to meet this requirement, innogy and MergeCo would enter into a 'Relationship Agreement', which would place certain restrictions on innogy to ensure MergeCo would meet the independence requirements set out in the UK Listing Rules, which apply to companies with a 30%+ shareholder. For example, the Parties told us that:

(a) so long as innogy was a 30%+ shareholder, it would be required to abstain from voting on any resolution to approve the election or re-election of any independent director; and

(b) innogy would also be required to conduct all transactions and arrangements with MergeCo at arm's length and on normal commercial terms.

Rationale

5.20 In this section, we set out the timeline of events leading up to the Merger, and innogy and SSE's rationale for the Transaction.

Events leading up to the Merger

5.21 SSE told us that in [✂] it sought [✂] to evaluate potential mergers and acquisitions opportunities (including the acquisition of Npower). [✂]. SSE told us that it arranged a preliminary discussion with the innogy CEO on 3 April 2017 to discuss the potential merger of SSE Retail and Npower, which eventually resulted in the Merger.

5.22 innogy told us that on 4 April 2017, following this meeting with SSE, innogy's CEO informed the innogy Management Board of the meeting, and that shortly

thereafter, and as reflected in its internal documents, more detailed discussions started between the innogy and SSE transaction teams.

5.23 The 27 June 2018 SSE shareholder circular concerning the Transaction stated that, following discussions with innogy regarding the 'future of innogy's own UK-based' domestic energy and services business (ie Npower), the SSE board concluded that a 'combination of both companies' household energy and services businesses would facilitate the delivery of greater benefits to all stakeholders going forward, including customers and employees', and that the combination was 'expected to deliver enhanced benefits by creating a more efficient new independent household energy and services business', which would be able 'to respond more effectively to the rapidly evolving competitive landscape'.[137]

5.24 The Parties told us that these preliminary discussions continued in the spring and summer of 2017 and that the Parties commenced due diligence and valuation work in September 2017, followed by further negotiations in October and early November 2017. The Merger was publicly announced on 8 November 2017.[138]

Transaction rationale

5.25 In relation to innogy's transaction rationale:

(a) innogy told us that it had been considering potential transactions involving Npower for some time as a response to the generally challenging competitive landscape in the domestic energy market in GB, and that the Merger was 'fully consistent with innogy's strategy to adapt its portfolio to improve position and performance against substantial previous investments'.

(b) innogy's internal documents showed that in the lead-up to, and during, its negotiations with SSE, innogy had been [✂].

(c) innogy told us that as 'competitive pressure in the retail energy market' intensified, it had concluded that Npower would need to improve on its cost efficiency, and that it would be best placed to do this in combination with a partner. innogy also told us that as a liquid financial investment for innogy, MergeCo:

[137] SSE shareholder circular for the Transaction (27 June 2018), page 10.
[138] See SSE household energy supply and services in GB, SSE (8 November 2017) and innogy and SSE agree to merge Npower with SSE's domestic retail operations in GB, innogy (8 November 2017).

(i) would help to preserve value and offer innogy the prospect of further upside and broader options (including a disposal), if market conditions are appropriate, after its minimum six-month holding period expired; and

(ii) would no longer be an 'operational exposure', and therefore allow innogy's management to focus on its other core businesses and earnings drivers.

5.26 Therefore, innogy told us that it believed that a 'proactive partnership approach' (ie between Npower and SSE Retail) offered a 'better solution for all stakeholders, freeing up management attention and focus within innogy', than Npower continuing on a standalone basis.

5.27 In relation to SSE's transaction rationale:

(a) The 27 June 2018 SSE shareholder circular concerning the Transaction stated that:[139]

(i) 'for some time' the SSE group had been 'undergoing significant evolution', eg as a result of its past investments, the 'large majority of SSE's asset base' and profits were 'driven by economically-regulated networks' and government-mandated 'renewable sources of energy'; and

(ii) the retail energy markets in GB were 'rapidly transforming', eg in terms of greater competition and customer switching at 'historically high levels', as well as the impact of 'disruptive technology' and an 'evolving regulatory environment'.

(b) The SSE shareholder circular stated that in view of these developments, the SSE board undertook a 'strategic review' in 2017 of its domestic energy and services business in GB, and reached the conclusion that:[140]

(i) a 'separation of SSE Energy Services' from the SSE group had 'strong strategic logic and the potential to drive significant benefits for the business and its customers'; and

(ii) a 'standalone household energy and services business' would benefit from its own board and management team, 'focused entirely on

[139] SSE shareholder circular for the Transaction (27 June 2018), pages 9–10.
[140] SSE shareholder circular for the Transaction (27 June 2018), page 10.

strategic and operational developments in the British energy retail sector'.

(c) SSE told us that the Merger conformed with its 'stated commitment to embrace change in each of its businesses, adapting them to the economic, social and technological requirements of customers and of society as a whole', and that following the separation of its retail business, it would retain a 'balanced and diverse range of related businesses, creating value through specialising in efficiently building, operating and investing in energy and infrastructure assets, and focusing on activities that support the transition to a lower carbon future'.

5.28 The Parties told us that the Merger was 'predicated on bringing together the best of both Npower and SSE Retail to create an efficient new independent retail energy supplier in GB by combining the resources and experience of two established players in a new market model', where:

(a) Npower was 'effective at promptly bringing out new products and updated tariff options for customers'; and

(b) SSE was 'very good at cost control, efficiency, and customer service'.

5.29 The Parties told us that by combining Npower and SSE Retail, this would make MergeCo 'well-placed to respond to the changing dynamics of an increasingly competitive retail energy environment, and to respond more effectively to customer expectations on tariff innovation and technological development'.

Jurisdiction

5.30 We are required to decide whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.[141]

5.31 A relevant merger situation is created if:

(a) two or more enterprises cease to be distinct; and

(b) one or both of the 'turnover test' or 'share of supply test' is (are) satisfied.[142]

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[141] In exercise of its duty under section 36(1) of the Act and pursuant to the terms of reference (see Appendix A).
[142] Section 23 of the Act provides that the value of the turnover in the UK of the enterprise being taken over must exceed £70 million ('turnover test') or, in relation to the supply of goods or services, as a result of two or more

5.32 As noted above, at paragraphs 5.3 and 5.4, the Parties entered into the Contribution Agreement on 8 November 2017 which is sufficient for the CMA to conclude that arrangements are in progress or in contemplation.

Enterprises ceasing to be distinct

5.33 The Act defines an 'enterprise' as 'the activities, or part of the activities, of a business' and a 'business' is defined as including 'a professional practice and includes any other undertaking which is carried on for gain or reward or which is an undertaking in the course of which goods or services are supplied otherwise than free of charge'.[143]

5.34 A company that owns a business operating as a going concern (in this case Npower) with the necessary assets, employees and customer contracts would clearly satisfy the definition of an enterprise for the purposes of the Act. Similarly, SSE Retail, the new entity containing the SSE businesses transferred to MergeCo as a result of the Merger, satisfies this definition of an enterprise.

5.35 For the purposes of the Act, enterprises cease to be distinct if they are brought under common ownership or common control.[144]

5.36 Pursuant to the Contribution Agreement, SSE Retail and Npower will be brought under common control, and the new entity, MergeCo, will be listed on the LSE. The CMA is accordingly satisfied that on completion of the Merger the enterprises of SSE Retail and Npower will cease to be distinct.[145]

Turnover Test

5.37 As noted in paragraph 5.31 above, the turnover test is satisfied where the value of the turnover in the UK of the enterprise being taken over exceeds £70 million.

5.38 According to the Parties, SSE Retail generated turnover in the UK of [✂] [approximately £4,000 million] in the financial year ended 31 March 2017. Npower generated turnover in the UK of £6,029 million in 2017.[146]

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enterprises ceasing to be distinct, at least one quarter of all such goods or services which are supplied or acquired in the UK or a substantial part of the UK are supplied by or to one and the same person ('share of supply test').

[143] Section 129(1) of the Act.

[144] Section 26 of the Act.

[145] At phase 1, the CMA also considered whether innogy would acquire material influence over MergeCo as a result of its minority shareholding in MergeCo following the Transaction. The CMA found at phase 1 that this gave rise to a separate relevant merger situation which was not expected to result in an SLC.

[146] RWE – UK Generation & Npower Supply CSS for the year ending 31 December 2017, page 5.

Consequently, the turnover test[147] is met, and we do not need to consider the share of supply test.

Provisional conclusion on jurisdiction

5.39 In light of the evidence set out in paragraphs 5.32 to 5.38, we are satisfied that a relevant merger situation has been created.

6. The counterfactual

6.1 We assess the possible effects of the Merger on competition compared with the competitive situation that would have prevailed absent the Merger (ie the counterfactual situation). That is, the counterfactual acts as a benchmark against which to assess the competitive effects of the Merger.[148]

6.2 Our Merger Assessment Guidelines (the 'Guidelines') state that the choice of counterfactual requires a finding that, on the balance of probabilities, a given scenario would have developed in the market in the absence of the merger.[149] The CMA will typically incorporate into the counterfactual only those aspects of scenarios that appear likely on the basis of the facts available to it and the extent of its ability to foresee future developments, and will seek to avoid any spurious claims to accurate prediction or foresight.[150] Where there is more than one possible counterfactual scenario, the situation most likely to have existed absent the merger will be selected.[151]

6.3 This section sets out our assessment and provisional conclusions on the appropriate counterfactual.

Parties' submission on the appropriate counterfactual

6.4 The Parties identified a number of recent or anticipated changes in the competitive conditions in the retail supply of energy, that they stated would intensify competition further in many respects, and that could be taken into account in the counterfactual or the competitive assessment.

6.5 The Parties submitted that:[152]

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[147] As set out in section 23(1)(b) of the Act.
[148] Merger Assessment Guidelines (CC2 Revised/OFT1254), paragraph 4.3.1. The Guidelines have been adopted by the CMA (see Mergers: Guidance on the CMA's jurisdiction and procedure (CMA2), Annex D).
[149] Merger Assessment Guidelines (CC2 Revised/OFT1254), paragraph 4.3.6.
[150] Merger Assessment Guidelines (CC2 Revised/OFT1254), paragraphs 4.3.2 and 4.3.6.
[151] Merger Assessment Guidelines (CC2 Revised/OFT1254), paragraph 4.3.6.
[152] Parties response to the Issues Statement, paragraph 1.6 and Section 2.

(a) there was 'no real uncertainty about the timing or likely effects of the Default Tariff Cap, and therefore, it should now be taken into account in the counterfactual'; and

(b) the effects of the CMA's remedies under the EMI were 'now sufficiently certain and foreseeable', and therefore should 'properly be taken into account in the counterfactual (in addition to the competitive assessment)'.

6.6 In addition, the Parties submitted that 'the potential E.ON/RWE transaction should not be taken into account in the counterfactual'.[153]

Assessment of the appropriate counterfactual

6.7 Below we consider whether:

(a) an alternative counterfactual other than the prevailing conditions of competition is appropriate, having regard to the likely alternative course of action that each of the Parties may have pursued absent the Merger (see paragraphs 6.8 to 6.13);

(b) the Default Tariff Cap should be taken into account in the counterfactual and our competitive assessment of the effects of the Merger, and if so, the extent to which it is possible to predict its likely effects (see paragraphs 6.14 to 6.32);

(c) any, or all, of the relevant EMI remedies should be taken into account in the counterfactual and our competitive assessment, and if so, the extent to which it is possible to predict their likely effects (see paragraphs 6.33 to 6.44); and

(d) any account should be taken of the proposed E.ON/RWE transaction within the counterfactual (see paragraphs 6.45 to 6.60).

Prevailing conditions of competition

6.8 We considered whether the prevailing conditions of competition represent the appropriate counterfactual, by assessing:

(a) the alternative options available to each of innogy and SSE prior to, and at around the time of, the Merger discussions; and

[153] Parties response to the Issues Statement, paragraph 1.7 and Section 2.

(b) whether there is any evidence to suggest that absent the Merger, either of the Parties would have been likely to pursue any of these alternative options.

6.9 Appendix C sets out evidence from the Parties' internal documents which we have considered in our assessment.

Assessment and provisional conclusions

6.10 Based on the evidence set out in Appendix C, we noted that:

(a) innogy had been considering a number of different strategic options between May and September 2017, in response to what it described as the 'generally challenging competitive landscape in the domestic energy market in GB', including [✂]. As late as September 2017, when innogy's negotiations with SSE in relation to the Merger were fairly advanced, the innogy board was presented with [✂].

(b) SSE had been evaluating potential merger and acquisition opportunities since [✂], including a potential acquisition of Npower, and had considered [✂]. SSE's [✂] options in relation to the current structure that was finally agreed in relation to the Merger were: [✂].

6.11 On the basis of the above evidence, we considered it likely that absent the Merger, innogy would have continued to operate Npower as a standalone entity.

6.12 We found no evidence to suggest that SSE was pursuing an alternative course of action in parallel with its discussions with innogy, that would suggest that it would not have continued to operate and compete independently, were its discussions with innogy not to proceed. We considered it more likely than not, that SSE would have continued to operate as a standalone entity, and [✂] the SSE Retail business continuing to operate and to compete independently.

6.13 On this basis, it is our provisional conclusion that the current market structure, and therefore, the current competitive situation represents the appropriate counterfactual.

Default Tariff Cap

6.14 We considered whether the Default Tariff Cap should be taken into account in the counterfactual, and if so, the extent to which it is possible to predict its likely effects.

6.15 Background information on the Default Tariff Cap Act and the obligations it places on Ofgem in relation to the implementation of the Default Tariff Cap, as well as Ofgem's published timetable for its implementation by the end of 2018 is set out in paragraphs 3.43 to 3.49 above. Further background information setting out the requirements on Ofgem under the Default Tariff Cap Act, and the actions taken to date by Ofgem to implement the Default Tariff Cap, are set out in Appendix D.

Submissions on the Default Tariff Cap

6.16 The Parties submitted that the impact of the Default Tariff Cap should be taken into account in the counterfactual given:[154]

(a) the 'imminent' introduction of the Default Tariff Cap; and

(b) its 'foreseeable effects'.

6.17 The Parties told us that it was 'reasonably foreseeable' that the Default Tariff Cap would have a 'significant impact on SVT price setting and will therefore affect the competitive analysis', and 'all currently available evidence' indicated that the Default Tariff Cap would become the 'principal yardstick against which suppliers set their SVT prices in the future'.[155]

6.18 The Parties argued that 'all evidence indicates that the price cap will result in suppliers' SVT pricing converging towards the level of the cap'.[156]

6.19 The submissions we received from Ofgem and other third parties are summarised in Appendix E. There was a broad consensus that the implementation of the Default Tariff Cap by Ofgem was imminent.

Assessment and provisional conclusions

6.20 In relation to the Default Tariff Cap, we consider below:

(a) Ofgem's likely timing for its implementation;

(b) its likely level; and

(c) its likely duration.

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[154] Parties response to the Issues Statement, paragraph 2.33.
[155] Parties response to the Issues Statement, paragraphs 2.29(ii) and 2.32.
[156] Parties Initial Submission (response to CMA phase 1 decision) (30 May 2018), paragraph 4.47.

Default Tariff Cap – implementation timing

6.21 Based on the evidence, we considered that we can be reasonably certain that the Default Tariff Cap will be in place soon, and in all likelihood, by the end of 2018. There are however uncertainties over the final form and duration of the Default Tariff Cap given that Ofgem is still consulting and deciding on its specification.[157] We consider these below.

Default Tariff Cap – level

6.22 While the final level for the Default Tariff Cap has yet to be determined, the Ofgem May 2018 consultation document indicates that the Default Tariff Cap would likely be set at a level below prevailing SVT levels, but high enough to ensure cheaper acquisition tariffs could still be offered to customers. For example:[158]

(a) Ofgem stated that the objective of the Default Tariff Cap would be to protect current and future consumers on SVTs or other default tariffs, and therefore, expected that consumers on default tariffs paying the highest prices would make 'significant savings' under the Default Tariff Cap; and

(b) in order to have regard to enabling suppliers to compete effectively and maintain incentives for customers to switch, Ofgem stated that the Default Tariff Cap was 'not intended to replace competition', and that it 'should ensure sufficient cheaper tariffs are offered to engaged consumers, while protecting consumers not on those deals'.

6.23 Therefore, based on Ofgem's policy intentions, which reflect those of the Default Tariff Cap Act, our expectation is that the Default Tariff Cap will be set below the prevailing level of SVT prices.

6.24 The extent to which the Default Tariff Cap could be expected to have a material impact on rivalry between the SLEFs and how they set their SVT prices, will be taken into account in the competitive assessment of the Merger where appropriate (see Section 9).

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[157] On 16 August 2018, Ofgem published an open letter to stakeholders stating that it aimed to launch its statutory consultation on the associated licence conditions and publish its policy decision in early September 2018, and reiterated its intention to have the Default Tariff Cap in force by the end of 2018 (Open letter to stakeholders 'Update on retail price protection', Ofgem (16 August 2018)).
[158] Default Tariff Cap: Policy Consultation Overview document, Ofgem (25 May 2018), page 7.

Default Tariff Cap – duration

6.25 In terms of the duration of the Default Tariff Cap, the Default Tariff Cap Act states that it will cease to have effect at the end of the year 2020 unless the Secretary of State, following a recommendation from Ofgem, publishes a statement to the effect that the conditions are not yet in place for effective competition for domestic supply contracts. In which case, the Default Tariff Cap will be extended to 2021. The Default Tariff Cap Act provides for a renewal mechanism each year up to the end of year 2023.[159]

6.26 The Parties submitted that they expected the Default Tariff Cap would be 'extended beyond 2020 and likely to 2023' for the following reasons:

(a) Ofgem had stated that it would 'take longer for the market conditions required to recommend removing' the Default Tariff Cap to be in place; and

(b) 'both major political parties support these price controls', so the 'policy drivers' for the Default Tariff Cap were 'very unlikely to have changed significantly by 2020'.

6.27 The Parties added that when the Default Tariff Cap is removed, either in 2020 or later, 'the market conditions relevant to SVT prices will have changed in such a way that Ofgem has concluded it no longer necessary to provide any degree of protection for SVT customers'. They added that this was 'particularly so given section 9 of the Default Tariff Cap Act, which requires Ofgem to review company pricing practices and identify whether any customers are particularly vulnerable to these practices before the cap is removed', and then 'take necessary steps' to protect any customers requiring such protections.

6.28 In our view, there are a number of variables that make predicting whether the Default Tariff Cap will be extended beyond 2020 very difficult, and what other reviews (or actions) Ofgem may undertake after it is removed (eg under section 9 of the Default Tariff Cap Act).

6.29 Currently, it is uncertain as to what criteria Ofgem and the Secretary of State will consider when deciding whether the conditions for effective competition for domestic supply contracts are in place. It is unknown how Ofgem will assess whether to recommend to the Secretary of State that the Default Tariff Cap should be extended beyond the initial two-year term.

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[159] Default Tariff Cap Act, section 8.

6.30 Moreover, we are not able to predict whether or not the Secretary of State will accept Ofgem's recommendation. Similar uncertainties also apply to Ofgem's reviews under section 9 of the Default Tariff Cap Act. Layered over these concerns is the fact that there are ongoing market developments increasing customer engagement (see paragraphs 6.33 to 6.44), which together with the impact of the Default Tariff Cap, make it difficult to foresee how long any future restrictions will be in place. Consequently, it is difficult for us to predict with any confidence whether the Default Tariff Cap will be extended beyond 2020.

6.31 Therefore our provisional view is that for the purpose of the counterfactual assessment, we can only foresee that the Default Tariff Cap will be in place for the initial two-year period set out in the Default Tariff Cap Act. While an extension to the Default Tariff Cap is possible, it cannot be foreseen with any degree of confidence.

6.32 We have not formed any expectation on what future actions, if any, may be taken under section 9 of the Default Tariff Cap Act, given the uncertainties set out above.

Increasing customer engagement

6.33 We have noted in paragraphs 3.5 to 3.12 recent increases in customer engagement. Measures which have helped to drive this include the EMI remedies and other Ofgem initiatives (with additional measures planned) that are expected to increase customer engagement further (see paragraphs 2.53 and 3.30 to 3.37).

6.34 We consider below, whether the current and potential future effects of these measures should be taken into account in the counterfactual.

Submissions on customer engagement measures

6.35 The Parties submitted that the CMA must take into account the effects (including the 'reasonably likely future effects') of all its remedies under the EMI and Ofgem's recent and future initiatives implemented in relation to the domestic retail energy markets.[160]

[160] Parties response to the Issues Statement, paragraph 2.25.

6.36 The Parties told us that many of the EMI remedies have already been implemented, and their effects were 'already sufficiently foreseeable to be included in the counterfactual'.[161]

6.37 The Parties also argued that:[162]

(a) given the CMA's 'legal obligation to implement remedies which would be effective', the CMA 'must assume that the [EMI] 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 Merger); and

(b) assuming that the EMI remedies would be effective would 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', and the CMA's statements that the package of remedies under the EMI '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'.

6.38 Ofgem told us that it had 'established a dedicated consumer engagement team to deliver two projects' to implement two of the EMI remedies, namely the development of: *(a)* a database of disengaged customers; and *(b)* prompts to increase customer engagement. Ofgem told us that since 2016, it had completed four trials and conducted various quantitative and qualitative consumer research, and that all of the intervention measures it had trialled had yielded an increase in switching rates from a baseline control group.

6.39 However, Ofgem told us that while these trials have had 'positive effects' on customer engagement, it added that these were 'not dramatic' effects against the baseline control group.

6.40 Further details of Ofgem's submissions and the views of two of the SLEFs are set out in Appendix E, where all submissions reported a positive impact on the market.

Assessment and provisional conclusions

6.41 Given that the CMA's orders and undertakings required to implement the EMI remedies have now been put in place, we considered that the EMI remedies

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[161] Parties response to the Issues Statement, paragraph 2.26.
[162] Parties response to the Issues Statement, paragraphs 2.27 and 2.28.

associated with such orders and undertakings (save where noted below) should be taken into account in our counterfactual and competitive assessment. Similarly, we will also take account of the initiatives that have already been introduced by Ofgem to increase consumer engagement. We therefore expect rates of consumer engagement to increase in the short-term.

6.42 However, the exact form and impact of some of these measures is currently unknown. The final form of the Database Remedy, which the CMA recommended Ofgem implement under its EMI remedies, is yet to be determined, meaning that its likely level of effectiveness cannot yet be gauged with any certainty. The likely level of effectiveness of the customer prompt remedy is also uncertain.

6.43 The CMA recognised in the EMI final report that the remedies would not be a 'quick fix', and that it would take time to reduce the substantial detriment it had identified. The EMI final report stated that the CMA's remedies would 'take time to fully address the features' it had identified, 'and in turn, reduce the detriment to domestic customers arising from them';[163] and the 'impact of future market developments, including the roll-out of smart meters', was 'somewhat uncertain'.[164]

6.44 Taking account of the implementation of the EMI recommendations and other measures to encourage customer engagement, we expect that the number of customers who do not engage will continue to decline, although the precise level of their effectiveness cannot be predicted until the details of these measures are agreed and they have been put into effect, which may not be determined for some time. However, we do not expect that the number of disengaged customers on default tariffs will be substantially eliminated in the short-term (for example the next couple of years), and as we set out in paragraphs 8.9 and 8.56 to 8.58, we consider that SVTs will continue to be an important tariff for the SLEFs in the foreseeable future with a significant number of customers continuing to be on SVTs. Therefore, we consider that in the counterfactual, a substantial proportion of consumers would remain on SVTs despite recent market developments that have increased consumer engagement levels.

The proposed E.ON/RWE transaction

6.45 On 12 March 2018, E.ON and RWE announced they had reached an agreement to enter into a transaction, the effect of which could potentially increase concentration in the retailing of energy in GB. We considered

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[163] EMI final report (24 June 2016), paragraphs 11.75 and 11.76.
[164] EMI final report (24 June 2016), paragraphs 13.74–13.77.

whether any account should be taken of the proposed E.ON/RWE transaction within the counterfactual.

6.46 Under the proposed E.ON/RWE transaction, E.ON would acquire between 76.8% and 100% of innogy, and RWE would hold a 16.67% stake in E.ON. Assuming completion of the Merger, E.ON would consequently hold an indirect stake of between 26.4% and 34.4% in MergeCo (depending on E.ON's final stake in innogy, and whether innogy retains its 34.4% shareholding in MergeCo (see paragraph 5.8)). E.ON and RWE stated that the transaction was expected to close by the end of 2019, subject to approval by the relevant antitrust and regulatory authorities.[165]

6.47 In reviewing mergers, our Guidelines state that the CMA may be required to consider a merger at a time when there is the prospect of another merger in the same market (a parallel transaction).[166] In this case, the CMA has considered the proposed merger of E.ON/RWE transaction as a parallel transaction.

6.48 In the context of parallel transactions in the same market between different parties, our Guidelines state that in a phase 2 merger review, parallel transactions do not have to have been referred to the CMA at the same time, and that the CMA does not give consideration of one referred merger automatic priority over another. The Guidelines state that when determining the relevant counterfactual for one of the referred mergers, the CMA will take into account whether or not it expects the other transaction to proceed.[167]

6.49 Before setting out our assessment, we first set out the background information on the proposed E.ON/RWE transaction.

Background information on the proposed E.ON/RWE transaction

6.50 On 12 March 2018, E.ON and RWE (which holds a 76.8% stake in innogy) issued a joint press release stating that they had agreed to enter into a transaction that would enable E.ON to focus on 'networks and customer solutions', and RWE on 'a fully diversified generation business', whereby:[168]

(a) E.ON would acquire RWE's 76.8% stake in innogy, and via an asset exchange, RWE would receive substantially all of E.ON's renewables

[165] See E.ON and RWE: two European energy companies focus their activities, E.ON and RWE (12 March 2018).
[166] Merger Assessment Guidelines (CC2 Revised/OFT1254), paragraph 4.3.25.
[167] Merger Assessment Guidelines (CC2 Revised/OFT1254), paragraph 4.3.27.
[168] See E.ON and RWE: two European energy companies focus their activities, E.ON and RWE (12 March 2018).

activities; innogy's renewables business; a minority stake of 16.67% in the enlarged E.ON; and certain other assets; and

(b) E.ON would make a voluntary public takeover offer to innogy's minority shareholders for the remaining 23.2% stake in innogy.

Submissions on the proposed E.ON/RWE transaction

6.51 The Parties told us that the CMA's phase 1 decision[169] '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 Merger.[170]

6.52 The Parties told us that the timing of the proposed E.ON/RWE transaction was uncertain, eg the Parties told us that both the asset exchanges and the public takeover offer were conditional upon, *inter alia*, the approval by the relevant antitrust and regulatory authorities, and therefore, their respective completions were also subject to the timing of those reviews, which could have a 'significant effect on the proposed timetable'.[171]

6.53 In relation to the uncertainty of the outcome of the proposed E.ON/RWE transaction, the Parties told us that it would not be appropriate for the CMA to 'prejudge' what the final outcome would be from these antitrust reviews, and that if the E.ON/RWE transaction raised any competition concerns, the CMA must consider the most likely outcome to be one where those concerns would be addressed fully by the relevant antitrust authorities.[172] The Parties also submitted that such an approach would be consistent with the CMA's previous decisions in BT/EE[173] and Fox/Sky.[174]

6.54 Utility Warehouse told us that the proposed E.ON/RWE transaction should be taken into account given the impact it would have on both SSE and Npower and the UK energy market. It cited two cases in support of this submission,

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[169] CMA phase 1 decision document.
[170] Parties response to the Issues Statement, paragraph 2.22.
[171] Parties response to the Issues Statement, paragraphs 2.9 and 2.10.
[172] Parties response to the Issues Statement, paragraph 2.12.
[173] The Parties submitted that in BT/EE, the CMA adopted a counterfactual in which the level of competition was equivalent to that existing prior to the Hutchison 3G/O2 transaction, ie the status quo excluding any effect of the later announced transaction, and that 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 (BT/EE final report, paragraphs 7.7–7.18) (Parties response to the Issues Statement, paragraph 2.13).
[174] The Parties submitted that in Fox/Sky, 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' (Fox/Sky final report, paragraph 13) (Parties response to the Issues Statement, paragraph 2.14).

NYSE/Euronext (OFT, 2006) and Fox/Sky (CMA, 2018) (see paragraph 18 of Appendix E.[175]

6.55 E.ON told us that the pre-notification process could take a long time and that it did not anticipate the relevant notifications to take place before the summer of 2018.[176] It added that it was 'uncertain' how quickly it would be able to notify the European Commission after the summer. In relation to the proposed transaction's other regulatory approvals, E.ON told us that this included approvals from the Dutch, Hungarian, Turkish and the United States of America (USA) energy regulators, as well as foreign investment reviews in the USA, Australia, France and Canada.

Assessment and provisional conclusions

6.56 We considered that the completion of the E.ON/RWE transaction, and its structure, was subject to some uncertainty as to whether, and when, it would proceed.

6.57 With E.ON and RWE both expecting the asset exchanges to complete by the end of 2019, and our expectation that the CMA's final report on the Merger would be published in advance of any assessment by the European Commission of the E.ON/RWE transaction, it is our provisional view that it is not possible at this stage, to predict with any confidence, the timings of any antitrust and regulatory reviews, or their likely outcomes (including any possible remedies).

6.58 Given the significant uncertainty over whether and when the E.ON/RWE transaction would complete, we have provisionally concluded that the counterfactual does not include the E.ON/RWE transaction proceeding.

6.59 We have reviewed the two cases that Utility Warehouse has brought to our attention in support of its submission set out above (see paragraph 6.54 above). We note that in both of these cases the relevant parallel transactions were not taken into account given the level of uncertainty surrounding those transactions proceeding. We do not see any reason to suggest that the approach taken in these cases contradicts the provisional view the CMA is taking in relation to the E.ON/RWE transaction.

[175] See NYSE/Euronext decision document and Fox/Sky final report.
[176] Summary of the hearing with E.ON, paragraph 28.

6.60 When the proposed E.ON/RWE transaction is notified to the European Commission, the CMA would expect to engage with the European Commission in the usual way.

Provisional conclusion on the counterfactual

6.61 Based on our assessment above, the counterfactual includes the following:

(a) the pre-Merger competitive situation represents the appropriate counterfactual;

(b) the introduction of the Default Tariff Cap up to 2020 is sufficiently certain to be part of the counterfactual, although its precise level and impact on competitive conditions are uncertain; and

(c) the EMI remedies associated with the orders and undertakings that the CMA has put in place (although their likely level of effectiveness cannot yet be gauged with any certainty given that the exact form and impact of some of these measures is currently unknown), as well as the initiatives that have already been introduced by Ofgem to increase consumer engagement.

6.62 It is also our provisional conclusion that the proposed E.ON/RWE transaction is insufficiently certain to be part of the counterfactual.

7. Market definition

7.1 The purpose of market definition is to provide a framework for the CMA's analysis of the competitive effects of a merger. The relevant market (or markets) is the market in which a merger may give rise to an SLC and contains the products and/or services that are the most significant competitive alternatives available to the customers of the merged companies.

7.2 Market definition is a useful analytical tool but is not an end in itself, and identifying the relevant market involves an element of judgement. The Guidelines indicate that the boundaries of the relevant market do not determine the outcome of the analysis of the competitive effects of the merger in any mechanistic way.[177] In assessing whether a merger may give rise to an SLC, it is possible to take into account constraints outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.

[177] Merger Assessment Guidelines (CC2 Revised/OFT1254), paragraphs 5.2.1 and 5.2.2.

7.3 In this section, we set out the relevant market in which we have assessed the effects of the Merger. We first define the product markets. Then we define the geographic markets.

Product market

7.4 The Parties overlap in the supply of electricity and gas to domestic customers.[178] We considered the appropriate frame of reference with regard to:

(a) whether there are separate markets for the retail supply of gas, electricity and dual fuel; and

(b) whether there is relevant customer segmentation by meter type, payment type and the degree of customer engagement.

Single and dual fuel tariffs

7.5 The Parties stated that the Transaction should be assessed by reference to separate product markets for the supply of gas to domestic customers and the supply of electricity to domestic customers. They also told us that 'dual fuel is a key driver of competition' and should therefore be 'taken into account where relevant in the assessment of the Transaction'.[179]

7.6 The EMI considered separate product markets for gas and electricity. Separate markets were identified because, certainly in the short-term, customers have limited ability to substitute between gas and electricity. Consequently, the possibility of customers changing from gas to electricity will not materially constrain gas prices and vice-versa. We have not received any evidence or received any submissions which challenge this approach.

7.7 In light of the Parties' submission we have considered whether it would be appropriate to consider a further separation of the product market into gas only, electricity only and dual fuel customers (ie to distinguish between single fuel and dual fuel customers).[180]

7.8 Dual fuel accounts are now the most common form of account and as of January 2018 there were:

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[178] The Parties also overlap in the supply of certain non-energy supply services, including home automation products, such as the supply of household smart thermostats. However, we were told their combined market share was less than [✂]% [0-5%], while there were many retail suppliers of home automation products in GB. We have not considered this overlap further and no concerns have been raised concerning this overlap.
[179] Parties Initial Submission (response to CMA phase 1 decision) (30 May 2018), footnote 11.
[180] This has also been considered to some extent in previous cases, for example Npower/Telecom Plus (2006).

(a) 20.2 million dual fuel tariff accounts (65% of all accounts);

(b) 7.8 million electricity only accounts (25% of all accounts); and

(c) 3.0 million gas only accounts (10% of all accounts).

7.9 Suppliers also have the ability to adjust prices independently for single fuel and dual fuel customers. Consequently we considered whether the nature of competition between these segments is distinct in a way which means that the effects of the Merger on these customer segments may differ.

7.10 There are some differences in shares of supply between gas only, electricity only and dual fuel customers (see Table 12). In particular, British Gas has a much larger share of supply to gas only customers than it does to dual fuel or electricity only customers. Similarly, although not as starkly, the other SLEFs have higher shares of supply for electricity only than for dual fuel or gas only customers. To some extent these differences are likely to reflect the historic incumbent positions of the suppliers and the fact that many customers may have never switched supplier or may have not switched recently.[181]

Table 12: GB shares of supply (as of 31 January 2018)

%

	Dual fuel	*Electricity only*	*Gas only*
British Gas	[20-30]	[5-10]	[70-80]
E.ON	[10-20]	[10-20]	[5-10]
EDF	[5-10]	[10-20]	[5-10]
Npower	[5-10]	[10-20]	[0-5]
ScottishPower	[5-10]	[10-20]	[0-5]
SSE	[10-20]	[10-20]	[5-10]
Other suppliers	[20-30]	[10-20]	[5-10]

Source: [✂].

7.11 We also note that there is some evidence that customer engagement is lower among single fuel customers. For example, single fuel customers are less likely to consider switching supplier.[182]

7.12 However, there are reasons to consider that these differences in shares of supply and levels of engagement between single and dual fuel customers do

[181] For example, Ofgem found that 58% of respondents had never switched or had only switched once (State of the energy market 2017 report, Ofgem (31 October 2017), page 6). In addition, the EMI survey reported that 72% of respondents had never switched tariff with an existing supplier, did not think it was possible or did not know if they had done so (EMI final report, Appendix 9.1 (24 June 2016), paragraph 5(d)).

[182] Ofgem found that households with both gas and electricity are twice as likely as electricity only households to have switched supplier in the last 12 months (GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 8).The EMI survey found that customers with separate suppliers for their energy were least likely to consider switching supplier in the next three years (EMI final report, Appendix 9.1 (24 June 2016), paragraph 67).

not reflect fundamental differences in the nature of competition which would merit the identification of separate product markets. In particular:

(a) Customers requiring both electricity and gas are able to switch easily between single fuel and dual fuel tariffs as necessary.

(b) Most suppliers offer single and dual fuel tariffs. Of the 72 suppliers active in March 2018, only 12 suppliers did not offer both gas and electricity (see Figure 3 above). Consequently, the suppliers a customer can select from are substantively the same for both single fuel and dual fuel tariffs.

(c) The Parties' data indicates that switching patterns for electricity and gas are very similar (see Table 13). This is consistent with there being little difference in the switching patterns (and therefore the underlying competitive conditions) of single fuel and dual fuel customers.

Table 13: Switching patterns of electricity and gas customers lost by Npower and SSE (2015-2017)

%

Party	*Supplier type*	*Electricity*	*Gas*
Npower	SLEFs	[✂]	[✂]
	Mid-Tiers	[✂]	[✂]
	Other	[✂]	[✂]
SSE	SLEFs	[✂]	[✂]
	Mid-Tiers	[✂]	[✂]
	Other	[✂]	[✂]

Source: CMA analysis based on data sourced from the Parties.
Note: Figures for Npower, SSE and British Gas include figures for their white labels; mid-tiers include Co-op Energy, First Utility, Ovo Energy and Utility Warehouse.

(d) Ofgem's 2017 consumer engagement survey found that a desire to obtain a dual fuel tariff is not a primary motivation for customer switching between suppliers.[183] Therefore the ability of a supplier to offer dual fuel tariffs has become less important over time.

7.13 Our provisional view is that this evidence does not indicate that the conditions of competition to supply these customers are sufficiently different to merit the definition of separate product markets.

7.14 Consequently, in light of the limited substitutability between gas and electricity, the evidence of similar competitive conditions to supply single and dual fuel customers and the Parties' submissions, our provisional view is that the product market definitions to use in this case are:

[183] Only 3% of the respondents to Ofgem's survey indicated that a desire to have a dual fuel tariff was a motivation for switching (State of the energy market 2017 report, Ofgem (31 October 2017), Figure 2.4).

(a) the supply of electricity to domestic customers; and

(b) the supply of gas to domestic customers.

7.15 In practice, the conditions of competition are similar for gas and electricity and in our competitive analysis it has not been necessary to distinguish between them.

Customer segmentation

7.16 We now consider whether it would be appropriate for the purposes of our assessment to identify separate markets on the basis of:

(a) meter type;

(b) payment type; and

(c) customer engagement.

Meter type

7.17 There are several different types of electricity meter in use:

(a) Single-rate meters – these meters only record an individual's aggregate electricity usage. These are the most common form of meter accounting for 84% of all electricity meters in 2017.[184]

(b) Restricted meters – restricted meters record electricity usage at different times of the day (or for different purposes separately).

(i) Economy 7 meters – these meters distinguish between peak and off-peak electricity usage allowing for seven hours of off-peak electricity usage at night. They are the most common single form of restricted meter.[185]

(ii) Non-Economy 7 restricted meters – there are a number of different types of restricted meter other than Economy 7 meters. These other restricted meters record electricity usage in a variety of different ways. Providers can use some of these meters flexibly (ie changing the times when cheap energy is supplied).[186]

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[184] This equates to approximately 23 million electricity meters (CMA analysis of data sourced from the Parties).
[185] For example, [✂]% of SSE's restricted meter customers are on Economy 7 meters (CMA analysis of data submitted by the Parties).
[186] Description from If you have a dynamically teleswitched energy meter on the Citizens Advice website.

7.18 Npower told us that it did not offer non-Economy 7 restricted meter tariffs to new customers. At the time of the EMI, Npower had only [✂] non-Economy 7 restricted meter customers.[187] Because of this we do not expect the Merger to have a distinct effect on competition to supply non-Economy 7 restricted meter customers. Therefore, we have not needed to decide on whether or not this constitutes a separate market. For Economy 7 meters, competitive options are similar to unrestricted meters, with a wide range of suppliers offering tariffs, and we have considered these along with unrestricted meters in our competitive assessment.

Payment types

7.19 The main payment options available to customers are direct debit, standard credit and prepayment.[188] Unlike other payment methods, prepayment is not typically a choice on the part of the customer and there is evidence that competition to supply prepayment customers differs significantly from competition to supply customers using other payment methods. In particular:

(a) The EMI identified a number of market characteristics[189] which were specific to prepayment customers and which affected the nature of competition to supply prepayment customers.

(b) Significantly fewer tariffs are available for prepayment customers than for other customers. Between June 2016 and June 2017 there were around 120 core tariff choices for direct debit customers, while there were only 30 choices for prepayment meter customers.[190]

(c) As noted in paragraphs 3.39 to 3.41, since 1 April 2017 a price cap has applied to prepayment meter tariffs (the PPM Price Cap). Since the PPM Price Cap was introduced, prepayment tariff prices for the major suppliers have converged around the level of the price cap (see Figure 13).[191]

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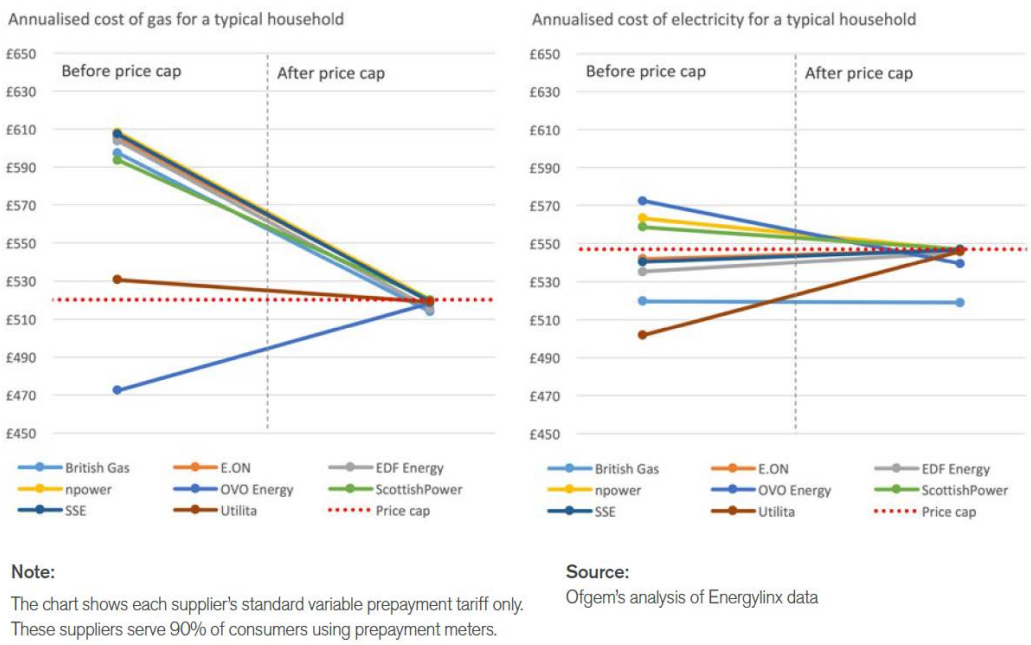
[187] EMI final report, Appendix 9.5 (24 June 2016), Table 2.
[188] We have not received any evidence to suggest that the conditions of competition to supply standard credit and direct debit customers are materially different. We also note Ofgem's Standard Licence Conditions require that any discount offered to direct debit customers relative to standard credit customers is cost reflective.
[189] These market characteristics were: a) higher actual and perceived barriers to accessing and assessing information (eg due to relatively low internet access) and b) higher actual and perceived barriers to switching (eg the need to change meter to access a wider range of tariffs and restrictions from the Debt Assignment Protocol on the ability in indebted customers to switch (see EMI final report (24 June 2016), paragraph 147).
[190] GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 47.
[191] Citizens Advice submitted that there was evidence that prices had not in fact converged around the price cap. We note that this appears to be confined to relatively small suppliers with relatively few prepayment customers while the prices of the SLEFs have converged around the cap, as illustrated in Figure 13. We also note that British Gas' price remained below the price cap. British Gas has indicated that this was as a result of its price freeze and that it has otherwise priced at or just below the level of the cap.

Figure 13: Ofgem analysis of prepayment meter tariffs



Source: State of the energy market 2017 report, Ofgem (31 October 2017), page 32.

7.20 However, we have not found it necessary to define a separate market for customers with prepayment meters. In the phase 1 decision on the relevant merger situation and SLC,[192] the CMA noted that the Parties are not close competitors for prepayment customers and that there were a number of strong competitors, in particular Ovo Energy and Utilita.[193] Furthermore, while the PPM price cap is in place, it is likely that prepayment tariff prices will continue to be set at or close to the level of the cap.

Customer engagement

7.21 As we discuss in Section 3, there are varied levels of customer engagement within the energy sector. The evidence indicates that a significant proportion of customers on default tariffs are disengaged while those on acquisition tariffs (since they have generally actively decided to switch to those tariffs) are more likely to be engaged. We also note that these differences in customer engagement lead to significantly higher prices for default tariffs compared to acquisition tariffs and the potential for customers to make significant savings if they switched from a default tariff to an acquisition tariff.[194]

[192] CMA phase 1 decision document.
[193] This was illustrated by the very low levels of switching between the Parties by prepayment meter customers. Switching from Npower to SSE is between [✂]% for gas and/or electricity and for SSE to Npower it is [✂]%.
[194] This was a finding of the EMI (see EMI final report (24 June 2016), paragraph 155).

7.22 Therefore, we have considered whether it would be appropriate to define a separate market for customers on default tariffs.

7.23 However, as we noted in paragraph 3.11, there are a variety of degrees of engagement and an individual customer's level of engagement can vary over time. Furthermore, we note that the competitive alternatives (in terms of tariffs and suppliers) available to engaged and disengaged customers are generally the same.[195]

7.24 Consequently, although a number of factors could be used to support the identification of separate markets for engaged and disengaged customers, we do not consider it to be necessary to do so in this case. We will address differences in customer engagement within our competitive assessment (see Section 9).

Provisional conclusion on product market definition

7.25 For the reasons given above, in our view it is not necessary to define the relevant product markets more narrowly than (a) the supply of electricity to domestic customers and (b) the supply of gas to domestic customers.

Geographic market

7.26 The Parties overlap in the supply of gas and electricity to retail customers in GB.[196] They submitted that the appropriate geographic market for the assessment of the Merger is GB,[197] on the basis of previous decisions by the OFT, the CMA and the European Commission.[198]

7.27 We have considered whether it is appropriate to consider a narrower geographic market than GB, because there are several factors which suggest that competitive conditions vary across geographic areas. For example, the SLEFs have higher shares of supply in all of their former incumbency regions than they do in other regions (see Table 2). Some suppliers also vary acquisition tariff prices (or selectively offer acquisition tariffs) across geographic areas. To some extent these price variations reflect differences in network costs across geographic areas. However, some suppliers vary prices by a greater extent than can be explained by cost differences, suggesting

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[195] On occasion suppliers offer tariffs which are specific to particular customer groups, eg existing default tariff customers.
[196] Npower is not currently active in domestic retail energy supply in Northern Ireland and a single electricity market covers both the Republic of Ireland and Northern Ireland. We were also told that SSE's business in Northern Ireland (and the Republic of Ireland) will not be transferred to MergeCo. As a result, we do not consider a geographic frame of reference wider than GB to be a relevant consideration.
[197] Parties Initial Submission (response to CMA phase 1 decision) (30 May 2018), paragraph 3.8.
[198] Telecom Plus/Electricity Plus Supply and Npower/Telecom Plus, EMI and EDF/British Energy respectively.

there may be a desire to compete more intensively in certain areas than in others.

7.28 Ofgem also submitted that there are some differences in competitive conditions across different geographic areas, noting both the differences in shares of supply and some differences in customer requirements. For example, 'most customers in the remote parts of Scotland are electricity only customers'. Other third parties also noted regional differences. For example, ScottishPower noted the difficulties of marketing to and attracting customers located in rural areas such as the North of Scotland where population density is lower.

7.29 We asked the Parties to explain their approach to regional pricing. [✂]. Npower told us [✂]. SSE [✂].

7.30 This is consistent with the Parties' approach to SVT price setting as illustrated by their internal documents. These documents show [✂]. Consequently, [✂].

7.31 The Parties' internal documents note [✂]. This is supported by evidence from Ofgem which illustrates that, once differences in network costs are accounted for, the SLEFs do not have a meaningful or consistent premium to their SVT prices in their former PES incumbency regions.

7.32 Although some suppliers do vary acquisition tariff prices regionally, we have not received evidence indicating that the conditions of competition are fundamentally different across geographic areas in a way which means that we should define separate markets for different geographic areas. We note that:

(a) the basic parameters of gas and electricity retail competition are determined by the regulatory framework which applies equally across GB;

(b) many suppliers are active in all regions, a large number of suppliers are active in every region and customers in each region can select from a large number of tariffs. As a result, customers have similar options with respect to the choice of supplier in each geographic area;

(c) switching patterns are similar across geographic areas. For example, of the Parties' customers who switched supplier in 2017 more than [✂]% switched to the SAMS in every region. This is consistent with the conditions of competition being similar across these geographic areas. It also suggests that differences in shares of supply for the SLEFs across geographic areas are likely to reflect their incumbency positions in these areas; and

(d) although some suppliers do vary prices and their choice of tariffs across geographic areas, others do not and, as noted above, the SLEFs do not appear to vary their SVT prices across regions beyond differences in costs. This indicates a limit in the extent to which competitive conditions vary across geographic areas.

7.33 Therefore, although there are some differences in the strategies of suppliers across geographic regions, our provisional view is that the nature of competition across these areas is not sufficiently different to justify defining a narrower geographic market than GB. The evidence does not indicate that the Merger will give rise to adverse effects in one geographic area which would not arise in other areas, although we will consider the possibility that any adverse effects could have a greater impact in some regions than in others in our competitive assessment.

Provisional conclusions on geographic market

7.34 For the reasons given above, we have defined the geographic market as GB and competition across areas within GB is not sufficiently different to justify a narrower geographic market.

Provisional conclusion on market definition

7.35 Our provisional conclusion is that the appropriate market definition for the purposes of this investigation are:

(c) the supply of electricity to domestic consumers in GB; and

(d) the supply of gas to domestic consumers in GB.

7.36 In practice, the conditions of competition are similar for gas and electricity and therefore in our competitive analysis it has not been necessary to distinguish between them.

8. Evidence on suppliers' price setting behaviour

8.1 In this section, we outline the available evidence relating to how suppliers set their prices for acquisition and default tariffs. This evidence informs our subsequent competitive assessment in Section 9.

8.2 As noted in paragraph 2.25, energy suppliers typically offer two types of tariff. First, a range of acquisition tariffs, usually FTCs, which are intended to attract

new customers. Second, default tariffs, typically SVTs,[199] which customers are placed on by default if they have not chosen another tariff.[200]

8.3 Below we review the evidence we have received regarding how suppliers set acquisition tariffs, before reviewing the evidence relating to setting default tariffs.

Acquisition tariffs

Pricing of acquisition tariffs

8.4 When switching supplier, customers are largely motivated by the possibility of saving money and their choice of supplier is primarily motivated by price (as discussed in paragraphs 3.26 to 3.28) with customers frequently using PCWs to explore available deals.[201] While some customers have a preference for particular suppliers (see paragraph 3.29), and may take account of reviews and other indicators of service, in the main, suppliers have to offer attractive prices to gain customers. Suppliers tend to vary acquisition tariff prices frequently, according to their desire to win new customers, whether they need to offer attractive tariffs to their own customers whose FTCs are expiring or in mitigation of changes in SVT prices.

8.5 The cheapest acquisition tariffs are generally offered by the SAMS.[202] Figure 14 and Figure 15 show Npower's and SSE's FTC pricing relative to the cheapest available tariffs. Each figure compares the cheapest FTC available from the Parties at each point in time compared to the cheapest available FTC from any supplier at each point in time.[203] This analysis indicates the relative price competitiveness of the Parties' FTC pricing strategies over time.[204]

8.6 Npower's data shows that:[205]

(a) Between late 2015 and mid 2017 Npower's cheapest FTCs followed the general pattern of the cheapest FTC available. On occasions, particularly

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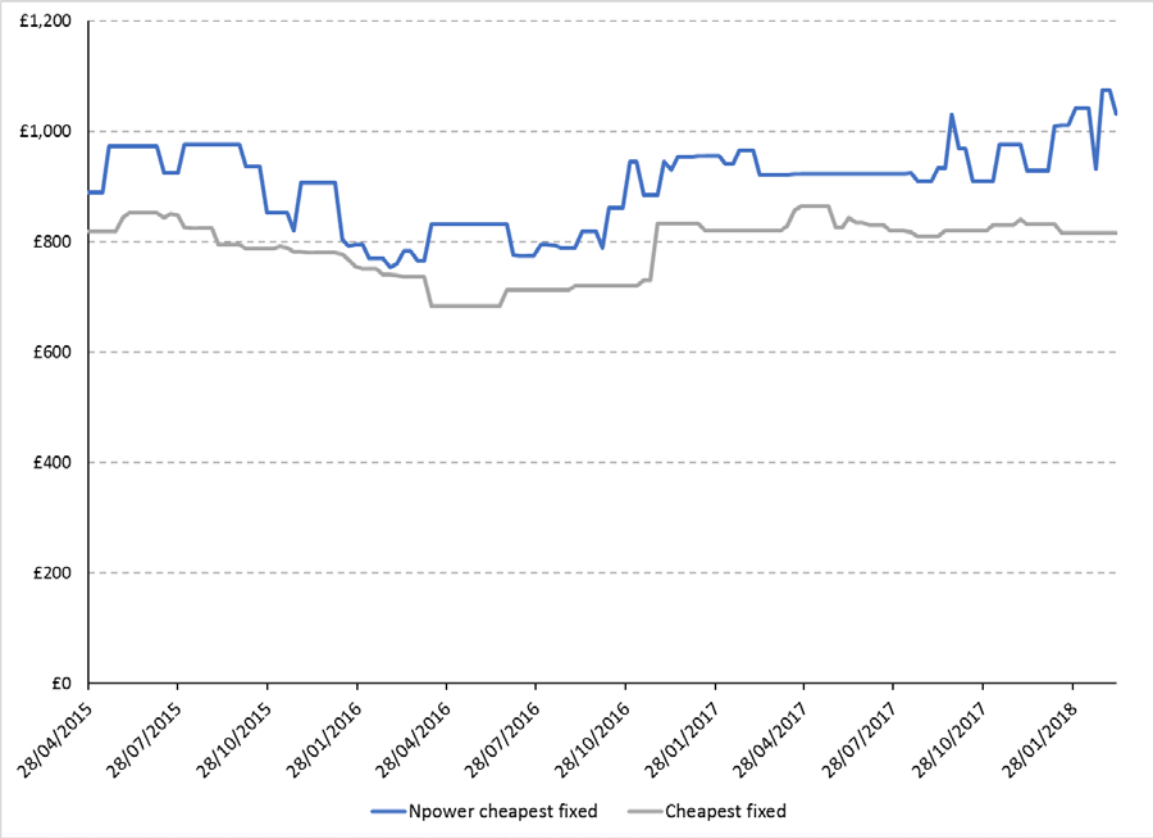
[199] Although a number of suppliers have recently introduced a fixed term default tariff and we discuss these tariffs in more detail below.
[200] Some suppliers offer only a single tariff, so that the same tariff is used as a default and an acquisition tariff.
[201] For example, [✂]% of Npower's acquisitions in 2017 were via PCWs.
[202] See for example, Cheapest tariffs by payment method: Typical domestic dual fuel customer (GB), Ofgem (July 2018).
[203] This comparison is based on Ofgem's Typical Domestic Consumption Values.
[204] This analysis should only be viewed as providing a general indication since (i) the price competitiveness of a tariff will depend on an individual's consumption and (ii) this analysis focusses only on price while tariffs can also vary by duration. Regarding (ii) while the cheapest tariffs in the market will tend to be one-year tariffs, any individual supplier may not always offer a one-year tariff. Therefore, the comparison may not necessarily be like-for-like.
[205] This general pattern of Npower's pricing strategy is consistent with the evidence from [✂] and [✂].

in early 2016, Npower's cheapest FTC was priced close to the lowest priced tariffs available.

(b) More recently, Npower's lowest priced FTCs have been less comparable to the cheapest tariffs available.

(c) Compared to SSE, Npower has adopted a more consistent FTC pricing strategy over time.

Figure 14: Npower fixed term tariff pricing strategy

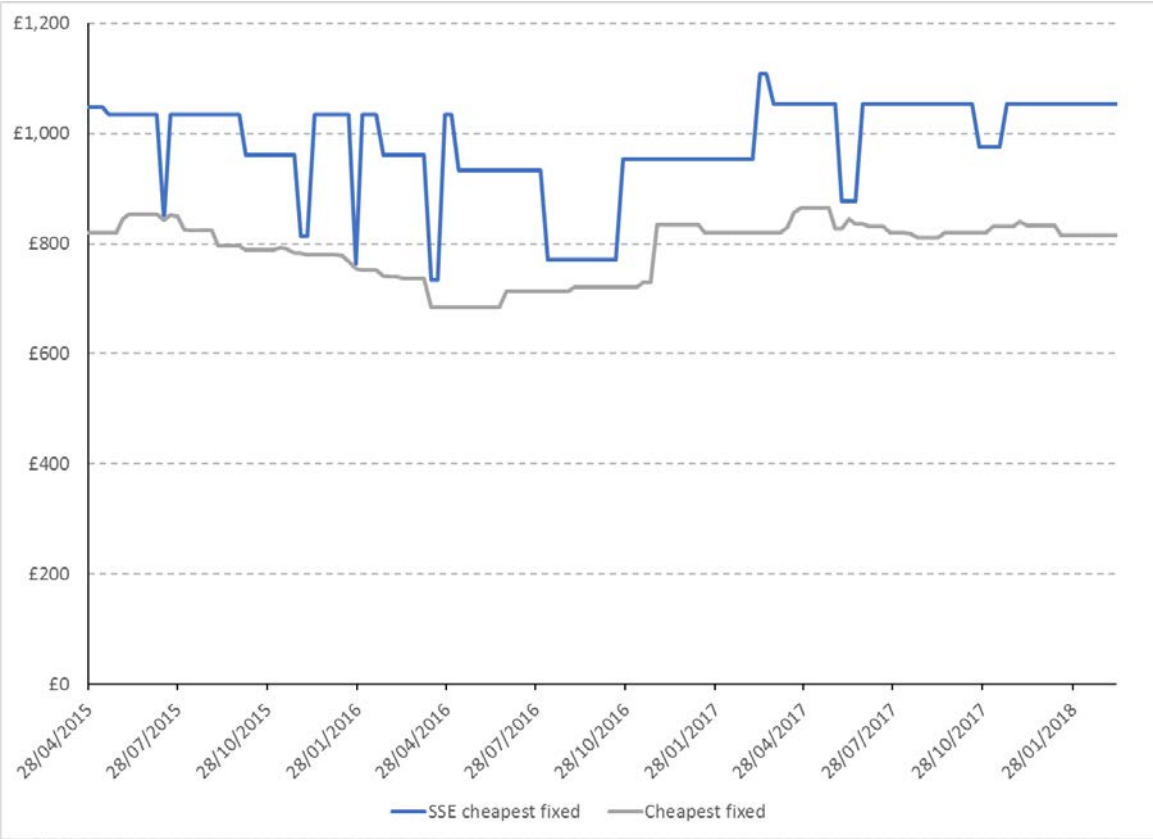


Source: CMA analysis.

8.7 SSE's data is shown in Figure 15. This illustrates that SSE's recent FTC pricing strategy has involved offering tariffs priced at the level of the cheapest available FTC for relatively short periods while offering tariffs at considerably higher prices outside of these periods.[206]

[206] This general pattern of SSE's pricing strategy is also consistent with the evidence from [✂] and [✂].

Figure 15: SSE fixed term tariff pricing strategy



Source: CMA analysis.

8.8 Because the SAMS tend to offer the lowest tariffs, and because the Parties and the other SLEFs tend to vary their acquisition tariffs frequently, there is no indication that there is any alignment of price changes or any recurring price leadership between the larger suppliers in respect of acquisition tariffs.

Default tariffs

8.9 In this section we review the evidence we have received regarding default tariffs. Nearly all of the Parties' default tariff customers are on SVTs[207] and consequently, much of the evidence we have received concerns SVTs. Therefore, our analysis focussed on possible effects on SVTs. However, some suppliers have recently introduced fixed term default tariffs and we have considered the implication of this change where relevant.

8.10 We have focussed on evidence regarding the SLEFs because they have a considerably greater number of customers on default tariffs than other

[207] Data from Ofgem indicates that all of SSE's default tariff customers were on SVTs while less than 1% of Npower's default tariff customers were on a fixed term default tariff (see Number of non-price protected domestic customer accounts by supplier: standard variable, fixed and other tariffs (GB), Ofgem (July 2018)).

suppliers[208] and their SVT price announcements are more prominent than those of other suppliers.[209] Moreover, the SLEFs pay particular attention to the likely timing and magnitude of SVT price changes by the other SLEFs when setting their SVT prices.[210] This will inform our assessment of the possible effects of the Merger on the Parties' competitive behaviour.

8.11 In this section we review the evidence concerning:

(a) the pricing of default tariffs;

(b) the reasons for changes to SVT prices;

(c) the effects of SVT price changes on customer switching and the factors which affect the level of customer switching in response to SVT price changes;

(d) the factors affecting the timing of SVT price announcements; and

(e) the introduction of fixed term default tariffs.

Pricing of default tariffs

8.12 Default tariff prices tend to be significantly higher than acquisition tariff prices. For example, the EMI estimated that the average gains to the SLEFs' dual fuel SVT customers from switching supplier, tariff and payment method between 2012 and 2015 was £164.[211] Ofgem's 2017 'State of the energy market' report noted that since the EMI 'price differences between variable tariffs and fixed tariffs have widened'.[212] This is illustrated by Figure 16 which shows that the difference between the average SVT price of the SLEFs and the cheapest acquisition tariffs:[213,214]

(a) Increased to over £300 in late 2016. This coincided with a period of decreasing wholesale prices.

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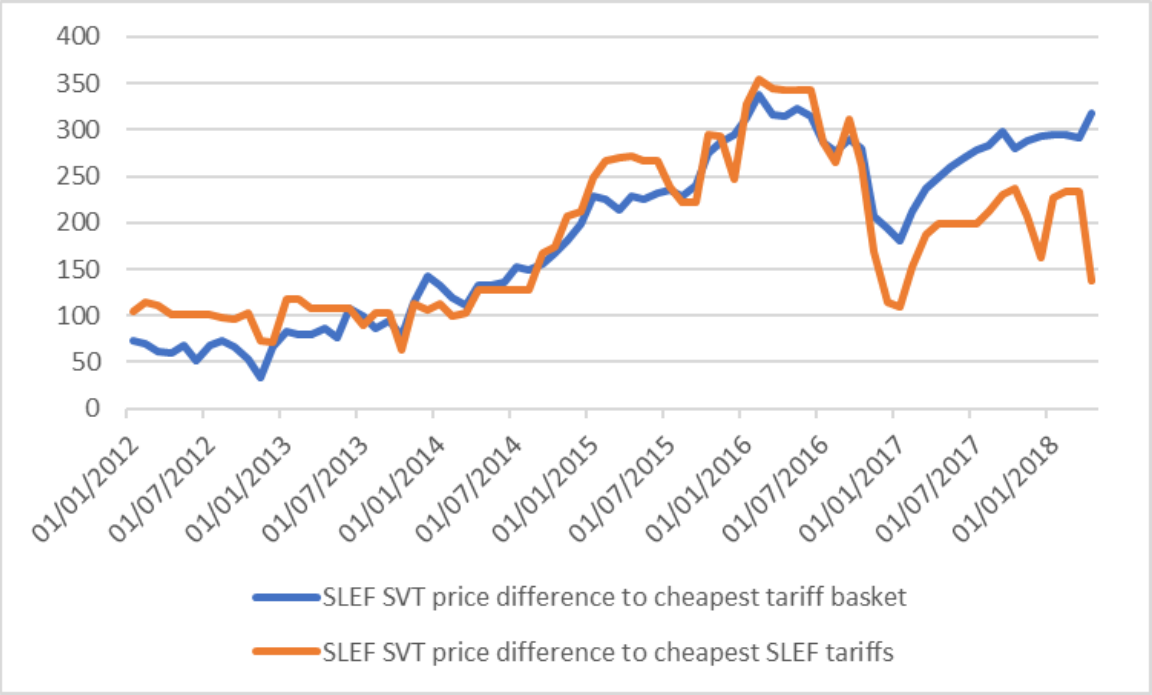
[208] For example, data collected by Ofgem shows that as of July 2018 Npower had approximately 1 million SVT customers (the fewest of the SLEFs) while Utility Warehouse had approximately 230,000 SVT customers (the most of the SAMS) (see Number of non-price protected domestic customer accounts by supplier: standard variable, fixed and other tariffs (GB), Ofgem (July 2018)).
[209] This is reflected in our press coverage analysis (see Appendix I) where we found that the coverage of a supplier's SVT price announcement rarely referred to the SVT price changes of suppliers other than the other SLEFs.
[210] As discussed further in Section 9 below.
[211] EMI final report (24 June 2016), Table 1 and paragraph 128.
[212] State of the energy market 2017 report, Ofgem (31 October 2017), page 6.
[213] The connection to movements in wholesale prices reflects the fact that SVTs are hedged over a longer period which reduces the volatility of wholesale prices associated with these tariffs.
[214] This is also consistent with analysis in one of [✂] internal documents which shows the gap between the SVT and the cheapest available acquisition tariff price increasing over time.

(b) Decreased significantly in late 2016/early 2017 to around £200 as wholesale prices increased. Since then, the difference to the cheapest available tariffs has increased to around £300 again while the difference to the cheapest of the SLEFs' tariffs has remained between £150 and £250.

Figure 16: SVT price differences to cheapest tariffs



Source: Retail price comparison by company and tariff type: Domestic (GB), Ofgem (July 2018).

8.13 Because customers who switch tend to be price sensitive (see paragraphs 3.26 to 3.28), a consequence of these price differences is that very few customers are likely to actively choose to go onto an SVT[215] and the evidence indicates that a substantial number of SVT customers are currently disengaged (see paragraph 3.9).[216]

8.14 The consequence of this is that there is no competitive rivalry between the Parties in relation to attracting customers to SVTs. Instead, suppliers are concerned with the potential loss of their SVT customers and how their actions may prompt engagement by such customers (eg following a price

[215] That is, once a previously disengaged customer starts looking at alternatives they will tend to choose a cheaper acquisition tariff.
[216] The Parties submitted that our assessment of SVT prices required that 'there exists a distinct set of SVT customers who are not engaging in the market currently and cannot be expected to do so in the future'. Our assessment has not required this and we have only identified that at any point in time there is likely to be a material number of SVT customers who are disengaged. While the number of disengaged SVT customers may change over time, and while the engagement levels of individual customers may vary over time, we have not received evidence to contradict our view that there currently continues to be material numbers of disengaged SVT customers.

rise). This is particularly so because SVT customers tend to yield higher margins to suppliers than those on acquisition tariffs given the higher SVT prices.[217]

8.15 It is in this context which we have reviewed evidence, including internal documents, from the Parties and from the other large energy firms regarding the factors which affect their SVT price setting decisions. This evidence is presented below and our detailed review of this evidence is presented in Appendix F.

Reasons for changes to SVT prices

8.16 The SLEFs told us that the prompt for suppliers to consider price changes is movements in costs, and that the magnitude and timing of cost changes is an important determinant of the magnitude and timing of SVT price changes.[218]

8.17 Suppliers monitor their costs on an ongoing basis to understand whether they have moved in a way such that an SVT price change is necessary if target profit margins are to be met. The main categories of costs considered by suppliers are:

(a) wholesale energy costs – which depend on both wholesale gas and electricity prices and a suppliers hedging strategy;

(b) network costs;

(c) operating costs; and

(d) policy costs – in particular environmental and social obligation costs.

8.18 Many of these costs are common across suppliers and therefore multiple suppliers are affected by similar cost movements at similar points in time. Consequently, as illustrated by our analysis of SVT price announcements (Appendix G), the SLEFs tend to adjust SVT prices at similar times to each other in 'rounds'.

8.19 Once an SVT price change is deemed necessary, each supplier considers the desired level and timing of their price change. This involves considering a

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[217] The SLEFs market their acquisition tariffs, in part, so that those SVT customers who do engage with the market (eg in reaction to a price rise) are not necessarily lost to another supplier. The Parties also told us they had undertaken campaigns to encourage their SVT customers to switch onto their other tariffs (Parties response to the Issues Statement, paragraph 3.17).
[218] See for example, Parties Initial Submission (response to CMA phase 1 decision) (30 May 2018), paragraph 5.19 (in reference to paragraph 116 of the CMA phase 1 decision document).

number of possible scenarios and we discuss below the constraints suppliers face in general and the factors they consider when adjusting their SVT prices.

8.20 In most cases suppliers determine a headline SVT price change before prices are adjusted across fuels, tariff structures and regions to deliver the headline price change. Once the details of a price change have been finalised suppliers typically publicly announce a price change.[219] We have conducted an analysis of the SVT price changes of the SLEFs since 2003 (Appendix G). This analysis shows that:

(a) there is no evidence of any one of the SLEFs consistently being the first to announce a price change or of price changes being made in a particular order;

(b) the precise timing of price announcements by each of the SLEFs and the delay between announcements within each round varies across price change rounds; and

(c) within rounds there is some variation in the magnitude of the price changes made by each of the SLEFs, most notably when some of the SLEFs do not adjust prices for one fuel while others adjust prices for both.

8.21 In the case of a price increase,[220] Ofgem's licence conditions require that suppliers provide 30 days written notice to customers of the price change. Ofgem requires that, in doing so, suppliers provide customers with a range of information including details of the cheapest alternative tariffs offered by that supplier. Therefore, the process of adjusting SVT prices involves significant cost (eg in producing and sending letters to all SVT customers), and decisions to increase prices need to be taken several weeks ahead of implementation.

8.22 Where a supplier uses default FTCs, price changes only apply to new customers coming on to the default FTC. Therefore prices can be readily adjusted as existing customers, whose prices are fixed for the duration of the FTC, are unaffected by such a price change and therefore do not need to be informed.

The effects of SVT price increases on customer switching

8.23 The main constraint suppliers face when adjusting their SVT prices is the risk that customers will switch to another tariff (internal switching) or supplier

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[219] Such public announcements are in addition to the written communication of the price change to customers which suppliers are required to undertake (see paragraph 8.21).
[220] There is no requirement for a supplier to notify customers ahead of a price decrease, although we understand that suppliers will often do so anyway.

(external switching). As noted in paragraph 3.20, this is because price changes can act as a trigger event and prompt customers to engage with the market and to switch to cheaper acquisition tariffs.

8.24 This is apparent from a range of evidence we have reviewed from the SLEFs. In particular:

(a) In their submissions, the Parties told us that 'SVT prices are constrained by the desire to balance a need to pass on changes in costs with an increased rate of customer losses'.[221] They also noted that 'SVT price rises are infrequent because of their significant impact on customer switching'[222] and 'the rate of loss (to internal FTC products and externally) picks up immediately following an SVT price increase'.[223]

(b) The Parties' internal documents regularly consider the increase in customer switching which will follow an SVT price announcement. For example, in 2017 one SSE document projected customer account losses of around [✂] (approximately [✂]% of SSE's SVT accounts at that time) in response to a 15% electricity price increase. Similarly an Npower internal document notes that '[✂]'.

(c) As Appendix F shows, evidence from the other SLEFs indicates that they expect SVT price changes to result in increased customer switching. For example, [✂].

(d) Our analysis of the Parties' switching data (see Appendix H) confirms that, while there is an underlying level of SVT customer switching throughout the year, there are material increases in customer switching at the time of SVT price changes. For example, [✂] Npower SVT electricity customers switched to a different supplier in January 2017 ([✂]% of Npower's SVT electricity customers). Npower then announced a 10% SVT price increase in February 2017 and lost [✂] and [✂] customers in February and March 2017 respectively ([✂]% and [✂]% of Npower's SVT electricity customers respectively), a substantial increase over the baseline level of switching observed before the price increase. Similarly, in February 2017 [✂] SSE SVT electricity customers switched supplier ([✂]% of SSE's SVT electricity customers). Following its 15% electricity price increase in March 2017, SSE lost [✂] and [✂] SVT electricity customers in April and May 2017 respectively[224] ([✂]% and [✂]% of

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[221] Parties response to the Issues Statement, paragraph 3.3(ii).
[222] Parties Initial Submission (response to CMA phase 1 decision) (30 May 2018), paragraph 5.9.
[223] Parties response to the Issues Statement, paragraph 3.25.
[224] Due the announcement being in mid-March, we have not focussed on the customer losses during March.

SSE's SVT electricity customers)[225]; again, a significant increase over the levels observed before the price announcement.

8.25 However, our analysis of the Parties' switching data (see Appendix H) also illustrates that the increase in customer switching following a price announcement is relatively short lived. That evidence illustrates that following the Parties' 2017 price announcements SVT customer switching increased for [✂] before returning to its previous level.

8.26 Therefore, in deciding whether or not to implement a tariff change, the SLEFs trade off the profit gains from a price increase with the anticipated loss of profit from the additional loss of customers.

8.27 In their submissions the Parties submitted that the vast majority of customer switching takes place outside of periods of price announcements. We agree that there is an underlying level of SVT customer switching and that this underlying level of customer switching has generally been increasing over time. However, in our view, evidence from a range of sources clearly indicates that SVT price announcements prompt material increases in customer switching above this underlying rate (see paragraph 8.24).

8.28 A substantial proportion of the customers who switch away from an SVT switch to another tariff offered by the same supplier. For Npower, [✂]% of both gas and electricity SVT customers who switched in 2017 switched to another Npower tariff. For SSE [✂]% of electricity SVT customers and [✂]% of gas SVT customers who switched in 2017 switched to another SSE tariff. However, these alternative tariffs tend to be lower margin acquisition tariffs, therefore, this switching represents a reduction of potential profits for the Parties.

8.29 Of the Parties' SVT customers who switched externally in 2017, less than 10% switched to the other Party, while over 50% switched to one of the SAMS (see Appendix H). This means that of the Parties' SVT customers who switched externally to one of the other large energy firms, less than 20% switched to the other Party.

8.30 In this context, our analysis of the evidence (see Appendix F) indicates that each of the SLEFs considers a number of factors when estimating the increase in customer switching that they expect to experience following a SVT price increase, including:[226]

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[225] [✂]
[226] [✂]

(a) The magnitude of the proposed price change – for example, SSE [✂] its estimate of the customer switching which would follow its 2017 price increase when compared to its 2013 price increase, [✂]. Npower assumed that customer switching would be [✂] in 2018 than in 2017 [✂].

(b) General trends in customer engagement – for example, the increase in customer switching over recent years (see paragraph 3.6 and Figure 7) led [✂].

(c) The time of year at which the SVT price change will be made – if a price increase is made during, or shortly before, the winter, when energy consumption is at its highest, customers are likely to be much more sensitive to its impact. Therefore, a greater proportion of SVT customers might switch in response to a price increase at this time of year. This led [✂]. [✂].

(d) The perception of the supplier's price announcement within the wider market context – as we discuss further below, the perception of a SLEF's SVT price change depends on a range of factors including the SVT price changes of the other large energy firms.

8.31 In considering how their price announcement will be perceived within the wider market context, suppliers take account of the likely media reaction (which includes not just press and television but also communications from consumer websites and PCWs). For example:

(a) In its submissions SSE has stated that '[✂]'.[227]

(b) Both Parties' internal documents consider [✂]. For example, one Npower document highlights the '[✂]' which will accompany a price announcement. In 2017 SSE [✂].[228]

8.32 Suppliers consider a range of factors when seeking to understand how their price announcement will be perceived, including:

(a) How the proposed price change compares to publicly available measures of industry cost changes such as Ofgem's Supplier Cost Index and changes in the prepayment meter cap.

(b) Relevant political and external events which are likely to influence the perception of a supplier's price announcement. For example, when

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[227] Parties Initial Submission (response to CMA phase 1 decision) (30 May 2018), paragraph 5.39(iv).
[228] Additionally, [✂] submitted 'that being the first supplier to announce a price rise leads to disproportionate customer losses as a result of negative media coverage.'

planning its 2018 price announcement Npower intentionally avoided announcing at the same time as [✂] stating that '[✂]'. Similarly, in 2013 SSE considered the implications of [✂].

8.33 Additionally, we have received evidence that the media reaction is likely to be stronger, and the subsequent increase in consumer switching is likely to be larger for a large energy firm, if (i) it is the first of the SLEFs to announce an SVT price increase,[229] or (ii) if its price increase is out of line with the other large energy firms. This is likely to arise because an increased media reaction targeted at a specific supplier is likely to prompt greater rates of engagement among that supplier's customers. We consider (i) and (ii) in turn below.

Costs of being a first-mover

8.34 Evidence from the SLEFs consistently indicates that each of them expects to experience greater SVT customer switching than would otherwise be the case if it is the first of the SLEFs to announce an SVT price increase (see Appendix F). Npower has submitted that '[✂]'. Likewise SSE has noted that '[✂]'.

8.35 The Parties' internal documents quantify the increase in customer switching that they expect to experience if they are the first of the SLEFs to announce a price increase.

(a) In connection to its 2017 price announcement, SSE estimated that it would experience [✂] if it was the first of the SLEFs to announce. [✂].

(b) In 2018 Npower assumed that being the first of the SLEFs to announce an SVT price increase would result in [✂].

8.36 The other large energy firms also referred to the increase in SVT customer switching they expected if they were the first of the SLEFs to announce a price change. E.ON told us that the first of the SLEFs to announce a price rise tended to suffer the most losses.[230,231] ScottishPower told us it was risky to be the first of the SLEFs to announce a price rise and explained that in 2011 it announced a 19% price rise and none of the other large energy firms raised

[229] For example, the Parties have submitted that 'the first supplier to announce its SVT price increase tends to face: (i) a significant amount of media attention immediately following their price announcement; and (ii) ongoing attention as they are referred to again in the context of subsequent press announcements' (Parties Initial Submission (response to CMA phase 1 decision (30 May 2018), paragraph 5.76).
[230] Summary of the hearing with E.ON, paragraph 16.
[231] E.ON also noted that it expected that the first supplier to announce an SVT price decrease was likely to receive the most favourable (least negative) media coverage which would support customer acquisition/retention.

prices until approximately eight weeks later. During that period ScottishPower lost [✂] customers.[232]

Relative SVT price differences

8.37 The positioning of a large energy firms' SVT price relative to the SVT prices of the other SLEFs also affects how each of the SLEFs' SVT price announcement will be perceived (and therefore the impact on SVT customer switching). The evidence indicates that both the magnitude and timing of SVT price changes by the other large energy firms affects the extent of SVT customer switching each of the SLEFs can expect to experience following an SVT price announcement.

8.38 SSE seeks to ensure [✂]. Similarly, Npower seeks to ensure [✂]. We have received evidence of the SLEFs seeking to predict the likely effects of cost changes on the other large energy firms and therefore the likely magnitude and likely timing of their price announcements. For example, following changes in costs, [✂] and [✂] model the ranges other large energy firms' price changes required to meet ranges of assumed margin targets.

8.39 SSE's internal documents quantify its expectations regarding the increase in SVT customer switching which will arise if it is an '[✂]'. As we discuss in Appendix F, [✂].[233] In 2017 it was estimated that this could increase the number of SVT customer accounts lost by SSE in response to its price announcement by [✂]. [✂].

8.40 We have received evidence that both of the Parties have considered the implications of price announcements by the other large energy firms for their own SVT pricing decisions. In particular, [✂]. Npower noted that '[✂]'.

Analysis of press coverage

8.41 Since suppliers consider the likely media reaction to their price announcements, we have conducted a review of the press coverage of the recent price announcements of the SLEFs (Appendix I). We were able to review and characterise past press coverage of the SLEFs' SVT price changes between December 2016 and May 2018, although we note that the press is just one part of media coverage.

8.42 This review illustrates that the most prominent factor reported on is the size of the announced price change by one of the SLEFs followed by the potential for

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[232] Summary of the hearing with ScottishPower, paragraph 24.
[233] [✂]

customers to save money by switching to an acquisition tariff. It is also common for articles to make comparisons between the SVT price announcements of different suppliers. The vast majority of such comparisons are made between the SLEFs, with very few comparisons made to the price announcements of the SAMS.

8.43 We also found some evidence that price announcements by British Gas were subject to more press coverage since there were more articles concerning these price announcements. This could be for two reasons:

(a) Timing – British Gas' 2017 price announcement followed some time after those of the other SLEFs and was effectively conducted in isolation while in 2018 British Gas was the first of the SLEFs to announce a price change.

(b) Size – British Gas is the largest supplier[234] with the most customers affected by an SVT price change.

8.44 The Parties have subsequently submitted that the media is not a significant factor prompting customers to switch away from an SVT and that this is reflected in a number of customer surveys where the media is not cited by respondents as the prompt for them to engage.[235] The survey evidence suggests that receiving supplier communications is the main prompt for engaging in the market. Nevertheless, evidence from other suppliers and the Parties, summarised in paragraphs 3.20 to 3.25 and at paragraph 8.31, clearly shows that the SLEFs consider that media coverage has a significant effect on customer engagement and customer switching in response to SVT price changes.

8.45 As regards the customer survey evidence cited by the Parties, we have some doubts about the ability of respondents to accurately recall precisely what prompted them to engage with the retail energy market at such a fine level of detail. This is especially so when the question may have been asked some time after the event and when customers are likely to receive multiple prompts simultaneously.

Impact of the difference between SVT and acquisition tariff prices

8.46 The Parties have submitted that the extent of customer switching following an SVT price increase is affected by the difference between SVT and acquisition

[234] Market Structure charts, Ofgem (accessed on 28 August 2018).
[235] We have considered this evidence in more detail in Appendix B.

tariff prices and that, therefore, they consider this difference when assessing the customer switching which will result from an SVT price increase.

8.47 We note the evidence provided by the Parties that customers are more likely to switch supplier the greater the potential saving available. The evidence on customer behaviour (see paragraphs 3.26 to 3.28) also illustrates that once a customer begins to consider switching supplier the most important factors in their decision are price and the possibility to save money.

8.48 However, we have also received evidence which indicates that the precise difference between SVT and other suppliers' acquisition tariff prices has a relatively limited impact on the magnitude of SVT price changes made by suppliers. In particular, [✂].[236]

8.49 We also note that there have been substantial differences between SVTs and acquisition tariff prices for a significant period of time and Ofgem has noted that 'price differences between variable tariffs and fixed tariffs have widened'.[237] This increase in the difference between SVT and acquisition tariff prices has occurred at the same time as increased customer engagement in general, continued entry by new suppliers and increased customer switching away from SVTs. If the difference between SVT and acquisition tariffs had significant implications for the customer response to an SVT price change, we would have expected suppliers to respond by reducing the price difference. This has not happened (see Figure 16 where differences have increased over the last year) suggesting that the difference between acquisition tariff and SVT prices is not the main factor which prompts customers to begin to consider switching supplier, although it is likely to influence a customer's decision regarding which tariff and/or supplier to switch to.

8.50 Additionally, [✂].' This does not suggest that reducing the price difference between default tariffs (including SVTs) and acquisition tariffs is likely to affect customer switching.

8.51 Finally, we note that one barrier to engagement for many customers is a lack of awareness of the potential savings which can be made by switching tariff.[238] The difference between acquisition tariffs and SVT prices is less likely to be the factor which prompts these particular customers to begin to consider switching supplier.

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[236] The SLEFs often actively promote their own acquisition tariffs to their default tariff customers as it is better to retain an engaged customer than to lose them.
[237] State of the energy market 2017 report, Ofgem (31 October 2017), page 6.
[238] For example, Cheaper Market Offers Letter Trial, Ofgem (summer 2017), paragraph 1.4.

The factors affecting the timing of SVT price announcements

8.52 Having decided to make an SVT price change, suppliers need to decide when to implement it. This involves trading off the profit gains from an earlier price increase against a possible loss of profits from the additional loss of customers.

8.53 The evidence we have received indicates that the SLEFs consider the following factors when deciding on the timing of their SVT price announcements:

(a) The extent of the cost movements experienced by the supplier and therefore the subsequent impact on its profitability. In other words how urgent it is to increase prices in response to increased costs (noting that a delay could necessitate a larger subsequent price increase in an attempt to achieve annual profit targets, with possible increased loss of SVT customers).

(b) Whether the supplier will be the first of the SLEFs to announce a price increase, given the increase in SVT customer switching which this is likely to prompt (see paragraphs 8.34 to 8.36).

(c) The benefits of delaying a price announcement in order to have further clarity regarding cost movements and other market developments. For example, [✂].[239]

(d) The number of customers coming to the end of an acquisition tariff and who, despite not currently being on a SVT, might also be affected by an SVT price change. For example, [✂].

8.54 Npower's internal documents discuss [✂]:

- [✂]
- [✂]
- [✂]
- [✂]
- [✂]

8.55 SSE's internal documents discuss [✂]:

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[239] [✂]

- [✂]
- [✂]
- [✂]
- [✂]
- [✂]

The introduction of fixed term default tariffs

8.56 As discussed in Appendix F a number of suppliers have recently introduced fixed term default tariffs. The evidence we have received indicates that:

(a) Default FTCs are likely to be priced at the level of or at a small discount to the supplier's SVT price.[240]

(b) The media and PCWs will continue to have incentives to comment on changes in fixed term default tariffs and to encourage customer engagement and switching. However, overall changes in fixed term default tariffs may receive less attention than changes in SVT prices because suppliers have greater flexibility to adjust the prices of fixed term default tariffs on an ongoing basis and, as explained in paragraph 8.22, fewer customers will be affected by any individual fixed term default tariff price change than by SVT price changes.[241]

(c) Fixed term default tariffs are unlikely to materially increase customer engagement since default tariff customers already receive frequent communication from their suppliers and from third parties such as PCWs. These communications include prompts designed to increase customer engagement and we have not received evidence which explains why fixed term default tariff customers would be materially more likely to engage with their choice of energy supplier simply because there is a definite point in time when they will receive a communication from their supplier.[242]

8.57 Additionally, we note that the evidence currently shows that for most of the SLEFs very limited numbers of customers have moved to a fixed term default tariff (see Appendix H). SSE introduced its fixed term default tariff on 26 July 2018. [✂]. Customers on SVTs cannot be moved to fixed term default

[240] See Appendix F, paragraphs 134 and 135.
[241] See Appendix F, paragraph 137 and 138.
[242] See Appendix F, paragraph 129.

tariffs without their consent. Therefore, in our view SVTs will continue to be an important tariff for the SLEFs in the foreseeable future with a significant number of customers continuing to be affected by SVT price changes.

8.58 Therefore, our consideration in Section 9 of the effects of the Merger on default tariffs concentrates on SVTs although we also consider whether the same concerns or any additional concerns apply to fixed term default tariffs.

Summary

8.59 We have reviewed evidence on how the SLEFs set prices for acquisition and default tariffs.

8.60 Acquisition tariffs are priced at lower levels than default tariffs, as customers who are switching tend to be price sensitive. Suppliers adjust acquisition tariff prices frequently depending on when they are seeking to recruit new customers.

8.61 Price changes by the SLEFs for default tariffs are less frequent, in part because the process of changing prices is lengthy, involves some cost and is likely to lead to additional publicity and prompts to SVT customers which increase customer switching. Our evidence shows:

(a) Default tariff changes are primarily driven by changes in costs.

(b) The SLEFs tend to announce price changes in rounds (because they face similar cost drivers).

(c) The SLEFs take account of the following in forming expectations of the switching that will result from a price change:

(i) the magnitude of the price change;

(ii) general levels of customer engagement and customer switching;

(iii) whether price changes are out of line with those of the other SLEFs;

(iv) whether they are the first of the SLEFs to announce a price change;

(v) the time of year, as customer reaction is likely to be more pronounced during certain seasons, eg before or during the winter;

(vi) relevant external events which may affect the response to the price change; and

(vii) whether it interacts with the ending of their FTCs for a substantial number of customers and how competitive are the new acquisition tariffs it is offering.

9. Assessment of the horizontal effects of the Merger

Introduction

9.1 We now assess the horizontal effects of the Merger on competition in the supply of electricity and gas to domestic customers in GB. We consider the vertical effects of the Merger and the Utility Warehouse wholesale supply and services agreement (the 'Wholesale Agreement') in Section 10. As described above, this is a market where disengaged customers are usually on one of the SLEF's SVTs and are paying the highest prices for their electricity and gas. Ofgem has noted that these customers are often the least able to afford those higher prices.[243] In the light of this context we have carefully considered the submissions and evidence received during our investigation of this Merger.

9.2 When considering a merger the CMA's role is to assess whether or not the merger gives rise to an SLC and not whether, more generally, there are any features of the market that may not be working well for consumers.[244] Therefore, in this section we identify and assess the strength of the competitive constraints on the Parties and consider to what extent the Merger will alter these, and whether an SLC may be expected to result.

9.3 In this case we consider it important to consider the effects of the Merger beyond its immediate impact in the next two years. This is a market in transition, but it is unclear how quickly customer engagement will increase. The full merger process and integration of the Parties will take longer than two years and the interests of a large number of consumers, some of them vulnerable, for which energy forms a major part of their expenditure, is of significant concern.

9.4 During the course of our inquiry we have received submissions from a range of third parties regarding the effects of the Merger. Before we undertake our assessment we summarise these submissions.

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[243] State of the energy market 2017 report, Ofgem (31 October 2017), page 3.
[244] Our function is to assess whether or not an SLC arises as a result of this Merger between SSE Retail and Npower, it is not an investigation into the state of the market and the inquiry group does not have powers to address any non-Merger specific issues.

Summary of third party submissions on the effects of the Merger

9.5 We received evidence from six consumer groups and representative bodies. Some of these submissions expressed general concerns that the Merger would strengthen the market power of the Parties, and would reduce choice,[245] particularly in northern Scotland where SSE has a high market share.[246] However, none of them told us they believed that there was an SLC. For example, Citizens Advice was doubtful that a reduction from six to five large energy firms would be likely to have a substantial effect on competition,[247] or on media-led prompts to customers to engage.[248] None of the bodies we spoke to saw reason to believe the Merger would impede the long-term progress of increasing customer engagement.

9.6 These groups also:

(a) expressed concerns that the process of integration of the Parties' businesses could be harmful for customers, as historically migrations of IT and customer service systems had led to disruptions in customer service quality;[249] and

(b) noted that the Default Tariff Cap could mitigate any potential adverse price effects on disengaged customers who were least likely to switch supplier.[250]

9.7 Ofgem said that it was concerned that the Merger, by increasing market concentration, could lead to price increases and it had general concerns in relation to vulnerable customers, especially given that the EMI had found that this was a market that was not working well. Ofgem believed that the Merger would not have a striking effect on consumer engagement, or on pricing in regions where the Parties were the former PES incumbents. Ofgem was also concerned as to whether the Merger would lead to any reduction in Npower's costs being passed through to consumers. Overall, however, Ofgem was unsure whether the Merger would give rise to an SLC and it noted that there were potential efficiencies.[251]

9.8 Ofgem submitted that it was possible that the amount of media coverage of default tariff price changes would reduce post-Merger with two considerably

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[245] Summary of the hearing with Energy Action Scotland, paragraph 11.
[246] Scottish Government response to the Issues Statement.
[247] Citizens Advice response to the Issues Statement.
[248] Summary of the hearing with Citizens Advice, paragraph 9.
[249] Summary of the hearing with Citizens Advice, paragraph 10.
[250] Summary of the hearing with Citizens Advice, paragraph 13.
[251] Summary of the hearing with Ofgem, paragraphs 16, 17, 19 and 22.

larger suppliers (ie MergeCo and British Gas) compared to the current structure of one larger supplier (ie British Gas). However, it also noted that it was possible that the larger two suppliers post-Merger might drive more media attention relating to their pricing decisions.[252]

9.9 The other large energy firms did not believe that the Merger would reduce competition. E.ON told us that there was enough competition in the market to constrain MergeCo, and it said the Merger would not impact on the way it set its SVTs as the market would only have one fewer competitor, making little difference.[253] ScottishPower said the Merger would have no specific effect on customers in Scotland, and Npower did not appear very active there.[254] British Gas told us that absent the effects of retail price regulation, there is an overall trend of innovation and improving consumer engagement and hence competitive pressure in the retail energy market which, in its view, would not be significantly reduced as a result of the Merger.[255]

9.10 E.ON submitted that SSE and Npower might be able to reduce their costs through synergies which would in turn make them more competitive.[256] EDF told us that the Merger may create an increased competitive constraint on British Gas.[257] E.ON also said that customer engagement may improve as a result of the Merger as MergeCo would have a better ability to serve customers and respond to their demands quicker,[258] although EDF told us that the Merger would not influence customer engagement.[259]

Our assessment

9.11 Our assessment of the competitive effects of the Merger is structured as follows. We:

(a) assess the effects of the Merger on competition in acquisition tariffs;

(b) assess the effects of the Merger on incentives when setting default tariff prices; and

(c) consider other possible effects of the Merger on service quality, price leadership and cross-subsidisation by the SLEFs.

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[252] Summary of the hearing with Ofgem, paragraph 21.
[253] Summary of the hearing with E.ON, paragraphs 21 and 23.
[254] Summary of the hearing with ScottishPower, paragraphs 12 and 13.
[255] British Gas response to the Issues Statement, page 2.
[256] Summary of the hearing with E.ON, paragraph 22.
[257] Summary of the hearing with EDF, paragraph 23.
[258] Summary of the hearing with E.ON, paragraph 24.
[259] Summary of the hearing with EDF, paragraph 21.

9.12 We have considered the effects of the Merger on acquisition and default tariffs separately. However, we note that there is a relationship between these two types of tariffs, particularly since many customers switch between default and acquisition tariffs (whether actively or otherwise), and the SLEFs will consider both when developing their competitive strategy and pricing, and we have considered the implications of this where relevant.

Effects of the Merger on competition in acquisition tariffs

9.13 We have considered whether the Parties are important competitors in acquisition tariffs such that the Merger is likely to remove a significant constraint in competition for these tariffs or otherwise reduce competition in acquisition tariffs. In doing so we have considered evidence regarding the competitive constraints each of the Parties faces when setting acquisition tariff prices, both from each other and from other suppliers. Additionally, Npower provides Utility Warehouse with gas and electricity under the Wholesale Agreement. Therefore, we have also considered whether potential substitution from SSE to Utility Warehouse following the Merger will create an incentive for the Parties' to increase their acquisition tariff prices.[260]

9.14 We have not received evidence that either Party is a particularly important constraint on the other (or on any other supplier) in acquisition tariff competition. This is reflected in the relatively low level of customer switching between the Parties. Table 14 shows the destination of customers switching away from the Parties. Less than 10% of each Party's customers who switch externally switch to the other Party and around [✂]% of Npower's customers and [✂]% of SSE's customers who switch externally, switch to one of the other large energy firms.[261]

[260] Since any customer switching from SSE to Utility Warehouse will increase the wholesale revenue earned by MergeCo.
[261] Utiltity Warehouse has also provided a GUPPI (gross upward pricing pressure index) analysis prepared by Oxera. We consider this analysis in Appendix J and as we note there, Oxera's estimated acquisition tariff GUPPIs would typically be considered to be relatively small, below the level at which concerns would usually arise and are based on a number of assumptions which are likely to mean that these GUPPIs are overestimates.

Table 14: Destination of customers lost by the Parties (2017)

%

		Fuel type	
Party	*Destination*	*Electricity*	*Gas*
Npower	SSE	[✂]	[✂]
	Other SLEFs	[✂]	[✂]
	SAMs	[✂]	[✂]
SSE	Npower	[✂]	[✂]
	Other SLEFs	[✂]	[✂]
	SAMs	[✂]	[✂]

Source: CMA analysis based on data provided by the Parties.
Note: Figures for Npower, SSE and British Gas include figures for their white labels.

9.15 We also note that substitution between Utility Warehouse and SSE is very limited. Between 2015 and 2017 [✂]% of SSE's electricity and gas customers who switched externally switched to Utility Warehouse. Therefore, we do not consider that Utility Warehouse currently provides a material constraint on SSE's acquisition tariff prices which might affect the Parties' acquisition tariff price setting following the Merger.[262]

9.16 Furthermore, there are a large number of alternative suppliers who compete to attract customers using acquisition tariffs and a large number of acquisition tariffs are available. The alternative suppliers include not only the other large energy firms but also the SAMS, who in the last couple of years have consistently offered the lowest priced acquisition tariffs.[263] The effectiveness of the SAMS' collective constraint on acquisition tariff prices is illustrated by the expansion of their share of supply (see paragraphs 2.35 and 2.36) and that over 50% of the Parties' customers who switch supplier, switch to one of the SAMS (see Table 14).

9.17 As noted in Table 2 above, the Parties have high market shares in certain former PES regions and some concerns were expressed that customers in certain areas (eg northern Scotland) may have a preference for certain suppliers who have a regional connection. We also note that some of the SAMS focus on competing in specific geographic regions. However, the analysis in Appendix H shows that in 2017 over [✂]% of customers switching away from the Parties switched to one of the SAMS, in every region of GB for both fuels, and we received no evidence to suggest that for those customers who are engaged and who have considered switching away from the Parties,

[262] This is either in isolation or in combination with direct switching between the Parties.
[263] We are aware that some concerns have been expressed about the financial sustainability of some of the SAMS, and that Ofgem has had to run two supplier of last resort processes over the previous 20 months and is reviewing its proposed approach to licensing (see Summary of the hearing with Ofgem, paragraph 2). However, we have not received evidence that these concerns relate to a significant number of SAMS.

there are material differences in their ability to switch to one of the SAMS across geographic regions.

9.18 The competitive constraints the Parties face when pricing acquisition tariffs are also illustrated by their internal documents which show that the Parties consider the competitive constraint from the SAMS as well as the SLEFs when setting acquisition tariff prices.[264] For example, Npower's documents discussing potential acquisition tariffs highlight [✂].[265] This includes a consideration of [✂]. Similarly [✂].

9.19 We note that, despite the success of the SAMS in acquiring customers, there is evidence that some customers have a preference to switch to a supplier with a recognised brand, such as one of the SLEFs. This is illustrated by the evidence that:

(a) although the Parties do not generally offer the most price competitive tariffs (see Figure 14 and Figure 15) they continue to attract significant numbers of customers to their acquisition tariffs;[266]

(b) a substantial proportion of the Parties' customers who switch externally switch to one of the other large energy firms despite the fact that the SLEFs do not generally offer the most competitively priced tariffs.[267] As shown in Table 14, of those customers lost by the Parties in 2017 between [✂] and [✂]% switched to another SLEF;

(c) the results of Ofgem's Cheaper Market Offers Letter Trial where only 7% of the tariffs on the letters were from the SLEFs but the SLEFs gained 38% of the customers who switched;

(d) suppliers choose to make investments in their brands and seek to maintain their brand recognition;[268] and

(e) customer survey evidence indicates that a supplier's brand is a relevant factor in the choice of supplier for some customers (see Appendix B).

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[264] This is also reflected in the Parties' documents monitoring market developments.
[265] [✂]
[266] This is also reflected in the substantial proportion of internal switching observed in the Parties' switching data. This indicates a preference to switch to a familiar supplier despite the offer of larger savings by other suppliers.
[267] This is illustrated by Ofgem's comparisons of pricing across suppliers (see Cheapest tariffs by payment method: Typical domestic dual fuel customer (GB), Ofgem (July 2018) and Figure 16).
[268] For example, [✂].

9.20 We have received evidence[269] that this preference may arise because customers are more comfortable switching to a supplier they have heard of, or they may believe that larger suppliers are more financially robust (and customers could be nervous of possible complications or interruptions to energy supply if their provider fails), or they believe known suppliers are likely to give better service (eg by offering support to vulnerable customers or by providing a wider range of options for communication).[270]

9.21 However, in this case any customer with a preference for a well known brand will continue to be able to choose from among the remaining five large suppliers. We also note that we have not identified evidence of suppliers currently seeking to selectively adjust prices for customers with a preference for a well-known brand.

9.22 Consequently, in light of this evidence, our view is that the remaining large energy suppliers and the SAMS will generally continue to provide an effective constraint on the Parties' acquisition tariff prices following the Merger.

9.23 Therefore, given:

(a) the limited switching between the Parties (even accounting for Npower's Wholesale Agreement),

(b) the range of effective alternatives available to customers that are switching, or considering whether to switch, and

(c) since most customers who switch are primarily driven by pricing in their choice of tariff or supplier,

we do not consider it likely that the Parties could profitably increase the prices of their acquisition tariffs as a result of the Merger.

Effects of the Merger on incentives when setting default tariff prices

9.24 As we have noted above (see paragraphs 8.13 and 8.14), customers do not in general choose to switch to an SVT (or to default tariffs more generally) and there is no competitive rivalry between suppliers in default tariffs as a means of attracting customers. Instead, suppliers are concerned with the potential loss of their existing SVT customers and how their actions may prompt engagement from these customers. The SLEFs are particularly concerned

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[269] For example, Summary of the hearing with Citizens Advice; Summary of the hearing with Ofgem; and GfK NOP consumer engagement in the energy market 2017 report, Ofgem (21 September 2017), page 72.
[270] For example, for those who prefer to interact over the telephone and are reluctant or unable to use digital communication.

about the loss of such customers because SVT customers tend to yield higher margins than customers on acquisition tariffs given that they are generally paying higher prices.

9.25 Consequently, in examining the effects of the Merger, we have considered whether the Merger could impact on the engagement of default tariff customers and/or change the consequences of such engagement and the resulting implications for the incentives of the SLEFs when setting default tariff prices. In doing so we have considered:

(a) the possible effects of the Merger on the level of SVT prices;

(b) the possible effects of the Merger on the timing of the SLEFs' SVT price changes; and

(c) the implications of the fixed term default tariffs for our analysis.

Effects of the Merger on the level of SVT prices

9.26 In most cases involving a merger between horizontal competitors, the primary concerns we address are whether the merger will lead to the loss of an important competitive constraint in the market which might create an incentive for the parties to increase prices. In particular, if a significant proportion of one party's customers switch to the other merging party then this would be consistent with the parties imposing an important constraint on each other which would be lost following the merger (ie a diversion effect). We have considered whether this is the case and the evidence regarding customer switching when making our assessment.

9.27 We also note (see paragraphs 8.37 to 8.40) that the SLEFs consider the likely SVT prices of other large energy firms when setting their own SVT prices and they do so despite the fact that SVT customers do not actively switch between SVTs. In part this is because if one of the SLEFs announces a price change which is out of line with the price changes of the other large energy firms it is likely to experience more SVT customer switching than would otherwise be the case (eg due to increased media attention (see paragraphs 8.33 to 8.40)). We refer to the action of considering the likely SVT prices of other large energy firms as 'benchmarking'.

9.28 In light of this, our Issues Statement[271] proposed that the Merger, by reducing the number of large energy firms, could reduce the risk that one of the large energy firms would announce a price which is out of line with those of the

[271] Issues Statement, CMA (29 May 2018).

other large energy firms. Our theory of harm is that the Merger, by reducing the number of comparators and/or by eliminating an important comparator for the other large energy firms, might reduce the benchmarking constraint on the size of SVT price changes. A change in the benchmarking constraint could affect the pricing of any of the SLEFs, not just the Parties, and given the large numbers of SVT customers across all of the SLEFs, even a small reduction in the benchmarking constraint could give rise to substantial detriment.

9.29 Consequently, in assessing the possible effects of the Merger on the level of the Parties', and the other large energy firms, SVT prices, we have considered evidence regarding both:

(a) the extent of SVT customer switching between the Parties and the implications for the competitive constraint which may be lost as a result of the Merger (a diversion effect); and

(b) the implications of a reduction in the number of the large energy firms on the large energy firms' incentives when setting the level of their SVT prices (a benchmarking effect).

Diversion effect on default price levels

9.30 We noted that the overall diversion ratios between the Parties, and as a proportion of customers that switch to one of the other large energy firms, are low, see Table 14. However, this evidence shows the switching patterns of all customers (ie those who are on acquisition tariffs and those who are on default tariffs). A supplier's incentives when setting SVT prices are primarily determined by the behaviour of their SVT customers and the likely response of those customers to changes in SVT prices. Therefore, we have considered whether the Parties' SVT customers would be likely to show different behaviour from customers previously on acquisition tariffs once they decide to switch supplier.

9.31 Figure 17 shows the switching patterns of the Parties' SVT customers who switched during 2017, both to other providers and internally (ie transferring onto an acquisition tariff).[272] Comparing these results with Table 14, shows that once SVT customers engage, their behaviour does not appear to be materially different to that of customers more generally. In particular:[273]

[272] Appendix H provides a more detailed analysis of the Parties' data regarding SVT customer switching.
[273] Utiltity Warehouse has also provided a GUPPI analysis prepared by Oxera. We consider this analysis in Appendix J and as we note there, Oxera's estimated SVT GUPPIs would typically be considered to be relatively small, below the level at which concerns would usually arise and are based on a number of assumptions which are likely to mean that these GUPPIs are overestimates.

(a) The rates of switching between the Parties by SVT customers is similar to the overall rate of customer switching between the Parties. Less than [✂]% of each Party's SVT customers who switched externally switched to the other Party (and less than [✂]% that switched externally to one of the large energy firms switched to the other Party), which is the same as each Party's customers more generally. Similarly, in 2017, [✂]% of Npower's electricity SVT customers who switched externally went to SSE which is the same as the proportion of all Npower's electricity customers who switched externally (see Table 14).

(b) The Parties' SVT customers are just as likely as the Parties' customers in general to switch to one of the SAMS, and SVT customers are no more likely than customers more generally to switch to another one of the SLEFs.

(c) [✂]% of SSE's SVT customers who switched externally switched to Utility Warehouse. This is the same proportion as SSE's customers more generally.

Figure 17: Destination of the Parties' SVT customers when they switch (2017)

[✂]

Source: Parties.

9.32 Therefore, given the relatively limited customer switching between the Parties by SVT customers (even accounting for Npower's Wholesale Agreement) and the range of effective alternatives available to customers, we consider that switching by SVT customers between the Parties will not be sufficient to provide a material incentive for the Parties to increase their SVT prices following the Merger.

Benchmarking effect on default price levels

9.33 We have also considered the implications of a reduction in the number of large energy firms for benchmarking and for the SLEFs' incentives when setting SVT prices, see paragraphs 9.27 and 9.28. In doing so we have considered whether, by reducing the number of large suppliers against which each large supplier can compare SVT pricing, the Merger will bring about a reduced constraint on the large suppliers' SVT pricing. We would also be concerned about the potential effects of the Merger if one or both of the Parties' SVT prices were a significant constraint on the other large energy firms' SVT pricing.

9.34 The Parties told us that benchmarking against the actions of other large energy firms plays a relatively minor role in the determination of the size of

price changes, in part because decisions are often made before the price announcements of other suppliers are known and therefore on the basis of limited information. However, we note that this does not rule out the possibility a supplier's expectations of a rival's behaviour could potentially be an important constraint on a supplier's behaviour.

9.35 Although we received evidence showing that the SLEFs do consider the positioning of their SVT price relative to the SVT prices of the other large energy firms (see paragraphs 8.37 to 8.40), we found no indications that the Parties' SVT tariff prices exert particularly strong constraints on the SVT prices of each other or of the other large energy firms. There are also no current indications that either of the Parties is seen as a particular price leader (for example because they do not tend to be the first to announce a price change or do not tend to announce the largest price changes) or that either of the Parties' SVT price changes has led any of the other large energy firms to adjust their proposed SVT price changes.[274]

9.36 Rather, each of the SLEFs seeks to position its SVT price appropriately relative to the range of SVT prices offered by the other large energy firms. While currently each of the SLEFs positions its SVT price with reference to the SVTs of the other five large suppliers, we expect that following the Merger each of the remaining large suppliers will continue to pay regard to the SVT prices of the other four large suppliers. We consider it unlikely that a reduction in the number of comparators faced by each of the large suppliers from five to four would have a significant impact on the constraints faced by each of the large suppliers in setting their SVT prices. Consequently, we do not expect that the Merger will significantly change the likelihood that a supplier will announce a price change which is out of line with the range announced by the other suppliers.

9.37 Additionally, when suppliers consider price changes for default tariffs, they take into account a number of other factors, of which the impact of cost changes and the effect of the price change itself on customer retention are more important. These other factors will be unaffected by the Merger and will continue to constrain the Parties (and other suppliers) following the Merger.

9.38 Finally, we have also considered whether the Parties might be able to use the SSE and Npower brands separately in order to increase SVT prices. For example, this could be done by announcing a higher SVT price than would

[274] [✂]

have been the case with one brand which assists in justifying a slightly higher price increase for the other brand.

9.39 However, we do not consider that the Parties will be able to sustain such a strategy following the Merger. There are a number of factors which are likely to make a two brand strategy of the nature described above unsustainable. For example, we consider that such a strategy is likely to be subject to significant media scrutiny making it difficult for MergeCo to set different SVT prices for customers of the two brands, to announce SVT price changes for the two brands at different times or to contain adverse publicity to just one of MergeCo's brands. Additionally, following the merger, Ofgem's regulations would require MergeCo to notify customers of the cheapest available tariffs of both brands regardless of the brand the customer was associated with, reducing the benefits to MergeCo of maintaining two brands. Similarly, MergeCo would have to incur additional marketing costs in order to maintain two brands. We also note that the Parties have informed us that the current intention is for MergeCo to transition to a single brand [✂] of the Merger.[275]

9.40 In summary, we considered whether the Merger, by reducing the number of comparators faced by each of the large suppliers from five to four, would have an impact on the constraints faced by each of the large suppliers post-Merger. This might arise because the SLEFs prefer where possible to set prices in line with the other SLEFs and therefore, following the Merger, each of the remaining large energy firms would be able to benchmark only against four other such firms (as opposed to five pre-Merger). Following our analysis of the Merger, our provisional view is that the Merger is unlikely to substantially lessen competition in this way, for the following reasons:

(a) we consider that the reduction in the number of large energy firms from six to five will not significantly change how they benchmark their price levels. In other words, the Merger will not significantly change the likelihood that a large supplier would announce a price change which is out of line with the range of price changes announced by the other large suppliers, as there will be sufficient comparators post-Merger;

(b) the Parties do not assign any particular significance to the other Party in benchmarking, and neither of the Parties appears to have a price leadership role (in timing or level) or to have prompted the other large energy firms to reconsider their proposed SVT price changes; and

[275] The Parties have stated that '… regulatory requirements will drive it [MergeCo] towards [✂]'. SSE also noted that it perceived that having a single brand provided [✂].

(c) a number of other factors, such as cost changes and the effects of the price change itself on customer switching, play a more important role in the SLEFs' determination of the size of SVT price changes. These factors will not be affected by the Merger and will continue to constrain the large energy firms' SVT prices following the Merger.

Effects of the Merger on the timing of the SLEFs' SVT price changes

9.41 As described in paragraphs 8.34 to 8.36, each of the SLEFs expects that they will experience increased customer losses in response to a price announcement if they are the first of the SLEFs to announce a SVT price change. The Parties both told us they expect this to be the case, since the first of the SLEFs to announce is likely to receive 'additional press and media attention'. Such media attention can not only have an immediate effect on customer switching but can also have wider adverse reputational effects.

9.42 Each of the SLEFs can seek to reduce its chances of being the first to announce, and can therefore reduce its expected customer losses, by delaying its price announcement. Such a delay will provide an opportunity for another of the SLEFs to announce a price change first. However, delaying a price increase announcement is likely to be costly since the supplier is likely to experience a reduction in profit as a result of the delay.[276]

9.43 Therefore, we have considered the possibility that the Merger may create incentives for the SLEFs to announce SVT price increases earlier. The Merger could do this because, by reducing the number of large energy firms, the Merger reduces the benefit to each firm from delaying their price announcement. This is because with fewer large energy firms setting an SVT, there is less chance that another large supplier will announce first.[277]

9.44 In general, the SLEFs would be more likely to consider delaying an SVT price change in order to reduce the likelihood that they will be the first of the SLEFs to announce a price change if:

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[276] This could be because the same price announcement only occurs later or a supplier decides that a delay will require a higher price announcement which will increase the risk of customer switching. As discussed below we have received evidence from a number of suppliers discussing the costs associated with delaying price announcements.

[277] The Parties submitted that such an effect was impossible because (i) the Parties lack the information required to predict the timing of price announcements of other suppliers and (ii) because of the logistics of implementing an SVT price change. We note that (i) the incentives described here may still be relevant regardless of whether the SLEFs can accurately predict the precise timing of the other large energy firms' price announcements and (ii) the SLEFs still have to make a decision regarding when to commence the process of implementing a price change and, as the evidence we have received illustrates, a number of factors affect this decision.

(a) the costs associated with delaying a price announcement are relatively modest; and

(b) the benefits of delaying are relatively significant because the increase in customer losses as a result of being the first of the SLEFs to announce a price change and any wider reputational effects are relatively large.

9.45 Therefore, we have considered the extent to which this is the case when making our assessment below.

9.46 We have also considered whether the possible timing of the other large suppliers' price announcements is an important or a minor factor in decisions regarding the timing of a SLEFs' price changes, and if so what would be the likely effect of the Merger on the timing of price changes.

9.47 The Parties have submitted that this theory of harm is internally inconsistent since if the Merger creates an incentive for the remaining suppliers to announce price changes earlier, then this would increase the likelihood that delaying a price announcement would allow a supplier to avoid being the first to announce. This would then create a countervailing incentive for suppliers to delay their price announcements.

9.48 Such a countervailing incentive may exist, however in our view such an effect could have only a moderating impact on the direct incentive the Merger creates for the large energy firms to announce earlier. This is because the overall effect of the Merger will be to reduce the number of large energy firms, increasing the probability of any individual large energy firm being the first to announce a SVT price increase and reducing the overall benefit of delaying a price announcement.

Our assessment of the likely effects of the Merger on the timing of SVT price announcements

9.49 We have received evidence from the Parties which has allowed us to assess both the costs associated with delaying a price announcement (see paragraph 9.44(a)) and the benefits of avoiding being the first supplier to announce a SVT price change (see paragraph 9.44(b)):

(a) Npower's internal documents suggest that the lost profit associated with delaying a price change is around £[✂] million to £[✂] million per day. SSE's internal documents suggest that the lost profit associated with

delaying a price change is around £[✂] million to £[✂] million per day.[278] The magnitude of any impact of delaying an announcement will largely depend on the magnitude of the underlying cost changes and the price change being considered. However, we note that SVT price increases are typically significant[279] and we consider that these figures are likely to be indicative of the costs of delaying an SVT price increase more generally;

(b) Npower estimates that being the first to announce leads to an additional [✂] gas and electricity account losses. Using Oxera's estimate of Npower's dual fuel SVT variable margin of around £[✂] per customer (based on Npower's Consolidated Segmental Statement (CSS)), this equates to a loss of approximately £[✂] million to £[✂] million profit per annum if Npower is the first to announce; and

(c) SSE's internal documents indicate that being the first to announce will lead to [✂] additional gas and electricity account losses. Using Oxera's estimate of SSE's dual fuel SVT variable margin of around £[✂] per customer (based on SSE's CSS), this equates to a loss of approximately £[✂] million per annum profit if SSE is the first to announce.

9.50 This evidence suggests that the costs of delaying a price announcement (£[✂] million to £[✂] million per day) are, for a delay of more than a few days, likely to be significantly greater than the possible benefit gained by avoiding being the first of the SLEFs to announce a price change (of the order of £[✂] million per annum), although these benefits are uncertain as there is no guarantee rivals will announce first in this period. This implies that, while the Parties might prefer not to be the first of the SLEFs to announce, the typical costs involved in delaying means that they are unlikely to delay a price announcement for long in the hope of avoiding being the first to announce. This is especially so given the uncertainty as to whether a delay will allow the Parties to avoid being the first of the SLEFs to announce. Consequently, such considerations are likely to play only a moderate role, relative to other factors, in the timing of price announcements.

9.51 This is confirmed by our review of the Parties' internal documents (see paragraphs 8.53 to 8.55 and Appendix F) which found that a number of other factors (such as cost pressures and external events) influence their decisions regarding the timing of their price announcements. It is also consistent with British Gas' decision to extend its 2017 price freeze. If the SLEFs' decisions

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[278] We note that this evidence is consistent with that received from other suppliers. For example, evidence from [✂] concerning its 2018 price announcement discusses a cost of delaying its price announcement of £[✂] per week.
[279] For example, since 2010 the average gas and electricity SVT price increases across all of the SLEFs is 8% (CMA analysis).

regarding the precise timing of their own price announcements were significantly affected by the risk of being the first to announce then one would expect the SLEFs to generally announce as quickly as possible once the first of the SLEFs has announced. However, on that occasion British Gas delayed its price change at a time when a number of the other SLEFs had already announced their price changes.[280]

9.52 Furthermore, following the Merger there will continue to be five large energy firms. Therefore, if one these large energy firms is considering delaying its price announcement (in order to reduce its chances of being the first to announce), it will still consider the possibility that the four other large energy firms could announce first. In our view, this means that the Merger, is likely to have a fairly limited effect on the benefits of delaying a price announcement. Consequently, the Merger will not materially reduce the incentive the SLEFs currently have to delay price announcements in order to reduce the risk of being the first supplier to announce.

9.53 We have also considered how the possibility of maintaining two distinct brands could affect the Parties' incentives regarding the timing of their SVT price changes post-Merger. For example, one possibility is that the Parties could have an incentive to announce earlier SVT price changes using one brand since this allows an earlier SVT price change by the other brand without incurring the risk that the second brand is the first to announce (thereby lowering the risk of SVT customer switching that is associated with announcing first). That is, such a strategy could internalise the benefits one rival currently experiences from another large supplier being the first to announce a price change.

9.54 However, we have discounted this possibility since, as noted at paragraph 9.39, we do not consider it likely that MergeCo will operate two brands beyond an initial transition period.

9.55 Assessing the above evidence in the round, it is our provisional view that the Merger will not lead the SLEFs to announce SVT price increases earlier because:

(a) The costs of delaying a price announcement in order to see if another one of the SLEFs increases its prices first are high. Meanwhile, the benefits of

[280] The Parties submitted that this was also illustrated more generally by the fact that price changes are not closely clustered together. However, we do not consider this to be strong evidence in light of the Parties' submissions that there are lengthy lead times between a decision to increase SVT prices and the actual implementation and announcement. The latter suggests that there are limits to the speed with which the SLEFs can respond to the SVT price increases of the other SLEFs and therefore the extent to which price announcements can be clustered together.

avoiding being the first to announce are relatively small. This suggests that the possibility of delaying a price announcement in the hope of avoiding being the first supplier to announce plays only a limited role in a supplier's decision regarding the timing of a price announcement.

(b) Consistent with this, our review of the Parties' internal documents indicates that the potential to delay price announcements in order to avoid being the first of the SLEFs to announce plays only a limited role in decisions regarding the timing of price announcements.

(c) Furthermore, the effects of the Merger on any incentive to delay price announcements in order to avoid being the first of the SLEFs to announce are likely to be small since, for each of the large suppliers, there will continue to be four other large energy suppliers who could announce following a delay.

Consideration of fixed term default tariffs

9.56 As noted in paragraph 2.25(b), some suppliers are introducing fixed term default tariffs. However, given that these tariffs have only recently been introduced and that several suppliers do not have material numbers of customers on these tariffs, it is not clear whether any differences will apply to the principles by which suppliers determine their pricing compared to SVTs. However, for the reasons set out at paragraphs 8.56 and 8.57, it is likely that there will be less media attention given to fixed term default tariff price changes, because these only affect new customers coming on to them, rather than affecting all default customers and requiring mass notification to existing customers. Given this, it is possible that any benchmarking effect would be less marked for fixed term default tariffs than for SVTs, ie there is less influence on pricing coming from the pricing decisions of the other large energy firms. Therefore, we do not expect a benchmarking effect to arise for these tariffs.

Provisional findings on the impact of the Merger on price setting for default tariffs

9.57 For the reasons set out in paragraphs 9.26 to 9.55, we have reached the provisional view that the Merger is not likely to result in an SLC in relation to price setting for default tariffs.

Other possible effects of the Merger

Service quality

9.58 We considered whether the Merger could have the effect of reducing the Parties' incentives to maintain service quality, and the provision of customer support, across their retail domestic supply businesses and especially for vulnerable customers.

9.59 We have received evidence that poor customer service can be a prompt for customers to switch provider (see Appendix B). For example, [✂]. We have also observed evidence of suppliers evaluating their customer service performance and comparing their own performance to that of other suppliers. For example:

(a) SSE's Brand Tracker reports provide regular updates of customer perceptions regarding SSE's customer service;

(b) [✂]; and

(c) the EMI also noted that suppliers regularly collect Net Promoter Score (NPS) data both for themselves and for competitors. Such data can be used to assess customer service quality.[281]

9.60 However, we did not identify any plausible way in which the Merger could reduce service quality, either in general or for individual groups of customers. First, customer services such as call centres deal with all of a supplier's customers. It is not clear that it would be practicable for the supplier to distinguish between customer types and to treat them differently. Second, and crucially, there is no apparent change in the incentives applying to the Parties concerning service quality as a result of the Merger. The level of customer support which is given is a commercial choice. We have seen that poor customer service can be a reason for switching and, as we noted in relation to acquisition tariffs, our view is that customers looking to switch supplier will continue to have sufficient choice following the Merger which will continue to constrain the Parties.

9.61 It also does not seem likely that the Merger will change customers' perception of the standards of service they would consider acceptable. Nor have we seen evidence that in determining what levels of customer service to offer, suppliers benchmark themselves against rivals in such a way that the Merger would be likely to get them to re-evalauate their standards. Finally, we also

[281] EMI final report (24 June 2016), paragraph 9.103.

note that all suppliers are subject to Ofgem's Standards of Conduct rules (Standard Licence Conditions 0 and 0A) which seek to ensure that suppliers treat each customer fairly. Ofgem has a number of powers which enable it to enforce these standards.

Price leadership and coordination

9.62 We have considered whether the Merger could lead to price leadership, specifically in respect to default tariffs.

9.63 Post-merger, MergeCo and British Gas would become the two largest suppliers with market shares of around 23% and 20% in electricity and 17% and 30% in gas respectively.[282] Meanwhile E.ON, EDF and ScottishPower would have market shares of around 10% to 13% for electricity and 8% to 11% for gas, respectively.[283] In this context, Ofgem questioned whether the Merger might, in changing the market structure to two very large energy suppliers (ie MergeCo and British Gas) with three other large energy suppliers, lead to these two suppliers driving pricing and media attention, or otherwise producing conditions for price leadership in terms of setting SVTs.[284] Under price leadership, MergeCo and British Gas would make pricing decisions without significant constraint from the remaining large suppliers, who would follow the prices set by these two very large suppliers.

9.64 In this regard, we noted that British Gas is currently the largest supplier by some margin and we have found no indication that it is currently a price leader. For example, our analysis of the SLEFs' SVT price announcements (Appendix I) confirmed the findings of the EMI that:

(a) both the size and the timing of SVT price announcements by the SLEFs varied within and between rounds; and

(b) no single supplier was consistently the first among the SLEFs in announcing SVT price changes.

9.65 Our review of the other SLEFs' pricing policies did not indicate that they have historically distinguished in their consideration of competitors' actions (and expected actions) by market share,[285] nor is there evidence of certain suppliers taking a price leadership role on any sustained basis. We did not

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[282] Electrocity and Gas supply maket shares by company: Domestic (GB), Ofgem (data as of Q1 2018).
[283] Electrocity and Gas supply maket shares by company: Domestic (GB), Ofgem (data as of Q1 2018).
[284] Summary of the hearing with Ofgem, paragraph 21.
[285] Beyond the greater prominence given to the possible SVT price changes of the other large energy firms in general.

receive any evidence from suppliers to suggest that this would change post-Merger.

9.66 We note that on coordination in general, the phase 1 decision document[286] described how the EMI found no evidence of coordination and how a number of changes in the energy market since the EMI will have made coordination less likely. In our Issues Statement we noted that we were not minded to investigate coordination further.[287] We have not received any further evidence specifically on this issue and our review of the evidence does not suggest that coordination is currently occurring[288] or that the Merger is likely to give rise to coordination.

9.67 On the basis of the evidence available, we have provisionally found that there is no evidence that the Merger can be expected to give rise to British Gas and MergeCo becoming price leaders in SVT price setting post-Merger, or that tacit coordination is likely.

Cross-subsidisation by the SLEFs

9.68 Ofgem's 2017 'State of the energy market' report noted that prices paid for default tariffs are considerably above those offered to the typical fixed tariff (ie acquisition tariff) customers.[289] Therefore, suppliers with substantial numbers of default tariff customers could potentially offer very competitive prices to engaged consumers while still making a profit overall. Concerns were raised during the phase 1 investigation that MergeCo could potentially recover a significant proportion of its fixed costs from its default tariff customers, allowing it to profitably offer low acquisition tariff prices. This could then affect the growth of the SAMS and their incentive to innovate and to expand, reducing competition. These concerns considered that the Merger could exacerbate any such issue by increasing the size of the Parties' inactive customer base, increasing their ability to offer low priced acquisition tariffs.

9.69 However, we have provisionally found that there is no evidence that the SLEFs are currently foreclosing entry or expansion through the use of this

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[286] CMA phase 1 decision document.
[287] Issues Statement, CMA (29 May 2018).
[288] For example (see Appendix G), SSE implemented a price freeze in March 2014. Following SSE's announcement of a price freeze there were two rounds of SVT price cuts as each of the SLEFs cut their prices. Had there been tacit coordination relating to SVT prices, SSE's price freeze could have been an attempt to signal to other suppliers not to cut prices. However, this did not prevent the other large energy firms from subsequently cutting SVT prices. In addition, British Gas announced an extension to its price freeze in February 2017, after Npower had already announced a price increase, on the same day that ScottishPower increased its prices and shortly before the remaining large energy firms increased their prices. Had the SLEFs been engaging in tacit coordination on SVT prices, British Gas would likely not have announced a price freeze at a time when other suppliers were announcing price increases and one of the SLEFs had already announced a price increase.
[289] State of the energy market 2017 report, Ofgem (31 October 2017), page 31.

practice and we do not consider it likely that the Merger is likely to lead them to do so. In particular, it is the SAMS who generally have the lowest priced acquisition tariffs and as Figure 16 shows, since 2017 the SAMS' acquisition tariff prices have consistently been significantly below those of the SLEFs.

9.70 Current acquisition tariff prices also appear to be financially sustainable for the SAMS. While a limited number of SAMS have exited the market recently, the overall number of suppliers and their aggregate market share has continued to grow and a number of suppliers have achieved significant growth. Ofgem told us that it did see some cross-subsidisation but it had not found evidence that cross-subsidisation was used by the SLEFs to attempt to foreclose competitors. We also did not receive any submissions which explained why, or provided evidence that, the Merger would make such cross-subsidisation more likely to occur.

Provisional findings on the horizontal effects of the Merger

9.71 As set out above, in assessing the horizontal effects of the Merger we have considered:

(a) the effects of the Merger on competition in acquisition tariffs;

(b) the effects of the Merger on incentives when setting default tariff prices; and

(c) other possible effects of the Merger on service quality, price leadership and coordination and cross-subsidisation by the SLEFs.

9.72 For the reasons set out in paragraphs 9.13 to 9.68, we have provisionally concluded that the merger is not likely to give rise to an SLC in relation to horizontal effects.

10. Impact of the merger on the Utility Warehouse Wholesale Agreement

10.1 In November 2013 Npower entered into an exclusive 20 year agreement to supply wholesale energy and related services to Utility Warehouse (the 'Wholesale Agreement').[290] Under the terms of the Wholesale Agreement, the wholesale prices for electricity and gas that Utility Warehouse pays are based on a discount to [✂] SVT prices of the SLEFs. Therefore, we have considered the extent to which the Merger will create incentives for the Parties to act to increase Utility Warehouse's wholesale price in order to either totally or

[290] We understand that the Wholesale Agreement includes wholesale energy and network costs.

partially foreclose Utility Warehouse, or to directly increase their profits from the Wholesale Agreement.

10.2 Input foreclosure can arise where a vertically integrated firm is both a wholesale supplier to, and downstream competitor of, another firm. The vertically integrated firm (Npower in this case) may have an incentive to increase the downstream competitor's (Utility Warehouse in this case) wholesale price since this will lead the downstream competitor to increase its retail prices leading some customers to switch to the vertically integrated firm. In assessing a merger, the relevant consideration is to what extent the merger affects this incentive. In this case, post-Merger MergeCo may have a greater incentive to foreclose Utility Warehouse than Npower does pre-Merger because MergeCo will benefit from Utility Warehouse customers switching to SSE as well as to Npower.

10.3 Utility Warehouse has made a number of submissions, supported by analysis from Oxera,[291] in relation to the Merger. In this part of our assessment we have focussed on Utility Warehouse's concerns that the Merger could create incentives for MergeCo to increase the wholesale price it charges (through increasing its SVT prices to all customers) and the implications this could have for Utility Warehouse's business and for customers.

Counterfactual

10.4 We considered whether, absent the Merger, the Wholesale Agreement would have continued in its current form. We have received unclear information from Utility Warehouse and Npower on the current status [✂] the Wholesale Agreement such that we cannot say with any certainty whether [✂] would have occurred and what the outcome of [✂] would have been.

10.5 The Wholesale Agreement contains [✂]:

(a) [✂]

(b) [✂]

10.6 However, we consider it unclear whether [✂]:

(a) [✂][292]

(b) [✂]

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[291] We discuss Oxera's analysis in more detail in Appendix J.
[292] [✂]

10.7 Based on the above, we cannot predict with confidence that the Wholesale Agreement [✂] absent the Merger, and therefore, we have considered the effects of the Merger against the counterfactual of the Wholesale Agreement continuing on existing terms.

Our assessment of the effect of the merger on the Utility Warehouse Wholesale Agreement

10.8 In assessing foreclosure theories of harm, the Guidelines describe how we will make our assessment by considering the following three questions:[293]

(a) Ability: whether MergeCo will have the ability to harm its rivals?

(b) Incentive: does MergeCo have the incentive to engage in this type of behaviour?

(c) Effect: to the extent that MergeCo has the ability and incentive to engage in this type of strategy, would the effect be sufficient to result in an SLC?

10.9 The Guidelines describe how the analysis of these questions may overlap and note that in order to reach an SLC finding, all three questions must be answered in the affirmative.

Ability to foreclose Utility Warehouse

10.10 Approximately 15 years remain on the exclusive Wholesale Agreement which may suggest that Utility Warehouse does not have an alternative option for procuring wholesale energy. However, there is a 'change of control' provision in the contract that allows Utility Warehouse to withdraw from the contract if Npower changes ownership as per the contract.

10.11 Npower and Utility Warehouse have not reached formal agreement on the applicability of the change in control clause. [✂].

10.12 However, given our provisional conclusion below concerning the incentives to foreclose Utility Warehouse, we do not consider it necessary to reach our own conclusions on whether the change of control clause is engaged as this is subject to the private commercial negotiations of Npower and Utility Warehouse.

10.13 We also note that Ofgem is consulting on introducing a Default Tariff Cap later this year. A price cap, by reducing the Parties' ability to adjust their SVT

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[293] Merger Assessment Guidelines (CC2 Revised/OFT1254), paragraph 5.6.6.

prices, would restrict the ability of the Parties to affect Utility Warehouse's wholesale price for as long as the price cap is in place. However, as noted at paragraph 6.32 we are unable to form an expectation that the price cap will continue in place after 2020 and, consistent with our approach elsewhere, we consider it appropriate to assess the possible effects of the Merger beyond its immediate impacts in the next two years.

10.14 Overall, while we note the existence of a change of control clause and that this may be triggered by the Merger, we cannot rule out the possibility that MergeCo will continue to have the ability to influence Utility Warehouse's wholesale price after the removal of the Default Tariff Cap. Therefore, we have considered MergeCo's incentives to foreclose Utility Warehouse post-Merger.

Incentive to foreclose Utility Warehouse

10.15 We have assessed the Parties' incentives to foreclose Utility Warehouse in two stages. First, we have considered the Parties' incentives to either totally or partially foreclose Utility Warehouse in the hypothetical scenario in which increasing Utility Warehouse's wholesale price does not involve increasing SVT prices. Second, we have considered the implications for the Parties' incentives of needing to increase SVT prices in order to implement any increase in Utility Warehouse's wholesale price.

10.16 In undertaking our assessment we have had particular regard to the economic analysis conducted by Oxera on Utility Warehouse's behalf (see Appendix J). The Parties provided a response to Oxera's analysis prepared by Frontier Economics which we have also considered. The conclusion of the Parties analysis was consistent with our analysis as described below.[294]

Incentives to totally foreclose

10.17 In order to have an incentive to totally foreclose Utility Warehouse, the additional profit that MergeCo could expect to earn from an increase in its retail customers would have to outweigh the profit it would no longer earn from supplying Utility Warehouse with wholesale energy and/or the Parties would need to expect to be able to profitably increase their retail prices after foreclosing Utility Warehouse.

[294] However, we did not agree with all of the assumptions made by Frontier Economics in their analysis. For example, Frontier Economics assumed that MergeCo would account for [✂], while our interpretation of the agreement is that MergeCo would account for [✂].

10.18 We do not consider that MergeCo would have any incentive to totally foreclose Utility Warehouse following the Merger. Npower's management accounts indicate that it made [✂] gross margin from the Wholesale Agreement in 2016. This is significantly more than any increase in retail revenue the Parties could reasonably expect to achieve as a result of foreclosing Utility Warehouse. For example, in 2017 [✂]% of customers leaving Utility Warehouse switched to one of the Parties, implying that MergeCo would require an implausible retail profit margin of over £[✂] per customer per year for this strategy to be profitable.[295] Furthermore, Utility Warehouse's exit would be unlikely to materially increase the Parties' market power due to the limited constraint Utility Warehouse imposes on the Parties[296] and the number of acquisition tariff competitors who would continue to exist post-Merger.

Incentives to partially foreclose

10.19 The Parties may have an incentive to partially foreclose Utility Warehouse by increasing its wholesale price, leading it to increase its retail price, prompting customer switching. The Merger's effect on the Parties' incentives to do this are determined by the extent to which customers switching away from Utility Warehouse can be expected to switch to SSE.[297]

10.20 An indication of the strength of this incentive can be calculated using Oxera's analysis[298] and information on Utility Warehouse's total number of customers and customer switching patterns. This information allows an estimate of the increased profit that MergeCo would receive as a result of SSE recapturing Utility Warehouse's customers to be calculated.

10.21 The assumptions used by Oxera imply that a 1% increase in Utility Warehouse's wholesale price could be expected to increase SSE's profits by around £[✂] per year, which we consider to be an overestimate given the assumptions used.[299] Furthermore, this potential benefit from foreclosing

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[295] For example, using information from the Parties published CSS's, Oxera's model is based on annual SVT per customer margins of £[✂] for SSE and £[✂] for Npower.
[296] For example, less than [✂]% of customers who switched away from the Parties between 2015 and 2017 switched to Utility Warehouse.
[297] Oxera's analysis also includes switching to Npower. However, we note that this incentive exists regardless of the Merger so is not merger-specific.
[298] See Appendix J for more details on Oxera's submissions.
[299] For example, we have used Oxera's assumption that Utility Warehouse's price elasticity of demand is [✂]. A lower elasticity would decrease the number of customers recaptured by SSE following a foreclosure strategy, and would therefore decrease the Merger effect. Using this assumption therefore gives a conservatively high estimate for the additional profit that MergeCo would earn from increasing Utility Warehouse's wholesale price.

Utility Warehouse must be viewed in light of the need for MergeCo to adjust its SVT prices in order to achieve this benefit.

Implications of having to increase SVT prices in order to increase Utility Warehouse's wholesale price

10.22 In order to implement, for example, a 1% increase in Utility Warehouse's wholesale electricity price, MergeCo would have to do one of the following:

(a) increase Npower's SVT price by [✂]%;[300]

(b) increase SSE's SVT price by [✂]%;[301] or

(c) increase the price to both Npower's and SSE's SVT customers by [✂]%.[302]

10.23 Therefore, achieving even a small increase in profits by foreclosing Utility Warehouse would require MergeCo to increase its SVT prices significantly. As we have described above, larger SVT price increases prompt increased SVT customer switching and therefore affect the profitability of a supplier's SVT. Consequently, we have considered whether MergeCo is likely to have incentive to increase its prices in order to foreclose Utility Warehouse given the likely implications for MergeCo's overall profitability.

10.24 SSE and Npower have approximately 2.1 million and 1 million customers on SVTs respectively.[303] In 2017 SSE's SVT customer revenues (excluding prepayment customers) were £[✂]. Npower's SVT customer revenues (excluding prepayment customers) for 2017 were £[✂]. Using estimates of SSE's and Npower's SVT margins based on Oxera's analysis of their CSS's indicates that their gross profits from SVT customers are around £[✂] and £[✂] respectively. This is considerably larger than [✂] (see paragraph 10.18).

10.25 Achieving any material increase in Utility Warehouse's wholesale price would require a substantial increase in MergeCo's SVT prices. This would likely result in additional SVT customer losses in the highly profitable part of its business (see paragraph 10.24), in order to gain only a small number of additional customers and profit from Utility Warehouse (see paragraph 10.21).

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[300] Since the wholesale gas price paid by Utility Warehouse under the Wholesale Agreement is based on [✂] SLEF SVT price, [✂], in order to achieve a 1% increase in [✂] gas price, Npower would need to increase its SVT price by [✂]%.
[301] For gas, SSE would have to increase its SVT price by [✂]% to achieve a 1% increase in [✂] SLEF SVT price.
[302] For gas, MergeCo would have to increase its SVT price by [✂]% to achieve a 1% increase in [✂] SLEF SVT price.
[303] Retail Market Indicators, Ofgem (as of July 2018).

Consequently, the loss in profitability resulting from SVT customer losses would likely be significantly greater than any increase in profit from capturing Utility Warehouse customers through foreclosure. As a result, any increase in SVT prices which has a material effect on Utility Warehouse's wholesale price is likely to have a significant negative impact on the Parties' overall profitability.

10.26 Therefore, given the limited additional profit to MergeCo from partially foreclosing Utility Warehouse, compared to the likely detrimental impact on MergeCo's overall profitability from increasing SVT prices to achieve this, we consider it unlikely that the possibility of a partial foreclosure effect would by itself have any material impact on the level at which MergeCo would set SVT prices. Consistent with this we note that Npower's internal documents indicate that the Wholesale Agreement is not currently a consideration in Npower's SVT price setting behaviour (see Appendix F).

The Merger's effect on the ability of MergeCo to influence Utility Warehouse's wholesale price

10.27 Oxera have also identified a 'wholesale margin' effect which refers to the possibility that following the Merger, SSE may have an incentive to increase its SVT price in order to increase the Utility Warehouse wholesale supply price in order to increase its profits from the Wholesale Agreement (regardless of any possibilities of foreclosure). This possibility arises because increasing Utility Warehouse's wholesale price requires Npower to adjust its SVT price and, as we have noted, this significantly constrains its ability to influence Utility Warehouse's wholesale price. Therefore, we have also considered whether post-merger, MergeCo is likely to be less constrained than Npower currently is in adjusting Utility Warehouse's wholesale price, thereby creating additional incentives to increase Utility Warehouse's wholesale price.

10.28 Utility Warehouse has argued that, since the Merger will give MergeCo greater control over [✂] SVT price used as the basis for Utility Warehouse's wholesale price than Npower had pre-Merger, it will give MergeCo a significantly increased ability to influence the Utility Warehouse wholesale price.

10.29 It is true that MergeCo will have greater control over [✂] SVT price used as the basis for Utility Warehouse's wholesale price than Npower does pre-Merger. For electricity, in order to implement each 1% increase in Utility Warehouse's wholesale price, pre-Merger Npower would have had [✂]. Following the Merger, MergeCo [✂].

10.30 In considering such a strategy, both Npower (pre-Merger) and MergeCo (post-Merger) will weigh up the benefits of increased wholesale profits against the customer losses they would expect following an increase in their SVT price and therefore the implications for SVT profitability.

10.31 In our view, it is unlikely to be the case that following the Merger, MergeCo could increase Utility Warehouse's wholesale price without suffering a similar level of SVT customer losses as Npower would if it attempted this strategy pre-Merger. While the percentage increase in SVT price required would be lower for MergeCo, it would have to implement this price increase across a much larger customer base (ie across all of both Npower's and SSE's SVT customers). Therefore, MergeCo's foregone profits may be similar to those of Npower prior to the Merger. Consequently, we do not consider it likely that this effect will provide a greater incentive for MergeCo to increase SVT prices with the specific intention of increasing Utility Warehouse's wholesale price.

Provisional findings on the Utility Warehouse Wholesale Agreement

10.32 For the reasons set out above, our provisional finding is that the Merger is not likely to lead to the foreclosure of Utility Warehouse because:

(a) MergeCo will have no incentive to totally foreclose Utiltity Warehouse since the loss in wholesale revenue will be significantly greater than any increase in retail revenue MergeCo could expect to achieve by undertaking such a strategy; and

(b) MergeCo will not have an incentive to partially foreclose Utility Warehouse as a result of the Merger. Given the limited additional profit to MergeCo from partially foreclosing Utility Warehouse, compared to the likely detrimental impact on MergeCo's overall profitability from increasing SVT prices to achieve this, we consider it unlikely that the possibility of a partial foreclosure effect would by itself have any material impact on the level at which MergeCo would set SVT prices.

10.33 Additionally, in our view the Merger will not affect the ability of MergeCo to influence Utility Warehouse's wholesale price when compared to Npower pre-Merger.

10.34 As we are of the view that MergeCo has no incentive to foreclose Utility Warehouse, we do not therefore need to have reached a conclusion on whether the change of control clause is triggered by the Merger.

11. Mitigating factors

11.1 While we have reached the provisional conclusion the Merger is not likely to give rise to an SLC, our investigation has also considered certain mitigating factors that have been put to us by the Parties, namely:

(a) the Default Tariff Cap;

(b) entry and expansion; and

(c) efficiencies

11.2 While we have discussed these factors below, given the provisional conclusion of our competitive assessment, we do not consider it necessary to reach a view on whether these mitigating factors would prevent a possible SLC.

Default Tariff Cap

11.3 The Parties told us that the Default Tariff Cap will remove the scope for any benchmarking or timing theory of harm to operate. The Parties said that they considered that it is [✂] that the cap will be set at a level that is lower than the SVT prices of each of the larger suppliers. They therefore expected that SVT price dispersion below the cap is very likely to be considerably smaller than it is currently. They said that following the introduction of the Default Tariff Cap at the end of this year, it will be the benchmark for pricing decisions – not only as regards the level but also as to the timing of price changes, which will follow subsequent changes in the cap made by Ofgem.

11.4 In paragraphs 6.14 to 6.24, we considered the introduction of the Default Tariff Cap, and set out our expectation that the cap will be set below the prevailing level of SVT prices. Therefore, the cap is likely to constrain the pricing of default tariffs while it is in operation, and SVT prices are likely to move in line with any adjustments to the level of the Default Tariff Cap. As a result, since the SLEFs will have little freedom on the level or timing of changes to their SVT prices, it is our view that the SLEFs are unlikely to benchmark their SVT prices against each other's SVT prices for the period in which the Default Tariff Cap is in place.

11.5 However, we also noted (in paragraphs 6.25 to 6.32) that it is difficult for us to predict with any confidence whether the Default Tariff Cap will be extended beyond its initial period, due to end in 2020. We therefore reached the provisional conclusion that while an extension to the Default Tariff Cap beyond 2020 is possible, it cannot be foreseen with any degree of confidence.

As set out in paragraph 9.3, it is also our view that it is appropriate to consider the impact of the Merger for a period longer than the two years for which we are confident that the price cap will be in place.

Entry and expansion

11.6 Our Guidelines state that in assessing whether market entry or expansion might prevent an SLC, we would consider whether such entry or expansion would be: *(a)* timely; *(b)* likely; and *(c)* sufficient.[304]

11.7 Our assessment of the barriers to entry and expansion, which might mean this constraint is ineffective, are summarised in Appendix K. However, we note that a large number of suppliers have entered the market over the past five years, and there are numerous mechanisms available for smaller suppliers to hedge their wholesale energy prices. We also note that the aggregate market share of the SAMS has increased from around 5% in 2013 to over 20% in Q1 2018. The market share of the SAMS appears to be continuing to increase and over half of the Parties' customers who switched supplier in 2017 switched to one of the SAMS. This indicates that barriers to entry and expansion are not sufficiently high as to stop the SAMS competing for acquisition tariffs, or for entry and expansion to not be a constraint.

11.8 There are some restrictions on expansion as a proportion of customers prefer to deal with larger or better-known suppliers and many third parties considered policy costs to be the main barrier to expansion. There are costs involved in growing beyond a threshold due to regulatory restrictions, ie those costs associated with a supplier's environmental and social obligations, which are incurred once a supplier has more than 250,000 customer accounts (although some suppliers participate voluntarily on small aspects of the schemes below these thresholds). These include the:

(a) Energy Company Obligation (ECO) scheme whereby suppliers are required to pay for household energy efficiency;[305]

(b) Warm Home Discount (WHD) scheme whereby suppliers are required to offer a £140 rebate to people who are in fuel poverty;[306] and

[304] Merger Assessment Guidelines (CC2 Revised/OFT1254), section 5.8.
[305] See Energy Company Obligation (ECO), Ofgem.
[306] See Warm Home Discount (WHD), Ofgem.

(c) Feed-in-Tariffs (FiT) where suppliers with over 250,000 domestic customer accounts pay fixed tariffs to certain small and renewable generators for electricity.[307]

11.9 While we see that none of the SAMS has expanded to a size where they are comparable to the SLEFs, the rate at which some have expanded is significant, eg Bulb Energy entered the market in January 2016 and increased its customer base in last two years to just above 0.5 million energy accounts. In aggregate, the various SAMS are significant in terms of new business won, see paragraphs 2.38 to 2.40.

11.10 We therefore consider that entry and expansion are potentially a constraint in respect of customers who are actively engaged in the market, and are considering switching supplier, and hence are potentially a constraint on acquisition tariffs.

11.11 However, we do not consider that entry and expansion are a constraint on default tariffs in relation to disengaged consumers. As noted at paragraphs 8.14 and 9.24, customers do not generally switch to default tariffs and consequently there is no direct rivalry between suppliers as regards customer acquisition in default tariffs. The limited engagement of default tariff customers is a barrier to expansion for suppliers. That the SLEFs are able to maintain price differentials for default tariffs relative to acquisition tariffs, demonstrates that the offers from the SAMS, and potential expansion of the SAMS, are not sufficient to significantly constrain the pricing of default tariffs.

Efficiencies

11.12 While mergers can harm competition, they can also give rise to efficiencies. Efficiencies arising from the merger may enhance rivalry, eg if they allow the merged entity to compete more effectively, with the result that the merger does not give rise to an SLC. To form a view that the claimed efficiencies will enhance rivalry so that the merger does not result in an SLC, the CMA must expect that the following criteria will be met: *(a)* the efficiencies must be timely, likely and sufficient to prevent an SLC from arising (having regard to the effect on rivalry that would otherwise result from the merger); and *(b)* the efficiencies must be merger specific, ie a direct consequence of the merger, judged relative to what would happen without it.[308]

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[307] See Feed-in-Tariffs (FiT), Ofgem.
[308] Merger Assessment Guidelines (CC2 Revised/OFT1254), paragraphs 5.7.1–5.7.4.

11.13 SSE's shareholder circular relating to the Transaction set out a table of the expected synergies (see Table 15 below).[309]

Table 15: Synergies announced in SSE's shareholder circular

£m

	Year 1	*Year 2*	*Year 3*	*Year 4*
Run-rate synergies				
IT system consolidation	13	13	20	53
Procurement	25	25	25	26
Other SG&A*	9	44	66	96
Total	47	82	111	175
In-year	18	67	100	154
Implementation costs	–49	–83	–70	–57
One-off capex savings	[✂]	[✂]	[✂]	[✂]
Net in-year synergies	[✂]	[✂]	[✂]	[✂]

Source: SSE shareholder circular for the Transaction (27 June 2018), Appendix 1.
Note: The net in-year synergies for Years 1 and 2 to one decimal place are £[✂] and £[✂] respectively.
* 'SG&A' means 'Selling, General and Administrative expenses'.

11.14 SSE's shareholder circular stated that these synergies were in addition to previously announced performance improvement programmes within the Parties' respective businesses, and would not otherwise be achieved on a standalone basis, ie that these synergies would not have arisen absent the Merger.[310]

11.15 The Parties told us that given the highly competitive nature of the relevant markets, MergeCo would be incentivised to pass on to customers the various savings arising from the Merger. The Parties added that these synergies had been 'prepared on a conservative basis', and therefore, were 'absolutely achievable', with an internal upside synergy scenario of around £[✂] million per annum (compared with the published synergies figure of £175 million) by Year 4, which would 'result in an even greater net benefit for MergeCo'.

11.16 The issue arises as to whether these efficiency benefits would be passed to consumers or whether they would be retained by MergeCo. This is likely to be influenced by the extent of competition in relation to both acquisition and default, tariffs. However, we have not reached a provisional view on this given our provisional conclusions on the competitive assessment.

11.17 For completeness, we also considered whether Npower's current higher indirect cost base could result in an increase in SSE's cost to serve following the Merger, and potentially disadvantage customers.

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[309] SSE shareholder circular for the Transaction (27 June 2018), pages 195 and 198.
[310] SSE shareholder circular for the Transaction (27 June 2018), pages 10, 12, 24, 51, 195, 196 and 198.

11.18 We assessed the Parties' plans for integrating the Npower and SSE Retail businesses under the Merger, and the extent to which Npower's costs might have an impact on MergeCo's cost base.

11.19 The Parties provided a forecast of MergeCo's cost to serve (primarily measured by indirect costs), and submitted that the realisation of these synergies would result in MergeCo's cost to serve falling below those of both Npower and SSE, by [✂]. This is illustrated in Figure 18 below.

Figure 18: MergeCo's forecast cost to serve vs. SSE and Npower standalone costs to serve

[✂]

Source: Parties.
[✂]

11.20 The Parties told us they anticipated that it would take around [✂] for MergeCo to migrate to a single platform, and that prior to this, MergeCo [✂]. Therefore, the Parties told us that [✂] as the migration of customers to a single system would not commence until [✂].

11.21 Based on the evidence available, we considered that the risk of Npower's higher indirect cost base affecting SSE Retail's customers under the Merger would largely be mitigated by MergeCo's intentions following completion to keep SSE Retail and Npower customers on their respective legacy systems until integration of their systems had completed (expected to be [✂]). Until this time, SSE Retail and Npower would effectively operate under their respective platforms and cost structures, such that SSE Retail customers would not directly be affected by Npower's higher costs.

12. Provisional conclusion on the SLC test

12.1 We have provisionally concluded that the proposed Merger may not be expected to result in a substantial lessening of competition (SLC) in the supply of electricity to domestic customers in GB and the supply of gas to domestic customers in GB.