

**RESPONSE TO THE PROVISIONAL FINDINGS
OF 30 AUGUST 2018**

ME/6721/17

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 **Freshfields Bruckhaus Deringer**

SLAUGHTER AND MAY

20 SEPTEMBER 2018

1. Introduction and Executive Summary

- 1.1. The Parties welcome the CMA's Provisional Findings' conclusion that the Transaction may not be expected to result in a substantial lessening of competition in the supply of electricity and the supply of gas to domestic customers in Great Britain ("GB"). These findings align with the Parties' long-held view that the Transaction is a procompetitive opportunity for the GB retail energy market that will deliver significant consumer benefits and intensify even further competition in the market.
- 1.2. The Parties nonetheless consider it worthwhile to note a few minor points in relation to the CMA's analysis to ensure it represents as accurately as possible the reality of the GB energy market's competitive dynamics. In particular:
 - (i) to the extent that the media has any impact on customer switching, that impact is very likely to be due to the emphasis of the media on the absolute value of the price change and on the savings available, rather than comparisons between the larger suppliers' SVT price changes;
 - (ii) FTCs and SVTs are inextricably linked as customers engage with the market and switch from SVTs to FTCs, largely motivated by savings. FTCs are therefore a key element of SVT customers' engagement and the driver for suppliers' customer losses when they raise their SVTs; and
 - (iii) the Parties do take into account the likely differential between FTCs and their increased SVTs based on trends in the market when they make their SVT pricing decisions. However, [REDACTED]. It is therefore logical that the [REDACTED].
- 1.3. The CMA has correctly identified a number of reasons why MergeCo will have neither the ability nor the incentive to foreclose Utility Warehouse post-Transaction. [REDACTED]
- 1.4. Since the Provisional Findings were published, Ofgem has released a consultation on the level of the Default Tariff Cap. From these proposals, it is clear that the interests of consumers will be safeguarded in the coming years. From 2020 onwards, either conditions will have developed that Ofgem considers sufficient to ensure effective competition for disengaged customers or, if this is not the case, the Default Tariff Cap will be extended until 2023 (at which point conditions should be sufficiently competitive for disengaged customers).
- 1.5. This short response sets out the evidence underlying each of the points outlined above.

2. The CMA has correctly identified a number of prompts that encourage customers to switch

- 2.1. The Parties agree with the CMA's assessment that "*a range of factors prompt customers to engage, including: communications from suppliers media coverage [which] can refer to a wide range of activities including press coverage and advertising by PCWs and competitors [and] poor customer service.*"^{1 2}

¹ Provisional Findings Report, paragraph 3.20.

² At paragraph 3.21 of the Provisional Findings Report, the CMA notes that the Parties submitted that "*media attention to price changes does not have a meaningful impact on customer engagement*". By way of clarification, the Parties consider that a distinction should be made between media coverage and advertising by price comparison websites ("PCWs"). Customer switching, for which PCWs earn commission, is constantly encouraged by PCWs' advertising (see the Parties' response to the Annotated Issues Statement, paragraph 3.18 and 4.20)...

- 2.2. The Parties agree with the statement that “*the most prominent factor reported on [in the press] is the size of the announced price change by one of the SLEFs followed by the potential for customers to save money by switching to an acquisition tariff.*”³ The importance of these elements is also clear from the frequency with which they appear in the title or strapline of articles. The Parties’ analysis of online articles about SVT price increases suggests that savings from switching were mentioned in the title or strapline of an article approximately six times as often as other larger suppliers’ SVTs.⁴ As a result, to the extent that the media has any impact on customer switching, that impact is very likely to be due to the emphasis of the media on the absolute value of the price change and on the savings available, rather than comparisons between the larger suppliers’ price changes.
- 2.3. The Parties also agree with the CMA’s finding that customer switching rates increase the larger the potential savings available.⁵ That is why advertising by PCWs is focused on the savings to be made from switching from an SVT to an FTC,⁶ and it is consistent with results of the Parties’ own leavers’ surveys and the 2017 Ofgem Consumer Engagement Survey⁷ all showing that price is by far the main driver of customer switching.⁸
- 2.4. In the Provisional Findings Report the CMA draws a distinction between the prompts that trigger customer switching and customers’ motivation for switching. On that basis, the CMA considers that there is no clear evidence that “*the precise price difference between SVT and acquisition tariff prices has a significant effect on the level of customer engagement.*”⁹ However, it is perfectly reasonable to draw inference not only from the method by which information is transmitted to customers, but also from the information itself. Communications from suppliers and PCW advertising focus on the savings that can be made by switching given the price differential between SVTs and FTCs. As the CMA concludes that those communications have an effect as a trigger for switching, it should also accept that the content of those communications (i.e. the savings available due to the price differential) has an impact.

³ Provisional Findings Report, paragraph 8.42.

⁴ Savings from switching were mentioned in 19% of online articles whereas larger suppliers’ SVTs were mentioned in 3% of online articles. See Response to Annotated Issues Statement, paragraphs 4.30.

⁵ Provisional Findings Report, paragraph 3.25 and Appendix B, paragraph 49.

⁶ See by way of example the Parties’ response to the Annotated Issues Statement, Figure 4.5.

⁷ The CMA has doubts about the ability of survey respondents to accurately recall precisely what prompted them to engage with the energy market (Provisional Findings Report, paragraph 3.22 and Appendix B, paragraph 34). The CMA therefore suggests that it has not received evidence which allows it to identify precisely which of supplier communications and media coverage is more important in prompting customer engagement (Provisional Findings Report, paragraph 3.23). The Parties however note that evidence across multiple surveys consistently shows supplier communications are more important than media coverage. The fact that some customers may misremember their trigger for engagement (likely because they identified the wrong category of supplier letter as their prompt) does not mean that this finding should be disregarded. There is no reason for bias in customer surveys. It is particularly unclear why customers’ alleged lack of memory would mean that they underreport the influence of the media relative to supplier communications when they appear capable of remembering PCW advertising as a prompt – it is cited more frequently than media coverage in both Ofgem’s Engagement Survey (Provisional Findings Report, Appendix B, Figure 3) and SSE’s leavers’ survey (Response to Issues Statement Figure 3.1).

⁸ See the Parties’ response to the Annotated Issues Statement, Figure 5.2. Over 90% of respondents quoted saving money or avoiding a price rise as their priority when switching.

⁹ Provisional Findings Report, paragraph 3.25.

2.5. The Parties note that the CMA's finding that customer switching rates increase the larger the potential savings available¹⁰ implies FTC prices must influence the level of SVT customer engagement and, therefore, the losses that suppliers experience following an SVT price change. This is true irrespective of any distinction between prompts that trigger customer switching and customers' motivation for switching (and the Parties do not consider that any such distinction can be drawn).

3. The CMA is correct that the Transaction will not affect decision-making on the level or timing of SVT price changes

3.1. The Parties agree that the Transaction is unlikely to have an impact on the constraints faced by each of the larger suppliers for the reasons set out at paragraph 9.40 of the Provisional Findings Report.

3.2. The Parties also agree with the CMA that the Transaction "*will not lead the SLEFs to announce SVT price increases earlier*", given, *inter alia*, the costs of delaying an SVT price increase and the fact that customer losses from being the first to announce play a limited role in those decisions (as reflected in the Parties' internal documents).¹¹

3.3. On that final point, the Parties note that the limited significance given to the risk of customer losses due to being the first to announce is due to the fact that the savings available from FTCs have a significant effect on customer engagement and switching (as set out above).

3.4. Since the effect that a larger differential between the SVTs and acquisition tariffs has on customer switching applies all year round, not just in the couple of months immediately following the price change, factors that continue to encourage customers to switch throughout the year are more relevant to the Parties when setting their SVT price than a factor that affects customers only in the period immediately following a price change.¹²

3.5. The CMA places undue weight on predictions of immediate losses made by the Parties following a price change.¹³ These predictions should be viewed in the wider context of actual losses throughout the year, since:

- (i) the infrequent nature of price increases means that predicting the impacts of price changes is inherently uncertain and the Parties' predictions represent estimates of the 'upper bounds' of likely customer losses; and
- (ii) the large majority of switching occurs outside the SVT price change period each year, driven by the potential savings available in the market (which is itself a function of the SVT prices). It remains the case that any predictions of losses around price increases should be viewed in

¹⁰ Provisional Findings Report, paragraph 3.25 and Appendix B, paragraph 49.

¹¹ Provisional Findings Report, paragraph 9.55.

¹² See Response to Annotated Issues Statement, paragraphs 4.47 to 4.51.

¹³ Provisional Findings Report, paragraphs 8.39, 9.30(b) and 9.30(c).

the context of the more significant volume of switching that occurs throughout the year and that provides the constraint under which SVT prices are set.¹⁴

- 3.6. Predictions of losses made by the Parties should also be viewed in the context of wider evidence on customer engagement and media coverage. In particular:
- (i) survey evidence suggest that media coverage is only a minor factor in driving customer engagement;
 - (ii) the CMA's and the Parties' analyses of media coverage, the only form of media coverage that the CMA has identified as making comparisons between the larger suppliers' price changes, suggests such comparisons are relatively infrequent and not prominent; and
 - (iii) the media coverage analyses do not clearly suggest that the volume of media coverage is higher for the first large supplier to announce a price change.
- 3.7. Wider evidence on customer engagement and media coverage therefore suggests that any link between the relative size of SVT price changes / the timing of SVT price changes and customer losses is weak. The Parties' predictions of losses should therefore be considered upper bounds.
- 3.8. The [REDACTED] does not mean that this is not a factor for the Parties.¹⁵ [REDACTED].¹⁶

4. Update on Utility Warehouse negotiations

- 4.1. The CMA is correct to conclude that the Transaction is not likely to lead to the foreclosure of Utility Warehouse as there will be no ability or incentive to adopt this strategy for the reasons set out in Section 10 of the Provisional Findings Report.
- 4.2. As Npower has informed the CMA previously, it [REDACTED].¹⁷ [REDACTED].

5. Update on the Default Tariff Cap

- 5.1. In light of the above, the Parties agree with the CMA that it is not necessary to reach a conclusion on the various mitigating factors identified in the Provisional Findings Report.¹⁸ The Parties have, however, set out some points below in relation to the Default Tariff Cap.

¹⁴ Response to the Annotated Issues Statement, paragraphs 4.47 to 4.51.

¹⁵ C.f. Provisional Findings Report, paragraph 8.48.

¹⁶ See Response to Annotated Issues Statement, paragraphs 4.54 and 4.55.

¹⁷ [REDACTED]

¹⁸ Provisional Findings Report, paragraph 11.2

5.2. The Parties agree with the CMA's finding that the Default Tariff Cap will likely be in place by the end of 2018,¹⁹ but note that the overview document published by Ofgem on 6 September 2018 provides some additional clarity as to the level and the duration of the Default Tariff Cap.²⁰ In particular, it is clear that:

- (i) Ofgem's proposed methodology for setting the cap will result in a cap that is below the prevailing SVT levels;²¹ and
- (ii) Ofgem expects the Default Price Cap to be in place "*until the right market framework is in place for competition to be effective for [disengaged] consumers.*"²²

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¹⁹ Provisional Findings Report, paragraph 6.21.

²⁰ <https://www.ofgem.gov.uk/publications-and-updates/default-tariff-cap-overview-document>

²¹ Ofgem has suggested setting the limit for default tariffs at £1,136 for dual fuel customers paying by direct debit and £1,219 for customers paying by standard credit. Ofgem's analysis suggests that such price caps would have result in 96% of SVT customers in 2017 paying less (see page 6 of the Ofgem Statutory Consultation Overview Document dated 6 September 2018).

²² Ofgem Statutory Consultation Overview Document, paragraph 3.37.