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Second submission on SSE-Npower merger: response to the Issues Statement

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Summary

1. The CMA has proposed a new theory of harm associated with a loss of rivalry in the setting of default tariff prices. (*CMA Issues Statement*, 29 May 2018) The parties have argued that the evidence does not support this. (*SSE/nPower Initial Submission* 30 May 2018)
2. There was indeed rivalry in the setting of default tariff prices – Standard Variable Tariffs (SVTs) - during the first decade that the domestic retail energy market was open. Such rivalry has been artificially suppressed or discouraged during the second decade. Given that a significant number of customers prefer a product like an SVT, rather than have to repeatedly shop around for a succession of fixed period tariffs, there is scope for rivalry in the setting of default prices to develop and indeed to be encouraged, to the benefit of such customers.
3. If the CMA maintains this theory of harm, a disposal of some of nPower’s long-standing SVT customers would address the CMA’s concern and increase competition and innovation, to the benefit of customers.

I Experience to date

4. During the period from about 1998, when the domestic retail gas and electricity markets were opened, to 2008, competition between retail suppliers was primarily on the basis of their Standard Variable Tariffs. So, during this ten-year period, there was rivalry in the setting of what are now called default tariff prices.
5. In order to attract new customers, former incumbent electricity retailers charged a lower SVT price to customers outside their former incumbent areas than they did to existing customers within these areas. In 2008 Ofgem expressed concern about this and introduced its non-discrimination condition. This, and Ofgem’s crackdown on doorstep

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selling, led suppliers to withdraw the lower prices but also to develop other means of competing, including via a greater use of fixed price fixed term tariffs.

6. Ofgem interpreted the resulting increase in number and variety of tariffs as confusing to customers. It therefore introduced a “simple tariffs policy”, restricting the number and variety of such tariffs that suppliers could offer. The practical consequence of this was that suppliers offered a single Standard Variable Tariff and two or three fixed price fixed term tariffs. Restrictions on the SVT meant that it could no longer be used as an acquisition tariff, and competition was focused on the fixed price fixed term tariffs.
7. In 2016, the CMA’s Electricity Market Investigation (EMI) found that Ofgem’s simple tariffs policy had restricted competition and innovation. The CMA recommended that the main elements of this policy should be discontinued.
8. Ofgem implemented this recommendation during 2017. There are nonetheless still restrictions on the use of SVTs. There is also pressure on suppliers, including from Ofgem, to reduce the proportion of their customers on SVTs, or indeed to cease offering SVTs entirely. Some suppliers no longer offer them to new customers. At the same time there is also pressure on customers, again not least from Ofgem, to engage more in the market and to switch away from SVTs to fixed price tariffs.
9. In sum, during the first decade of the domestic competitive retail market there was rivalry in the setting of default tariffs (SVTs). During the second decade this rivalry has been precluded or restricted or discouraged by various regulatory interventions. And, of course, a temporary price cap on default tariffs would severely restrict such rivalry for the next few years. But this is not to say that, over the longer term, such rivalry could not or should not develop once more. Indeed, it could usefully be encouraged.

II Encouraging rivalry in setting default tariff prices

10. Customer surveys, and actual customer behaviour, repeatedly show that a significant number of customers prefer an energy product where they do not have to continually make decisions about the price or term of the product, or about the identity of the supplier. Many customers trust, or would prefer to trust, their existing supplier. A view is frequently expressed, not least on Parliamentary committees, that customers should not have to keep changing tariff or supplier in order to get a reasonable price.
11. This suggests that a policy of encouraging competition between suppliers with respect to their SVTs (or default tariffs or equivalent) should be considered. This would better assure customers that their present SVT from their own supplier is at an acceptable level when compared to those offered by other suppliers. Alternatively, it would enable customers to choose a more attractive SVT from a supplier with a better record. In doing so, it would of course also increase the competitive pressure on suppliers to ensure that their SVTs – or other default tariffs - offered good value compared to the SVTs of other suppliers - and, for that matter, compared to alternative fixed price tariffs and other products. Such a policy would not be inconsistent with facilitating switching and encouraging and enabling customers to better engage in the market.
12. The obvious place to start is by comparing the SVTs of the various different suppliers, rather than (or in addition to) comparing such SVTs against the best available fixed term

prices. The top half of Table 1 shows the SVTs offered by the Six Large suppliers and four medium sized suppliers, at approximately six month intervals over the last three years. The bottom half of the Table ranks the SVTs in each year, and shows the average rank of each supplier over the whole period.

13. Ideally one would go back further, in order to establish how securely the suppliers have established their reputations over a longer period of time. I do not have access to such data, but presumably Ofgem would have. The data are for one particular region (Southern), chosen at random. Further study could indicate whether the ranking is different in other regions. The data are for a consumer with average consumption, and obviously the figures and rankings could be different for higher or lower levels of consumption.

Table 1 SVT tariffs at average consumption levels in Southern Region

Supplier	Jun-16	Dec-16	Jun-17	Dec-17	Apr-18	
British Gas	£ 1,054	£ 1,054	£ 1,054	£ 1,111	£ 1,111*	
EDF Energy	£ 1,080	£ 1,096	£ 1,174	£ 1,153	£ 1,169	
E.ON UK	£ 1,052	£ 1,042	£ 1,136	£ 1,115	£ 1,145	
npower	£ 1,086	£ 1,086	£ 1,203	£ 1,180	£ 1,180	
Scottish Power	£ 1,094	£ 1,083	£ 1,169	£ 1,160	£ 1,223	
SSE	£ 1,077	£ 1,077	£ 1,144	£ 1,133	£ 1,133	
First Utility	£ 1,180	£ 1,180	£ 1,180	£ 1,163	£ 1,163	
Ovo Energy	£ 1,080	£ 1,069	£ 1,069	£ 1,051	£ 1,051	
Utility Warehouse	£ 1,022	£ 1,022	£ 1,022	£ 1,136	£ 1,136	
Co-operative Energy	£ 1,050	£ 1,081	£ 1,137	£ 1,115	£ 1,115	
Ranking of suppliers						Average rank
Supplier	Jun-16	Dec-16	Jun-17	Dec-17	Apr-18	
British Gas	4	3	2	2	2	2.6
EDF Energy	6=	9	8	7	8	7.7
E.ON UK	3	2	4	3=	6	3.7
npower	8	8	10	10	9	9.0
Scottish Power	9	7	7	8	10	8.2
SSE	5	5	6	5	4	5.0
First Utility	10	10	9	9	7	9.0
Ovo Energy	6=	4	3	1	1	3.1
Utility Warehouse	1	1	1	6	5	2.8
Co-operative Energy	2	6	5	3=	3	3.9

Source: data from Cornwall Insight. *Note: in April 2018 British Gas did not offer its SVT to new customers, and its default tariff rate was a fixed rate tariff at the same level as its SVT.

14. Table 1 shows that, over this period in this region, British Gas and Utility Warehouse had the lowest SVTs. The highest SVTs were from nPower and First Utility. (It will be seen below, however, that the medium-sized suppliers had very few SVT customers.) The picture changed somewhat during the period, with Ovo gradually becoming more competitive. As noted, different regions or time periods might change the picture slightly – for example, calculations based on tariffs published by Ofgem during a similar time period (presumably reflecting a national average) rank the Coop as offering one of

the highest SVTs rather than the lowest. But the general picture seems to be clear: some suppliers consistently offer SVTs that are good value compared to those of their rivals, while others do not. Some, like SSE, seem to be consistently around the middle of the pack.

15. Being with one of the better ranking suppliers offers savings to customers. While not as large as the savings from moving to the lowest fixed price deals (which over time requires frequently changing tariff or supplier), the savings are nonetheless worth considering. For example, over this period a customer would have saved nearly £200 with Utility Warehouse compared to nPower, or nearly £80 per year.
16. It is also important to note that other smaller suppliers not listed in Table 1 offer competitive SVTs. For example, the supplier Bulb offers only a single tariff, which is an SVT, and I am told that it has grown to some 700,000 customer accounts in little over a year.

III Market shares for default tariff customers

17. Table 2 shows the number of non-prepayment domestic customer accounts of different types by supplier. The CMA's concern is essentially with those SVT customers that have been with their supplier for over 3 years. (Those customers on fixed tariffs and non-SVTs, or on SVTs for less than 3 years, are assumed to be sufficiently engaged in the market not to be a source of concern.) As of October 2017 there were 7.85m such customers, accounting for 34% of the 23.4m customers listed in Table 2.²

Supplier	Fixed Tariff	Other non-SVTs	SVT (less than 3 years)	SVT (over 3 years)	SVT (over 3 years) as %
British Gas	2,122,713	0	1,575,115	2,854,952	36.3%
EDF	1,391,486	0	738,141	745,608	9.5%
First Utility	630,804	0	151,674	24,170	0.3%
OVO	440,881	0	139,784	10,606	0.1%
Coop	226,806	0	91,627	32,606	0.4%
E.ON	1,317,898	9,367	809,080	1,233,876	15.7%
Npower	1,308,185	14,764	432,376	737,549	9.4%
Scottish Power	1,456,292	60,009	460,799	549,872	7.0%
Utility Warehouse	65,950	157,208	128,656	118,653	1.5%
SSE	648,424	324,709	848,207	1,546,202	19.7%
Totals	9,609,439	566,057	5,375,459	7,854,094	100%

Source: Ofgem, Standard Variable Tariff indicators, final column and final row added.

² Note Ofgem's qualification: "For each supplier, a 'dual fuel' customer account (i.e. where a customer takes gas and electricity from the same supplier) is counted as one account, rather than two separate accounts. While the dual fuel figure can be used as a proxy for the number of customers with each supplier, please note that adding these accounts across suppliers would result in double counting for customers who get their gas and electricity from different suppliers."

18. Of these 7.85m long-standing SVT customers, 19.7% are with SSE and 9.4% with nPower. A merger would therefore create a company with 29.1% of these customers. That would be the second-largest grouping of such customers. In fact, the two largest such groupings would be British Gas 36.3% and the merged company 29.1%, making a total of 65.4%.
19. Whether this would result in a substantial lessening of competition is for the CMA to judge. But it would be unfortunate if the merger were to be seen in the public eye as the recreation of a duopoly in the energy market, supplying no less than two thirds of the customers that are seen as least inclined to engage in the market. Furthermore, the merger would reduce the number of independent decision-making entities with a significant share of this market and thereby better able to make a significant impact on it.

IV Addressing the CMA's concern

20. I suggested in my previous Submission on SSE-Npower merger (14 March 2018) that a concern about such a potential reduction in competition could be addressed by a suitable divestment of customer accounts to other existing or potential small or medium suppliers in the market. With the recent clarification of the CMA's potential concerns, and the data in Table 2, it is possible to make more specific suggestions.
21. It would seem that the CMA's present concern about the loss of rivalry in the setting of default tariff prices could be completely alleviated if nPower were to divest to a buyer other than SSE those of nPower's customers who have been on SVTs for more than 3 years. There were just under 740,000 such customers as of October 2017. (Some of these may be dual fuel customers though I understand that most are electricity-only customers.) Alternatively, SSE might undertake, or be required, to dispose of such customers as a condition of the merger.
22. This would be a potential maximum disposal sufficient to meet the CMA's concern. Taking into account potential benefits of the merger, the CMA might consider that divesting a smaller number of these customers would suffice to address its concerns.
23. The extent of the competitive benefit of this disposal might also depend on which party or parties acquired these customers. The potential acquirer(s) of these customers would obviously need to be someone other than a Big6 supplier (ie not British Gas, E.On, EdF or Scottish Power). A variety of potentially attractive possibilities suggest themselves (without in any way committing the companies mentioned).
24. For example, these 740,000 customers would approximately double the size of First Utility or nearly treble the size of Ovo or Utility Warehouse. Such merged entities would have between about 1.3m and 1.6m customers, about the half the size of the smaller Big6 suppliers. (According to Table 1, E.On has 3.3m customers, EdF 2.9m and Scottish Power 2.6m.) This could provide an effective challenge to what would now be the Big5 suppliers, without the opprobrium sometimes attached to being a large supplier. The larger number of such a supplier's customers would sooner make it a household name. Moreover, it would enable these medium sized suppliers to acquire a

substantial number of customers of a type, and on a type of tariff (SVT), where they currently have very few such customers.

25. Alternatively, dividing 800,000 customers between half a dozen smaller suppliers would enable those half dozen suppliers to move promptly through the 250,000 customer barrier. This would reduce the number of suppliers that are effectively subsidised by the present exemptions for social and environmental costs, and enable competition to take place on a more solid and less controversial base.
26. I refer also to my previous submission, which gave ten indications of the various benefits to customers that a divestment remedy could bring.³
27. Preferably, it would be for the parties to negotiate and agree precise terms of disposal of these long-standing SVT customers. The CMA might consider whether it was necessary to protect customers transferred from nPower to another supplier, and if so how. The parties and the CMA might therefore wish to consider the record of the acquiring parties with respect to the level of SVT tariffs. However, it would appear that most potential acquiring parties have a better record over the last three years than nPower has.

³ This previous submission is available at https://www.eprg.group.cam.ac.uk/wp-content/uploads/2018/03/S.-Littlechild_Submission-to-CMA-on-SSEnpower-merger_15Mar18.pdf