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Dear Will

### **Supplementary Submission on Provisional Decision on Remedies**

On 14 April 2016, one week after the 7 April closing date for submissions on the CMA's *Provisional Decision on Remedies*, two items were published that had potentially significant implications for the CMA's provisional remedies. These were the NAO's Report<sup>1</sup> on the Government's Green Deal and Energy Company Obligation and OFGEM's letter<sup>2</sup> to suppliers and others concerning the CMA's provisional remedy for the removal of certain RMR 'simpler choices' rules. This Supplementary Submission makes three points for the CMA's consideration.

### **NAO Report on Green Deal and ECO**

1. In publishing the NAO Report, the Comptroller General (Head of the NAO) said "in practice, its [the Government's] Green Deal design not only failed to deliver any meaningful benefit, it increased suppliers' costs – and therefore energy bills – in meeting their obligations through the ECO scheme". More specifically, the Report finds that "Energy suppliers spent £3.0 billion meeting their obligations between 1 January 2013 and 31 December 2015". It says that "energy suppliers changed their billing systems to accommodate Green Deal loans" (para 17). It also says that "A lack of continuity in government energy-efficiency policies is likely to increase costs, as businesses require a higher return on risky investment in training, accreditation and capacity." (para 25)
2. This additional and uncertain cost, averaging £1bn per year, will have fallen primarily on the Six Large Energy Suppliers (SLEFs). It is very significant in relation to the claimed detriment to customers of £1.7bn per year, which is based on a comparison of the prices of the SLEFs and two Mid-tier Suppliers. The latter will have paid only a fraction of the £3bn, and then only in the last year or so. Moreover, the £3bn excludes the costs to suppliers of changing their billing systems to accommodate Green Deal Loans. The costly, changing and uncertain Green Deal and ECO policy obligations, and the financial penalties for non-compliance, will also have increased the SLEFs' cost of capital. The opportunity cost is relevant too: dealing with this issue would have reduced the management time and focus available to deal with general cost efficiency issues, quality of service, innovation and marketing, etc. The aggregate environmental and social costs of the SLEFs amounted to

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<sup>1</sup> *Green Deal and Energy Company Obligation*, Report by the National Audit Office, HC 607 SESSION 2015-16, 14 April 2016

<sup>2</sup> *CMA provisional remedies: removal of certain RMR 'simpler choices' rules*, Ofgem letter to suppliers and others, 14 April 2016

£4.6bn in 2014, comparable to aggregate indirect costs of £4.5bn. They thus constituted a significant burden on the SLEF supply businesses, and the Green Deal and ECO components, in particular, were for the most part not imposed on Mid-tier and smaller suppliers.

3. The significant changes to the scale, scope and cost of the obligations over the period of the CMA's analysis, combined with their complexity and the small supplier exemption, suggest that the CMA could usefully have considered whether the schemes themselves gave rise to an Adverse Effect on Competition. At the very least, the CMA needs to consider whether these schemes account for more of the differences in supplier costs and profits, and explain more of the estimated customer switching gains, than it presently allows. The CMA needs to be particularly cautious in making comparisons of pricing as between suppliers who were and were not liable to these costs.
4. We therefore urge the CMA to take full and accurate account of this factor in its appraisal of the costs, efficiency, pricing, profitability and service quality of the SLEFs and the claimed detriments to customers.
5. The NAO Report also notes that only 1% of the homes that were improved by the scheme had taken Green Deal loans, because "very few households saw Green Deal finance as a sufficiently attractive proposition" (para 24). The Comptroller General commented "The Department [DECC] now needs to be more realistic about consumers' and suppliers' motivations when designing schemes in future to ensure it achieves its aims."
6. The same advice surely applies to the CMA's analysis of the retail market and its proposed remedies. As we explained in our last submission of 11 April 2016, the CMA's concept of a well-functioning retail market, its calculations of potential gains from switching, and its claimed weak customer response, are all based on unrealistic assumptions about consumers' motivations. Not surprisingly, they lead to implausible and inconsistent estimates of customer detriment. Similarly, the CMA's proposed remedies, particularly the Ofgem programme to promote engagement, the Standard of Conduct to have regard to comparability of tariffs, and the Database remedy to make available details of disengaged customers, are again all based on questionable assumptions about consumers' motivations. Furthermore, the CMA's calculations of customer detriment, excess profits and inefficient costs are all based on unrealistic assumptions about how competitive markets work, the business models of the SLEFs and the options open to them.
7. We therefore urge the CMA to revise its retail analysis and remedies so that they are based on more realistic assumptions.

### **Ofgem's proposed changes in licence conditions**

8. In its *Provisional Decision on Remedies*, the CMA proposed a new Standard of Conduct to "require suppliers to have regard in the design of tariffs to the ease with which customers can compare value for money with other tariffs they offer". In our responding submission of 11 April, we observed (para 73) that such a licence condition "does not seem consistent with the CMA's findings on the adverse effects of those requirements, and with its explicit

view on innovation and regulatory restrictions. It could also be misinterpreted by Ofgem, which appears to continue to oppose much tariff variation.”<sup>3</sup>

9. Ofgem has recently given guidance to suppliers in response to the CMA’s proposed removal of certain ‘simpler choices’ provisions. We welcome Ofgem’s prompt intention to remove these provisions. However, its guidance heightens our fears about Ofgem’s interpretation.
10. For example, Ofgem says that “The CMA also proposes introducing a new principle-based requirement on suppliers to enable consumers to compare their tariffs easily.” It then says of “the CMA’s proposed new principle”: “This means that consumers should be able to understand any new tariffs and assess the value for money compared to other tariffs that the supplier offers.”
11. However, the CMA did *not* propose that suppliers be required “to enable consumers to compare their tariffs easily”, and Ofgem’s interpretative sentence is *not* what the proposed new principle means. Rather, the CMA proposed that suppliers be required to “*have regard*” to the ease of comparing value for money. Our reading is that the CMA intended that it would be open to a supplier, having had regard to ease of comparability, then to decide that, on balance, other considerations (such as innovation) outweighed this. Ofgem’s incorrect interpretation would not allow this outcome, and would impose a more onerous and restrictive condition on suppliers.
12. Ofgem then says “We also expect suppliers to consider the risk of causing detriment to consumers (including those in vulnerable situations) and take appropriate steps to address this.” In our view, suppliers can be expected to consider, and as far as possible avoid, the risk of causing detriment to their customers. In a competitive market it is in their commercial interest to do so. Our concern is that Ofgem is using the CMA’s proposed changes in licence conditions to introduce yet another explicit or implicit principles-based obligation on suppliers - to take appropriate steps to avoid causing detriment to consumers – that is unnecessary, unclear, uncertain and potentially restrictive of competition.
13. Especially as interpreted by Ofgem, the proposed new licence condition on comparability of tariffs seems ominously like the simple tariff licence conditions without the four tariffs restriction. The CMA has found that the simple tariff conditions have had an Adverse Effect on Competition. There is every reason to fear that the proposed comparability licence condition, as interpreted and enforced by Ofgem, would have a similar effect. We therefore urge the CMA to reconsider the issue and withdraw this proposed remedy.

**From:**

Stephen Littlechild, Director General of Electricity Supply and Head of the Office of Electricity Regulation (Offer) 1989-1998

Sir Callum McCarthy, Chairman and Chief Executive of Ofgem and the Gas and Electricity Markets Authority (GEMA) 1998-2003

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<sup>3</sup> “Ofgem said that it did not want to return to the ‘confusopoly’ that existed prior to the RMR rules and that multi-tier tariffs, tariffs with multiple components and loyalty discounts might make tariff comparisons more difficult.” (*Provisional Decision on Remedies*, para 5.376)

Eileen Marshall CBE, Director of Regulation and Business Affairs, Offer 1989-1994; Chief Economic Adviser and later Deputy Director General of Ofgas 1994-1999; Managing Director, Ofgem and Executive Director, GEMA 1999-2003

Stephen Smith, senior executive positions at Ofgem 1999-2002 and 2003–2010 including Managing Director, Markets, 2004-2007 and Executive Board Member, GEMA 2004- 2010

Clare Spottiswoode CBE, Director General of Gas Supply and Head of the Office of Gas Regulation (Ofgas) 1993–1998.