

# Energy market investigation

## Coordination in the retail market facilitated by price announcements

**5 March 2015**

This is one of a series of consultative working papers which will be published during the course of the investigation. This paper should be read alongside the updated issues statement and the other working papers which accompany it. These papers do not form the inquiry group's provisional findings. The group is carrying forward its information-gathering and analysis work and will proceed to prepare its provisional findings, which are currently scheduled for publication in May 2015, taking into consideration responses to the consultation on the updated issues statement and the working papers. Parties wishing to comment on this paper should send their comments to [energymarket@cma.gsi.gov.uk](mailto:energymarket@cma.gsi.gov.uk) by 18 March 2015.

© Crown copyright 2015

You may reuse this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence.

To view this licence, visit [www.nationalarchives.gov.uk/doc/open-government-licence/](http://www.nationalarchives.gov.uk/doc/open-government-licence/) or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: [psi@nationalarchives.gsi.gov.uk](mailto:psi@nationalarchives.gsi.gov.uk).

The Competition and Markets Authority has excluded from this published version of the working paper 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 [✂].

## Contents

	<i>Page</i>
Introduction .....	2
Approach.....	3
Conditions for coordination to be sustainable.....	4
Outcomes consistent with coordination on market segmentation and/or prices .....	16
Appendix 1: Cost structures of the Six Large Energy Firms .....	19

## Introduction

1. In this working paper we set out our initial views in relation to the evidence we have gathered on the issue of tacit coordination by the Six Large Energy Firms in the supply of gas and electricity to domestic customers in Great Britain.
2. The State of the Market Assessment found that several characteristics of the markets for the retail supply of gas and electricity were conducive to coordinated behaviour. It also found that aspects of the behaviour of the Six Large Energy Firms appeared to be consistent with tacit coordination between them, including the announcement of price changes around the same time and of a similar magnitude and convergence of domestic supply margins.
3. In our issues statement<sup>1</sup> we said that we would consider the evidence that the Six Large Energy Firms (while not reaching agreements on their behaviour) were tacitly coordinating, in adopting strategies and behaviours to their mutual advantage. In particular, we said that we would consider the following two possibilities:
  - (a) The pre-announcement of price increases may facilitate tacit coordination in prices. This practice may have had the effect of reducing the uncertainty for a supplier in relation to how its rivals might respond to a price increase, allowing suppliers to coordinate the timing and scale of price increases, and so sustaining prices at a higher level than would otherwise prevail. An increase in prices is an event that might stimulate customers to search for a better price; yet if other suppliers raise prices by similar amounts, at much the same time, the potential savings to be had from switching are likely to be reduced. Reducing customer expectation of the gains from switching might soften competition.
  - (b) Vertical integration in the supply of gas and electricity may facilitate market sharing. It has been suggested that vertically integrated suppliers are increasingly using similar strategies across their businesses, including in relation to hedging and generation portfolios. One argument is that they may try to avoid asymmetries in their hedging strategies and generation portfolios that might give any of their competitors windfalls from upstream activities that may influence their conduct in the retail market, including their incentives or ability to expand downstream. The effect might be to reduce the incentives of suppliers to compete aggressively to increase market share.

---

<sup>1</sup> Issues statement, paragraph 55.

4. With regard to the second of these possibilities, we consider, on reflection, that the behaviours identified, if established, would be relevant to our assessment of whether the structural characteristics of the market are conducive to tacit coordination (and not evidence of actions taken by the Six Large Energy Firms to reach, sustain or enhance tacit coordination). Our preliminary analysis of the strategies of the Six Large Energy Firms including strategies in relation to hedging and generation portfolios are set out in other working papers (in particular, Liquidity and Descriptive Statistics (Upstream)).
5. In this working paper we therefore focus on the evidence in relation to tacit coordination facilitated by price announcements.
6. We note an initial view that certain behaviour or practices of the Six Large Energy Firms do not currently indicate that tacit coordination is occurring. This does not preclude us from having concerns, if the evidence comes to light, in relation to their competitive effects, nor from having concerns regarding tacit coordination in other behaviour.

## **Approach**

7. In general terms, suppliers might coordinate on the prices at which they sell a product or on the markets in which they compete to supply a product and/or service.
8. In the issues statement we distinguished between collusion and coordination. We said that collusion involved companies reaching explicit agreements or engaging in concerted practices – eg in relation to the prices and/or quantities of a product to be sold – and was prohibited under Chapter 1 of the Competition Act 1998. In contrast, tacit coordination may arise in a stable market where firms interact repeatedly and come to be able to anticipate each other's actions, allowing them to coordinate behaviour without reaching any agreement to do so. Such coordination involves firms competing less aggressively over time and forgoing the possibility of higher individual profits in the short term (by cutting prices unilaterally), in the expectation that this will lead to higher profits in the longer term.<sup>2</sup>
9. Our standard approach to investigating allegations of tacit coordination is to consider, first, whether the market is conducive to coordination and, then, whether the evidence of behaviour and market outcomes is consistent with coordination.<sup>3</sup> Given this, our approach is as follows:

---

<sup>2</sup> Issues statement, paragraph 53.

<sup>3</sup> *Guidelines for market investigations: Their role, procedures, assessment and remedies (CC3)*, paragraph 244.

- (a) We first revisit the evidence on whether the characteristics of the retail supply of gas and electricity to domestic customers are conducive to tacit coordination (paragraphs 12 to 33).
  - (b) We then consider whether there is evidence of tacit coordination facilitated by price announcements (paragraphs 34 to 53).
  - (c) Finally, we consider whether market outcomes are consistent with tacit coordination (paragraphs 54 to 58).
10. Our main sources of information are as follows: the main parties' responses to information requests including a request specifically concerned with their behaviour around price announcements; documents provided by the main parties in response to the 'first day letter' and the supply questionnaire; and a summary of the documents gathered by Ofgem in conducting the Energy Supply Probe and the retail market review (RMR) reforms.
11. We conducted a thorough trawl of the documents provided by the parties. It is our preliminary view that there is no evidence in these documents to suggest explicit collusion among the Six Large Energy Firms.

### **Conditions for coordination to be sustainable**

12. The Competition and Markets Authority (CMA) guidelines for market investigations (and previously the Competition Commission guidelines) state that three conditions need to be satisfied for coordination to be sustainable:<sup>4</sup>
- (a) Firms need to be able to reach an understanding and monitor the terms of coordination. When there is no explicit agreement, firms need to have sufficient awareness of each other and be able to anticipate each other's reactions so as to identify a mutually beneficial outcome.
  - (b) Coordination needs to be internally sustainable among the coordinating group – ie the firms have to find it in their individual interests to adhere to the coordinated outcome; and they must lack an incentive, or have a positive disincentive, to compete because they appreciate how each other will react.
  - (c) Coordination also needs to be externally sustainable, in that coordination is unlikely to be undermined by competition from outside the coordinating group or from the reactions of customers.

---

<sup>4</sup> CC3, paragraph 250.

13. An important part of our investigation is therefore to establish whether or not the specific structural characteristics of the market create the conditions in which coordination can arise and be sustained. We assessed whether such characteristics are satisfied in the domestic supply of gas and electricity. In particular, we looked at:
- (a) the degree of symmetry between suppliers measured by market shares, cost structures and suppliers' business models, which we consider to be relevant to the ability of suppliers to reach an understanding on mutually beneficial outcomes (paragraphs 15 to 23); however, this should not be overstated: there are circumstances under which firms may find it mutually beneficial to coordinate even in the presence of asymmetries;
  - (b) the degree of market transparency on conduct, and the stability of market shares and demand, which we consider to be relevant to the internal stability of coordination (paragraphs 24 to 29); and
  - (c) the extent of barriers to entry and expansion, which we consider to be relevant to the external stability of coordination (paragraph 30).
14. Our initial findings are set out below.

## **Symmetry**

### *Market shares*

15. Market shares in the supply of gas and electricity to domestic customers are set out in the Descriptive Statistics: Retail working paper, Appendix A. These initial results suggest that market shares for the Six Large Energy Firms are fairly similar for electricity at a national level. For gas, Centrica is the market leader, as the former national incumbent, whereas market shares of the other five are all of a similar size.
16. In addition to that, the market shares of the Six Large Energy Firms appear fairly stable over time for both gas and electricity. Further analysis shows that this is also the case at a regional level. However, monthly data on the number of domestic customers gained and lost by supplier is variable (see the Descriptive Statistics: Retail working paper, Appendix J). In particular, this shows the number of customers gained and lost by each supplier changes considerably month-by-month, and that the relative performance of suppliers, as measured by net gains (or losses), also changes over time.

### *Cost structures*

17. Information is provided in Appendix A on the cost structures of the Six Large Energy Firms in the supply of electricity and gas to domestic customers. These show that:
  - (a) for all suppliers, three cost items – energy, network distribution and transmission charges – and social and environmental obligations have accounted for around 80 to 90% of the total costs of supply; and
  - (b) in any year, these three cost items each account for a similar proportion of total direct costs across suppliers.
18. Suppliers have limited control over the costs associated with network distribution and transmission, and social and environmental obligations. These will vary between suppliers according to, among other things, differences in their regional presence, customer mix and policies, and performance in relating to meeting their obligations.
19. We examined hedging behaviour of the Six Large Energy Firms as part of our liquidity work (see the Liquidity working paper). We found that their median supply hedges were pretty similar, but not identical.
20. We also looked at how indirect costs compared across suppliers on a per customer account basis. Indirect costs include costs associated with billing, metering, bad debts, marketing and sales, and contributions to central costs. We found considerable variation between suppliers that could be due to differences in the range or quality of the service provided to their customers, differences in the efficiency in the delivery of these services or internal accounting practice on the allocation of costs (see the Profitability of Retail Energy Supply working paper).

### *Business models*

21. While the physical product supplied to domestic customers is homogeneous, there is scope for differentiation in both:
  - (a) the terms and conditions of supply including the payment terms offered to customers, the structure of fixed-period tariffs (such as the length of the contract and whether there are exit fees) and whether the tariff offers rewards such as gift vouchers; and
  - (b) the range of service offered such as services to help with controlling energy usage and boiler repair services.

22. In practice, as set out in the Pricing Strategies working paper, there are similarities in the product offering of the Six Large Energy Firms. For example, all the Six Large Energy Firms:
- (a) offer a standard variable tariff to which the majority of their domestic customers subscribe;
  - (b) offer fixed-rate non-standard tariffs with contract lengths typically between one and two years;
  - (c) offer a similar range of payment options (ie prepayment, credit and direct debit); and
  - (d) have the same distribution channels.
23. To an extent these similarities are a reflection of the regulatory regime that limits the structure of tariffs, discounts and other financial terms that suppliers can offer (see the Legal and Regulatory Framework working paper). Nevertheless, emerging evidence suggests material differences in the commercial strategies of the Six Large Energy Firms (see the Pricing Strategies working paper). We also note that the Six Large Energy Firms are all vertically integrated. That said, there are different degrees of integration within each of the vertically integrated firms and the degree of generation/supply balance.

### ***Transparency***

24. Overall, we consider that there appears to be a high level of transparency in the markets for the supply of gas and electricity to domestic customers, as follows:
- (a) Information is readily available on the prices and other terms of supply for all products currently being offered by each supplier. Internal documents provide evidence that all suppliers are continuously monitoring the products offered by their rivals.
  - (b) All suppliers make public statements, in advance of implementation, of intentions to change the price of their standard variable product. These announcements will typically give a 'headline' rate change and an implementation date. The headline rate is typically an average across regions and based on the change in bill for a dual fuel domestic customer, paying by monthly direct debit with 'typical' consumption.
  - (c) Cornwall Energy publishes quarterly market share statistics for the domestic retail energy markets for Great Britain and by region. These

statistics appear to be widely used in the industry. In addition, suppliers will each typically have information on the suppliers to which they lose domestic customers and the suppliers from whom they gain domestic customers.

(d) Since 2009 Ofgem has required the Six Large Energy Firms to produce an annual consolidated statement to show the costs, revenues and profits for the different segments of their generation and supply businesses. Ofgem produces a review comparing profits between the companies, and over previous years. Ofgem's objective is to make the market clearer and the information provided by the statements easily available to domestic customers.

(e) Ofgem's Supply Market Indicator provides a commentary on recent and possible future cost trends energy firms face and how they change over time. It also estimates the annual bill for average domestic gas, electricity and dual fuel customers and the cost per customer a large supplier incurs to deliver gas and electricity. The Indicators are published monthly.

25. For each of the Six Large Energy Firms, their expectations in relation to the conduct of rivals have an input into commercial decision making. For example, a factor in determining the price of the standard variable tariff is expectations in relation to the prices of rivals' standard variable tariffs (see the Pricing Strategies working paper). These expectations will be informed by published financial and market statements, market reports and the segmental statements suppliers are required to provide to Ofgem. We understand that the segmental statements provide no more information on the supply businesses of the energy firms than would be available if these supply businesses were listed on the London Stock Exchange. Furthermore, for each supplier, these statements are published six months after the end of its financial year. Nevertheless, the segmental statements appear to be particularly helpful in modelling rivals' energy purchasing strategies.<sup>5</sup>

---

<sup>5</sup> For example: an internal EDF Energy 2011 document stated the following:

Centrica represents our key competitor and hence our main focus is on their portfolio. Historically Centrica have published more financial data than its peers (such as a split between Upstream and Downstream or specific energy costs) this decreases the level of uncertainty and number of assumptions that need to be made. However, recent regulation requirements (OFGEM segmented results) have required all large energy suppliers to publish financial data on residential business given us an opportunity to get more transparency regarding competitors' hedging strategies. With the growing importance of understanding the interaction between competitors and impact of new regulation proposals it's becoming essential to have a robust competitor hedging methodology that can be applied for all our competitors.

### *Stability of demand*

26. The stability of demand is relevant to the assessment of the incentive for suppliers to deviate from coordinated outcomes and the ability of other suppliers to detect deviating behaviour. In particular, all other things being equal, the less sensitive domestic customers are to changes in relative prices, the lower the potential gains to be had from deviating from any tacit understanding; and the more stable industry demand the easier it is to detect deviation.
27. Initial findings relevant to the assessment of the price sensitivity of domestic customers are the pricing policies of the Six Large Energy Firms; statistics on the tenure and the frequency of switching; estimates of the potential gains to be had from switching tariff/supplier; and survey results in relation to the reasons for switching and the barriers to switching. Results are set out in full in other working papers.
28. For the purposes of this paper, we note the evidence that a sizeable proportion of the domestic customers of the Six Large Energy Firms have not switched internally or externally to take advantage of the availability of cheaper tariffs. In particular:
  - (a) for each of the Six Large Energy Firms a sizeable proportion of their domestic customer base has been with them for four years or more (in the range of around 40 to 70%); and
  - (b) the majority of their domestic customers subscribe to the standard variable tariff even though all these firms have offered cheaper tariffs. The differentials are often at least 5% (see the Pricing Strategies working paper).
29. There are two dimensions to industry demand: the number of domestic customers and the amount of energy they use. The number of domestic customers has increased over time and the amount of energy used per customer has fallen reflecting improved energy efficiency. However, these changes are longer-term trends that are predictable. That said, we have also observed variations in consumption levels from year to year, which may be more difficult to predict.

### *Barriers to entry and expansion*

30. Our findings so far in relation to barriers to entry and expansion are set out in our case studies on barriers to entry and expansion in the Retail Supply of Energy in Great Britain working paper. This provides evidence of the obstacles that smaller firms have faced in entering the supply of energy to

domestic customers and growing their businesses. We note, however, that in the past years these suppliers have grown rapidly. Their domestic market shares grew from around 1 to 7% between July 2011 and July 2014 for electricity and from around 1 to 8% for gas over the same period.

### ***Current thinking***

31. Our initial view, applying the criteria set out in our guidelines, is that there are some characteristics of the market that are conducive to tacit coordination. In particular: the degree of transparency on the prices offered by suppliers and other terms and conditions, and the suppliers to and from whom domestic customers are lost and gained; the degree of similarity in the cost structures and business models offered by suppliers; and the proportion of domestic customers who appear price insensitive ie those subscribing to standard variable tariffs.
32. However, we have also found that there are some differences in the business models of suppliers; there will be short- to medium-term differences in energy costs reflecting differences in purchasing strategies; and there are groups of domestic customers, including those subscribing to fixed-rate products, who are price sensitive. We would expect these differences to make it more difficult to align and maintain incentives to coordinate across the group of Six Large Energy Firms.
33. We also note that smaller suppliers have recently achieved significant growth in the share of domestic customers, particularly in the fixed-priced/fixed-period segment of the market, which is another factor that may mitigate the risk of coordination in the retail market.

### ***Tacit coordination on price***

34. In addition to investigating structural characteristics of the markets that may be conducive to coordination, we have looked at whether the Six Large Energy Firms have taken any actions to reach, sustain or enhance coordination.
35. The Six Large Energy Firms make public statements, in advance of implementation, of intentions to change the price of their standard variable product. These announcements will typically give a 'headline' rate change and an implementation date. The 'headline' rate is typically an average across regions and based on the change in bill for a dual fuel domestic customer, paying by monthly direct debit with 'typical' consumption.

36. We said in the issues statement that we would investigate the possibility that the public pre-announcement of ‘headline’ changes to standard variable prices could be a practice facilitating tacit coordination – see paragraph 3(a) above).
37. In investigating this matter we have, among other things, considered the scope of the price announcements; alternative explanations for why suppliers might announce, in the way they have, intended changes to prices for standard variable tariffs; and whether suppliers are indeed using these announcements to signal their intentions to rivals and for rival suppliers to be in a position to adjust their behaviour accordingly.
38. We note that the standard licence condition (SLC) 23 (formerly 44) of gas and electricity supply licences requires suppliers:
- (a) before April 2011 to notify their customers of a unilateral variation of their contract to increase prices or in any other way that is to the significant disadvantage to the consumer either (i) optionally in advance or (ii) up to 65 working days after the variation took effect; and
  - (b) since April 2011 to notify domestic customers directly in writing at least 30 calendar days in advance of the date on which the price increase (or other unilateral variation) takes effect.
39. Ofgem has not required suppliers to publicly announce/publish information on intended or proposed price changes. As noted above, the requirement is to inform domestic customers.

#### *Scope of the price announcements*

40. We asked the Six Large Energy Firms to confirm the scope of price announcements in terms of what tariffs they cover. The responses were as follows:
- (a) Centrica said its public announcements concerned prices for its standard variable tariffs for standard meters and prices for tariffs in some way linked to the standard variable tariff including capped and tracker products.
  - (b) EDF said that it only publicly announced price changes relating to its standard variable tariffs.
  - (c) E.ON said that its public announcements of price changes concerned only standard variable tariffs, but that the announcements may have referred also to the launch or withdrawal of fixed-term tariffs.

- (d) RWE npower said that its public announcements related to its standard variable tariffs for standard and Economy 7 meters.
- (e) Scottish Power said that its public announcements of price changes generally concerned standard variable tariffs, and discounted variable and capped tariffs where applicable.<sup>6</sup>
- (f) Scottish and Southern Energy (SSE) said that its public announcements of price changes generally concerned standard variable, discounted variable, capped and white label products.

41. These statements appear to be consistent with the copies of press statements and internal documents provided by suppliers.

#### *Reasons for price announcements*

42. The Six Large Energy Firms told us that in announcing price changes their objectives were, in broad terms, to manage their relationships and reputation with domestic customers, regulators and politicians, and to meet market regulatory requirements. In particular:
- (a) Centrica suggested that the key reasons for making announcements were London Stock Exchange rules that required all publicly traded companies to make an announcement for events that affected their profits, and the desire to ensure that the inevitable media reporting of a British Gas tariff price change was accurate and not likely to mislead customers.
  - (b) EDF's reasons for making public announcements were to generate positive PR messages (announcements being an alternative to giving customers advance notification when prices were reduced, and so it had no obligation to write to customers, although it had done so for some price decreases), to mitigate the impact of customer losses to competitors that had already announced and/or implemented price decreases, and to manage potentially negative media coverage.
  - (c) E.ON said that public announcements allowed it to ensure that journalists and commentators had access to accurate and complete information including information on actions being taken to support vulnerable customers and/or the context for any changes made to comply with regulations.

---

<sup>6</sup> The 6 January 2014 announcement included selected fixed-price products that had a GB average direct debit, dual fuel bill above that of its new standard variable direct debit prices, which were also reduced to the same level as the new GB average standard variable direct debit, dual fuel bill.

- (d) RWE npower said that the primary drivers for its public announcements were a desire to ensure accuracy in terms of both the message and the figures reported in the media, and to ensure transparency for customers.
- (e) Scottish Power said that when listed on the London Stock Exchange it was required under listing rules to make an announcement in respect of any price change that could materially have affected its earnings. Scottish Power also said that public announcements allowed it to ensure greater accuracy of media reporting and to explain to its customers the reason for the price increases and ways in which they could mitigate their effect.
- (f) SSE said that, as well as market drivers and regulatory obligations, other factors taken into account in determining the timing of price announcements included competition; customer relations; logistics; and political and financial reporting considerations.

43. Our initial view is that these explanations appear consistent with the documentary evidence we have received.

*Timing of price announcements, notification and implementation*

- 44. We asked the Six Large Energy Firms to give, for each change in the price of its standard variable tariff since 2004, the date of any public announcement, the date of implementation and the date the supplier started notifying domestic customers.
- 45. We note that since 2004 the periods between price changes have been between seven and nine months. Suppliers told us that this reflected the preference customers have for certainty and the costs to suppliers of changing prices including the reputational damage associated with price increases.
- 46. We considered the length of the period between a supplier announcing a price change and (a) notifying domestic customers or (b) implementing the change to be key to our analysis of whether price announcements may be used by suppliers to signal their intentions to rivals, and for rival suppliers to be in a position to adjust their behaviour accordingly.
- 47. The shorter the period between an announcement and notification and/or implementation the less opportunity there is for suppliers to use the public announcement of changes as a device for coordinating on the size or timing of a change.
- 48. We generally found that the period between the Six Large Energy Firms' public announcements of a price change and starting to notify domestic

customers or implementation has since mid 2011, which is when SLC 23 came into effect, been at most around ten days. Before this date there were instances when the period was longer, but we did not identify any particular patterns in the behaviour.

#### *Centrica*

- (a) Since 2004 British Gas has started notifying customers the same day as any public announcement.
- (b) Generally British Gas announced price increases between four and six weeks before implementation, and often implemented price reductions on the same day as any public announcement.
- (c) In 2008 British Gas implemented two price increases with no advance announcement.

#### *EDF*

- (a) From 2012 EDF has announced price increases six to seven weeks before implementation.
- (b) In 2011 EDF notified customers between the announcement date and ten days afterwards.
- (c) Before 2011 customers may have been notified of a change a week either side of the implementation date, or on the same day as the announcement and/or implementation.
- (d) From 2009 to 2011 the period between announcement and implementation was typically shorter than six weeks.
- (e) From 2004 to 2008 changes may have been implemented on the same day as the announcement or a few days or weeks later.

#### *E.ON*

- (a) Since mid 2011 E.ON has started notifying customers within a few days of the public announcement of a price increase.
- (b) Since mid 2011 E.ON has announced price increases approximately six weeks before implementation.
- (c) Between 2008 and mid 2011 E.ON generally announced price changes four weeks before implementation.

- (d) Between 2004 and 2008 E.ON either started notifying customers or implemented a change within two or three weeks of a public announcement.

*RWE npower*

- (a) Since 2004 RWE npower has started notifying customers of price changes the same day as any public announcement.
- (b) Since mid-2011 RWE npower has announced price changes five to seven weeks before implementation (there were two exceptions when price changes were announced within three to four weeks before implementation).

*Scottish Power*

- (a) Scottish Power does not have full information on the dates it started notifying customers of price increases, but said that its policy had been to issue public announcements just before starting to notify customers. Practice for price decreases varied.
- (b) Since 2011 price increases have been implemented within six to seven weeks of a public announcement, reflecting the time taken to prepare and issue a mailing and give 30 days' notice to individual consumers in line with new regulations.
- (c) From 2004 to 2011 price increases were generally implemented within a few days to three weeks of a public announcement.

*SSE*

- (a) Since 2012 SSE has commenced the customer notification procedure the same day as the public announcement.
- (b) Since mid 2011 SSE has generally announced price changes eight to eleven weeks before implementation (one price change was announced 14 weeks before implementation; however, this was in relation to one of SSE's white label tariffs).
- (c) From 2004 to 2011 the customer notification procedure generally commenced within three weeks of a public announcement. The period between an announcement and implementation and/or notification has been as long as seven or eight weeks. However, for half of the price change announcements for this period the customer notification

procedure commenced around one month, and sometimes as long as two months, before implementation.

#### *Modification of plans between announcement and implementation*

49. The Six Large Energy Firms told us that they were, in effect, committed to a change once they start notifying their domestic customers. While a supplier could theoretically reverse or modify its decision, this would be an unattractive option because it could be costly in management time, damaging to the firm's reputation with domestic customers and delay a price change for which presumably there were good commercial reasons.
50. Centrica, EDF, E.ON, RWE npower and SSE confirmed that there were no occasions on which they had modified the level or timing of price changes between announcement and implementation.
51. Scottish Power said that it had not identified any occasions when its plans in relation to a change in price changed materially following the public announcement. There was one instance prior to Scottish Power's acquisition by Iberdrola in 2007, when there was a slight error in the London Stock Exchange announcement, the announcement was withdrawn, an apology given and the corrected notice republished.
52. We recognise that a rival pre-announcing an intention to raise or lower prices might prompt a supplier to do the same shortly afterwards. This might be the case regardless of whether the supplier had been contemplating changing its prices. Nevertheless, we consider this could also be consistent with competitive behaviour – in particular, suppliers responding to the actions of rivals.
53. On this basis we have reached the initial view that the evidence we have reviewed to date does not indicate the Six Large Energy Firms modifying their behaviour in relation to the scale or the timing of announced price changes in response to subsequent price announcements made by rival suppliers.

#### **Outcomes consistent with coordination on market segmentation and/or prices**

54. Tacit coordination may be consistent with:
  - (a) stable market shares;

- (b) similar pricing strategies, ie suppliers charging the same prices; suppliers increasing or decreasing their prices at the same time and by similar amounts;
  - (c) similar profit margins and/or a convergence of profits over time; and
  - (d) high profitability.
55. Our initial findings in relation to these outcomes are as follows:
- (a) Market shares: As explained above (see paragraphs 15 and 16), we found that market shares have been stable nationally and at a regional level. We do not observe one of the Six Large Energy Firms making substantial gains at the expense of its rivals or tit-for-tat behaviour.
  - (b) Prices: Our findings to date in relation to the pricing of the standard variable tariffs offered by the Six Large Energy Firms are set out in the Pricing Strategies working paper. We observe that standard variable tariffs do move together. While we do not see a consistent convergence of tariffs over time, it appears that in 2013 and 2014 the range of tariffs was typically narrower than that seen in the years 2006 to 2012. Also, three of the suppliers said that they had adopted mid-market positions at certain times over the period 2006 to 2014. Finally, we note SSE's comment made in 2012 that the narrow dispersion was evidence of firms not seeking to gain competitive advantage through the pricing of their standard variable tariff.
  - (c) Profitability and margins: At this stage we have not come to a view on whether the margins are high. However, we do observe that (a) margins, as measured by earnings before interest, taxes, depreciation and amortisation (EBITDA) and earned by each of the Six Large Energy Firms, have varied over time; and (b) that there are substantial differences in the margins earned by suppliers. Our findings to date in relation to the profitability of retail energy supply are set out in the Profitability of Retail Energy Supply working paper.
56. We note that none of these outcomes would by themselves be evidence of tacit coordination. In particular, some of these outcomes could also be consistent with weak competition arising from unilateral market power (eg stable market shares and high profitability), and some could be consistent with a competitive market (eg price parallelism).

### **Conclusions – initial views**

57. Based on the evidence set out above, our initial view is as follows:

- (a) There are some characteristics of the supply of gas and electricity to domestic customers that may be conducive to coordination. However, we have also identified factors that may make it more difficult for firms to reach and sustain coordination.
  - (b) At this stage, we do not have evidence of suppliers using price announcements as a mechanism to signal their intentions in relation to the pricing of their standard variable tariff to rival suppliers to determine their prices accordingly.
  - (c) We do find some evidence of outcomes consistent with coordination, but we note that those outcomes can also be observed in markets that are not subject to coordination.
58. However, even though our initial view is that suppliers' motives for announcing prices around the same time are likely to be unilateral, this does not mean that such behaviour is not capable of softening competition by reducing customer expectations of the gains from switching.

## Appendix 1: Cost structures of the Six Large Energy Firms

