

## **ENERGY MARKET INVESTIGATION**

### **Summary of hearing with EDF Energy on 11 March 2015**

#### **Background**

1. EDF Energy stated that although it was often described as an ‘incumbent’ in the energy market, it considered itself to be a ‘challenger’. It sought to innovate its offerings to consumers and tried to keep its retail prices low. It was aiming to be a long-term sustainable competitor, and took a long view of the market and its operations.
2. EDF Energy considered the retail market to be competitive. It continually monitored indicators such as how many customers it had won and lost, and how many it had managed to gain, in part, through its innovative tariffs and pricing strategies like its Blue+Price Promise. It had also sought to engage small business customers.
3. EDF Energy’s choice of business model was one of common ownership of generation and supply. It recognised that this was its choice, but felt that this model brought benefits to customers and did not harm those companies that had made a different choice of business model.
4. In order to maintain a successful business, EDF Energy needed to win the trust of its customers, and it tried to ensure that its activities in the retail market met the standards of its own ‘Trust Test’. A large proportion of its customers were on fixed-rate tariffs.
5. EDF Energy supported effective regulation of the energy market but regretted the increased political pressure on the regulator in recent years. It considered that this may have led to even more complex regulations.

#### **Market rules and regulation of generation**

##### ***Balancing and dispatch***

6. EDF Energy considered that given the current market environment and regulatory framework, there was little difference between the current self-dispatch system and a central dispatch one. The current dispatch system was as efficient as a central dispatch or pool system would be, so there was little need for change in this area.

7. As far as the cash-out mechanism was concerned, EDF Energy supported the move to a single imbalance price. In principle, it also supported more marginal cash-out pricing but had concerns about moving to a price average reference volume of 1 megawatt hour (PAR 1) from PAR 500. It thought that a move to an average based on a greater volume of trades (PAR 100) compared to PAR 1 would be more appropriate. It did not have a strong view about reserve scarcity pricing, but it would welcome a clear resolution on the implementation of cash-out reform in the near future.

### ***The capacity mechanism***

8. EDF Energy noted that there was some alignment in what the Department of Energy and Climate Change was trying to achieve with its capacity mechanism and some of the drivers behind the cash-out reforms of the Office of Gas and Electricity Markets (Ofgem). It was a strong supporter of the capacity mechanism as it believed that it was the best way of securing investment in new generation capacity and did not see cash-out reform as a direct alternative to the capacity mechanism. It considered that any risk of 'double-counting' because of the interaction between the capacity mechanism and the cash-out reforms would be addressed by greater certainty around cash-out reform. This would allow generators to take account of what was happening on the reserve scarcity pricing side in their capacity market bids. When preparing its bids for the capacity auction, [REDACTED].
9. EDF Energy considered that the way that the costs of the capacity mechanism would be recovered from consumers was efficient and fair. It was likely that this would need to be tweaked as the system settled in. Its view was that interconnectors should be able to participate in the capacity mechanism. Demand-side response (DSR) should also be allowed to participate in the system (as was already the case). EDF Energy would support extending the contract lengths to two or three years if that was what was required by DSR providers to facilitate investment. More DSR was likely to participate in the 2016 auction than had done in the December 2014 auction. Overall, its view was that the decision of the Department of Energy and Climate Change to set up the capacity mechanism and modify it as necessary was a more pragmatic approach than seeking to achieve a 'perfect' system from the start.

### ***Contracts for Difference and low-carbon generation***

10. EDF Energy considered that the introduction of Contracts for Difference (CfDs) would reduce the level of risk involved in investing in low-carbon energy and would lead to lower prices for consumers. It thought that the CfDs system was an improvement on the Renewables Obligation (RO) system as

CfDs were mostly allocated through a competitive auction process. The fact that the CfDs system also included a mechanism for favouring less established forms of generation at the expense of more established ones was understandable as it would assist the development of a broader range of renewable technologies than the market might support on its own. The CfDs allocation process was intended to balance competition with the need to support future technologies that would help meet the UK's decarbonisation targets.

11. EDF Energy argued that a competitive process would not have been an appropriate way of investing in its proposed nuclear power station at Hinkley Point C. This was because at the time the government ran the contest for investment support, Hinkley Point C was the only new nuclear project put forward, so it was not possible for there to have been a meaningful competition. It also noted that the very high upfront development costs for nuclear generation required to enter a competitive auction would be likely to present a barrier to participation if firms thought there was a chance that they might not win. Its proposal had been scrutinised by the UK government and the European Commission to ensure that it would deliver value for money. The European Commission had also concluded that it would not have been appropriate to have a competitive auction in this case.
12. EDF Energy's view was that it was appropriate for the RO and CfDs systems to co-exist for a transitional period. It noted that prices bid in the recent CfDs auctions were lower than comparable Renewables Obligation Certificate (ROC) prices. This was because the CfDs process gave investors greater certainty on returns. Also many of the renewable energy projects that competed in the recent CfDs auction would not have been eligible for the RO. Its view was that CfDs would reduce the costs to consumers compared to the RO.

### ***Locational pricing***

13. EDF Energy considered that while locational pricing was theoretically a perfect approach, the benefits it might provide needed to be shown to be real and these needed to outweigh the practical difficulties it might cause. It had been considered in a number of countries in Europe but had not been implemented because of its complexity. That complexity could affect the market negatively by dividing it up into small sections, which would make it difficult for the market to give meaningful price signals.
14. As far as locational pricing for losses was concerned, EDF Energy stated that a number of factors would need to be considered, such as the size of losses involved. It did not think that the values involved in losses justified such a

significant reform. There had been a number of recent reforms to the wholesale market, and it would be best if these could be allowed to bed in before further reforms were launched.

## **Market power in generation**

15. EDF Energy agreed with the CMA's view in its updated issues statement that the generation market was not characterised by market power. It noted that there were many legal and practical constraints on how power stations were operated which prevented generators from exercising market power.

## ***Profitability in generation***

16. EDF Energy broadly agreed with the CMA's assessment thus far of the returns it made on its nuclear assets and noted that its returns were slightly lower when considering its generation assets as a whole. Given current market conditions, the outcome of the capacity market auction, and the impact of the RO and of CfDs going forward, EDF Energy did not think that generators' assets would make large returns in the foreseeable future.
17. As well as its investment in Hinkley Point C, EDF Energy also planned to make significant investments in its existing nuclear plants to extend its lifespans. In deciding whether to make this investment, it had to examine technical and safety considerations as well as economic ones before looking at whether it would be allowed to go ahead by its shareholders, the regulator and bodies like the Environment Agency. Extending the life of a plant cost approximately £[redacted] per plant per year of extension of life and this was on top of regular ongoing expenditure. It was therefore a significant investment.
18. Seven out of eight of EDF Energy's coal units at its two coal power stations had won three-year contracts at the capacity market auction. This meant that it was now committed to investing to keep them open until 2021, which would require spending between [redacted] between now and then. It might not have continued to keep operating these plants without the certainty provided by the capacity market auction. It would make some investments in renewables, but the £[redacted] it, and its equity partners, planned to invest in Hinkley Point C would be its biggest investment. It would also be making a decision in [redacted] as to whether to invest in two nuclear reactors at Sizewell C.

## **Liquidity in the wholesale market**

19. EDF Energy agreed with the CMA's view in its updated issues statement that there was sufficient liquidity in the wholesale market and that it was not

possible for generators to foreclose suppliers. It believed that the market's liquidity had improved in recent years, thanks to cooperation between the regulator and the industry.

20. EDF Energy's view was that there were a sufficient number of different wholesale products available to enable larger and smaller suppliers to meet their shape requirements. Generators were now required by Ofgem to offer fair access to market, answering some of their specific needs, for instance selling amounts of energy (clips) as small as 0.5 megawatts, so that smaller market participants could easily access the market.

## **The domestic retail market**

21. EDF Energy considered that overall the market was competitive and felt that it always experienced competitive pressure. This was not to say the retail market worked perfectly. It felt that the key question should be how to improve things to make the market even more effective for customers, particularly by improving customer engagement.

### ***Competition for customers***

22. There was very strong competition between energy suppliers on its fixed-rate tariffs. Most fixed-rate tariff customers switched from one fixed-rate tariff to another, either internally or between suppliers. EDF Energy had strong incentives to win customers who were on standard variable tariffs (SVTs) with its competitors. [✂]
23. When pricing fixed-rate tariffs, [✂]
24. When re-pricing its SVT [✂]
25. [✂] EDF Energy had around 40% of its customers on fixed-rate tariffs, which it believed was one of the highest levels among the six large energy suppliers. In future, it expected that the gap between fixed-rate tariffs and SVT prices would narrow, so it would be possible to have a sustainable business with large numbers of customers on fixed-rate tariffs. It considered that this would be possible even in a market in which smaller suppliers, which currently had lower costs to serve than larger ones, had recently grown their market share to around 10% by offering cheaper fixed-rate tariffs. It had gained some ideas from the smaller suppliers about how to reduce costs. However, it had not done so by having restricted types of customer service, such as for example, having discounted internet-only tariffs, where the discount would be lost if the customer telephoned the energy supplier.

26. [REDACTED] EDF Energy engaged with all its fixed-rate tariff customers when their current tariff was ending to remind them that unless they took out another fixed-price offer, they would move to the SVT. It wanted to move to a market where other providers communicated with their customers in a similar way, and it hoped that over time this would change the current dynamics of fixed-rate tariff and SVT pricing.
27. EDF Energy's strategy of having more customers on fixed-rate tariffs had been based on trying to understand what customers wanted, doing it, and then engaging with other participants in the market and the regulator to move market rules and regulation to better match customers' wants. It noted that the number of customers on SVTs would not be considered a problem if they were engaged customers. If there were more engaged customers then fixed-rate tariffs would be more likely to be premium products, but current regulation had forced the energy suppliers to compete on fixed-rate tariffs.
28. Leaving aside energy costs, payment methods were the main difference between the costs of serving fixed-rate tariff and SVT customers. SVT customers were more likely to pay by cash or cheque, and more debt recovery activities were associated with this payment method.
29. 47% of EDF Energy's Priority Services Register customers were on fixed-rate tariffs, so the perception that vulnerable customers were normally SVT customers was not correct. It also noted that [REDACTED]% of its SVT customers had been with it for less than five years, and [REDACTED]% had been its customers for less than ten years. It argued that this showed that the perception of SVT customers as being 'sticky' was incorrect. In the areas where it was the 'incumbent' supplier (London, the South East and South West of England), its market share averaged [REDACTED]%, so there was clear evidence that it had faced competition for customers in these areas. It noted that this was not the same for other 'incumbent' supply areas, for example, in Scotland where market shares of the incumbent suppliers was much higher.

### ***Hedging and pricing***

30. [REDACTED]
31. [REDACTED]
32. EDF Energy had a cautious hedging strategy because this aligned with its view of how a long-term participant in the market should behave. It wanted to avoid 'knee-jerk' reactions to upward changes in wholesale energy prices. It looked to adapt how it hedged while maintaining a stable overall strategy. Wholesale energy prices had recently become less volatile than they used to

be. For example, there had been no recent events like the gas and electricity price spikes in 2008. It had been able to handle these spikes without passing on large price hikes to its customers because of its cautious hedging strategy. It considered that some of the current crop of new entrants who had riskier hedging strategies might not survive events like those of 2008.

33. EDF Energy noted that because of the long-term nature of its SVT hedging strategy, it had not been able to reduce its SVT price by as much as some other suppliers. Customers expected to see a direct link between changes in current wholesale and retail prices, when in fact much of the energy an SVT customer was using had been bought some time earlier, so a recent change to wholesale price would likely not affect SVT customer bills for some time.
34. While EDF Energy had not recently reduced its SVT gas prices in percentage terms by as much as some of the other large suppliers, its price before the reduction had been consistently relatively low, and following its most recent reduction of 1.3% had been lower than all but one other of the large suppliers, so it considered this price to be competitive. As far as the fixed-price market was concerned, it did not want to be drawn into short-term reactions, so it took a long-term approach to the market that involved reducing its costs and introducing products like its Blue+Price Promise.
35. EDF Energy had observed the widening gap between SVT and fixed-rate tariff prices and noted that it would have expected more customers to switch to obtain the lower prices available on the fixed-rate tariffs. It considered that many customers were disengaged for a variety of reasons including complexity, lack of transparency, and lack of unbiased information and the need for 'triggers' to encourage engagement. It noted that when it lowered its SVT prices, even though it did not do so to win new SVT customers, the price reduction would act as a trigger for customers to engage with it and perhaps move to a fixed-rate tariff. It felt that as a challenger it had demonstrated that customers could be engaged and also believed that through this activity more of its customers were engaged than the average of its other large competitors.
36. Even though EDF Energy had the cheapest SVT of the six large energy suppliers (for 93 out of the last 104 weeks, from March 2013 to March 2015) it was not winning new SVT customers in any great volume. As this was the case, it could be argued that it should raise its SVT price to be more in line with its competitors. It explained that its current SVT price was the result of many decisions taken over a number of years. Notably, in 2013 when its competitors increased their dual fuel direct debit SVT prices by between 8 and 10%, it had decided to increase its own by only 3.9%, but it had approached the government with a proposal on reducing its Energy Company Obligation contributions, which had been successful and enabled it to limit its increase to

the stated 3.9%. This then allowed some other suppliers to subsequently reduce their prices.

37. An indirect consequence of EDF Energy's limited increase on its SVT was that it was perceived as being cheaper and fairer than its competitors, and as a result it had gained many fixed-rate tariff customers at the end of 2013 through a combination of a keenly priced fixed-term contract and the 'Price Promise'. When making pricing decisions, it took into account both commercial issues and how fair the decision would be to its customers. So while it might have the opportunity to raise its SVT, it tried to refrain from doing so, particularly as it recognised that some of its SVT customers were less engaged.

### ***Consumer engagement and marketing***

38. EDF Energy noted that the CMA's customer survey showed that 89% of energy customers knew they could change to a new supplier and that 76% knew they could change tariff with their current supplier. It was not the case that all SVT customers who had not switched were disengaged or vulnerable. Some were making a positive choice to remain with their current supplier on their current tariff. While overall trust in the energy industry was poor, at less than 30%, 62% of customers trusted their own supplier. The results of the CMA's survey were similar to EDF Energy's own findings in this respect.
39. EDF Energy expected that the independent suppliers' market share would continue to grow but that some current independent suppliers might leave if it turned out their business models were unsustainable. Smaller new entrants were not subject to all of the environmental and social obligations larger firms had to comply with and this meant their retail prices could be lower. There were no significant barriers to entry. It was not clear how much the balance between the number of customers on fixed-rate tariffs and those on SVTs would change in future. It would need to continue to innovate, reduce costs and work on its brand in order to differentiate itself from its competitors. It took a wide view of its responsibilities as an energy company that went beyond simply making a profit.
40. If the large number of customers currently on SVTs were to choose to switch to fixed-rate tariffs, this would probably lead to a rebalancing of prices and may lead to a reduction of price differentials between fixed-rate and standard variable tariffs. Increased engagement of customers would also be expected to result in increased competition between suppliers, which would benefit customers in the form of greater innovation and better customer service.

41. In looking at how to attract its competitors' 'sticky' customers, EDF Energy had found that two of the biggest reasons why customers had not switched was concerns about both the complexity of comparing tariffs and the switching process and the worry that if the customer got it wrong; then he or she would be stuck on the wrong tariff for them. It had sought to reassure customers and address these concerns by removing termination fees and introducing its Price Promise. However, it was still reliant on trigger events to get other suppliers' 'sticky' customers to engage, which was why it tried to coordinate its actions on its SVT and fixed-rate tariffs. It did not know what tariffs its new customers had been on with their previous suppliers, except in the case of prepayment meter customers, which in the main had to be on SVTs. In 2014, [X]% of new EDF Energy customers joined on fixed-rate tariffs and [X]% joined on SVTs ([X]% prepayment plus [X]% 'passive' joiners eg following a house move).
42. Price comparison websites (PCWs) and other third-party intermediaries (TPIs) worked hard to stimulate those customers who were less engaged. There had been concerns about how the PCWs presented information about what tariffs were available and whether customers that used them were getting a full picture of the market. PCWs had become more important as a sales channel since suppliers had moved away from face-to-face selling. All of EDF Energy's tariffs were visible on PCWs. Ofgem's four-tariff limit as part of its Retail Market Review (RMR) made it difficult for EDF Energy to offer a different, direct-only price that would not be on PCWs and that might provide an additional cost effective sales channel.
43. [X]% of customers who switched to EDF Energy in 2013 did so via PCWs. It did not expect this number to grow significantly in the future. Increasingly, customers were more willing to move to independent suppliers, but it still considered the propensity of customers to switch to one of the six large suppliers in its pricing decisions. It considered that there was still some value in its customers' eyes to its brand, and it sought to promote this via its advertising campaigns.
44. EDF Energy also used direct sales channels (outbound telesales and direct marketing) to contact potential customers. It did not market any of its products under a 'white label'. It had concerns about how these were being used by some energy suppliers to offer cheap deals to one group of potential customers without offering them to their existing customer base. Apart from PCWs, it did not have any other marketing partnerships. It wanted to be in direct contact with its customers as much as possible. PCWs were all about competition on price but it wanted to compete on more aspects than just price.

45. Smaller energy suppliers were currently benefiting from a benign market with lower wholesale prices that allowed them to offer lower retail prices. If, however, a smaller supplier, which operated entirely on one-year hedges, was faced with a sudden rise in wholesale costs; then the tariffs it could offer in the next year would need to reflect this jump in prices. EDF Energy's strategy [X] was designed to smooth sudden price changes for its fixed-rate tariff customers.

### ***Smart meters***

46. The introduction of smart meters would be one way of reducing the numbers of disengaged consumers. EDF Energy noted that technology by itself never solved any problem without understanding what it was intended to achieve and how it would do this, but it was positive about the introduction of smart meters. For the programme to be successful, it needed to focus on how customers would use and benefit from the information provided by the smart meters, not on the technology itself. The information smart meters would provide customers with ought to bring customers substantial benefits. Smart metering would particularly benefit prepayment customers, who for infrastructure reasons were limited to SVTs, as it would enable them to access a wider range of tariffs.

## **Retail market regulation**

### ***The role of regulation***

47. EDF Energy supported the effective regulation of the energy market and appreciated the need for a regulator such as Ofgem. However, it felt that Ofgem had become increasingly politicised, and that this had led to an increase in the amount and complexity of regulation. Ofgem's role ought to be to ensure that competition in the market operates properly in order to ensure it benefits consumers and the market as a whole. However, in its view, Ofgem might have gone beyond what was strictly needed and into areas which were not critical to achieving this end and which might be done better by others. This gave rise to the potential for Ofgem to try to micro-manage the market.
48. The government had an important role to play in the energy market, eg making strategic decisions about UK energy supply and protecting vulnerable customers, but its role and Ofgem's needed to be clearly defined. National Grid, as the System Operator, played a crucial role in the market. It was important that there was a body that oversaw the management of what was a very complex system. Energy generators and suppliers had their roles as well. It was important that each party played its own role and did not try to play that

of another. The regulation of the market had increased in recent years and had become more prescriptive. For example, the size of the supply licence document had grown from 90 pages in 2009 to over 450 pages at present.

49. EDF Energy understood the concerns that had led Ofgem to introduce the RMR package. It was felt at the time that the market had become very complex and confusing for consumers and so EDF Energy had been supportive of some of the reforms, including the four-tariff rule and tariff messaging on bills, because they were about making the market simpler and more transparent. Whether the four-tariff rule would be the right approach in future was open for debate. There were parts of RMR that it considered had gone too far, such as the degree of prescription of the information on bills or of how telephone conversations with customers should be conducted. The degree of prescription in these areas was too great and arguably did not benefit consumers. It also created a burden for market participants, particularly smaller ones, and created a significant compliance risk that required an equally significant compliance regime. The ability of suppliers to decide themselves how best to serve customers was also reduced.
50. Ofgem had recently signalled that it wanted to move to a more principles-based form of regulation that would be less prescriptive. EDF Energy considered that if this was executed properly it would set down key principles for market participants to abide by but allow them to decide how best to meet them, which in turn could become part of a supplier's competitive offering. If done well, a principles-based system would be welcomed. A badly-executed regime, however, would mean that participants would not understand what was expected of them and would become a significant compliance risk. It would be necessary to ensure that the regime's framework was correct at the start. There would need to be a dialogue with the regulator as to how principles should be interpreted, and the regulator would need to be willing to engage with industry participants to help them understand what was required of them.
51. EDF Energy cited the nuclear safety regime it operated under as a good example of principles-based regulation which set goals for nuclear generators and operators of other nuclear facilities to meet but left it up to them as to how they did so. It would be important for a new principles-based regime for the energy industry to have clear aims.
52. It was also important that a degree of trust existed between the regulator and market participants. In nuclear generation, the regulator had to trust that operators were trying to reduce risks in the right way while producing electricity and not to overly interfere. EDF Energy's experience of this type of regulation had been that it led to ongoing improvement and higher standards.

It was also clear to the public at large that the regulator, generators and policy-setters all were able to trust each other, and this made it easier for the public to trust the industry.

53. Currently, EDF Energy internally operated both a principles-based regime (referred to as the 'Trust Test') and a prescriptive regime to ensure compliance with regulation. Via the 'Trust Test', which was applied to all its processes, it felt it had managed to embed principles-based thinking throughout the business. It appreciated that this had not been an easy undertaking, and that it would require effort to establish principles-based regulation across all participants in the retail market.

### ***Standard Licence Condition 25A***

54. EDF Energy noted the CMA's observation that SVT prices had increased faster than levels of direct costs since 2009/10. It explained that a number of the six large energy suppliers had made losses in their retail businesses prior to 2009/10 and that, along with addressing increased costs, the increase in SVT prices had been made to bring the businesses back to profitability. The introduction of Standard Licence Condition 25A (SLC 25A), which restricted suppliers from offering lower prices to consumers outside the six large energy suppliers' incumbent areas than within them, had produced the effect of reducing competition on SVTs and moving it to the fixed-rate tariff part of the market. This meant the prices for SVTs and fixed-rate tariffs (which up to that time had generally been higher than SVTs) began to equalise. This had led EDF Energy to move towards competing on fixed-rate tariffs.
55. Even though Ofgem had recently confirmed that SLC 25A was no longer in force, EDF Energy did not plan to change its pricing policy significantly. In addition to noting that the focus of competition across the market had moved away from SVT to fixed-price tariffs, it explained that this was also because of the difficulty consumers had in comparing prices. Prices were often quoted as a national average, which was seen to be a representative figure. It considered that it would seem disingenuous if that national average was made up of prices that varied by region if there were no good cost reasons for that variation, and this could lead to accusations of 'postcode lottery pricing'.
56. [✂]

### ***Doorstep selling***

57. EDF Energy had welcomed the end of doorstep selling. The level of control required and regulation applied to ensure that doorstep selling was done properly made it very difficult to do it at all. However, there were some

customers, who did not engage with the market in other ways, who were now difficult for suppliers to access and who would be less engaged than they would have been previously.

### ***Ofgem's Retail Market Review***

58. It was difficult to determine why an energy consumer chose to switch, and there were no obvious signs that RMR had increased consumer engagement so far. EDF Energy had already made changes to its billing and tariffs along the lines of RMR prior to its implementation, including introducing informing customers about cheapest available tariffs on annual statements and starting to simplify its tariff structure. There were aspects of RMR which it felt had not worked well. It considered RMR to be quite prescriptive as to how its changes were implemented, eg specifying precisely how messages about cheapest available tariffs should be presented. It did not consider that the tariff comparison rate that RMR had introduced was a reliable enough indicator of the differences between tariffs as it was dependent on a customer's energy use. In order to ensure compliance with RMR, interactions with customers were now scripted to an onerous degree, so that it now took around 25 minutes for a customer to change their tariff by phone.
59. EDF Energy had been broadly in support of the four-tariff rule when it had been introduced as it had already reduced its tariffs at that time, so it had not had to make many changes to accommodate RMR. Also, its view had been that there was probably a problem with customers facing too many choices of tariff and being unable to choose between them. In future, there would need to be changes to the four-tariff rule in order to accommodate new kinds of tariffs based on smart meters. It would also like to be able to have tariffs that were only offered by itself and were not available on PCWs, which it could not do under RMR. The most important thing was to find a better and more straightforward way for consumers to be able to compare tariffs as it appeared that despite the introduction of the mandated tariff comparison rate, most consumers were still finding it difficult to compare energy tariffs.

### ***Price comparison websites and collective switching***

60. EDF Energy supported Ofgem's Confidence Code for PCWs. It felt that Ofgem should have consulted more with the industry about the tariff comparison rate and that while Ofgem should encourage and push the industry to be more consumer focused, it should do so in a constructive, rather than an antagonistic, way. More collaboration between Ofgem and suppliers on initiatives like tariff comparison might contribute to restoring consumer trust.

61. PCWs received commissions from energy suppliers (with whom they had commercial agreements) for switching customers to them. The amount of commission paid by EDF Energy to PCWs per customer switched was about [X]. It noted an instance where a PCW had refused to display its tariffs because EDF Energy had refused to pay them for switching a customer internally from one EDF Energy tariff to another. It had considered this demand to be unjustified.
62. Collective switching was good as far as engaging customers, but it did not necessarily deliver cheaper prices for consumers. Suppliers that participated in collective switching were able to offer a cheaper price to the customers participating in switches than they were required to notify to their own customers. This was possible because prices offered for collective switches did not have to be included in the RMR rules on price transparency (ie cheapest tariff messaging), so customers participating in collective switches would be aware of a price that the wider market would not be. EDF Energy considered that this ran counter to the intended purpose of RMR, which had been to simplify the market for consumers and make prices more transparent.

### ***Settlement systems***

63. EDF Energy considered that the current gas settlement system was inaccurate, but it did not know whether this was causing a competition problem by preventing smaller suppliers from differentiating their services by offering customer energy saving advice. It was supportive of Project Nexus, which was intended to address the problems with the current system, but it noted that the timetable for the project's implementation had slipped, and it would like reassurance that it would not slip further.
64. As far as electricity settlement was concerned, the current system, which used profiles to settle energy payments in five stages over a 14-month period, was suitable at present. However, once customers had smart meters, which would provide suppliers with half-hourly information about customers' usage, this would not be the case. The current system did not allow for the information provided by smart meters to be used to provide time-of-use tariffs and other new types of tariffs. While half-hourly settlement was technically possible at present, it was not cost-effective without smart meters. As well as half-hourly settlement and new types of tariffs, smart metering would enable a number of other innovations, such as 24 or 48-hour switching. However, the introduction of smart meters would be a major change to the industry, and the challenges involved in making that change and getting the system to work effectively and deployed appropriately should not be underestimated.

## Vertical integration

65. EDF Energy stated that its business model of common ownership of generation and supply was simply its choice, and allowed it to take both a holistic and long-term view of the market. It recognised that there was no one-size-fits-all model in the industry due to the diverse nature of market participants. There were a number of business models that energy firms, both generation and retail, could have which would be successful in the market. When it sold the electricity it generated to its supply business, without exception it did so at a clear transfer price based on the wholesale market price. It recognised that being such a large company meant that it was sometimes difficult for it to react to some changes as quickly as some of its smaller competitors could but this reflected its choice. EDF Energy and its employees had a common sense of purpose – to generate electricity safely and efficiently, and to provide a good service to its customers.

## EDF Energy's retail business customers

66. EDF Energy had a separate division that served all its business customers, whether they were large firms (industrial & commercial (I&C)) or small and medium-sized enterprises (SMEs), which also included microbusinesses. Its SMEs and microbusiness customers varied greatly in how much energy they consumed. [X] % of its SMEs customers used less electricity than a typical domestic customer. It believed that overall this market was competitive, but competition was stronger in particular areas of it. I&C businesses and larger SMEs used more energy and tended to be more engaged with the market, so competition for their business was more intense.
67. TPIs, such as brokers and PCWs, preferred to engage with larger SMEs that used more than around 20 megawatt hours of energy (broadly equivalent to £2000 a year). They did not tend to target the smaller SMEs and microbusinesses market as the commissions they would earn would not be large enough to make doing so profitable. EDF Energy noted that supplying energy to smaller SMEs and microbusinesses was not particularly profitable.
68. Smaller SMEs and microbusinesses had relatively low levels of engagement with the energy market, and the reasons for this were similar to those seen in the domestic market. As noted above, larger SMEs and I&C business were much more engaged, and TPIs had increasingly moved into this market. Around 80% of I&C businesses used TPIs, compared to only around 20% of microbusinesses.
69. Another key feature of the microbusinesses and smaller SMEs market was the lack of transparency in pricing. Combined with the lack of incentives for

TPIs to get involved in the market and for suppliers to supply these small businesses, it was possible there were failings in this area of the market. Opaque pricing also had a negative effect on the larger SMEs market as it meant that it was difficult for these businesses to check whether TPIs were acting in their best interests and offering them the cheapest prices. While many brokers were reputable and did act in their customers' interests, EDF Energy considered that TPIs should be directly regulated to ensure this was always the case.

70. Deemed customers were another feature of the small SMEs and microbusinesses market. The regulation of how suppliers should handle these customers was principles-based, and, in case of pricing, simply stated that prices for deemed customers should not be 'unduly onerous'. EDF Energy would welcome clarification from Ofgem as to how it expected the rules for this section of the market to be implemented. Comparisons of how different suppliers applied these rules would be especially welcome. It applied its 'Trust Test' to dealings with all its business customers, including I&C firms. Prices for deemed customers were significantly higher than for other business customers because they could change supplier without their current supplier being able to object, including, for example, when they had payments outstanding. This meant that all deemed customers were charged more in order to cover the risk that some would leave without paying their outstanding debts.
71. SMEs and microbusinesses customers had been unhappy with rollover contracts for a number of reasons, which, in EDF Energy's view, included some 'sharp' practices such as customers only having a short period to switch before being rolled over onto a new contract with their current supplier, and customers being locked into a very high margin contract at a high price. When moves to change rollover contracts began, it had done market research with around 700 of its customers about what they disliked about rollover contracts. Its customers had told it that the problem was not the rollover contract itself, but the termination fee that a customer had to pay to leave it. The customers also said that they would prefer a rollover fixed-price contract at a lower price to a variable price contract at a higher price. In response to these findings, it had launched a 12-month fixed-price rollover contract called Easy Fix. While the Easy Fix tariff was slightly higher than a standard fixed-term rollover contract, it had no termination fee, and customers could leave without paying a termination fee by giving 30 days' notice so long as they were not in debt.
72. EDF Energy said that from its understanding of the CMA's working paper on microbusinesses, it appeared that one of its competitors was applying a premium to its deemed customer tariffs that presumed the highest level of risk and added this to the basic price. Unlike other energy tariffs for business,

deemed tariffs were published, so it knew what its competitors were charging and had wondered how they could justify the high deemed prices. Its own deemed tariffs were at the lower end of the market.

73. In its aim to be a challenger, EDF Energy had tried to differentiate itself from its competitors in the small SMEs and microbusinesses market, particularly with respect to transparency, by introducing a website where businesses could obtain a quote based on their consumption and postcode (and subject to credit). This was potentially commercially detrimental to EDF Energy as its competitors and TPIs could also access it and obtain sample quotes. This initiative fitted in with its overall view that it was worth accepting some short-term commercial disadvantages because by, for example, applying its 'Trust Test' and by dealing with customers fairly and openly, it would reap long-term benefits for its brand and commercial position.
74. EDF's Energy SMEs gas business was very small in terms of the overall SMEs and microbusinesses gas market. It had only launched a gas product in 2014, [redacted].
75. EDF Energy faced similar challenges in the SMEs and microbusinesses gas and dual fuel markets to those it faced in the rest of the business retail sector such as engaging smaller customers and transparency. It felt that these challenges would make it difficult to enter the market and access business customers. While it published its standard variable prices for this market, very few other suppliers did, which made the business market very different to the domestic one. Small business customers found it much harder than domestic consumers to find out what suppliers' prices were. It argued that some of the reasons for this may be historical. When energy markets had been deregulated, it started at the large end of the market where the incentives were clear and the assumption was that the advantages would trickle down to every segment of the market. However, in reality there existed a segment where it was not easy to compare prices and where TPIs were potentially not always acting in the best interests of customers.
76. As far as TPIs were concerned, EDF Energy had trust-driven policies intended to ensure that its arrangements with TPIs did not conflict with customers' best interests. For example, it only paid commission to TPIs when a customer signed up with it. Unlike other suppliers, it did not prepay TPIs in advance of winning a customer contract.

## **Industry codes**

77. EDF Energy considered that the codes that governed the energy industry were more complex than was desirable, and that this complexity presented

challenges to all participants in the market, particularly smaller ones. It would support some rationalisation if that were to be possible. It was important to remember that the codes were necessary for the industry to operate properly, and that much of their content was essential and needed to be prescriptive and precisely expressed. A considerable reform of the codes would also impose burdens on the industry, particularly smaller participants who would have to engage with the process of the reform itself as well as comply with the revised codes.

78. EDF Energy did not agree with the assertion that the industry used the code governance arrangements to block change. It did not think that the larger participants deliberately used the code modification processes to create changes to the codes that disadvantaged smaller participants. It was important that there was a high degree of industry engagement in the process since it was industry participants that had the expertise necessary to produce well-thought out modifications. It would therefore be a mistake to give Ofgem increased powers to push modifications through more quickly.
79. It was easier for larger participants to take part in modification processes as they had more resources than smaller participants. Smaller participants had brought forward modifications and had been actively engaged on others, but it was necessary for them to consider their available resources and then engage on those code modifications that were most important to them.
80. The average length of time for a proposed change to go through the code modification process was around seven to eight months. Some proposals took longer than others, particularly those that were more complex or controversial. EDF Energy did not consider that it was usually the case that larger and smaller participants would find themselves on opposite sides of a given proposal. In many cases changes would be either supported or opposed by a mix of different types of participants.
81. It was possible for Ofgem, rather than industry participants, to put forward proposals via National Grid. EDF Energy noted that it, and many smaller participants, had opposed the proposals to move to PAR 1 pricing for the cash-out mechanism. Had Ofgem had powers to push through a change it initiated, like PAR 1, more quickly, it might have done so in a way which was disadvantageous to smaller firms. In the case of the TransmiT project, EDF Energy considered that Ofgem's initial proposal had been deficient and that it had been greatly improved by the industry as it progressed through the code modification process, something which Ofgem acknowledged at the end of the process. There had also been instances where Ofgem had taken a long time (up to two years) to reach decisions about modifications or had remitted proposed changes back to the industry for further consideration.

82. EDF Energy considered that while much of the codes' content was necessary, it ought to be possible to streamline governance arrangements for particular codes and make them more consistent across all the codes. The Grid Code and the Distribution Code were two examples where the governance arrangements could be improved. There were also some subjects, such as cash-out and smart metering, which were dealt with by a number of codes, so implementing changes on these topics required progressing multiple modifications through multiple governance processes. If the industry was starting from scratch it would not have what it has now. Ideally, it would be sensible to have one governing body or regime for all the codes, but this would be a significant exercise and it would be necessary to gauge the benefits of undertaking it.

## **Profitability**

83. Based on trends on its EBIT margins, EDF Energy considered that the market would become more competitive. It had looked to improve its margins by reducing costs in its domestic retail business. [REDACTED] EDF Energy [REDACTED] had taken a number of actions to improve its performance including a major IT systems replacement and upgrade, which was now fully in place and delivering benefits. It had also grown its customer base.
84. Over the past five years, EDF Energy's commercial retail business had experienced intense competition, [REDACTED] it estimated its margins on SMEs and on larger I&C customers as being [REDACTED]%, but this calculation depended on how costs were allocated.
85. [REDACTED] In making its processes more efficient, EDF Energy was also trying to make them work better for its customers. It saw good customer service and efficiency as being complementary.
86. [REDACTED]
87. EDF Energy was also looking at ways it could encourage innovations that would make it more efficient, improve how it served its customers, or both. It planned to set up a way that its research and development staff could work with its business staff on new ideas.
88. Overall, through all the initiatives set out above, EDF Energy aimed to achieve around [REDACTED]% further efficiencies. In profitability terms, it had an EBIT target of [REDACTED]%.