



By Email

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Dear Energy Markets and Affordability team and Future Retail Market Design Team,

Flexible & Responsive Energy Retail Markets

Thank you for the opportunity to respond to this consultation. I am responding on behalf of the Npower Group.

We welcome the decision by BEIS and Ofgem to review the energy retail market to ensure that it is fit for the future. This is essential in the light of recent market developments and the Government target to achieve net zero carbon emissions by 2050.

We believe there are three key challenges where focus is needed:

1. Ensuring consumers have choice and protection in an ever-changing market, so that no one is left behind. Central to the new market arrangements must be a model for delivery of universal service.
2. Facilitating innovation, through consumer engagement, enabling non-traditional business models and innovators in the market arrangements. The data architecture also needs addressing, and data use must find the right balance between privacy and an efficient low cost system. We believe that the Energy Data Taskforce recommendations should be implemented in full.
3. Ensuring that there is a well-functioning, equitable competitive market. We have

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previously shared with you our views on supplier exemptions and are happy to discuss this further. In addition, we believe that the distortions created by supplier defaults and mutualisation of costs must be addressed.

I attach our detailed responses to the specific consultation questions. Part of our response is confidential, and I have set this information out in a separate attachment (Appendix B).

If you would like to discuss our response, or if you have any questions, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in cursive script that reads "Sasha Pearce".

Sasha Pearce
Policy Manager, Policy & Public Affairs

Encs.

APPENDIX A – NPOWER’S RESPONSE TO CONSULTATION QUESTIONS

(NOT CONFIDENTIAL)

1. Do you agree with our vision for the future of the energy retail market, the outcomes we are seeking to achieve and our characterisation of the key challenges we need to overcome?

Broadly, yes we agree. The aim should be a clean, secure, affordable, competitive market, supported by a simple, clear regulatory framework.

We recognise that consumer engagement with energy efficiency and new energy markets is becoming increasingly important, and is key to achievement of net zero by 2050. We agree that there should be wider choice for customers and that the regulatory framework should not constrain that choice, whilst providing proportionate protection for customers, ensuring that no one is left behind. We agree that the market should not be distorted by unfairly applied obligations or exemptions, and a reduction in regulatory complexity would help to level the playing field.

There need to be incentives for people to engage in the market, and for those that cannot engage for reasons of vulnerability, there should be appropriately funded social mechanisms to protect them. In a future world, there is a particular need for proactive policy support for those who are not digitally or otherwise enabled.

We recognise that this will require significant, phased regulatory reform.

2. Are there examples of new products, services and business models that would benefit current and future consumers, but are blocked by the current regulatory framework?

Yes, and this is evidenced by the fact that few new products, services or business models have yet come to market at scale.

The key here is to enable and reward engagement. There needs to be some incentive for people to engage in order to drive innovation. In addition, energy suppliers are going through an intense period of low/negative margins from core business, which ultimately stifles investment and thus innovation.

Bundling of energy services with core supply can be done, but it is difficult to achieve given the stringent tax guidelines which make attractive propositions to customers very difficult. The consequence of this is that it is hard to sell to customers and traction massively slows up as a result, again leading to less profit, less investment and then less innovation. On Demand Side Response, we question whether price signals are sufficient to encourage customers to engage and more may need to be done to incentivise action.

To address these issues, work is needed on a number of fronts. The smart revolution is just beginning and will enable a much wider choice of energy services. We continue to believe that it is essential that Smart metering is mandated on all suppliers (and must be the norm for consumers) through the regulatory framework. While our preference has been for a “hard” mandate on consumers (customers must use smart meters, and thereby must accept a supplier’s offer of a smart meter), in the face of government opposition, we continue to

explore alternative options that enable government to deliver the benefits of a mandated, controlled and efficient roll out, without compromising on the two key tenets that underpin the current policy to “offer” smart: consumer choice and consumer right to privacy; There are a range of “soft mandate” options on consumers, which we believe deserve further consideration. Under these models the consumer must accept the smart asset but chooses service, data collection and privacy. In addition, there should be some onus on customers (especially in the business market) to take action to support de-carbonisation. Creating such an onus will help to reinvigorate the market and cause innovation to thrive. The regulators are unfortunately not exhibiting joined up thinking in the national policy interest. One example of this is the Information Commissioner’s Office ruling that the promotion of benefits of smart metering (required in energy regulation) constitutes marketing and is thereby subject to the consent rules on marketing. This is a clear and critical blocker. Finally, the provision of universal service needs to be addressed. .

3. Are there current or emerging harms to energy consumers which are currently out of scope of the regulatory framework? Do these differ for domestic and non-domestic consumers?

Yes, there are a number of such harms.

Energy supplier malpractice - in recent months, we have witnessed a lot of supplier malpractice taking place and enforcement has not been pursued, at all, or sufficiently in most cases. For example, the recent failures of Eversmart Energy and OneSelect, where customers were encouraged to build up credit balances which other suppliers and customers have been (illegally, we say) required by Ofgem to pay following a Supplier of Last Resort event. In the OneSelect example, the appointed Supplier of Last Resort has been allowed to claim £3mn for the recovery of 61% of OneSelect’s customers’ net balances. In the arena of supplier failures, we also note that Ofgem has been silent on whether administrators inherit supply licence obligations in relation to dealings with customers, and this has clear potential for consumer harm. Similarly, the treatment by Ofgem of Feed in Tariff defaults and levelisation appears deficient in allowing the default and out of keeping with statute in terms of mutualisation.

Services outside the energy supply arena – customer protections need to be extended and we support the expansion of Ofgem’s remit, enabled of course by primary legislation, for example in heat, third party intermediaries, non-traditional business models for energy, and activity at the grid edge such as peer to peer where there is clear effect on the network. For example, grid-edge/off grid has an uncertain regulatory framework and this needs to be addressed, including the regulation of new market actors such as aggregators. We continue to support the work that has begun on the regulation of heat networks and we believe that Ofgem is the obvious party to do this in future. In the microbusiness arena, we have previously flagged our concern that there is potential for microbusinesses to be misled by TPIs, which are unregulated. We note that the Federation of Small Businesses has said that whilst TPIs can be incredibly helpful to small businesses searching for fair energy deals, there is a lack of trust in the industry partly caused by some rogue TPIs who cut corners or act unethically. FSB has expressed support for the development of a code of practice for non-domestic TPIs. Finally, in the domestic market, new service providers such as price comparison sites/auto switching sites could potentially mislead consumers.

4. Would it be beneficial to allow suppliers to specialise and provide products and services to targeted groups of customers? If so, how can this be delivered while balancing the need for universal service?

Yes, specialisation should be possible, but universal service in energy supply must be addressed, as we believe the current provision is broken.

There must be some form of universal service provision for those who cannot engage in the market for whatever reason, and responsibility for this provision must be allocated or tendered for in a fair and transparent way among suppliers/service providers and compensated by levelisation or taxation. In addition, supplier exemptions are currently driving a two-tier market and this must be addressed.

One line of thought is working with assertions already made by Ofgem and CMA, that customers on SVT and/or not on Direct Debit are disproportionately represented in the “lower” demographic groups (an assertion presumably made on the basis of evidence that you have gathered from time to time in various studies and surveys).

Customers that are regarded as financially attractive can broadly be associated with: high consuming, engaging online, paying by direct debit, with good credit scores, in affluent areas, on the gas grid, and more likely to buy “kit” and value added services. These customers give suppliers higher revenues at lower costs and are attracted selectively (this is straightforward, through targeting, choice of channel, and aligning service propositions to target customer base) by growing suppliers, leaving the low/negative margin customers behind. As a consequence, the Universal Service of the essential service of energy is undone and the regulatory culture of cost socialisation is under stress. Universal Service is now in danger of collapsing.

Some form of bidding for elements of Universal Service merits serious consideration. One mechanism for example is for a local authority to take control of all utilities and services for a resident and tender for subsidised provision of services, including energy supply. This can be tax or rate payer funded, or hypothecated within the energy sector, via Value Added Tax, or distribution charges (which would be likely to require primary legislation). Alternatively, if all suppliers are required to provide a universal service offering, then the costs arising from high cost-to-serve customers could be funded through a system of levelisation.

5. Are incremental changes to regulation sufficient to support the energy transition and protect consumers? Or does this require a more fundamental reform, such as moving to modular regulation?

We believe that a major reform of the energy market is required, however we think that this can be achieved mainly through incremental change, which carries less risk and therefore provides more prospect of beginning right away.

We recognise the difficulty in seeking to put through major reform in one go, however we believe that the Significant Code Review process allows major reform to be managed effectively, enabling a wide range of views to come to the table and making it possible to assess the impact of change on a wider scale. It also promotes broader communication and visibility for market participants.

We do not support a modular approach to regulation, as we believe this might be detrimental to consumer protection, depending how far service providers are expected to go in terms of understanding their customers and their lives. If, for example, a customer made a bad choice of product, how would this then be resolved? It might also present more risk of “cherry picking” which naturally leaves some people behind.

Whatever way forward is chosen, innovation must be enabled and the provision of universal service is critical and a prerequisite. Any change should not cause competitive distortions or impose substantially different regulatory burdens for the provision of the same services, and should minimise any ability for gaming the framework.

6. Are there any other potential market distortions we should be considering as part of our review?

Yes, we agree with BEIS’ conclusion that the current design of policy delivery obligations, which exempts smaller suppliers, is distorting consumer choices and driving up cost to serve of customers who are more vulnerable, or less engaged. In addition to the distortions created by the uneven distribution of high cost-to-serve customers in the market, we believe that regulation (ie supplier obligations and exemptions) is further distorting and driving up cost to serve of customers who are more vulnerable, or less engaged. It must be remembered that high cost-to-serve customers are generally also low revenue customers for suppliers as they tend to have lower consumption.

Supplier obligation exemptions have unsurprisingly resulted in a sustained tariff differential which Ofgem calls a two-tier market. The additional costs of environmental policies are being picked up by customers through the price cap on a levered basis, since customers on unsustainable tariffs do not pay them. Some obligated suppliers have not provided for these commitments and are defaulting on these payments and other industry charges, leading to company insolvency and supplier of last resort situations. We also believe that some suppliers are guilty of deliberate malpractice e.g. by allowing customers to build up unnecessarily high credit balances, and failing to make payments for supplier obligations in a timely way. Following a supplier default, these costs are being mutualised, which in turn is placing additional, unexpected cost burdens on other suppliers and on other consumers. A vicious circle is being created.

Based on the information from the Consolidated Segmental Statements, supplier margins in 2018 were around £10 per customer account, and we expect the margins to be even lower in 2019.

7. Would removing the thresholds for the Energy Company Obligation and Warm Home Discount help remove imbalances in the retail market, and could this be done without significantly increasing barriers to supplier entry or expansion in the retail market?

Yes, we strongly believe that these thresholds should be removed or reduced significantly (i.e. immediately to 50,000 customers and then further).

ECO has been highly effective in the progressive delivery of energy conservation, but the exemptions remain highly distortive, increasingly regressive, and place Ofgem in the position of choosing to break the law in setting the ECO cost in the cap below the level required in

the Electricity and Gas Acts. The situation is getting worse, as the differential between SVT and Fixed Term Contract prices is worsening (as explained in Appendix B). Accelerating ECO defaults caused by exemptions should be taken into account when considering the ECO contribution to carbon budgets. The recent Energy UK paper on alternative options for ECO delivery, which has been shared with the BEIS Energy Efficiency and ECO team, sets out a range of ideas.

With regard to Warm Home Discount, the recent threshold reductions have had the effect of increasing the broader group rather than the core group, mainly because action to implement wider data-sharing has not been taken. We agree with the BEIS conclusion that wider data-sharing is key and this must be expedited.

8. How could the delivery burden on suppliers from the Energy Company Obligation be reduced, for example through the introduction of a buyout mechanism?

As mentioned in our response to question 7, the Energy UK paper on alternative options for ECO delivery sets out a range of ideas. For example, obligations could be placed on energy network companies, and the costs recovered through network charges, thus ensuring that all households contribute fairly. This would be our preference. This approach has been adopted in respect of the recovery of supplier costs for Supplier of Last Resort events, so there is precedent. Alternatively, costs could be recovered via taxation.

Alternatively, if government is reluctant to move the obligation to network companies and recover through network charges or via taxation, we would support a buyout mechanism as a means of reducing thresholds. This could sit alongside the trading arrangements which exist currently and would reduce costs for new entrants or smaller suppliers participating in the scheme.

9. What effect does the range of Energy and Climate Change Policy Levies have on the retail market?

In our view, these policy levies are fair in that all suppliers are obligated to recover these costs, however these policies are significant and overlapping, and also far too complex.

Simplification is needed. For example the capacity mechanism excludes some technologies on grounds of double count with other subsidies. It would be better to pay the capacity mechanism and remove the double payment in the other subsidies (e.g. pay the capacity mechanism but deduct from the CFD).

There is negative impact on the market when mutualisation of costs is needed following a supplier default, and it is imperative that the regulator takes action when there is a breach of statute. For example, in the case of the Renewables Obligation, the statute is clear that at the end of the late payment window if a supplier has not made payment then its licence should be withdrawn. In recent cases of non-payment, licence withdrawal action was not taken by the regulator.

In addition, we note that suppliers who have previously been actually or likely (e.g. not paid by the start of the late payment window) deficient in meeting their obligations have nevertheless been appointed as Supplier of Last Resort for customers of other failed

suppliers. We question the sense in this – surely this adds to the risk of further default occurring?

10. What actions could government take to reduce any negative impact of Energy and Climate Change Policy Levies?

Improved monitoring of suppliers' ability to meet their cost obligations is required, and prompt and fair enforcement action needs to be taken as soon as non-compliance (or risk thereof) is identified. Mutualisation is an issue - we have already flagged our concerns about the impact of mutualisation in our response to question 6 above. It must be recognised that suppliers cannot always pass costs through to customers, for example where fixed price deals are in place.

In June, Citizens Advice stated "British energy customers are facing a potential bill of £172 million from the collapse of 10 domestic energy suppliers since January 2018". This is a significant sum, which is likely to continue to increase, and it is no surprise therefore that energy industry profits are declining in the light of such behaviour by corporate adventurers.

11. Do you agree that now is not the time to make further changes on system and network cost recovery, metering and access to data as part of this retail market review?

Yes, we agree that on balance no further changes should be made with regard to system and network cost recovery, or metering, at the moment. However, we see a need to act further on data.

The changes currently in progress re networks and access are the biggest, most wide-ranging changes the industry has seen for a long time. With regard to data, we believe there is a compelling need for wider consumer data sharing, and there is a tension between a privacy compliant solution and an outcome that would be for the best public good. This must be addressed, either through this review or elsewhere. At the moment, this is a missing piece in the jigsaw.

12. What total costs do suppliers face with regards to bad debt and supporting consumers who struggle to pay for their energy?

Suppliers face a range of costs on bad debt.

As suppliers do not generally disconnect consumers on the grounds of non-payment, this has led to utility debt being effectively treated as interest free credit. Credit reference agencies are a force for good as they reduce the socialisation of bad debt. However, growing suppliers are increasingly able to filter out unwanted gains, leaving such customers behind on Standard Variable Tariff, which in turn cross subsidises affluent choice-enabled customers.

We provide some insight into our costs in managing bad debt and supporting customers who are struggling to pay in the **confidential appendix** (attached).

13. How could any potential distortions related to high cost-to-serve customers be addressed, for example by the provision of additional support services for customers struggling to afford their energy?

We believe that these distortions are due to the universal service obligations in the supply licence now being broken. This needs to be addressed urgently.

We have seen a change in our customer base over recent years, whereby the more attractive, affluent customers are switching away (attracted by lower price, online deals offered by smaller players), leaving us with less engaged, more vulnerable customers who carry higher costs to serve (for example, because they need additional support or are in debt).

We believe that some key principles for Universal Service should be established. In our view these are:

- Energy is an essential service (as is water)
- Everyone has a right to a safe connection to a source of energy.
- Everyone has a right of access to a flow of energy sufficient to have warmth, lighting and to be able to cook.
- Either all energy suppliers (with no exemptions) must be obliged to provide a universal service to consumers or universal service must be supported with a new mechanism.
- There must be a joined-up approach, linking universal service with support for the vulnerable, fuel poverty and energy efficiency policy.
- It is the State's responsibility to provide individuals with additional support where their circumstances require this (e.g. through the benefits system).

Some form of bidding for elements of Universal Service merits serious consideration. One mechanism for example is for a local authority to intermediate all utilities and services for a resident and tender for subsidised provision of services, including energy supply. This can be tax or rate payer funded, or hypothecated within the energy sector, via Value Added Tax, or distribution charges.

14. Would addressing market distortions (for example size-based obligation thresholds for some policy schemes, supporting those who are struggling to afford their energy bills) help reduce incentives for suppliers to adopt pricing strategies that lead to excessive prices for loyal consumers? If so, to what extent (providing quantitative evidence, where possible)?

Yes, such interventions would in our view help to bring prices down for those customers who are currently higher cost to serve.

Some suppliers profits are shown in the Consolidated Segmental Statements. Of the five published for 2018 the aggregate profit was c £480m i.e. c£10 per account, which is about half of the National Grid annual charges just for energy balancing. So average prices are not the issue. It is the case that there is wide price dispersion in the market, and this is a regulatory construct. The causes do need examining. One of the main causes are the supplier obligation exemptions. The current market is structured such that larger suppliers have greater obligations per unit of consumption than small ones. Examples are the ECO,

WHD, smart meter rollout and Universal Service. Some suppliers are explicitly or implicitly fully exempt. If competition is broadly of Bertrand type (i.e. driven by rapid switching to the cheapest price in the market), then the exempt suppliers become the price leaders and the other suppliers must either approach this price or dwindle. Provided that prices exceed variable costs then to remain at stable size these other suppliers must match the cheapest price with their gain tariff. This causes non recovery of the obligation costs, which may then load onto the enduring tariff (Standard Variable Tariff, SVT). In fact the effect is leveraged, i.e. *all* of ECO, WHD flows onto SVT, thus causing a doubling of pass through to this customer group. Our view is that there is much scope to reduce the complexity and burden upon suppliers to provide certain services and obligations which would be better managed via the state through general taxation or more joined-up governmental policies.

15. What are your views on the measures being considered to address loyalty penalties in different markets? What approach or – combination of approaches – would be most effective in the energy retail market?

In our view, the “loyalty penalty” is in fact the mirror image of an “engagement benefit”.

We recommend that BEIS and Ofgem adopt more positive language in relation to this issue, to incentive people to act. *All* markets with continuous delivery have introductory discounts. We must find ways of incentivising customers to engage in the market if we are transition to a net zero future and price incentives are a key tool which should be considered – see our response to question 2 above.

16. What other approaches could be adopted to ensure loyalty penalties do not re-emerge?

We believe that the answer is to focus on incentives.

Mandating the full adoption of smart metering would in our view help to eliminate the barriers preventing engagement. In addition, as already mentioned, a two-tier market has been created and this should be addressed to ensure that all suppliers have the same responsibilities. Government intervention is needed to deal with this.

17. What protections or support may be required to engage consumers in vulnerable situations in the future market?

It is generally true in the wider market, not just in the energy industry, that consumers are not consistently protected, and more support will be needed if such consumers are not to be left behind. We believe that action is needed on a number of fronts.

In energy, the rules are not consistently enforced by the regulator. An efficient enforcement regime is essential, as is a simpler regulatory framework. In addition, proper triangulation and sharing of data is needed. Consumer protection from abusive practices is patchy and unstable. For example; i) suppliers taking money from consumers, not owed, never to be returned, occurred under the eye of the regulator, ii) the CMA has advocated a new consumer protection regime that largely abandons the UK constitutional and governance structure, for example the executive telling the judiciary how to decide. We are uncertain as to how this will actually evolve.

Vulnerable consumers are often inadequately served - this is a societal issue (poverty) and universal service is needed to address it. We believe that responsibility for defining what constitutes a vulnerable person lies with the Department of Work and Pensions.

Whilst our overall view is that this is a societal issue rather than something which the energy industry should address, the erosion of Universal Service is a significant issue and a structural solution needs urgent attention. The introduction of a new regulatory approach to transient vulnerability has in practice had the effect of preventing the capture and sharing of data between companies and agencies, where this collection could be helping consumers with longstanding vulnerability. Our view is that it is not the energy industry's responsibility to ensure that no one is left behind and therefore to pick up the costs of supporting the most vulnerable in society. If however it is decided that energy suppliers must serve the poor and vulnerable at our cost, then subsidies should be provided.

It is also important to bear in mind that the future definition of vulnerability may change in the light of technological advancement. For example, changes to household energy efficiency requirements may mean that affordability is not just around heat, but rather extends to other areas such as Demand Side Response, and access to data. We are surprised that the Equality Act has not been applied to the energy market – why is this? Increasingly only financially comfortable, enabled customers have full access.