Energy Markets and Affordability Team,
Dept for Business, Energy and Industrial Strategy,
1 Victoria Street,
London,
SW1H 0ET

12th September 2019

Dear Sirs,

Consultation on Flexible and Responsive Energy Retail Markets

Thank you for the invitation to respond to the above consultation. Bristol Energy is a national gas and electricity supplier that is making a positive difference by building a sustainable energy company that has social value at its heart. Bristol Energy has delivered over £12m in social value, since launch, and is committed to working with city partners to help Bristol hit ambitious social and environmental goals as set out in the Council's One City Plan.

<u>Executive Summary</u>

Bristol Energy welcomes the Government's review of the energy retail market. One of the key requirements to improving flexibility and responsiveness of the market must be to encourage as many customers as possible to engage in the market and limit regulatory substitution of competition to the smallest cohort of customers who have a vulnerability that actively prevents them from engaging in the market directly or by proxy.

The current market is based on some bedrock principles that need to be challenge, such as one supplier per fuel, per property and any sales must be in kWh of fuel consumed. Both these principles reflect the old market and are hindering innovation and more flexible products and services. However, they are difficult to avoid due to the weight of regulations that are underpinned by them. Without tackling such sacred cows, a truly flexible market cannot develop.

The complexity of the market, including the social and environmental obligations makes operating in the market a numbers game. It is very difficult to be a niche supplier due to the fixed costs of operating in the market which demands suppliers have to grow to significant size to be profitable, and that threshold is forever increasing due to the pace of regulatory change.

Finally, we refute the suggestion by large suppliers that they struggle because they have a higher number high cost to serve customers. If this is true, then this is due to their actions to keep such customers disengaged from the market and thus they are the cause of their own misfortune. Bristol Energy and several other non-incumbent suppliers would gladly relieve the incumbent suppliers of many more such customers and offer them a better deal in the process.

We have answered your specific questions below, expanding our response where necessary.

Q1. 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?

We are supportive of the vision and support the view that customers in vulnerable situations should be properly protected. It is important for a competitive market to function that customers that can engage with the market are encourage to do so by receiving financial benefit and better services. Customers who can, but choose not to engage, should not be protected by delivering through regulation those same benefits so their inaction is encouraged. It is one of the failings of the current market that the regulatory environment continually strives to make all suppliers deliver the same level of services to all customers thus hindering the ability to be different.

We are supportive of the outcome of allowing a wide choice of energy services. The key to this will be allowing different parties to offer different services without the hinderance of being all things for all people. The challenge will be whilst allowing this specialisation of services, that basic energy services remain accessible for all. There is also a wider challenge, that if niche service providers are to prosper, then the current number of customers a supplier needs to cover the fixed costs of participation in the market need to fall substantially. For example, Bristol Energy would like to focus on Bristol and surrounding areas, but the required customer numbers required to breakeven means we must seek customers on a national basis to the extent that just 13% of our domestic customer base is in the Bristol area.

Customer protection in general must be rolled back to one of ensuring customers are entitled to a minimum basic level of care and service that is consistent across all providers. It should be competition rather than regulation that drives better standards of care with customers being allowed to choose the quality of care they wish to receive recognising the trade off in terms of price this may entail. Protection for customers in vulnerable circumstances should focus on ensuring as many can participate in the market as possible, with additional support to those who genuinely cannot.

We fully support the outcome of minimal market distortions and that where policy obligations are imposed, they should be designed so the costs fall proportionate to a market participants size rather than creating artificial threshold barriers. It is also important that these obligations fall on all participants in the market and not just licensed parties. The Government should consider whether some of the current obligations should be placed on network companies, with the costs recouped equitably via network charges to network users.

We are supportive of competitive prices for all, and that customers should not face excessive prices. However, in the future retail energy market, parties should be able to offer services to customers beyond just supplying the energy and therefore we disagree with the benchmark mentioned not paying considerably more than the cost of supply energy. For example, a supplier may offer a service where they offer to heat a property to an agreed level, transferring weather risk from the customer to the supplier. The supplier will need to price that risk and in a mild winter the customer may pay considerably more for their energy, with the converse being true in cold winters. Customers may also wish to pay for premium customer service levels, or for low carbon energy from their local solar or wind generator.

We also think the Government and the Regulator should stop seeing customer loyalty as a bad thing. In many market customers who feel well treated by their current provider, recognise and accept they pay a premium, but remain happy to do so. The issue until recently in the energy market is that many customers of incumbent suppliers did not feel well served but fail to resolve the issue by switching provider. However current switching rates suggest this situation is becoming less of an issue.

The best protection for customers in vulnerable situations is to ensure they can engage with the market either directly or by proxy. For example, whilst auto switching sites are currently focussed on the price savvy customer, we see an opportunity in time for charities and other trusted parties to engage with the market on behalf of vulnerable customers to get the most suitable tariff for those customers. If the fixed cost to serve can be brought down, then there may also develop a market for parties to provide specialist services to vulnerable consumers, which cannot develop if all market players are obligated to provide such services.

In terms of regulatory simplicity, this will not be an easy feat to achieve. A lot of the current market complexity is about ensuring interoperability on a customer changing supplier. As the market diversifies, then there will be additional complexity, for example, if customers can in future appoint more than one supplier to a property, then there will be an inevitable increase in complexity in the change of supplier process. That said, there are many areas where the regulations over prescribe or dictate a particular solution. In some cases, regulations have been bolted on to facilitate alternative processes, rather than removing the process that blocks multiple solutions.

In our view regulation should only exist where it;

a. Is essential to security of supply to the customer or stability of the energy market
b. Is required to facilitate the ability of the customer to switch supplier(s) with minimal intrusion
c. Protects the consumer for significant harm or facilitates the inclusion of customers in vulnerable situations.

If a regulation does not meet any of the above criteria, then its existence should be questioned.

Q2. 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?

We believe there are a number of services and products that are blocked by the current regulatory framework. One of the key blockers is the right to switch resulting in the inability of suppliers to tie customers into a long-term contract with variable pricing. Currently a supplier can only offer a fixed term at a fixed price, or via tracker mechanism. This means suppliers are unable to offer bundled energy efficiency or generation packages which include installation of assets with long term payback periods. This is particularly preventing the development of Heat as a service where a supplier offers to heat a property for an annually fixed price, and then is incentivised to invest in the property to reduce its fuel usage. Typical payback period is 15 years, but a supplier cannot fix a price for such a duration given the volatility of the energy market.

Local Energy markets are also curtailed because the fixed costs of being a supplier are too high compared to the number of customers a local energy market can hope to sign-up. At the moment, Local Energy Markets are happening only in “white label” when they have a larger licensed supplier as a partner to get the economies of scale. However, working with a larger supplier often curtails the innovative solutions open to a Local Energy Market operator or curtail the financial benefits of a local energy solution.

Finally, the sheer complexity of the market combined with the low level of trust in the industry. Typically, this is caused by a small cohort of parties and then exacerbated by regulatory action across industry rather than at the offending parties. This then deters innovative companies from entering the market as they fear it may result in the erosion of their own brand by association with the industry.

Q3. Are there current or emerging harm to energy consumers which are currently out of scope of the regulatory framework? Do they differ for domestic and non-domestic customers?

The current regulatory framework is based on two premises. Firstly, that the supplier has a direct relationship with the end consumer, and that relationship is linear, i.e. The customer has only one supplier per fuel.

Due to the complexities of the market and the development of technology there are increasing numbers of customers who do not have a direct relationship with their energy supplier. In the non-domestic market, more and more customers use energy brokers, not all of whom deliver the best service to the businesses they serve, but such brokers act outside the regulatory framework. In the domestic market, we are seeing more and more customers delegating their energy purchasing to auto-switching services and thus the auto-switching service is their point of contact, not the supplier. This makes it difficult for the supplier to identify vulnerability, and debt collection becomes harder, a cost which is ultimately met by all customers in the form of bad debt.

Many innovators want to see a change to the market which allows multiple suppliers to a metering point. Whilst this may assist customers to get better solutions, it does create problems as a lot of the regulations assume one supplier, and that that supplier will remain responsible for that supply until another supplier takes it on. If meter splitting is allowed, then steps will need to be taken to ensure a customer has a supplier for every half-hour, and an understanding how regulatory and social obligations are split between those suppliers. There also needs to be a level playing field, so if an incumbent supplier to a metering site is not obligated to continue to offer the same tariff to a customer, if another supplier takes over for certain periods of supply.

As the market evolves into something more dynamic there is a risk that customers in vulnerable situations may suffer harm that does not currently exist. In today's market most customers are on a single rate, or a static two rate tariff. As time of use tariffs evolve there is a risk that customers are encouraged on to time of use tariffs that they are unsuited to, or because a change in circumstances, perhaps linked to a vulnerability they later become unsuited to, but they are unable to manage the situation.

We are also concerned that Ofgem's current proposals around Network charges may force suppliers to switch to more complex tariffs to recover those charges for the network companies. We would encourage BEIS to discuss this with Ofgem and ask question whether this approach is in the customer's interest.

Finally, the emergence of a greater number of heat networks, both large and small raise concerns as customers on heat networks are unprotected in regulation and are unable to switch supplier. This needs to be addressed in tandem to the reform of the electricity and gas market.

Q4. 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?

We believe it would be hugely beneficial to allow suppliers to specialise and provide products and services to selected customers. In truth, it is not the Universal Service Obligation that prevents this, but the need to get significant customer numbers to make acting as an energy supplier cost effective. The high fixed cost of participating in the market need to be reduced, so that supplying a smaller number of customers can be done profitably.

The universal service obligation requires suppliers to offer a tariff to a customer, it does not obligate suppliers to offer all tariffs to all customer. In reality, all customers have access to energy, not least because unless a metering point is a new connection then the current supplier can only cease to supply if another supplier takes over.

We believe that a simple regulatory obligation on parties to offer terms to a new connection in a geographic area they operate should ensure all customers have access to a supplier, then to ensure customers have access to the switching market, parties should be required to not unduly discriminate on grounds of vulnerability, including financial vulnerability, without just cause. This would mean suppliers could not refuse to take a customer on because they were financially constrained but could refuse if they did not operate in that area or there was a specific criterion for entry such as having an Electric Vehicle or agreeing to provide access to HH data.

Q5. 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?

The market has been evolving on an incremental basis since the retail market opened to competition. This has led to the current complexity as new approaches have been laid on top of existing regulations, rather than returning to basics. As a result, the regulatory framework is unstable, incomprehensible and requires shoring up with additional regulations of increasing complexity. A good example of the problem is the decision by Ofgem in 2015 to reduce the complexity of the supply licence by moving to principle-based regulation. At the time the electricity licence was 453 pages long and generally agreed to be over prescriptive. Today, despite this initiative to move to principles that licence has grown to 481 pages, and about 2,000 pages of subsidiary codes have been added over the same time period.

It is therefore our view that incremental change will actually worsen the situation in terms of complexity and create additional barriers to market entry whilst leaving customers unprotected outside the rigid regulatory boundary. A more fundamental redesign to the very basic architecture of the energy retail market is required if the energy transition is to be delivered. Whilst a modular activity-based approach would help manage the blurring of responsibilities, it will not deliver the required results if all existing regulations are just taken and carved up into modules.

As stated in our response to Question 1. Every current and future regulation should only exist if it facilitates one of the three requirements;

a. Is essential to security of supply to the customer or stability of the energy market
b. Is required to facilitate the ability of the customer to switch supplier(s) with minimal intrusion
c. Protects the consumer for significant harm or facilitates the inclusion of customers in vulnerable situations.

In addition, unless there is an over riding need to do so, any regulation should be outcome based, not process based.

Q6. Are there any other potential market distortions we should be considering as part of our review?

One of the biggest drains on retailers in the energy market is the requirement to post credit collateral multiple times over, particularly to monopoly service providers or obligations which are doubly protected by the ability to mutualise any short fall. The retail market is heavy on cash flow with suppliers needing to make payment to other market players before customers pay their energy bills. Any shortfall in collection from customers has to be made good by suppliers. (i.e. Suppliers cannot pass bad debt onto network companies or obligations such as the RO or FIT.).

Larger parties, or those who are part of an asset rich group of companies can rely on credit ratings or parental guarantees, whereas smaller parties or those with no parent company end up placing significant cash sums in escrow arrangements.

We accept that credit arrangements have their place, but the current retail market is over collateralised and needs returning to reality. Unfortunately, the recent spate of supplier failure is pushing the demand for more collateral to be posted rather than seeking a more equitable solution. The risk here is that if changes are made to facilitate more flexibility, but collateral requirements deter parties from taking the new opportunities available.

Q7. 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?

If anything, the lowering and proposed removal of the threshold has increased the distortion in the market in favour of the larger parties who can use their economies of scale to deliver more efficiently than smaller parties, although the evidence suggest they do not deliver their obligations efficiently hence their insistence that the threshold is removed to reduce the harm to them by pushing up costs of more agile suppliers.

Bristol Energy has participated as a voluntary supplier in the Warm Home Discount for core group for several years. We support the current arrangements but suggest that non-participants should contribute to the reconciliation process so that the costs are shared equitably across all parties. The broader group is more problematical and, in our view, detrimental to the most vulnerable in society as they struggle to apply for it. We strongly support the abolition of the Broader group with an expansion of eligibility of the Core group in its place using DWP data matching. This will remove the 1st come, 1st served distortion of the broader group, which fails the most vulnerable.

With regards to the ECO, we feel this is a very inefficient and pot luck way to deliver energy efficiency. The drive to net zero requires an increase in the level of ambition in energy efficiency, and the ECO is a terrible way to deliver such an important policy and is hugely inefficient with far more being spent on administration due to its complexity than should be the case.

As a party that will become obligated in April 2020, we have found it impossible to find any cost-effective solution to deliver the ECO at a cost level used in the consultation, and larger suppliers are not offering to buy out our obligation in anything like a competitive approach. The Government was wrong to reduce the ECO threshold without delivering more fundamental reform to support smaller parties. The ECO has now become a huge barrier to growth and needs addressing urgently.

Q8. How could the delivery burden on suppliers from the Energy Company Obligation be reduced, for example through the introduction of a buyout mechanism?

The biggest issue with the ECO is that suppliers cannot be sure of the costs they face in delivering their obligation. Finding eligible properties is proving harder as existing ECO providers have picked the low hanging fruit. It is also difficult getting agreement from the resident and or property owner, once identified. Newer supplier when entering this market are also at a disadvantage as they do not know where measures have already been installed by other parties or the property owner has decided not to participate. Something longstanding ECO parties will have. The cost of identification is therefore higher for new entrants, even if their total obligation is lower.

Any buyout mechanism must be financed based, such that when Ofgem informs suppliers of their obligation size, it should also state the cost of buying out that obligation. It will be then up to parties to decide whether they can meet their obligation at a lower price than buying out, or accept the premium for the buyout, in return for the knowledge the obligation is discharged.

Ofgem should then auction the subsequent buyout pot to bidders (Licensed and unlicensed parties) willing to deliver the most measures.

Q9. What effect does the range of Energy and Climate Change Policy Levies have on the retail market?

Whilst the range of policy levies have an impact on customer prices, both directly as a cost and indirectly by the need to administer them we do not feel they significantly distort competition. However, those obligations that require the posting of credit collateral such as the CFD do distort the market.

Q10. What actions could the government take to reduce any negative impact of Energy and Climate Change Policy Levies?

Each of the various policy levies is managed in a different way, with different collection cycles, different requirements for credit cover and different levels of administration. In our view, the collection of the RO should be aligned to the CFD & Capacity market, perhaps with the LCCC taking over its collection.

The Feed-in tariff is perhaps the best in class in terms that it collects the cost from all parties, and covers the administration costs for those parties obligated, or volunteering to deliver. A similar mechanism could be used for the WHD and ECO.

Q11. 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?

Ofgem's current proposals on network charges seem to be counter to the direction of travel and have serious implications as to how suppliers pass these costs through. Whilst we do not think the Government needs to reform network charging, it should ensure that its own proposals for reform of the retail market are not hindered by the short-sighted proposals currently being put forward by Ofgem. In our view, several of the proposals could only be implemented if network companies billed the customers direct rather than using suppliers to bill by proxy. The Government and Ofgem's retail team must review and respond to Ofgem's network team's current proposals when they consult on them.

We agree now is not the time to make changes to the metering arrangements, however, change may be required if changes to the retail market means a customer can have more than one supplier or be supplied by a non-licensed party. At this point it may be beneficial to look at a more fundamental change rather than making the metering arrangements more complex to shoe-horn multiple suppliers into a system designed around one supplier per metering point.

There are already several initiatives ongoing regarding access for data. We believe the Government should be mindful of the principle of customer opt-in consent to sharing their data and be wary of mandating that a customer's data can be shared without that consent unless there is substantial benefit to the operation of the energy system. This review of the retail market should not seek to duplicate data work elsewhere.

Q12. What total costs do suppliers face with regards to bad debt and supporting customers who struggle to pay for their energy?

Bristol Energy's mission is to address fuel poverty, particularly in Bristol and therefore attracts many high costs to serve customers. We strive to manage these customers in an efficient manner and encourage customers who do not need extra support to self-serve where possible. e.g. Using their online account rather than phoning our contact centre.

We know our average cost to serve is higher than industry average, although we think £96 is too high and probably includes inefficient supplier data and are seeking to bring this in line with industry averages through the development of efficient solutions.

We do not accept the argument that the incumbent suppliers have a higher proportion of high cost to serve customers, and where they do it is down to them not encouraging these customers to engage with the market. It would appear they want to keep hold of these customers, whilst getting their competitors to bail them out on the additional costs. A classic case of wanting to have their cake and eat it.

Q13. 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?

Whilst we fully support helping customers who are struggling to afford their energy, it is important that they are properly identified. So, for example, providing financial support to disengaged customers should first be tackled by getting them to engage with the market to get a better tariff before financial assistance is considered. As the cost of supporting these customers falls upon other customers, it is important that other avenues are considered first.

To this end, encouraging additional support to switch would be the first solution, support for energy efficiency second and only after these avenues have been explored, financial assistance.

Q14. 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 customers? If so, to what extent?

Addressing market distortions, will not on its own resolve the issue of loyalty penalties, all that will occur is that some suppliers with large inherited disengaged customer on their books will make a greater margin on them. What is actually needed is greater competition so that suppliers who impose loyalty penalties run the risk of losing their customers.

The issue at the moment is that the regulators sees loyalty as a bad thing per se and seem ignorant that some suppliers have earnt their customers loyalty with good prices and service. A number of suppliers would like to roll their customers automatically onto their best tariff at the time of renewal, but as this is seen as "defaulting" by Ofgem it can result in customers ending up on the disengaged database, and the best tariffs needing to be reported under the price cap.

Suppliers should be encouraged to earn their customers loyalty rather than see it as a regulatory risk, and where they fail to earn it, then customers can move to another provider with ease. This is what needs to be addressed, not imaginary distortions that large suppliers use as an excuse to overcharge disengaged customers when they are complicit in keeping them disengaged.

Q15. 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?

We would support measures to protect vulnerable consumers from excessive harm. Any support would need to be carefully targeted and focused on helping such customers engage with the market rather than financially helping them pay any loyalty penalty they are paying their supplier.

We would also support a stronger enforcement of consumer law targeted at those suppliers who impose loyalty penalties, rather than broad-brush measures that increases regulation on all suppliers, irrespective of whether they are engaged in such practises or not.

Q16. What other approaches could be adopted to ensure loyalty penalties do not re-emerge?

The best enduring solution would be to encourage greater participation in the market. The more customers who are engaged, the less scope exists for loyalty penalties. This engagement should not just measure supplier switching, but also renewal of fixed term tariffs with existing suppliers.

One interim approach may be to reinstate a revised form of Supply Licence Condition 25A which was allowed to lapse in 2012. This prohibited undue discrimination in the application of costs across customers. This would prevent suppliers loading more costs onto disengaged customers to provide lower prices to engaged customers.

Q17 What protections and support may be required to engaged consumers in vulnerable situations in the future market?

Key to supporting vulnerable consumers will be ensuring they are identified. The current process of self-identification via the Priority Services register leaves some of the most vulnerable unprotected. Better use of Government data to help identify customers and tailored support to engage with the market, either directly or via proxy such as an auto switching service run by charities or consumer organisations would be very helpful.

I hope you find this response useful. If you have any queries, please do not hesitate to contact me.

Kind regards,

Chris Welby

Chris Welby
Head of Regulation