

Energy Markets and Affordability Team
Department for Business, Energy and Industrial Strategy
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Emailed to: energyretailmarketsreview@beis.gov.uk & futuresupply@ofgem.gov.uk

16th September 2019

Dear BEIS and Ofgem,

Consultation on Flexible and Responsive Energy Retail Markets

Drax Group plc (Drax) owns two retail businesses, Haven Power and Opus Energy, which together supply renewable electricity and gas to over 350,000 business premises. Drax also owns and operates a portfolio of flexible, low carbon and renewable electricity generation assets – providing enough power for the equivalent of more than 8.3 million homes across the UK. This is a joint response on behalf of Haven Power and Opus Energy and is non-confidential.

The energy market has seen dramatic changes since the foundations were laid at privatisation, from how consumers engage with energy to the services they are offered. The future market framework needs to adapt to this continuing evolution and support the net-zero transition. This review presents an opportunity to bring together the different reform activities that Ofgem, BEIS and industry are focused on, to ensure they fit together into a coherent overall plan and are fit for the future.

We outline our key points as follows:

- We broadly agree with the vision for the future of the energy retail market but would encourage Ofgem and BEIS to consider distinct interventions and outcomes for the domestic and non-domestic energy markets respectively. It is vital that all consumers receive adequate protections, however the nuances of the non-domestic market mean that this may not be successfully achieved by a one size fits all regulatory framework.
- The unprecedented number of supplier exits in the past 18 months, coupled with poorly run suppliers making insufficient provisions for liabilities, has highlighted flaws in the mutualisation process as suppliers, and in turn their customers, are consequently left to shoulder the regulatory burden and costs of their competitors. Whilst this could partly be addressed by Ofgem ensuring suppliers have sufficient knowledge and robust business plans to fulfil their requirements, changes could also be made to the regulatory framework, such as more frequent payments of the Renewables Obligation, so that unpaid amounts don't accumulate over long periods of time.

- The energy market is evolving rapidly, and in our view, the greatest risk of consumer detriment arises from the proliferation of unregulated third parties. Ofgem and the CMA have acknowledged these risks and issues but have, as yet, failed to take any meaningful steps to address the problem. With the majority of business customers now making use of such services, there is a risk of further consumer detriment if the regulatory framework does not adapt and protect consumers from these key market actors.

Our responses to the specific consultation questions are appended. We would be happy to discuss any aspect of our response with you further if it would be helpful.

Yours sincerely

Matt Young

Group Head of Regulation
Drax Group Plc

Appendix - Consultation Questions

Question 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?

We agree with the vision for the future of the energy retail market but we strongly encourage BEIS and Ofgem to consider the interventions and outcomes needed separately between the domestic and non-domestic energy markets. Any change to the existing regulatory framework should be reflective of the nuances of each market to ensure that consumers receive adequate protections and are not unnecessarily burdened by a one size fits all regulatory framework.

We also agree that it is right to open the energy market up to new business models, allowing innovation and creativity. It is however important the regulatory framework ensures everyone bears their fair share of the costs (e.g. energy network costs and decarbonisation policy costs) to avoid market distortions, such as an influx of new parties who benefit from the market without paying their way. Moreover, market-wide interventions resulting in considerable direct and indirect costs to consumers need to be carefully considered in light of the problem they are seeking to address; material interventions should not be made simply to favour a new business model which has little (if any) proven customer demand.

Question 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?

We don't see any parts of the non-domestic regulatory framework which prevent or frustrate the advent of new products, services or business models. As evidenced by a modification proposed to the Balancing and Settlement Code - P379 'Multiple Suppliers through Meter Splitting' - it is within the gift of parties to seek changes to how prevailing parts of the market work via the industry code modification process.

We do however harbour concerns that some changes proposed through the code modification process can impose significant costs on the industry with small benefits accrued only by niche market participants. Therefore, it is important that an appropriate cost/benefit analysis is properly conducted and considered as part of the code modification process with specific focus on whether modifications will benefit the end consumer in a cost-effective manner, rather than benefiting a small number of industry participants whilst imposing costs upon other participants.

There are often more economical solutions found outside of the energy market that, as an industry, we could be looking to for inspiration. This is evidenced in the example of P379, the premise of which is that a new entity - Customer Notification Agent - would aggregate and reconcile energy consumed by a single meter to enable the allocation of volumes and costs to different BSC parties. The parties would then reflect the volume and costs in customer's bills, the intent being that customers could pay different parties for their primary and secondary consumption (e.g. 'primary' electricity used for day to day business use and 'secondary' electricity used to charge an electric vehicle). However, 'fuel cards' already used across corporate car fleets could provide a far more straightforward and cost-effective solution than fundamentally changing the way industry processes work under P379. In this example, fuel cards could be pre-loaded with funds by the customer and used at charging stations – including at the home – with a 'tap-and-go' functionality.

Question 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?

The energy market is evolving rapidly and, in our view, the greatest risk of consumer detriment arises from the proliferation of unregulated third parties. Arrangements involving multiple providers or services make the market more complex. With increasing complexity, there is greater risk that consumers will be ill-informed about the products and services they are choosing. In the case of business consumers, where time is a precious commodity, expecting them to spend more time interacting with multiple providers could be detrimental compared to a single relationship fostered through the current supplier hub model.

Additionally, convergence across markets is likely to lead to consumers increasingly interacting with unregulated businesses. A refresh of Consumer Protection laws to reflect this evolving landscape is overdue and could go some way to future-proofing protections by deterring mis-selling of inappropriate products and services by parties not governed by a supply licence.

As with most aspects of the domestic and non-domestic energy market, there are differences in the current and emerging harms to consumers. For instance, Price Comparison Websites (PCWs) and automatic switching sites continue to grow in the domestic market but are not active in non-domestic. On the other hand, Third-Party Intermediaries (TPIs) have long been an important part of the non-domestic market but their customers are afforded little protection.

A large segment of the non-domestic market uses TPIs to source and manage their energy supply contracts, yet TPIs still remain an unregulated player in the energy market. We view the practices of some TPIs operating in the non-domestic market as posing the most significant risk and the greatest potential cause of consumer harm. In 2018, 67% of small and microbusinesses used a broker to help agree their energy contract. With the majority of business customers now making use of such services, there is a risk of consumer detriment if the regulatory framework does not adapt and protect consumers from these key market actors. We continue with our long held the view that TPIs should be governed through a market-wide Code of Practice, either piggy-backing off the Supply licence or captured under a general authorisation regime.

Question 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?

In the non-domestic sector, where universal service is not an obligation, customer specific energy business models already exist. In our experience, this has allowed suppliers to focus on specialist products and services targeted at particular customer segments that will benefit most from them, with no detrimental impact on consumers' ability to access the market.

Question 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 do not see any evidence to suggest that fundamental reform is needed or wanted. However, we do see the need for more market participants to be held to similar levels of accountability as suppliers currently are. TPIs are increasingly acting as the main customer point of contact in the energy retail market (both domestic and non-domestic), without them being subject to the same obligations and potential sanctions that licensed providers are. It would be inappropriate, inefficient and ineffective to oblige licensees to

regulate or monitor the behaviour of other market participants and instead customers should be afforded direct protections from poor behaviours or malpractice.

With innovation becoming ever-present and rapid advances in technology any future regime that regulates unlicensed providers must be swift to respond to emerging issues and potential consumer harm. Moving to a regime with a licence for each emerging service or category of provider would be reactive and slow, and burdensome for Ofgem (and others) to implement. Notwithstanding that, in practice it would be impossible to predict what new technologies and categories of service will emerge and thus impractical to explicitly define the category of each market participant.

In order to protect consumers from market players that are not governed by a supply licence, we are supportive of an authorisation regime, where parties must adhere to a Code of Practice governing their behaviour, and poor practice results in swift and appropriate sanctions, for example fines and/or operational restrictions. This approach has been suggested for the non-domestic TPI market but could apply more broadly. On balance, we feel the proposed way of carrying out the authorisation regime in the energy sector (Codes of Practice for emerging services alongside supply licences) presents the easiest way to reduce the risk of consumer harm. Particularly when compared to the other two options proposed in the consultation – separate licences and modular licensing.

Irrespective of the eventual approach adopted, it is important that the regulatory framework can adapt to an ever-changing market and the way in which services offered by TPIs may evolve, so that any new regime remains fit for purpose without endless new rules being bolted on.

Question 6 – Are there any other potential market distortions we should be considering as part of our views?

As a non-domestic only supplier, we are not aware of any demonstrable market distortions that need to be considered.

Question 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?

As a non-domestic only supplier, we have no comments in response to this question.

Question 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 a non-domestic only supplier, we have no comments in response to this question.

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

The costs of Energy and Climate Change Policies are levied on energy suppliers, who then pass them onto consumers through their energy bills. This is a valuable benefit of the supplier-hub model. There are many third-party and policy charges levied across the sector, but customers only have to be concerned with paying a single party – the supplier. Without such a model, where some market participants may only operate in distinct areas of the energy supply chain, having a myriad of complex charges and levies applied from different parties is likely to be increasingly difficult for any customer to manage.

However, the current mechanism for the recovery of these levies means that poorly run suppliers are not making prudent financial provision for their liabilities. Mutualisation of these outstanding liabilities, due to supplier failure, burdens other suppliers and their customers with additional costs, and in many instances means some consumers are paying twice for policy costs.

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

We acknowledge the administrative complexity of the policy levies; however, all suppliers should have a full and accurate understanding of the payment terms. Whilst this could partly be achieved by Government ensuring suppliers have sufficient knowledge and robust business plans to fulfil their requirements, changes could also be made to simplify the regulatory framework to ensure that suppliers are less likely to be able to avoid their obligations and leave other suppliers to shoulder the regulatory burden and costs.

Suppliers should be required to pay their liabilities more frequently so that amounts owed cannot accrue over significant periods of time to become large amounts. As a prime example, there is a lengthy gap between the RO obligation occurring and a single annual payment falling due, with no credit or collateral provisions to mitigate any non-payment from suppliers. Given that the costs of any mutualisation are of a material level, suppliers need to recover those unforeseen costs from today's customers. Moreover, following the upward and seemingly ongoing trend in the frequency of supplier failures and resulting mutualisation, it is likely that suppliers will need to start to reflect that future risk of mutualisation in higher future prices.

Given the inherent difficulty in forecasting the future costs of policy levies, Ofgem could consider fixing costs for defined periods of time and truing-up any under or over-recovery in future scheme years. We recognise that this would create complexities given the requirement to maintain regular payments to generators, but it would provide suppliers with greater cost certainty enabling them to offer consumers fixed-term fixed-price products with less risk premium included.

If any new levies are introduced in the future, the Government should reconsider the existing collection methodology and whether it can be based on one of the existing schemes, rather than introducing another complex collection methodology (e.g. as seen for CfD and CM), that is entirely different and equally complex, making it more difficult for suppliers and consumers to understand.

Question 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?

We agree that now is not the time to make further changes in these areas. Substantial reforms are already being explored as part of Ofgem's Access and Forward-looking Charges and Targeted Charging Review SCRs (Significant Code Reviews). Likewise, access to data is included in a range of ongoing initiatives including the Energy Data Taskforce and Smart Data Review. While it is important to maintain an awareness of developments and ensure workstreams align, further changes should not be in scope for this review.

Given the critical importance of the Smart meter rollout, we would also consider that it isn't an appropriate time to contemplate further reforms to metering arrangements. Suppliers and other parties have developed operating models and commercial arrangements to reflect the rollout requirement and it is difficult to see what benefit would come from changing the fundamentals of this now.

Question 12 – What total costs do suppliers face with regards to bad debt?

From a non-domestic supply perspective, the increased cost-to-serve associated with bad debt stems primarily from the need to deploy additional internal and external resource to collect debt, agree payment plans and investigate fraudulent changes of tenancy. Costs further increase if matters escalate and suppliers are left with no option but to resort to site visits, warrants and litigation.

There are additional challenges associated with recovering debt from customers on deemed contracts. It is difficult to determine who is occupying a property without an existing relationship. And even where we have identified the occupier, we are far less likely to have a full set of contact details, or a direct debit agreement, than with those customers who proactively contract with us. Also, in our experience, once customers on deemed contracts start to accumulate debt, they are less likely to contact their supplier. Additionally, non-domestic suppliers are not currently permitted to object to customers on deemed contracts switching supplier if they are in debt. However, the chance of recovering the debt reduces considerably once the customer has switched leading to a high proportion of debt for deemed customers being written off.

Question 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?

In theory, non-domestic suppliers have the ability to reflect higher costs-to-serve in the bespoke prices offered to particular customer types, rather than recovering the costs through tariffs applied to their whole customer portfolio.

Question 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)?

As a non-domestic only supplier, we have no comments in response to this question.

Question 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?

As a non-domestic only supplier, we have no comments in response to this question.

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

As a non-domestic only supplier, we have no comments in response to this question.

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

As a non-domestic only supplier, we have no comments in response to this question.