

Ofgem – Call for input on the non-domestic gas and electricity market: Energy UK Response

31 March 2023

Introduction

Energy UK is the trade association for the energy industry with over 100 members - from established FTSE 100 companies right through to new, growing suppliers, generators and service providers across energy, transport, heat and technology.

Our members deliver nearly 80% of the UK's power generation and over 95% of the energy supply for 28 million UK homes as well as businesses.

The sector invests £13bn annually and delivers nearly £30bn in gross value - on top of the nearly £100bn in economic activity through its supply chain and interaction with other sectors, and supports over 700,000 jobs in every corner of the country. The energy industry is key to delivering growth and plans to invest £100bn over the course of this decade in new energy sources.

This is a high-level industry view and this response is not intended to be confidential. Energy UK's members may hold different views on particular aspects of the call for input. We would be happy to discuss any of the points made in further detail with Ofgem or any other interested party if this is considered to be beneficial.

Executive Summary

Energy UK welcomes Ofgem's call for input on the operation of the non-domestic retail energy market. We also welcome Ofgem's production of a series of Consumer-Supplier Roundtables to bring suppliers and customer groups (business trade bodies/associations) together to discuss experiences operating in the non-domestic market and consider solutions for challenging issues.

We agree there is a role for Ofgem to help businesses understand how regulations can affect the pricing of their non-domestic energy bills. In this response we also explain some of the key factors such as market conditions and suppliers' debt risk management that can drive pricing and the offer of energy contracts to businesses.

We are also mindful that the impact of high energy prices is about to get worse for many business as financial support is reduced. Government and Ofgem should openly and transparently prepare British businesses for the imminent reduction of the value of financial support for their energy bills. This could cause some businesses to struggle and even fail. Businesses which are struggling, or expected to struggle, with their energy bills should contact their energy supplier and see what support is available. Energy UK wants to continue to work with the government, Ofgem and business groups to ensure businesses know about the changes from April 2023 and who to speak with if they are struggling. This work is more important now than at any point during the crisis.

Energy suppliers have worked at pace to deliver energy bill support schemes for businesses and to procure the gas and electricity required from volatile and very high wholesale markets. We consider that no further regulatory intervention into the supply of energy to businesses is required. It is our view that Ofgem already has the necessary powers and processes to identify, scrutinise and take enforcement action where necessary. The non-domestic supply market includes a wide variety of different business sizes and sectors. As there is a high risk of unintended consequences, any potential regulatory intervention must be very carefully considered and evidence-based.

Regulatory interventions could hinder competition in the non-domestic energy supply market by causing unwarranted barriers to entry, or limiting customers' flexibility as to the range of products they can access. The UK economy has been through an extraordinary and sustained period of wholesale price shock, in the wake of the Covid19 pandemic and war in Ukraine. Energy UK urges Ofgem to ensure that regulation, of any sort, should not be reactive, and that any long term policy takes into account the wider context. While we appreciate Ofgem has a duty to ensure any reports of harm to customers are thoroughly investigated, it is important, that as a responsible regulator, Ofgem properly validates the concerns raised using a detailed analysis of the facts, supported by robust data.

Energy UK and other customer groups have consistently called for further regulation of third party intermediaries. Business customers can benefit from some focused regulatory support through the establishment of a robust regulatory oversight framework for brokers and intermediaries which makes clear how they must demonstrate that they are treating businesses fairly.

As regards extending the scope of definition of "microbusiness", we urge caution. We propose that Ofgem examines the potential wider impacts on the market and are transparent about the evidence on which any decision-making is based.

We consider that Energy UK's supplier members will be best placed to submit individual evidence to Ofgem on specific matters of the supply of energy to businesses.

The role of Government support

The role of Government support for business with the price of energy should not be understated. While energy bill support schemes remain in place for businesses, albeit at reduced values, their design and delivery need to provide confidence and certainty for non-domestic businesses and energy suppliers.

While wholesale energy market prices have improved, a weak or unpredictable economy in 2023 could have a very material impact on certain sectors, such as those dependent on customers' discretionary spend. This could lead to higher levels of insolvency in sectors that have already accumulated large levels of debt during the COVID pandemic. This is a poor outcome for the UK, for businesses and for energy suppliers. Energy suppliers want to see businesses thrive and grow.

Government can have a role to play to support the industry. If government support schemes are utilised, then we would recommend that careful consideration is given to the right levels of protection so that intervention is used to sustain and support businesses that are able to operate as an ongoing entity in the medium to long term. Any public money offered as support must be provided to businesses that are operating on a sustainable basis. We would expect to see that public money is not being provided to organisations that in any other circumstances will likely fail. Furlough was an example where Government support kept some businesses going that would have failed anyway, and once furlough stopped they did.

The Government may wish to consider other options to continue giving support to businesses in certain sectors during 2023. This could involve loans or credit facilities along the lines used by the government during the pandemic. Such support could in turn reduce the risk to energy suppliers, reducing costs for the business and therefore being able to pass through cheaper prices to the customer.

Pricing, contracting and behaviour

Suppliers must operate in a financially responsible and sustainable way, in a manner proportionate to the significant risk created by market conditions, while still ensuring customers are treated fairly.

Market Conditions

We consider that the non-domestic market is competitive and broadly operating effectively. Generally, market pressures within the non-domestic segment act as a balance and check mechanism to drive appropriate supplier behaviour. Suppliers are also seeing signs of the market returning to normal as stability and confidence return after a period of unprecedented conditions and customers are making choices based on different offers being presented.

The recent challenges for businesses reflect the prevailing market conditions, much as a result of external factors on the global stage. It is important to consider the bigger picture of the economic situation that the UK is currently experiencing, the operating environment and market conditions that businesses are operating in. While higher energy costs have undoubtedly been a factor in the increased costs businesses face, they are not the only factor, and any regulatory response needs to be proportionate and evidence-based.

Sector Risk

Certain business sectors have a much higher risk of debt and insolvency and as a consequence their energy supplier can accrue debt. Unless well-managed through appropriate risk management policies, this can pose a very serious risk of suppliers failing, leading to a cost on all customers and leaving fewer energy companies to supply businesses. Suppliers manage these risks in a range of ways. Some suppliers require a security deposit as part of their credit risk assessments. Security deposit arrangements to some extent can allow customers different options and access to competition as the risk approach one energy supplier takes may be different (higher/lower) than another supplier. Ofgem already provides guidance in this area which we consider to be sufficient. Another risk is that lower EBDS discounts and a potential period of weak economic conditions could further adversely impact certain business sectors and see an increase in the level of business debt and insolvency.

We urge Ofgem to support the work being done on exploring the development of a Government-backed trade credit insurance scheme and Energy UK will continue to support this work where we can.

Even with high-quality risk management strategies in place, there are a number of circumstances that often result in business debt building up. For instance, change of tenancy/occupier (COT) can be a very significant cause of bad debt for energy suppliers. This may be because the previous tenant does not notify the supplier that they have vacated the premises; do not provide a forwarding address for the business or the new tenant does not agree a contract with the supplier. The fluctuation of wholesale prices has resulted in an increased level of COTs. Non-domestic energy suppliers have expressed concerns that with scaled back support, this will become an increasing problem and that it is anticipated fraudulent COTs will also increase significantly. An example is where a business seeks to avoid repaying accrued debt, or seeks to escape agreed contract terms.

Supplier activities during the gas price crisis

Ofgem published its good practice guide for debt and disconnection in December 2022 which includes its expectations on security deposits. It is possible that businesses may experience an increase in the amount of security deposit being requested in comparison to previous years. This is due to factors including higher levels of commodity prices and the risk of non-payment. As a result, a security deposit of three months' consumption (as referred to in Ofgem's good practice guide) value is higher now than in previous years.

Energy UK is not aware of any evidence that there has been an inflation in energy prices linked to the EBRS rather than the underlying wholesale price or the company-specific risk of supplying energy. We see no justification at this point for Ofgem to consider price regulation in non-domestic energy supply. Energy suppliers acted quickly to implement the EBRS and have priced energy contracts in line with the wholesale market and the EBRS. There are licence conditions already in place to regulate how suppliers

set their deemed prices and as recently as this January, Ofgem completed two comprehensive requests for information (RFIs) to assess this.

Having said this, it may be possible for suppliers to take steps to improve the clarity and transparency of their charges and processes – such as deemed rates and contractual decisions – to business customers, as well as the support available to businesses. In 2019, Energy UK wrote to Ofgem referring to Ofgem's Evaluation of the Competition and Markets Authority (CMA) Price Transparency Remedy. This requires energy suppliers to make price information more easily available to microbusinesses through their own websites, or through Price Comparison Websites (PCWs). We suggested the provision of a central repository for microbusinesses to access suppliers' online quotation tools required by the price transparency remedy. We proposed that such a service could be delivered by Citizens Advice or similar body, providing a first stop for microbusinesses to browse the market. This would have the additional benefit of helping Ofgem to monitor and assure themselves that suppliers are complying with the requirements of the remedy.

More recently, non-domestic energy suppliers have been working with Ofgem on some reasonable expectations that business customers may hold when dealing with their suppliers. We have suggested these should be hosted on the websites of Ofgem or the Department for Energy Supply and Net Zero (DESNZ). We hope official authorities' hosting of this information will maximise its reach and the trust.

Opportunity for Ofgem's transparency about the regulatory impacts on pricing

We urge Ofgem to help business customers understand when and how pricing is affected by regulatory requirements. Significant changes are occurring to various network charges that will impact unit rates and standing charges for businesses. These include costs relating to Balancing Services Use of System (BSUoS) and levies including the Climate Change Levy. Further, April 2022 saw an increase in electricity standing charges for customers linked to the implementation of the Targeted Charging Review (TCR), moving residual rates from unit rates to standing charge.

Ofgem should examine where regulatory requirements have an impact on customers' bills and, with the regulator being the owner and trusted source of this information, set out easy to understand explanations on the Ofgem website. Suppliers' websites can then signpost customers to this information on the Ofgem website.

Deemed rates

Last year saw significant volatility in commodity costs which was subsequently reflected in suppliers' prices. This was primarily due to the war in Ukraine which has created the risk of European and UK supply deficits, as natural gas flows into Europe from Russia during 2022 declined to much lower levels than in previous years. Exceptionally high and volatile wholesale prices continued throughout 2022 as the market priced in the risk of market tightness.

Currently, energy suppliers must supply a non-domestic customer on deemed rates (or offer them contractual terms) when the business moves into a property. This in turn accrues a higher level of risk to suppliers in accumulating debt that will never be repaid. Deemed contract rates need to reflect the flexibility to the customer of the contractual arrangement; the associated risk to the supplier of not being able to hedge forward purchases with certainty and the increased debt risk from non-payment. In addition, we note suppliers cannot (under the regulations) object to a change of supply request for a customer under a deemed contract for an outstanding balance.

Deemed prices have also been impacted by an overall increase in industry costs as a result of previous regulatory policy decisions – relating in particular to BSUoS costs, as mentioned above, and Unidentified Gas. Further, the April 2022 TCR costs increase has driven up deemed rates.

In any assessment, Ofgem should consider the impact on deemed rates of wholesale price volatility, customer credit/debt risk and regulatory changes to network charges.

Suppliers' communication and actions to help customers

Non-domestic suppliers aim to provide high quality services to their business customers. Below are some examples from our members of their activities and approach to giving business customers the best service. Suppliers spend significant time and resource on customer communications and seek to provide clear and easy access on their websites to information about what a customer can do if they have an issue they need to resolve with the supplier. This would typically outline the steps that a customer can take if they are unhappy and who they should contact. Suppliers also:

- Provide other useful information to help customers such as signposting on their websites how customers can follow the recently-introduced third party intermediary Alternative Dispute Resolution (ADR) process.
- Communicate with customers in a friendly, straightforward and pro-active way to help them understand what support and advice is available.
- Seek to engage customers as quickly as possible in order to understand their circumstances and to provide appropriate support.
- Require customers to notify them within 30 days of moving to ensure the information held is up to date and customers are billed accurately.
- Reduce costs to customers (related to bad debt) by introducing processes to minimise the risk of fraudulent Change of Tenancy.
- Contact deemed and out of contract customers to ask whether they would like to sign up a fixed contract. Beyond this, a supplier may look at their internal processes to see if there is anything they can do over and above what is required of them to do to provide fair and cost-reflective pricing for deemed customers.
- Provide energy efficiency tips for businesses and enable them to get paid for saving energy, for example through demand-side response initiatives which allow customers to shift energy usage out of peak times to help balance the grid and get paid to do it.

Further regulatory intervention regarding supplier activities

Ofgem has conducted a comprehensive RFI where suppliers have self-assessed against Ofgem's good practice guide on debt and disconnection. Suppliers operating in the non-domestic market typically have mature and comprehensive debt and disconnection policies and procedures.

We stress that Ofgem has sufficient existing powers based upon existing supply licence conditions to hold suppliers to account in the event that there is evidence of company specific or systemic industry wide bad practice. Where warranted by the evidence, Ofgem should use its existing powers to carry out compliance and enforcement activity. We do not believe Ofgem requires any additional powers beyond those already held and that further regulatory change in the form of additional licence conditions are unwarranted and unnecessary.

We urge Ofgem to work in a transparent way that builds in opportunities for energy suppliers to respond to any specific criticisms levied on them (whether generic at market level or direct to an individual supplier) so that the full facts are understood and considered by the regulator in a balanced environment. Any changes to the regulatory framework, where required, should not be based solely on the poor experience of a minority of customers or the shortcomings of an individual energy supplier.

Energy UK considers that any industry-wide regulatory changes could constrain supplier innovation, differentiation and effective competition. If Ofgem believes that intervention is required, all of the facts and data used in making such decisions need to be made available transparently, clear and easy to understand. While we appreciate there have been accounts of poor behaviour toward customers, we consider that it is imperative that scale (depth and breadth) also informs regulatory approaches to the resolution of these issues. Particularly so, bearing in mind changes to the regulatory framework are likely to endure beyond the crisis.

Ofgem should also consider whether further regulatory change may lead to unforeseen, unwanted consequences, such as an increase in costs to businesses, which will be a factor in the costs of goods and services borne by the end customer.

Focused regulatory support for business customers

Third party intermediaries

The main segment of the non-domestic energy market that we believe should be looked into further is Third Party Intermediaries (TPIs) and the risks to non-domestic customers as a result of the absence of robust regulatory oversight in that sector. Energy UK has previously highlighted concerns in the non-domestic market over the lack of TPI regulation. Ofgem's Microbusiness review identified concerns over TPI behaviour but stopped short of progressing any changes in regulating this market.

In 2021, Energy UK wrote to the Department for Business, Energy and Industrial Strategy urging the ministry to work together with Ofgem to implement direct regulation of TPIs given the increasingly important role they play in customers' engagement with the energy market and the transition to Net Zero.

Regarding non-domestic customer harms, it is often not the larger businesses that experience the most detriment from any third-party actions, but the smaller businesses and microbusinesses – which, typically, do not have a dedicated Energy Manager responsible for energy related affairs. We suggest future regulatory framework should primarily focus on ensuring that smaller businesses are adequately protected from such harms when interacting with brokers or other TPIs.

In particular, the lack of transparency relating to the business models and commission made by TPIs is confusing and can cause harm across the non-domestic market. This could be easily addressed, for example making it clear at the point of sale that going through a broker will mean paying a given amount more than going directly to a supplier. We urge Ofgem to look to wider harms than just securing the lowest price for a customer, such as TPIs recommending supply contracts with no consideration of the suitability to that customer and their specific needs.

We suggest that any future TPI regulatory framework should ensure that every TPI entering and operating in the market can evidence that it has been established and set-up in the appropriate manner. This would be evidence that can be examined for its creditability and the TPI's fitness for operation in the market. This should act as a reasonable barrier to market entry to ensure that TPIs will treat customers fairly, and are both aware of and geared-up to meet their responsibilities. At present, voluntary codes of conduct do not go far enough and are not effective in protecting customers from such harms as they do not provide a legal basis for enforcement for non-compliance.

Energy UK urges Ofgem to review the future TPI regulatory framework, and ensure it has an appropriate body to monitor compliance. We note that Ofgem's guidance on Qualified Dispute Settlement Schemes places the burden on suppliers or TPIs to monitor these potential Alternative Dispute Settlement providers, rather than appointing an external compliance monitoring body. We are concerned that such an approach could result in an inconsistent application of accreditation and ongoing service provision.

The scope of the microbusiness definition

We note that Ofgem chose not to revise the definition of microbusiness in its recently concluded Microbusiness Strategic Review and if this is to be done now, we would urge Ofgem to transparently provide evidence as to why this is required at this stage but not prior to the gas price crisis. Energy UK is not aware of any evidence which would support the expansion of the microbusiness definition, or the creation of a new protected class of customer in the non-domestic market.

Regarding amending the existing microbusiness definition or introducing an additional protected customer segment against certain criteria, we urge consideration of the practicalities involved in suppliers' application of these criteria in consistently across the market. For example, suppliers would not have access to customer employee numbers or revenue data – were such points to be applied in redefining microbusiness. Any criteria should reflect data which is consistently recorded across energy

suppliers, or which could serve Ofgem or a third party in reliably identifying relevant customers and delivering such identification to energy suppliers.

Further, non-domestic energy suppliers would not have a contractual relationship with these end-users. The relationship is usually via a third party which holds a commercial contract with the supplier, and is responsible for activities including passing through Government support and providing for various relevant services. Suppliers are unlikely to hold sufficient or consistent data on non-domestic end users, where no contractual relationship exists between the parties, to facilitate equivalent monitoring and provision of services.

A diverse population of businesses is captured by the current definition, and caution is needed to avoid implementing policy which creates negative unintended consequences. Such consequences include constraining innovative offerings; diminishing the commercial attractiveness of market segments with prescriptive or onerous requirements; damaging competition and reducing customer choice.

We suggest that should Ofgem consider undertaking this work, it would warrant a standalone consultation, rather than being addressed solely in this broad call for input. This would allow Ofgem to conduct a cost benefit analysis and consider the possible impacts of broadening the scope of the definition. Matters we suggest Ofgem would have to consider carefully in broadening the scope of the microbusiness definition include:

- Provide clarity on what is expected for existing contracts.
- Provide clarity on definitions which can be applied universally across customers, suppliers and regulators. For example, an SME can mean various things from different perspectives.
- Provide clarity on whether new supply licence conditions would be needed, indicate what these may be and follow the normal consultation process.
- Ensure support organisations such as Ombudsman Services: Energy are adequately consulted and prepared for an expansion of what is required of them.
- Consider the impact on customers and suppliers of suppliers finding their microbusiness customer base expands overnight, leaving them having to re-examine their commercial offering.
- Consider the impact and cost of suppliers having to adjust systems.
- Consider transitional arrangements and time for changes to be implemented.

We urge Ofgem to provide the evidence and rationale before positing that larger SMEs are detrimentally impacted by not being classed as microbusinesses.

If you would like to discuss the above or any other related matters, please contact me directly on 020 7747 2964 or at candice.orr@energy-uk.org.uk.