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Retail Market Review
Response from Co-operative Energy Ltd

Co-operative Energy welcome the opportunity to comment on the proposals. As a recent new entrant we believe we are ideally placed to understand and comment on the issues faced by new entrants and small suppliers.

If Ofgem require any clarity or would like to discuss our proposals in more detail we would welcome such an opportunity.

Our response follows the question format outlined in the consultation document.

Question 1: Do stakeholders agree with our findings of the Review in relation to causes of persistent consumer harm and barriers to entry in the energy retail markets.

We agree that the following features are key factors that result in low consumer engagement and trust with the energy market:

- Complex tariff information
- Poor supplier conduct.

We also agree that the structural features detailed below combined with certain market behaviours also weaken competition:

- Sticky customers and large incumbent market shares
- Vertical integration and low liquidity
- Poor liquidity in wholesale trading market (and de minimis volumes too high for new entrants, non-standard products not available)
- Transaction costs
- Credit requirements
- Similar pricing and hedging strategies.

Proposal 1: Make it far easier for domestic consumers to compare prices and choose a better deal

Question 2: Do stakeholders consider that Ofgem should take action to reduce the complexity consumers face and enhance engagement with the energy market?

Yes

Question 3: Do stakeholders agree with our initial proposal for intervention to reduce the complexity consumers face and enhance engagement in the energy market?

Whilst we agree with the underlying issues identified and support the need to reduce the complexity of tariffs we believe the proposals could be improved to ensure delivery of the outcomes without causing unintended consequences, such as restriction of competition and limiting consumer choice.

Question 4: If not, then do stakeholders have alternative suggestions for proposals to reduce the complexity consumers face and enhance engagement in the energy market?

We fully support the aims of this measure and offer some enhancements to further increase its effectiveness.

Each supplier will have to nominate a single evergreen tariff which becomes its default tariff. This should be a "live" standard tariff with the lowest current charges (We acknowledge that whether a tariff has the lowest charges depends on the customer's consumption patterns, but this requirement is essential if customers are to be compulsorily migrated onto a default tariff). Any customer who has not actively chosen another tariff within the last 2 years will be defaulted to this tariff. This includes customers who choose a fixed term tariff, when the fixed term expires and they have not actively chosen a new tariff.

We believe the default evergreen tariff should have a standing charge and a single unit charge although our preference is that these should be set by the supplier. The reason for this is to allow for competition between suppliers and hence choice for customers.

We understand that one of Ofgem's objections to standard evergreen tariffs is that they can lead to suppliers exploiting customer inertia. We would therefore support the use of the annual energy statement to remind the customer of the current cost of the customer's chosen tariff, the cost of alternative tariffs provided by that supplier and the availability of accredited switching sites with which to compare prices in the wider market.

We believe that fixed term tariffs do not offer any greater prospect of consumer engagement than standard evergreen tariffs, notwithstanding the regular opportunity in theory for the consumer to renew or break their commitment. Experience from the domestic insurance sector shows that fixed term contracts have not led to significantly greater consumer engagement.

Suppliers should be able to offer alternative evergreen products, conditional upon them being 'no strings' i.e. without restrictions over term, exit charges, or any other form of penalties. This will allow products such as renewable energy products, and innovation over smart meters, or other innovations yet to be identified.

If suppliers were to be restricted to a single evergreen product this would restrict choice and hence competition, and exclude customers who choose evergreen products because of market innovation. We believe that it is not up to Ofgem or the industry to restrict customer choice.

The extensive market research we conducted prior to launching Co-operative Energy indicated that a very large proportion of the population preferred evergreen products and resented the pressure to purchase fixed term products. We are very concerned that these proposals as they stand would disengage and disadvantage these people, but with minor enhancements can we believe satisfy the Ofgem concerns (which we share) and benefit customers.

We would propose that as part of the switching sites' code of conduct the price comparison tables be separated between the default evergreen tariffs, 'no strings' evergreen tariffs and others such as fixed term. Presently, switching sites include all types of tariff in a single league table, which we believe is misleading.

We are concerned that if Consumer Focus is wound up as a government body there would be no independent and impartial organisation left to regulate the switching sites. We believe this function should be taken up by Ofgem.

There are a significant number of UK households who are either off-line and/or prefer to communicate off-line. It is these customers who are in need of the most help rather than the internet savvy who use the current range of switching sites and it is important that independent comparison advice is accessible.

We believe the current proposals need to be clarified to ensure that "white-labelling" is not restricted by the current proposal to restrict each licence to a single Evergreen tariff per payment type. This would not be in the interests of providing customer choice as under such agreements the products can be different to the "parent's" licence. Perhaps it would be better to ensure that each "white-labelling" entity is also subject to the same Evergreen restrictions.

To encourage suppliers being open and honest with their existing customers we propose that "win back" activity is restricted such that a losing supplier is not able to actively market to these customers for a period of 6 months. If introducing restrictions is unacceptable we believe that the losing supplier should only able to offer the appropriate "default evergreen" tariff.

Question 5: We are proposing to standardise evergreen contracts across suppliers. Do stakeholders agree with the proposed contents of the standardised charge?

As previously mentioned, we believe the standard evergreen tariff should have a standing charge and a unit charge although our preference is that these should be set by the supplier. The reason for this is to allow for competition between suppliers and hence allow customer choice.

Question 6: We are proposing to create a standardised metric to allow consumers to compare evergreen and fixed term contracts across suppliers. Do stakeholders agree with our proposal for a standardised metric?

See answer to questions 4 and 5.

Further to comments already made regarding the importance of engaging customers who are offline and/or prefer more traditional communications, we believe that suitably reformed, switching sites could be help by being available to offline customers. Their ranking results need to be more discerning of the different types of tariff and their commission arrangements should be transparent.

Question 7: Do stakeholders have any comments on the costs and risks of our proposal, or any alternative suggestions that you have put forward, to reduce the complexity consumer face and enhance engagement in the energy market?

The current proposals and our additional suggestions are at a high-level so more detail is needed to quantify the risks and costs. It is however possible to make some general comments:

- If the outcome is that small lean suppliers need to increase the number of tariffs they offer this could place them at a cost/efficiency disadvantage compared to the Big 6 who are likely to significantly reduce their total number of tariffs
- Lack of opportunity to innovate could dissuade new entrants and stifle new product offerings.

Proposal 2: Improve access to wholesale market products for new entrants and independent suppliers and generators

Question 8: Do stakeholders consider that low electricity market liquidity constitutes a barrier to entry in the domestic retail supply market?

Cooperative Energy agree that current wholesale market fundamentals act as a barrier to entry as domestic energy suppliers. The key points are:

- Inability to purchase the volumes required (de minimis levels are too high for initial market entry)
- Difficulties in managing shape through energy purchases – product diversity short-comings
- Cost of trading relatively high due to fixed infrastructure and transaction costs

Question 9: Do stakeholders consider that our two proposed interventions (the MA and the MMM) could improve the ability of the wholesale electricity market to meet independent participants' needs, and will ultimately improve the likelihood of retail supply market entry?

Yes we agree that the proposals should benefit small suppliers and attract new entrants. We do however have some proposals that should make them more effective in meeting their stated aims.

These proposals seek to specifically address the concerns of new-entrants and small suppliers on the one hand and wider competition issues on the other.

In order to remove barriers to entry for new-entrants and small suppliers we advocate a refined MMM proposal, while the wider market concerns might be met with a refined MA proposition.

The refined MMM proposal would, critically, only be available to participants with less than 100MW peak supply (inc Triad) to prevent gaming by larger players. The 100MW peak supply limit is an indicative proposal that would need further analysis to ensure the reasonable requirements of smaller suppliers are met. The total size of the MMM is kept small compared to the overall market (approx. 2%) such that larger players have no reasonable need to participate. Exclusion of larger players is important to remove any concerns over market manipulation. If the current proposal was implemented with the Big 6 having to place 10-20% of their volume into the market they would also have to be participants which would still leave concerns over potential market manipulation which would increase the risk on small suppliers/new entrants.

The MMM participants will need to register with OFGEM to enable trading (qualification) and OFGEM to conduct suitability and credit checks.

These checks may also determine how far forward the particular participant is permitted to trade. It may also be necessary to cap the purchasing volumes of individual participants in any given month to facilitate on-going liquidity, especially where further-than month-ahead is offered.

In order not to disadvantage the larger players who are required to submit volumes into the scheme, the total volume requirement for the MMM should not exceed the total requirement of registered participants (<100MW) plus some growth allowance (10%). Further, any "unsold" volumes can either be returned to the donating parties to support the principal of exclusion from bidding in the MMM or rolled into the MA proposal (below).

All entities with generation greater than 1500MWs should "contribute" to meet "the requirement" in proportion to their proportion of the total generation amount found by summing the generation capacity of entities with a capacity >1500MWs. This donation should also accurately reflect their own generation portfolio mix and should include related renewable energy products (e.g. ROCs, Lecs and Regos) where appropriate. These volumes should be provided as financial contracts (equivalent to their energy proportion), specifically as baseload and peak contracts with a ratio of 1:2.5 respectively. This stipulation places some of the risk/onus on the existing large generators to provide according to demand (i.e. some basic shape) and would generally be a constant fraction of their daily operation regime(s). Further, these volumes should faithfully represent a seasonal quality reflected by seasonal fluctuations in National Demand, These volumes would be "donated" prior to their relevant month (where they are active) as follows; 25% three months prior; 25% six months prior and 25% nine months prior and 25% 13 months prior – this permits the MMM to offer volumes to registered participants further forward than one month, which is vital for prudent hedging practices, business planning, etc.

The MMM fulfils the critical role of providing new entrants with the small volumes they require at start-up but also, critically dilute the burdensome additional costs of imperfect-shape-hedging and associated imbalance costs which a larger player can absorb or address more easily. Where these costs cannot be managed by small suppliers they usually manifest themselves as uncompetitive prices or reduced margins and therefore reduced business viability/sustainability.

The MMM would re-offer the contributed volumes as described with the following refinements:

- i) MMM provides minimum trading volumes of 0.5MW
- ii) MMM provides shape product
  - i. Hybrid domestic profile (existing National proportion P1 and P2) with monthly volumes set verses annual peak demand equal to 0.5MW
  - ii. Small/Micro Business (existing National proportion P3-P8) with monthly volumes set verses annual peak demand equal to 0.5MW
  - iii. Commercial and industrial Loads offered as peak and baseload blocks of 0.5MW in any month.
- iii) MMM provides peak block derivative products (e.g. 3A, 5B, 6A)
- iv) Registered participants offered term based on credit rating, e.g. bad credit can trade 1 month forward, good credit can trade 12 months forward.
- v) Fees associated (operational costs) smeared across all volumes – this should include likely high-volume trading by low-credit-worthy suppliers. This does not therefore penalise low-credit-worthy suppliers.

To address wider competition issues the MA proposal would represent the mechanism by which the larger proportion of "donated" generation volumes could be re-distributed competitively. If the MMM represented <2% of total generation contributed, the MA would deal with the remaining 8-18% (of the 10-20% proposed originally).

The MA would be open to all market participants.

All entities with generation greater than 1500MWs should "contribute" to meet "the MA requirement" in proportion to their proportion of the total generation amount found by summing the generation capacity of entities with a capacity >1500MWs. This donation should also accurately reflect their own generation portfolio mix and should include related renewable energy products (e.g. ROCs, Lecs and Regos) where appropriate. These volumes should be provided as financial contracts (equivalent to their energy proportion), specifically as baseload and peak contracts with a ratio of 1:2.5 respectively. This stipulation places some of the risk/onus on the existing large generators to provide according to demand (i.e. some basic shape) and would generally be a constant fraction of their daily operation regime(s). Further, these volumes should faithfully represent a seasonal quality reflected by seasonal fluctuations in National Demand, These volumes would be "donated" prior to their relevant month (where they are active) as follows; 25% three months prior; 25% six months prior and 25% nine months prior and 25% 13 months prior – this permits the MA to offer volumes to registered participants further forward than one month,
For example, volumes available up to 12 months forward at that particular auction-date as 100% of the volume for 1 to 3 months ahead, 75% volume for 4-6 months ahead, 50% for 7-9 months ahead, etc.

Volumes made available at auction would faithfully reflect the proportions they were donated in, with regard to peak/off-peak ratios, i.e. 1:2.5.

Question 10: Subject to the results of our further wholesale market assessment, do stakeholders consider that both interventions could be necessary to meet the objectives stated in questions 8 and 9?

Yes - The interventions are complementary and help to overcome different challenges faced by independent suppliers

Question 11: Do stakeholders consider that there are other intervention options we should be developing?

Yes, we believe that a key enhancement can be made to the original Ofgem proposals and the further recommendations we have made in response to Q9.

The present proposal is to establish MMM arrangements. We believe it would be beneficial to have the MMM function undertaken by an Independent Organisation (IO).

Such an IO would be better placed to ensure accountability and transparency. Further, a single IO charged with operating this scheme would have benefits associated with making and monitoring (small-participant) market activity (within its remit) and as a sole entity could be easily measured with regard to performance and the assimilation and distribution of reported data.

The ideal structure from a small participants perspective would utilise an IO (for the above reasons) which would be charged with offering "suitable products" in "suitably sized volumes" with minimal transaction cost at market rates with high frequency - thus, facilitating the responsible and cost-effective hedging of their portfolios at a competitive rate. The IO would be inaccessible to larger participants to prevent gaming (for example a large player purchasing all available volume to remove it from the market).

Small participants (<100MW peak (triad?) demand) would be required to register with the IO to enable trading and the IO to conduct suitability and credit checks.

In the interests of promoting competition any losses accrued to the IO (as well as operating costs) would be smeared across the Industry (at a unit rate level) – "competition levy." However, all offers made by the IO to small participants would be at market-based rates (at the time of offer), so as to minimise potential trading losses and to promote equity between all parties.

The sum of the energy requirement "deducted" ("the requirement") from the existing large market participants would equal the sum of the small participants requirements plus some "growth" allowance, say 10%. Any untraded volumes would be returned to the original donators in proportion.

All entities with generation greater than 1500MWs should "contribute" in proportion to meet "the requirement" in proportion to their proportion of the total generation amount found by summing the generation capacity of entities with a capacity >1500MWs. This requirement should be provided as financial contracts (equivalent to their energy proportion), specifically as baseload and peak contracts with a ratio of 1:2.5 respectively. This stipulation places some of the risk/onus on the existing large generators to provide according to demand (i.e. some basic shape) and would generally be a constant fraction of their daily operation regime(s). Further, these quantities will faithfully represent a seasonal quality reflected by seasonal fluctuations in National Demand, These volumes would be "donated" previous to their relevant month (where they are active) as follows; 25% three months prior; 25% six months prior and 25% nine months prior and 25% 13 months prior – this permits the MMM and MA to offer volumes to registered participants further forward than one month, which is vital for prudent hedging practices, business planning, etc..

The IO would receive these contracts and re-offer the volumes under the MMM scheme as described with the following refinements:

vi) IO provides minimum trading volumes of 0.5MW
vii) IO provides shape product
   i. Hybrid domestic profile (existing National proportion P1 and P2) with monthly volumes set verses annual peak demand equal to 0.5MW
   ii. Small/Micro Business (existing National proportion P3-P8) with monthly volumes set verses annual peak demand equal to 0.5MW

iii. Commercial and industrial Loads offered as peak and baseload blocks of 0.5MW in any month.

viii) IO provides peak block derivative products (e.g. 3A, 5B, 6A)

ix) Registered participants offered term based on credit rating, e.g. bad credit can trade 1 month forward, good credit can trade 12 months forward.

x) Fees associated (operational costs) smeared across all volumes – this should include likely high-volume trading by low-credit-worthy suppliers. This does not therefore penalise low-credit-worthy suppliers.

Question 12: On the basis that we could decide to take forward these interventions, do stakeholders have comments on the indicative design choices we have made, as set out in Appendix 2. In particular, views are welcome regarding our initial position on each of the following:

Volume requirements: 0.5MW min trade
Product requirements: shape products as much greater proportion of available volumes (MA<MMM). Buying baseload (or even a peak block) does not help a small supplier or new entrant as it just increases costs and acts as another effective barrier. New entrants/small suppliers need the majority of power available to be shaped or (short-duration) blocks.
Frequency: monthly reflecting seasonal volume variations (winter more than summer)
Governance arrangements: critical and real-time
Participation: Circa 100MW Peak (inc Triad) demand

Question 13: Do stakeholders have any comments on the costs and risks of our proposal, or any alternative suggestions that you have put forward, to take action to improve wholesale electricity market liquidity?

Our proposals should reduce the costs and risks for new suppliers without putting an undue risk on the existing system and market participants

Proposal 3: Make sure the Probe remedies are strengthened, and where necessary enforced, so that they achieve their original objectives

Question 14: Do stakeholders consider that Ofgem should strengthen licence conditions around suppliers' communications and interactions with their customers, to give suppliers less freedom in how they interpret these obligations?

Yes

Question 15: Do stakeholders consider that Ofgem should increase its monitoring and enforcement activity to enhance suppliers' compliance with licence conditions?

Yes

Question 16: Would stakeholders welcome the extension of some elements of the Standards of Conduct into domestic supply licence conditions?

In principle yes but would need to look at detailed proposals to evaluate the potential impact

Question 17: Do stakeholders agree that more needs to be done to improve consumer trust and use of switching sites?

Yes

Question 18: Do stakeholders have any comments on the costs and risks of any of our suggested policies under Proposal 3?

No comment

Proposal 4: Take further action to prevent unfair contracting practices in the non-domestic sector

Question 19: Do stakeholders consider that Ofgem should strengthen licence conditions to prevent unfair contracting practices in the non-domestic sector?

Yes

Question 20: In particular, would stakeholders welcome additional licence conditions surrounding the objections procedure?

Yes

Question 21: Would stakeholders welcome the extension of some elements of the Standards of Conduct into non-domestic supply licence conditions?

Yes in principle, but we need more details eg. for all non domestic customers or just the smaller non-domestic customers? The results of an impact analysis would identify whether such measure are proportionate.

Question 22: Do stakeholders agree with our position, at this stage, not to extend our proposals on tariff simplification into the non-domestic sector?

Yes but as for above question believe more detail is needed. It may be appropriate for the smaller non-domestic customers to benefit from similar support.

Question 23: Do stakeholders agree that Ofgem needs to look further at the role of third party intermediaries (TPIs) in the non-domestic market?

Yes – To ensure that non-domestic customers are getting the service they deserve the TPI market needs further research and action taking where appropriate.

Question 24: Do stakeholders have any comments on the costs and risks of any of our suggested policies under Proposal 4?

No Comment

<u>Proposal 5: Improve further the transparency in vertically integrated utilities</u>

Question 25: Do stakeholders agree with Ofgem's proposal to appoint a leading firm of accountants to review the transfer pricing and hedge accounting practices of the vertically integrated suppliers?

Yes – We fully support this.

Question 26: Do stakeholders have views on how Ofgem could improve segmental reporting in future years?

The review to be undertaken by the leading firm of accountants will help identify any outstanding market issues and therefore the necessary actions to overcome.

Question 27: Do stakeholders consider that our proposals will be sufficient to protect the interests of consumers, including vulnerable consumers, or are additional consumer protections measures necessary?

No Comment

Question 28: Do stakeholders consider that our measures to simplify tariffs will reduce the ability for suppliers to price discriminate between regions and so reduce the need for a licence condition prohibiting undue discrimination?

We agree that such proposals will reduce the ability of suppliers to price discriminate but as detailed in our responses we believe that there could be a number of unintended consequences and therefore we need to see further details (or the results of an impact analysis). However, we believe the case for action is well made and a desire for analysis should not used as an excuse to delay and/or stop the intended outcomes being delivered.