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Dear Mr Bojanowski

**Retail Market Review Consultation Response – Ebico Limited**

Ebico is a not-for-profit company established, in 1998, specifically to help the fuel poor. We are different from all other energy providers in that our gas and electricity tariffs (EquiGas and EquiPower) are the same price (nationally for gas and regionally for electricity) regardless of how the customer pays. Thus, our direct debit customers pay the same price per unit of fuel as our PPM customers. We also have no standing charge and no tiered pricing: we charge the same price per unit of fuel whatever quantity of fuel the customer uses. This helps consumers who use low quantities of energy (often those on low incomes in small dwellings).

In general we welcome Ofgem's initiatives proposed in the Retail Market Review.

We support the idea of a mandated auction of electricity contracts but believe strongly that, for a long-term solution to wholesale market illiquidity, it is essential that the auction is in the form of a day-ahead uniform clearing price auction to establish a national half-hourly reference price for electricity which will benefit all market participants and their customers.

We agree with the simplification of the number and form of 'evergreen' tariffs, but urge that, when considering the number of evergreen tariffs operated under a supply licence, Ofgem should give regard to the fact that a number of small energy providers have used the supply licences of other companies on a 'white label' basis as a means of overcoming the retail market's barriers to entry and so offering innovative tariffs to consumers.

We note the Government's wider proposals will offer assistance in price risk management to developers of low-carbon generation capacity. Applying this logic to the energy retail market, we believe that energy service companies (ESCos) which reduce the amount of energy consumed by their customers should, likewise, be offered price risk management assistance.

We do not believe that regulatory involvement in the provision of energy price comparison services is required, assuming the industry continues to make voluntary improvements to the Consumer Focus code of best practice. However, we do believe that there needs to be significant improvement in the transparency of the financial relationships in retail market door-step selling.

Our answers to the questions posed in the consultation paper are detailed below.

**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 consider that developments in the retail market have reached something of an impasse. The volatile nature of wholesale energy markets, with volatility driven by weather, illiquidity, lack of storage and links to oil and gas prices, means that risk management by vertical integration is the logical response as 'verticos' are able to mitigate a margin squeeze in one segment of the value chain by countervailing margin growth in other segments. Yet, this model has significant implications for consumers.

The market is very difficult to enter for non-verticos with much generation being either owned, or contractually controlled, by the Big-6. The resulting illiquidity in the wholesale electricity market results in even greater price volatility which, in turn, requires higher levels of margin to be lodged by the smaller, less well-capitalised, new entrants causing greater strain on their working capital.

From a Big-6 perspective, the domestic supply sector's high marginal cost structure results in there being limited upside potential. It is hard to achieve greater margins from each customer and difficult to gain significant market share without sacrificing margin. So a large incumbent will see the risks from radical moves on their part as all being on the downside. This might be expected to result in a conservative approach to pricing and product design.

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

We consider this step to be necessary but not sufficient to increase levels of engagement with the energy market. Ofgem's own study into likely behavioural aspects of the retail energy market, proposes that there are other psychological barriers that prevent consumers making rational decisions regarding their energy supply.

**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 welcome Ofgem's proposals for tariff simplification in general, we do have a specific concern. Ofgem proposes to limit the number of 'evergreen' tariffs that a supplier can offer to one per payment type. Ebico, as with some other small-scale energy providers, does not have its own supply licence but utilises the services of a licenced supplier to operate the tariffs on its behalf. This 'white label' approach to supplying customers is a particularly useful form of arrangement as it permits entry to the retail electricity market without many of the considerable up-front costs associated with equipment purchase, systems development and personnel training that are necessary for qualification under the various energy market codes and agreements. If the Ofgem proposal for a single evergreen tariff per payment type is applied at the level of supply licence, then white label energy providers will be precluded from offering such contracts. We are concerned that this will require white label energy providers to replace all existing contracts with fixed-term contracts. We believe that this would cause both unnecessary disruption and concern to customers, and to additional costs being incurred by energy providers. We believe that a simple solution to this potential problem would be for Ofgem to ensure that, when it reviews the number of evergreen tariffs supported by a licenced supplier, evergreen tariffs that are distinct from those of the licenced supplier and that the supplier operates under white label arrangements with commercially independent third parties, are excluded from consideration.

**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?

N/A

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

Yes

**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?

Yes

**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?

No

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

Yes. As described in our response to Question 1, in our view the low level of liquidity in the electricity wholesale market exacerbates price volatility which makes price and volume risk management more expensive for new market entrants which have significantly lower levels of capitalization than the Big-6.

**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. However, we believe that, for an enforced solution to the market's liquidity problems to stick and be more than a token exercise, it must also be useful to the Big-6.

In the case of the market-maker proposals, we believe that this service would offer the major physical players very little in terms of commercial benefits yet would place administrative, operational and procedural burdens on them. Given this balance of costs and benefits, we believe that it is unlikely that the considerable and sustained levels of commitment, innovation and co-operation that would be required of the Big-6 would be forthcoming. If the major physical players are required only to provide small volumes in small two-way clips to the market-maker, then, even if maximum bid-offer spreads are specified, knowing that the potential counter-parties will primarily want to buy would likely permit two-way prices to be set in such a way as to offer a premium over the wider market from the perspective of a potential purchaser. The market-maker's prices would, thus, become a 'ghetto' of small retailers who would otherwise be unable to participate in the 'regular' market. The market-maker's services would, then, fall into disuse. Insistence on larger volumes to back the market-maker market would likely be rejected on the grounds that it represented a requirement to take excessive commercial risk.

As regards mandatory auctions (MA) we are of the view that, with the exception of more extensive Continental market interconnection, a mandatory uniform clearing price auction represents the only viable route to greater market liquidity with the current market structure. Where we disagree with Ofgem's proposal is in regard to what, exactly, is to be auctioned. We believe that a mandatory day-ahead uniform clearing price auction covering each of the 48 half-hours, in reasonable volume (n.b. Ofgem's proposed volume requirment seems reasonable to us ), would establish a credible market clearing price for each half-hour if, in addition, Big-6 supply licences were amended to require of them a minimum purchase volume in the auction. The resulting market cleared price, based upon reasonable physical depth and half-hour granularity, would enable the development of a market for swaps and CfDs based upon this cleared price. We consider that the cashflow and settlement risk advantages of trading CfDs, as opposed to physical contracts, would prompt the development of a market in these financial derivatives amongst the major players. Settlement risk would be constrained to the day-ahead electricity flows only. Indeed, if the entity conducting the auction process were entitled to smear the cost of delivery/payment failure across all auction participants pro rata to their total volume, then settlement risk would be mitigated still further.

For the small supplier, guaranteed access to an auction would have considerable advantages in terms of securing access to volume. In addition, with the market clearing price established, non-physical risk intermediaries would be able to offer more tailored risk management products to small suppliers which could be suited to their individual requirements and, thus, conducive to new entrants in supply.

We are aware that Ofgem is seeking to mandate the auction of electricity in shape and tenure that will, in their view, be useful to small suppliers and, thus, the Regulator remains to be convinced by the idea of the auction of short term power contracts. However, mandating day-ahead auctions of 'prompt' power will give volume and price security to risk intermediaries who will, thus, be prepared to construct both physical contracts and CfDs in the shape, and with the tenure, that the customers for their risk management services require. By contrast, mandating, ex-ante, the shape and tenure of contracts to be auctioned monthly runs the significant risk that what is expected to be required is not that which, at the time of the auction, is required.

A compulsory auction of shaped contracts in clips small enough to be useful to small suppliers will be of little or no practical use to the Big-6. By contrast, re-establishing a half-hourly national reference price for electricity would enable the incumbents to reduce their own credit and settlement risk management costs with resulting benefits to their customers. Once the half-hourly auction is established, we can envisage a steady migration of longer-term contracting from a physical basis to a financial basis across the market, with the volume of the auction growing, voluntarily, beyond the minimum required by the Regulator.

DECC's Wholesale Electricity Market Review has proposed CfD arrangements for certain qualifying types of low-carbon generation (FiT CfDs). It is unclear what reference price these proposed CfDs would be struck against. We believe that such a FiT CfD reference price could be derived from a day-ahead auction clearing price.

**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?

Assuming a mandatory day-ahead auction is successfully implemented we do not believe that a mandated market making activity would be necessary.

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

If the number of participants in the electricity retail market is to be significantly increased, then the working capital burden for smaller players, represented by the need to lodge margin in price and volume risk management activities, needs to be reduced. For instance, a default insurance bond could be established to which all parties with greater than a threshold market share would be required to lodge pro rata to their supply volume. The resulting default insurance fund would be available to the wholesale contract counterparties of any defaulting party irrespective of their size. Whilst we accept that this would, in effect, be a cross-subsidy between larger and smaller market participants, such risk management cross-subsidies have already been proposed by the Government in their review of the wholesale electricity market. Specifically, in recognition of the higher cost of capital for developers of low-carbon generation caused by electricity wholesale market price volatility, the Government is proposing to introduce, for them, free price risk management in the form of CfD FiTs or Premium FiTs.

Given the Government's willingness to initiate price risk management subsidy arrangements to promote decarbonisation on the supply side of the electricity market, we believe it would be consistent and appropriate for it to do so on the demand side. New entrant energy service companies (ESCos) who are able to demonstrate that their objective is to reduce electricity usage (for example, ESCos offering Green Deal energy efficiency packages along with energy supply) should, we believe, be offered price risk management subsidies.

**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

Product requirements

Frequency

Governance arrangements

Participation

Platform

Not at present, but we would be happy to contribute to working groups established by Ofgem.

**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?

We have nothing further to add.

**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?

Until a review of the effectiveness of the other measures Ofgem propose is completed, we do not believe so.

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

Until a review of the effectiveness of the other measures Ofgem propose is completed, we do not believe so.

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

Until a review of the effectiveness of the other measures Ofgem propose is completed, we do not believe so.

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

We note and support the work done by Consumer Focus, in consultation with market participants, to improve the Code of Practice for internet switching sites. Given the progress being made by this industry-supported initiative, we do not agree that Ofgem should seek to extend its activities to this area at this time. However, we believe that, as another important customer information route, door-step selling would benefit from improvement to its reputation. We consider that the suspicion with which the door-step selling activity is viewed is a result of the opaque nature of the relationship between the agent and the supply company. We believe that, essential to the rebuilding of credibility in direct selling, is openness regarding the financial relationships between the agent and the supplier that they are representing. We do not believe that the imposition of disclosure requirements for information relating to sales relationships is, necessarily, a role for an economic regulator such as Ofgem. Rather, we consider that it is a logical continuation and extension of the 'code of best practice' work done by Consumer Focus – with Ofgem only seeking additional statutory powers in this regard if participants fail to respond.

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

We believe that Ofgem has sufficient powers to investigate possible licence infringements by suppliers and that the licence conditions are framed sufficiently broadly as to enable Ofgem to take effective enforcement action if necessary.

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

We have no view on this matter

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

We have no view on this matter

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

We have no view on this matter

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

We have no view on this matter

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

We have no view on this matter

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

We have no view on this matter

**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?

We agree

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

The transfer pricing arrangements between generation, trading and retail functions in each of the Big-6 are likely to be different. Establishing a standard transfer pricing arrangement, for the purposes of licence condition reporting, will represent a major step forward in financial transparency.

**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?

We believe that vulnerable customers are particularly at risk of doorstep miss-selling. Please refer to our response to Question 17.

**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 have no view on this matter.

Yours sincerely

Phil Levermore

Managing Director