

## Non-traditional business models (NTBMs) – Supporting transformative change in the energy market

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Minutes of the workshop held on Non-traditional business models.	From Date and time of Meeting Location	Jeff Hardy 23 March 2015 13:00 Ofgem	31 March 2015
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### 1. Chair

Jeff Hardy

### 2. Definition

2.1. There was broad support for the definition although it was noted that:

- growth of NTBMs could just transform the market, not necessarily the energy system; and
- the definition shouldn't serve to exclude 'traditional' businesses that are already in operation but that have the potential to offer non-traditional services. It was noted that the discussion paper didn't deal with this point in a consistent way.

### 3. Drivers

3.1. There was broad agreement with the drivers suggested but attendees noted a range of issues and additional drivers related to the development of NTBMs, including:

- Communities and individuals want to take more control of their interaction with the energy market.
- That there is significant pent-up demand for engagement from non-traditional market players, and that the enquiries that reach Ofgem are likely to only represent the tip of the iceberg.
- That some companies who could support market transformation are wary of getting involved in the energy sector for fear of tarnishing their core brand by association with a sector that has low levels of consumer trust and confidence.
- Conversely, the negativity associated with the existing market is being viewed by some as an opportunity to offer an alternative, particularly if it can move away from commodity prices.
- The opportunity for reduced fuel costs associated with new technologies and renewable generation.
- The potential for large non-domestic customers to improve their security of supply.
- The maintenance of an ageing infrastructure provides a high cost counterfactual to the costs associated with the growth of non-traditional models including local generation and distribution.

- NTBMs can offer better transparency and accountability to consumers.
- That there are a range of supply chain opportunities associated with the growth of NTBMs.
- That NTBMs offer an route to move away from the commodification of energy towards service based models.
- The need to recognise that there will be new offers in the market where energy is only one (maybe small) component of the overall service on offer.
- NTBMs emerging because incumbent arrangements don't allow for active participant nor for innovation in the diversity of participation/participants.
- That major global players such as Apple and Google could have a significant transformative effect if they were to enter the market.
- International trends offering enticing models that could be replicated.
- Increased availability of investment in new technologies.

#### **4. Understanding of NTBMs**

4.1. There was broad agreement on the characteristics that were proposed in the discussion paper although attendees also noted:

- The need to emphasize "niche-ness" and the recognition that businesses might not look to expand beyond their core business offer or consumer base.
- However, it is also important not to assume they are a homogenous group, there are organisations who will be thinking more mass market.
- That it was important to recognise that the characteristics proposed are framed by what's possible within current regulatory and policy frameworks rather than what might be possible. For instance, the CE business model is largely a FIT prescribed business model, rather than what CE might want to achieve.
- That there is a need to recognise business and industrial prosumers.
- There is appetite amongst public authorities to take ownership of distribution assets either as IDNOs or to purchase networks from DNOs.

#### **5. NTBMs within current regulatory arrangements**

5.1. There was broad agreement to the regulatory issues identified within the discussion a paper although attendees noted some additions, including:

- That the paper overlooked gas shipping and that the lines between gas shipping and supply get blurred.
- That obligations placed on suppliers (eg the smart meter roll out, faster switching) can have the effect of stifling innovation as it leaves no market space for alternative niche offers to develop.
- There are issues associated with using centralised/standardised regulatory approaches for an increasing decentralised energy market and for the roll-out of

mass energy efficiency activities. Regulation needs to balance consumer protection and leaving space for innovation.

- Heat, particularly heat networks, has growing importance in national energy policy but there isn't the same regulatory framework as for other energy (such as electricity and gas).
- That EU level regulation is overlooked, and that the impact of developments including the Energy Union and the drive towards greater inter-connectivity and storage need to be recognised.
- That the impact of financial regulation needs to be recognised.
- That requirements for such things as next day switching makes assumptions that suppliers have automated systems or the capacity for supporting weekend working, which will not always be the case for small niche suppliers.
- That the pace of regulatory change creates instability, and that the layers and complexity of both the regulatory framework and the market make it a challenging place for new entrants to navigate.
- It was also noted that non-traditional business models might require non-traditional regulation. Alongside this it was suggested there is a need for educative and training support for NTBMs seeking to enter the market.
- Energy system/regulatory complexity act as a barrier to engagement and innovation.
- Many of the models described in the discussion document might require more strategic system oversight: for examples DNOs might need to become more like distribution system operators (DSOs).

## **6. Market effects of NTBMs and future challenges for regulation**

6.1. Attendees provided a wide range of comments on the potential costs and benefits of NTBMs, and considered the transformational effect of NTBMs, and the regulatory challenges that this would entail. Specifically it was noted that:

- Security of supply was missing from the assessment of risks and benefits, with the potential for new smaller market entrants to face increased risk of business failure.
- There are challenges in assessing the benefits of NTBMs when the current framework is set up in the favour of the status quo.
- The wider costs and benefits should include consideration of wider and enhanced competitiveness, increased consumer choice, as well as the potential impact on conversion losses and the challenge of integrating different energy products. There was a desire for system wide assessment approach.
- Ofgem's sustainability duties and the requirement to consider the needs of existing and future customers should allow for the differentiation of the long term costs and benefits associated with the growth of NTBMs.

- That it is important to consider the question of what success looks like and select the appropriate metrics for evaluating progress – cost might not be the right value measure.
- There is not necessarily enough network capacity to accommodate increases in local supply.
- The current arrangements do not accommodate locational pricing.
- The issue of environmental programme costs being socialised through bills or through taxation was raised. It was suggested this can lead to perverse messaging, lack of clarity for participants and affect the development of business models.
- New business models are forced to justify their existence in a way incumbents are not. At the same time, a regulator cannot be expected to redesign the system on the basis of a 'hunch'.
- Assessing benefits on the basis of small number/scale of models is difficult. Consideration should be given to how best to 'bundle' a number of reforms together in one place to provide a test bed for NTBM approaches to be tested (one example given was a test bed for local energy markets).
- Not all new entrants to the market are innovative.
- Enhanced consumer choice must be seen as a key benefit.
- A step change needed in the way that energy is described. Is it an essential service or a means of revenue generation? Current system designed to reward energy provision rather than the provision of energy services, such as thermal comfort.

## 7. Other Points

7.1. Attendees were invited to raise any other points for consideration. Key issues raised included:

- That consideration of security of supply should query the assumption that consumers expect or demand to be connected to electricity at all times and should question how far future generations might view their entitlement to energy supply.
- Every regulation stops something from happening, even in a consumer space where consumers might be prepared to take risks.
- A move to more principles based regulation could deliver potentially significant gains but it will require potentially significant change in mind-set (for regulated parties as well as the regulators) – and that it needs to provide space for business to innovate where consumers are prepared to take risks. It was noted that definitions of what is 'fair' changes over time.
- That we need to better understand customer needs and wishes. There seems to be an assumption that all customers are the same but NTBMs are all about

choice. For example some customers may be prepared to pay more for local – like paying more at a local shop.

- Some consumers may be willing to take risks and accept different levels of protection (eg intermittent tariffs). Vulnerable consumers must always be protected, but this should not prevent market innovation for more informed/engaged consumers. Rather than universal, can differentiated services be allowed?
- That 'new' doesn't mean 'non-traditional' and to recognise that traditional businesses are also capable of innovation and change to offer more non-traditional services.
- Ofgem should take an explicit stand on whether energy is viewed as a commodity or an essential service to society. This will have a big impact on how the discussions on NTBMs are framed.
- The regulators need to be prepared to make a change in mind-set from dictating a number of hoops to be jumped through to one that says 'why not'. Identify the possible risks and weigh them up against the benefits.
- There is a huge amount of research (nationally and abroad) related to these themes; Ofgem should set-out what resources are being used to progress NTBMs thinking.