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Non-traditional business models: Supporting transformative change in the energy market

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

EDF Energy is supportive of a regulatory framework that facilitates market access for all parties seeking to adopt innovative approaches including a non-traditional business model (NTBM) that delivers desirable benefits to consumers. As an overriding principle, it is vital that any regulatory measures designed to further innovation in the market, including facilitating entry by NTBMs, does not confer any competitive advantage to any party, ensure proper market functioning and continue to protect both the short and long-term interests of all energy consumers.

Ofgem's role

We agree that it is appropriate for Ofgem to keep under review the regulatory framework in order to ensure that unnecessary regulation is not standing in the way of innovation through for example NTBMs, or indeed the development of innovative products and services by existing market participants. We agree that a market that facilitates innovation and new entry has the potential to deliver real consumer benefits, promote greater engagement and deliver other wider environmental and social benefits. However, it is vital that Ofgem's role is seen as one of facilitation and not one that seeks to actively promote new business models as an alternative to the models already adopted by incumbents. Furthermore, it should not be Ofgem's responsibility to ensure that all business models succeed; market entry and exit are standard features of healthy markets.

Existing regulatory framework

EDF Energy believes that wholesale and retail energy markets, and the way that participants including ourselves compete, are fundamentally shaped by regulation. We believe that a stable and predictable regulatory framework that is designed to promote competition and protect consumers' interests will create the right environment for new entry and investment in energy markets.

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Ofgem's focus in its consultation paper is on regulatory issues that may affect future market transformation and the emergence and viability of NTBMs. However, we believe a more appropriate starting position would be to conduct a fuller review of the existing regulatory model. Such a review, that applied the Better Regulation principles which require regulation to be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed, would introduce greater benefits for existing and future market participants and ultimately consumers.

An overriding principle of any regulatory framework should be the creation of a level playing field where all market participants are subject to the same rules and free to compete in a fair manner irrespective of their size or business model. Differential treatment for specific business models, through exceptions or special rules, should on the whole be avoided. Such exceptions can lead to the provision of subsidies, through for example the avoidance of costs, and the creation of an unfair competitive advantage.

We believe a full scale review approach of the regulatory framework, consistent with the principles outlined above, should be the starting position for Ofgem. We believe such an approach will introduce greater benefits to both market participants and consumers as opposed to one where Ofgem attempts to second guess what business models may evolve in the future and seeks to adapt the existing regulatory model in order to accommodate such models.

Principles based regulation

In a market which has inherently complex operational rules and where sometimes competing and complex regulatory objectives need to be addressed, it is inevitable that levels of prescriptive regulation will be a continuing feature of energy markets into the future. In light of this it is therefore essential that reviews of existing regulations (and the introduction of any new rules) are subject to the Better Regulation principles as outlined above.

Prescriptive regulation can lead to problems when it is overly complex, voluminous and intrusive. For example, it can impede the development of innovation, both in terms of products and services for customers, and in terms of business models, where the innovation does not "fit" the model envisaged by the regulator (and is codified in the prescriptive regulation). Ofgem has stated that the introduction in 2013 of Standards of Conduct within the supply licences was a critical first step towards greater reliance on regulation through general principles and that over time, it wanted such principles-based regulation to replace the more detailed and prescriptive standards that are currently in use. We are supportive of Ofgem's desire to duly consider the extent to which prescriptive regulation can be reduced and replaced where appropriate by principles based regulation.

Consequently, we are keen to understand how Ofgem plans to undertake this review, including on such matters as timescales, pre-requisites and licence review, etc. We believe that a review of this kind provides a real opportunity to address aspects of the current regulatory system which are potentially affecting the emergence of innovation and market entry.

'Standard Business Model'

We believe the perception that the market is dominated by a 'standard business model' is incorrect. It is important to acknowledge that there is already variety in the business models adopted by existing market participants and that there is evidence that parties are actively seeking opportunities to differentiate themselves from the competition in terms of products and service, subject to the degree to which that is permitted by the regulatory framework.

EDF Energy regards itself as a challenger brand - challenging the status quo through, for example, consistently lower than average pricing, innovation (e.g. through our Blue+Price Promise) and social initiatives. We are incentivised to do so by virtue of the fact that in the retail sector historically we were materially smaller in size at the domestic level compared to some of our main competitors. We want to be able to compete fairly for customers of our competitors and grow our business and consistent with such an aim we have taken many steps to further engagement and enhance our reputation. Consequently, any assessment of how regulation can better accommodate energy market change should take a 'whole market view' and consider how both existing and new market participants can be provided with the scope to develop innovative products and services that have the potential to deliver real benefits for consumers.

Third Party Intermediaries (TPI)

It is worth noting that many of the models referred to within the consultation would fall within the definition of a TPI between customer and supplier. The development of TPI activities in the non-domestic supply sector is an example where services to consumers have evolved outside the scope of regulation. However, in this instance this has led to concerns (shared by EDF Energy) around the extent to which consumers are receiving a standard of service that is consistent with the requirements placed on licensed suppliers via the Standards of Conduct. Due to such concerns, Ofgem proposed to enhance the current regulations in order to improve the standards of behaviour in the non-domestic TPI market. We believe this example demonstrates the importance of having appropriate, robust regulation in place in the first instance prior to any consideration as to how possible future market entry models could be accommodated within the regulatory framework.

Industry Codes

As part of our submissions to the CMA's energy market investigation, we have argued that although the current system of industry codes is complicated, we are not convinced that this is a barrier to entry or competition as evidenced by the entrance and growth of new suppliers. We also note that a 'licence lite' framework has been developed as means of addressing the issues around code compliance for prospective licensees.

That said, we agree that there may be scope for further standardisation of code processes, and rationalisation between codes which would benefit all new and existing parties to the Codes. This would enhance competition and would likely be of particular benefit to smaller market participants, who have fewer resources to devote to participating in Code

developments. We would support any reform that resulted in a lessening of the regulatory burden, while recognising the following:

- The codes deal with the fundamental issues to do with the rules and systems for participating in the market and as such there is a great deal of the content of the existing codes that is necessary.
- There is a balance to be struck between how much rationalisation can be achieved, and how disruptive that process would be. Reforms that involve rationalisation of the content of codes, and potentially combining some of the codes and code administration, are most likely to be cost and resource-efficient if they can be delivered alongside other significant industry developments.

Future developments

Ofgem's development of a smarter markets regulatory framework is an important development in the promotion of consumer engagement and empowering consumers to make the right the decision for their individual needs whilst at the same time ensuring that there remains scope for market innovation to secure the relevant benefits. In particular, the roll-out of smart metering and the development of Midata are already providing an impetus for market innovation. In this respect, we would question the degree to which Ofgem should be attempting to predict what form such innovation will take and alternatively suggest instead that it would be better to allow the market to evolve innovate and address any identified regulatory concerns as they arose.

Further challenges

Finally, we would like to draw Ofgem's attention to two issues that have not been captured by the consultation. Firstly, there is no reference to EU regulation and the extent to which significant new initiatives and changes to GB market rules are resulting from EU policy and how these may potentially impact innovation and market entry. Secondly, it is possible that new business models may involve cross market (non-energy) elements and so Ofgem needs to consider if, and how, it can consider the full impact of energy regulation on such models and the other markets in which they operate.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact Steven Eyre on 01452 653741, or myself. I confirm that this letter may be published on Ofgem's website.

Yours sincerely,

A handwritten signature in blue ink that reads 'Paul Delamare'.

Paul Delamare
Head of Customers Policy and Regulation