

Energy UK response to Ofgem discussion paper on non-traditional business models (NTBM)

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1. Introduction

- 1.1. Energy UK is the main trade association for the energy industry, representing over 80 energy generators and suppliers of all sizes. Our members supply gas and electricity and provide network services to both the domestic and non-domestic market. Energy UK members generate over 90% of energy capacity in the UK market which supplies 26 million homes and contributes over £25 billion to the UK economy each year.
- 1.2. Energy UK welcomes Ofgem's consultation on non-traditional business models (NTBM). We strongly believe that a competitive energy market supported by stable and independent regulation can foster trust in the industry and support innovation to deliver sustainable, long-term benefits to consumers.

2. General remarks

- 2.1. The retail market has seen significant growth. According to Cornwall Energy¹, there are now 27 suppliers in the market offering electricity, gas or both – an all-time high. Of these, 22 are dual fuel suppliers, up from 18 in 2014. Compared to other similar sectors, the energy sector has a range of businesses competing for customers.
- 2.2. It is important that all market participants are able to compete on a level-playing field. A stable and effective regulatory regime that promotes competition is fundamental to achieving this. It provides a framework for competition to thrive and a backstop for when competition cannot be used to deliver certain outcomes.
- 2.3. Ofgem's discussion paper is a welcomed opportunity to begin an industry-wide discussion to assess the current regulatory framework and the changes that are potentially needed to accommodate future market developments. We note that Ofgem has made statements of transitioning towards a more principles-based approach to regulation and would welcome further engagement with Ofgem on what this would look like and how it is best implemented. Central to this should be government's own principles of good economic regulation.
- 2.4. It should also be noted that there are various streams of work already underway within Ofgem and DECC on areas covered by this discussion paper. For example, the work on smart grids under work stream 6 of the Smart Grids Forum and the small suppliers work programme that is jointly led by DECC and Ofgem. The Competition and Markets Authority is also completing its own investigation into the energy market. It is important that any work from this consultation is joined-up with and complementary to existing work already underway.
- 2.5. Energy UK is not best placed to respond to all of the discussion points raised in the paper. Below we set out our initial views around the following themes: the definition of NTBMs; market

¹ Competition in British household energy supply markets: an independent assessment, Cornwall Energy, April 2015.

drivers, engagement with Ofgem and the impact of current and future regulation. We welcome further engagement with Ofgem as their work in this area develops.

3. Definition of non-traditional business models

- 3.1. The discussion paper states that NTBMs have the potential to transform the energy market and the way in which regulation may impact these NTBMs both now and in the future. It sets out a proposed definition of what is a NTBM, which is:

“Business models offering new products or services, or new ways of delivering these, that are different to those traditionally provided in the existing energy market. Those offering such services have diverse motivations (technological, social and environmental as well as financial) and ownership arrangements, and operate at various scales. Over time NTBMs have the potential to transform the existing energy system.”

- 3.2. While we appreciate the intention behind defining a NTBM, there is a risk of confusion by oversimplifying the energy market into two camps of traditional and non-traditional. The paper acknowledges that what could be termed ‘non-traditional’ includes existing market players that may service particular groups of customers. It is also worth bearing in mind that new models/entrants can come from across the market and may not necessarily be new businesses, but established organisations looking for new business opportunities.
- 3.3. Policy and regulatory requirements on particular suppliers have also encouraged market diversification, so it is arguable to whether it is possible to have a ‘traditional’ business model.
- 3.4. Rather than focusing on particular types of business models, we suggest a better way of framing the discussion would be to consider how customer propositions and service offerings are evolving, will continue to evolve and what implications this has for the regulatory framework and wider energy system, both now and in the future.

4. Drivers for market entry and types of business models

- 4.1. We agree with the three broad categorisations of business types set out in the paper. The long-term trajectory to move to more low-carbon sources of generation, an increased proportion of decentralised energy and the transition to a smart energy system are important changes to the market that we believe will bring forward innovation in customer propositions. The discussion paper sets out a number of drivers for entry into the market which we broadly agree with, although we would like to highlight three areas that are not specifically mentioned in the paper:

4.1.1. **European policy** – the paper notes the carbon reduction ambitions of the UK, however the direction of European policy will be critical, particularly developments around the Energy Union which are likely to impact on the development of new products and service.

4.1.2. **On-site generation for large intensive users** – the paper makes reference to energy service companies and the use of energy contracting which is more prevalent in the non-domestic sector. With an increasing focus on decentralised energy, there could be an increased interest in on-site generation and consumption by large intensive users.

4.1.3. **Collaboration between organisation** – as well as new entrants into the market, new customer propositions and services may result from collaboration between different participants (including non-energy businesses) looking to use the strengths of their respective businesses to develop new services.

5. How can Ofgem engage better

- 5.1. It is important for there to be a trusted and collaborative relationship between the regulator and industry. Energy UK continues to call for the creation of a dedicated policy interpretation and advice function to help all suppliers, but particularly new entrants, to ensure they fully understand the policy intent behind specific regulations.
- 5.2. For a new entrant, particularly a small organisation with limited resource, the ability to engage with continual development and change within the energy industry is challenging. Energy UK believes that a dedicated policy interpretation and advice function would assist *all* suppliers in delivering Ofgem's desired outcomes and could be particularly important in building trust and understanding if Ofgem intends to move towards principles-based regulation.
- 5.3. We welcome the initial steps that have been taken to improve engagement with both DECC and Ofgem through the introduction of small supplier champions. We have also found that the open workshop-based approach Ofgem has been using when developing its policies useful, particularly with the early stages of policy development. In order to deliver the ambition to move to principles-based regulation, a collaborative and trusted relationship with the regulator is essential.

6. Issues arising from regulatory framework

- 6.1. The paper identifies set up costs, regulatory compliance costs, supplier obligations and code compliance as four discrete areas which may have disproportionate impacts on smaller market participants and NTBMs. The introduction of a policy interpretation and advice function within Ofgem would be a positive step forward in helping participants to better manage these impacts.
- 6.2. As noted in the discussion paper, the Competition and Markets Authority are leading a market-wide investigation that will report on its provisional findings this summer. Energy UK does not have specific comments on the areas covered by the investigation. Our members may provide specific comments in their own submissions.
- 6.3. Evolution of business models and customer propositions in the energy market introduce new questions about how a future regulatory framework is managed. Changes will be required to the regulatory framework, including industry systems, to ensure innovation is not precluded. In this respect, it is important that Ofgem considers how the governance structure of the market evolves to ensure a level playing field for all business models.
- 6.4. More broadly, we do have some general remarks on the regulatory framework:
 - 6.4.1. **Retail Market Review (RMR):** the retail market has recently undergone a significant change as part of the RMR, restricting the number of products that a single supplier can provide. Since these regulations were introduced, there have been a noticeable number of derogation requests approved by Ofgem, which could be a sign that the current regulatory framework is limiting and constrains innovation.
 - 6.4.2. **Demand side response and flexibility:** we agree that the provision of demand side flexibility may require changes to the regulatory framework, particularly with regards to ensuring a level-playing field, and clear roles and responsibilities amongst market participants especially where the actions of one participant affects another. For example, in a future smart grids world, there could be opportunities for new products and services, and for actors that may not have directly engaged with energy consumers before.

- 6.4.3. **System-wide impacts:** Diversification of supply and consumption has introduced new market opportunities, providing customers with wider choice and supporting innovation. It is, however, important to consider how these adaptations are managed and integrated, particularly any system-wide impacts. An increase in the number of market participants and customer propositions will lead to increased market complexity. The government and regulator will need to consider how the energy system adapts, including changes to industry systems.
- 6.4.4. **Devolution:** subsequent to the May 2015 General Election, Ofgem will need to consider potential impacts of further devolution on the GB market.
- 6.4.5. **Direction of regulatory framework:** Ofgem has stated on a number of occasion that in the long-term, the energy market should transition away from prescriptive licence conditions to a principle-based approach. Principle-based regulation could be effective provided it is designed appropriately. We believe that this would be a significant change in the regulatory framework that must be fully thought-out. We would welcome further engagement with Ofgem on its proposals and would be pleased to meet and discuss how we can best input into this work stream.

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