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

Dear Jeffrey,

Thank you for the opportunity to review and respond to this discussion paper. Please find enclosed a summary of our view on the questions you asked.

We found the aim of the discussion and some of the questions asked quite vague and open to interpretation. Therefore we have answered the questions as we have interpreted them but we believe there could have been further clarity on some of these questions.

Overall, we feel that Ofgem have covered most of the types and drivers of Non-Traditional Business Models (NTBMs), however, we believe that the inclusion of Traditional Business Models (TBMs) doing something different (be it an innovative proposition, or affinity, for example) is a key component, and so the definition must not be limited solely to new entrants in the market. It is also important to note that the landscape of NTBMs will change, and the categories that Ofgem have outlined in the paper may vary as we see more in the market.

We also feel that Ofgem have identified the Regulatory issues, however, with respect to the issues for smaller scale NTBMs, we would point out that the market as it is does broadly support the development of small suppliers with NTBMs, as we see smaller suppliers entering. The main blocker to NTBMs thriving at the moment (for new and existing suppliers) is the restrictions that RMR rules place on suppliers. RMR can be overly prescriptive and requires a default way to market to a customer. NTBMs often require tailored products for their customers, and as TBMs innovate also, there would need to be more flexibility to allow inclusion of these new products or tariffs. In order to allow for greater innovation in the energy market, there should be some flexibility in regulatory arrangements, and this should be a high priority in any future regulatory change. We also believe that it is vital to ensure a level playing field for NTBMs (both new entrants and existing suppliers developing NTBMs).

While we agree that NTBMs will likely bring benefits and potential transformation to the energy and heat markets, they do also carry risks, and we've outlined our thoughts on these in detail below. We feel that the largest risk is around customer protection in the future energy market, which may become more difficult with the growth of NTBMs – particularly the devolution of the supplier hub. In future, customers will have the potential to be in contact with a broader range of counter-parties, which may leave them open to further risk, particularly as Ofgem do not currently regulate all of them. We'd like to stress the importance of considering how the customer will be protected from these, and what Ofgem's role will be, as NTBMs grow and develop.

Please do not hesitate to contact me with any questions you may have, or to discuss anything further.

Yours sincerely,

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1. What is your view on our definition of non-traditional business models?

Defining a NTBM is difficult, since there are many different types, and these could change in the future. We welcome the broad range of activities under consideration, both on the supply and demand side. With regard to Ofgem's definition (as outlined in paragraph 1.5), we would note the following comments.

There is currently uncertainty in what the market will look like in terms of Traditional Business Models, specifically with regard to the CMA investigation, which should be considered in this definition. There will also be examples of NTBMs which we haven't seen yet, and these may sit outside of those that Ofgem have identified.

The definition of a NTBM in the UK could change depending on EU regulation affecting UK markets. For example, a change in EU legislation which affects how we do business in the UK could mean that a NTBM previously placed in one category, may technically fall into another as the change is implemented. This level of uncertainty in the market should mean flexible definitions of NTBMs.

The discussion paper also appears to be focussed on small suppliers and the relationship with domestic customers, there is little on how NTBMs could and are being used to drive innovation and choice for business customers, such as the existing market for Demand Side Response (DSR) services.

There are examples of NTBMs involving a relationship between larger and smaller suppliers, such as White Labels, License Lite and Affinities, whereby a larger supplier is supporting a new entrant in a NTBM relationship.

The definition and types of Non- Traditional Business Models should also include a situation where different market participants (which can include two larger suppliers) collaborate in a relationship that plays to the strengths of each. Each participant brings different skills, and therefore takes responsibility for the related responsibilities in the Business Model.

A good example of this is npower's relationship with Telecom Plus, which utilises the strengths of both parties in a Non- Traditional working relationship. We would be happy to discuss this further with Ofgem if desired.

2. We would like to hear your views on the drivers for market entry. Do you think there are other important drivers?

We believe there are other drivers for market entry of NTBMs that aren't covered in the report, and have outlined them below. We would also highlight that the order of importance of these drivers will vary depending on the current political climate and customer focus.

- **Commercial drivers:** many NTBMs have grown due to an opportunity to make money that exists in a particular part of the market.
- **Customer desire:** many customers now want to see innovative solutions in the utilities space, particularly as technological trends become ever more intelligent. NTBMs are providing solutions which match to these needs.
- **Choice:** customers want more choice that reflects their own personal views and values (e.g. focus on low carbon or vulnerability), and this has driven the growth of NTBMs
- **Growth of Non-traditional sources of capital:** as non- traditional sources of capital have increased, for example crowd funding, increased obligations (i.e Community Benefits Funding) and not for profit organisations, business models have evolved to use these. This is another driver for the entry of NTBMs.

3. Do you have any thoughts on the characteristics and types of NTBMs?

We have outlined our thoughts on characteristics of NTBMs in question 1. It is important that Ofgem includes organisations with 'traditional business models' that are also developing non- traditional business models in any future work on this subject.

4. We recognise that there are relevant issues within current regulation. Please let us know if there are any other issues?

We would like to highlight that in many cases, the energy market as it is currently, has encouraged and facilitated the growth of NTBMs, as there are already examples in the market – such as Utility Warehouse. We're also pleased that Ofgem currently offers suppliers the opportunity to apply for derogations within current market rules to do this. However, we would note that the derogation process can be time consuming and can cause delays to the launch of innovative products as the regulator has to validate the proposal against RMR rules.

We do believe that in the future, as NTBMs evolve and grow, there may be further issues within the current regulatory framework that could act as a barrier to their success. Our comments on the points made by Ofgem are shown below. We have also included additional examples within current regulation that could be classed as barriers to the entry of NTBMs into the market.

4.7. Organisations using NTBMs may be small both in terms of their size and the communities they seek to serve. Regulation is a 'cost of doing business' for all participants, but its complexity and costs can be more of a burden for some new entrants and smaller participants. These businesses often have lower customer bases over which to spread these costs, less resource and fewer staff to engage with regulatory developments and compliance, and limited energy industry-specific expertise.

We do not think entry into the market is particularly complicated or costly; however it can be a lengthy process. The availability of products such as 'Supplier in a Box', however, enables market entry and makes this process easier for new entrants.

A move to more principles based regulation may also enable development of NTBMs and new, innovative products, which would mean that as new starters and incumbents begin to develop non- traditional propositions and business models; they are able to do so in a less prescriptive environment.

4.9 Although new entrants are emerging in Non-traditional business models, in the retail supply space, supply is mostly delivered by a small number of vertically integrated companies...Some argue that the sheer size and complexity of this system may lead to inertia, which can make it difficult for new organisations to establish themselves, or establish new ways of doing things.

It is not always the case that larger, established suppliers act as a barrier to the emergence of NTBMS. Some of the NTBM examples outlined by Ofgem (Licence Lite, White Labels, our relationship with Telecom Plus) need existing "traditional" business models to succeed. In these cases, traditional suppliers are actually supporting new entrants and the development of new market arrangements. Regulations around Licence Lite and similar arrangements should be flexible enough to support both parties and work on a principle basis to allow bilateral commercial arrangements to take place.

The CMA investigation has also found that vertical integration should not create barriers to new entrants in the UK Market. The Energy Market Investigation Updated Mission Statement – February 2015 (paragraph 99) states:

'If there were fundamental deficiencies in liquidity in electricity, or if vertically integrated firms were forming their electricity hedges by trading internally, we would expect to see that comparable gas products are traded further ahead than electricity in external markets; but that was broadly not the case. Similarly, if vertically

integrated firms gained an advantage in electricity from having the option to trade internally, we might expect to see them hedging further ahead in gas than in electricity; but again, that was broadly not the case.'

We have already seen small suppliers in the market, showing that vertical integration is not a blocker to new entrants. Therefore, we do not envisage that vertical integration will be a problem for NTBMs entering the energy market.

4.10 A liquid market is particularly important for companies that are not vertically integrated (ie independent suppliers or generators) and can therefore not easily balance supply and demand from within their portfolio. We have consistently found that GB wholesale electricity market liquidity is poor.

We do not see that Liquidity in the wholesale market will be a problem for small or independent NTBMs, and an initial outcome of the CMA Investigation supports this view.

The CMA's Energy Market Investigation Updated Mission Statement – February 2015 (Paragraph 100) states '*Current levels of liquidity appear to be sufficient to allow independent suppliers and generators to trade and hedge in the same way as the Six Large Energy Firms*'.

Therefore, we do not agree that poor liquidity in the market will be a problem for NTBMs.

Additional points:

Additional to those issues outlined by Ofgem, we also believe that the following are current regulatory issues that could act as a barrier to NTBMs entering the energy market.

- **Regulatory view of propositions:** the view that current Regulation has of energy propositions could be considered outdated. Propositions will need to evolve as customer needs and priorities change, and as the technology to offer different types of proposition becomes more prevalent (e.g. PV, heat pumps, electric cars). Smart metering in particular can help to change the way customers engage with their energy usage and their supplier, and this should be reflected and enabled in the number and type of propositions suppliers are able to offer.

RMR is a specific example of regulation negatively impacting the potential for more NTBMs. RMR can be overly prescriptive and assumes there is a default way to market to a customer. NTBMs will begin to target specific customers – potentially ones that haven't been specifically marketed to previously – and this may lead to a broader range of products on the market that are tailored towards these different customers. Standardising what suppliers can offer gives an asymmetrical view of regulation and doesn't foster this innovation (for any business model).

Increased flexibility in what a supplier can offer their customers would be beneficial; as there isn't a standard way of offering products to each customer. Not all products work for all customers; and being able to offer a more tailored product to each customer would work with Ofgem's interest of protecting them, as it reduces the risk that some customers are not benefiting.

This will continue to be a problem following the rollout of Smart Meters, and the development of tariffs tailored to these. It will be difficult for suppliers to develop tariffs directly tailored towards customers with a smart meter, since there will still be a high proportion of customers with traditional meters. The number of tariff restrictions will make catering to both smart and traditionally metered customers more difficult.

A lot of innovation has also already happened in the Industrial & Commercial market, which has helped to increase engagement, grow competition and increase consumer choice. There seems to be a direct correlation between the amount of regulation and the level of innovation. The domestic market has much more regulation than the Industrial & Commercial market and so could be perceived as a much more restrictive market for NTBMs.

Customers have asked for new and innovative tariffs, but we are currently unable to provide these due to current Regulatory rules. We would be happy to discuss these with Ofgem further if desired.

- **The Regulatory approach should be standard for incumbents and new entrants:** the nature of new and existing market players will vary, as will their approaches to innovation. However, currently, the regulations are different for smaller suppliers, particularly with regards to obligations, and as such can be more difficult for incumbents to manage. Therefore, any changes to Regulation that aims specifically to encourage innovation in the Industry should ensure there is a level playing field for everyone in the market to compete – developing non-traditional business models shouldn't be allowed to develop simply on the avoidance of existing social and environmental requirements.
- **Volume of Regulatory Obligations:** the current amount of regulatory obligations placed on suppliers can act as a barrier to greater innovation and forward thinking, regardless of the size (or type) of supplier. For example, significant resources (finance, staff time etc) are required to implement mandatory changes like CfD's, Capacity Market, P272, and Nexus etc. Whilst we accept and agree that these changes are important to the industry, the current level is a very heavy burden on suppliers and the risk remains that the level of concurrent change makes the development of more cost-effective and appropriate solutions harder to deliver. This level of large scale change could potentially deter possible new entrants.
- **Smart meter rollout and Data Restrictions:** smart data rules will mean customers own the data generated by their smart meters. There will be limits as to what a supplier and other providers (which includes NTBMs) can access, and this could pose a problem for NTBMs that rely on this data enablement. Innovative products tend to be very data driven commodities. A review of data access rules (how it's collected and stored) and more clarity on who can access the data may be beneficial to ensure that the entry of NTBMs will not be blocked by this.
- **Smart Grids:** the development of smarter grids and the increased complexity for DNOs will likely create issues in the Regulatory Structure as it stands. Increased pressure on DNOs (through an increase in intermittent generation, and increase in demand (from heat pumps / electric vehicles etc) coupled with reduced network capacity will likely increase the demands on alternative solutions for DNOs – including introducing changes (such as more RAG tariffs) which may require / encourage increased demand side participation from consumers, and also provide opportunities for new products and services (e.g. the battery storage solutions).

As DNOs then become customer facing as we move away from the supplier hub principle, they may have to undertake certain Regulatory Obligations associated with this, which can be difficult for some parties to manage.

5. What are the benefits, costs and risks of NTBMs? Who do these accrue to?

We agree that NTBMs will bring some benefits, costs and some additional risk. In addition to the points raised by Ofgem in Section 5 of the discussion document – we have some specific comments on the various points (included in Table 1), which are below.

Benefits

- ***Consumer bill reductions through increased engagement and competitive pressure (Table 1: Direct Benefits)***

We agree that increased engagement could lead to reduced customer bills. NTBMs can increase consumer choice (for consumers on how they manage energy or what product they have) and simplicity, but a change in customer behaviour and engagement with energy is more likely to result in lower bills.

For example, smart technology has the power to both reduce the amount of work for consumers (to send meter reads for accurate bills, or for smart devices to manage energy use for the cheapest rate) and to also offer the opportunity for more engagement. Bill reductions will likely be seen if consumers then engage further with this technology, and their energy.

- **Avoided/reduced network costs: losses, connection, reinforcement, transmission, distribution (Table 1: Direct Benefits)**

It is unlikely that the rise of NTBMs will lower network costs overall, though they may target the network costs for their specific customers (and lower them on an individual basis). Cost savings would be more likely if a network led approach to some areas of Regulation and the use of technology was taken. As we develop the networks, then consumer benefits in DSR could be seen.

- **System balancing cost reductions: e.g. if NTBMs enable greater demand management (Table 1: Direct Costs)**

We would raise the question of how Ofgem expect the system operator to manage balancing of the grid if they have no direct control over localised generation such as PV, Heat Pumps etc?

Risks

We would add the following as Risks that NTBMs pose to the energy system.

- **DSR:** as there is more innovation in this area, more data enablement will need to happen and could bring about data protection issues.

There will also be issues around costs as more DSR is enabled and encouraged. How will these be charged (and on what basis)? How will cross subsidy of costs from those that can't shift their load be avoided?

- **Future role of Ofgem:** As we see more NTBMs in the market, their revenue will change, and not all of their revenues will be directly attributable to energy (other services, heat). Will Ofgem extend their remit to cover those activities or will those activities be Self Regulated?

Third Party Intermediaries (TPIs) are not currently regulated, but are responsible for offering consumers a range of energy related services and interacting with them regularly. As NTBMs develop in the energy market, TPIs could be more heavily involved, and possibly be a NTBM themselves. Ofgem should consider how they will be regulated in future, and how customers will be protected from any associated risks.

- **Exclusion of certain customer groups:** there is a risk that those customers less able to participate in some NTBM activity (Demand Side Response, for example) will be marginalised (in that they'll have less choice, and NTBMs that require flexibility will not be able to supply them) and these customers need protecting. Examples of these customers will be those 'Inflexible' customers such as care homes or Social Housing customers.
- **Increased costs to consumers:** an increase in NTBMs may mean a continually decreasing portfolio for some suppliers. This would mean that the total cost for certain obligations (FIT, WHD, ECO) could be borne by a smaller number of consumers and therefore lead to higher energy costs for consumers, as they are passed on in the consumer's bill.

To ensure fair distribution of these costs, it may be worth applying supplier funded obligations to all market participants, or to a general taxation.

Furthermore, moving away from TBM will cost money, and this is likely to be from TBM which, in turn, may increase prices for some consumers. How do Ofgem expect these costs to move the industry to one that supports NTBMs to be raised?

To support future NTBMs, there should be the application of non-discriminatory regulation which considers the whole economic (and social/ environmental) impacts, and is not designed so as to create a market for a NTBM that is reliant upon funding (or cost) on TBM.

- **Risks associated with Smart Grids:** with the devolution of the supplier hub principle will come added risks for consumers and DNOs. If consumers begin to deal with DNOs and Transmission Network Operators as well as suppliers, there will be the risk of customer confusion and more customer protection needed.

DNOs are also at risk, as they will then have to start dealing with more Regulatory Obligations as they take on a customer facing role.

6. Do you agree with the line that we've drawn between direct energy system effect and wider indirect benefits?

We largely agree. However, we would ask whether Ofgem have considered the wider indirect costs? In so far as many of the direct energy system benefits may result in direct energy system costs – there is a similar corollary between the wider indirect system costs.

7. How could NTBMs potentially transform the energy market and what fundamental challenges to regulatory arrangements could this entail?

NTBMs do have the potential to transform the energy market in many ways. Key examples are:

- Reduced reliance on the current System Operator as NTBMs introduce more options for generation and storage.
- Significant changes to consumption profiles (across different sectors)
- Move towards a more decentralised/ flexible/ volatile system
- Increased complexity: of the markets as we see more participants and tariffs, and also of the system as we see a more diverse system of suppliers and consumers.

Challenges to current Regulatory Arrangements

- **Growth of Heat networks:** as these are not regulated by Ofgem, current regulations around customer protection for Gas and Electricity consumers and district heating customers are different. There is a concern that as we see more in the market, it may be unsustainable for this practice to continue. Consideration should be given to how these two areas interact and align. Would Ofgem consider moving Heat Networks within Ofgem's powers?
- **Greater pressure to alter RMR requirements:** as we've previously outlined, in order to foster innovation, these rules will likely need to change, since NTBMs target a different customer base and require more freedom to offer the services they want. Altering RMR requirements will provide more customer choice and as a result, more competition in the market.
- **Marginalisation of some customers:** some new business models will need data access (half hourly) to enable them. Customers that choose not to grant access to may inadvertently shut themselves out of access to better / more appropriate supply deals.

- **Consumer view:** as we move away from the supplier hub model, customers will be more exposed to different (and confusing) pricing models, which previously hasn't been a concern. For example, DNOs costing models change frequently - how will customers be able to take comfort in being given the correct price if it is changing so often? The need for clarity and security for customers could mean challenges to the current pricing structure from DNOs.
- **Customer Protection:** the balance of amount of customer protection will need to be carefully considered. It should allow flexibility for customer choice, but deter bad practise. It should allow customers who choose to engage with new / more innovative business models to do so on the basis of a full understanding of any potential risk.

8. How could regulatory arrangements change to accommodate NTBMs?

As we have outlined throughout our response, there are fundamental challenges, and therefore changes, that may need to be made to allow NTBMs to flourish in the energy market. A key issue will be the political desire for a more market based approach, rather than a reliance on prescriptive regulation and market intervention.

Changes may include:

- Alterations to the RMR rules, which are quite prescriptive as to how suppliers can offer propositions to customers. RMR rules also have a narrow view of what customers want to see in tariff structure. Alterations to those rules which allow greater freedom in what suppliers can offer to customers may facilitate greater innovation and increased competition, and help NTBMs emerge and grow.
- Movement to a more forward thinking, future proof regulatory setup: this could mean moving towards more principles based regulation. This would then set out the framework and principles that all market entrants must work towards, which will allow more innovation (one of the key drivers of NTBMs).
- Rules around data access and sharing: these may need to alter to ensure that NTBMs reliant on access to certain data in order to innovate are able to do so. Provision of greater access will also mean less resource needs to be spent finding the data elsewhere.

9. What role do NTBMs and other parties have in managing energy market transformation and regulatory change?

Smaller/ new entrants are less likely to have the time or resource to make policies and regulations. TBMs are more likely to be managing both (participating and contributing to shaping the rules too). However, there are efforts from Cornwall Energy and Energy UK to engage with small suppliers more.

NTBM do have the potential to provide innovation and provide a disruptive influence within the market. This is particularly the case where by a NTBM launches a new product / service to the market. However given the fundamental importance of energy / heat it will be critical to ensure that those organisations work within the parameters of existing regulation, and where regulation doesn't exist (or disproportionately constrains the development of their NTBM) they must fully engage (including in conjunction with other industry stakeholders) with the political and regulatory functions to amend / create the necessary regulation.