

OVO Energy response to Ofgem discussion paper on “Non-traditional business models: Supporting transformative change in the energy market”

Introduction

1. OVO Energy started in 2009 and now has around 450,000 customers. We believe we have been at the forefront of innovation in the retail energy market, including in how we provide our award-winning customer service.
2. Last year, we launched a business called OVO Communities, which sees us partnering with Local Authorities and other groups to offer innovative supply tariffs which we hope will be attractive to customers who have traditionally been let down by the energy market. We have since launched several partnerships, including with Cheshire East Local Authority. The partnerships offer bespoke tariffs to local residents. There have been early signs of success, including in attracting 'sticky' customers who have previously not been active in the energy market. These customers have made significant savings. We have also launched a smart prepayment business, which aims to use technology to improve outcomes for one part of the energy market which has traditionally not benefited from competition.
3. There is huge potential for business models that challenge the Big 6 suppliers and provide a competitive answer to some of the problems of incumbency identified by Ofgem and the Competition and Markets Authority. These are driven both by new business ideas and by new technology. They can only be beneficial for competition and customers.
4. Many of our innovations have struggled to gain acceptance from Ofgem because they do not fit with the way the industry has operated in the past.
5. Having experienced first-hand the barriers involved in setting up this NTBM, we welcome the opportunity to share our thoughts on how the regulatory framework can support, rather than hinder, the development of future NTBMs.
6. Looking at the specific questions posed in the discussion paper, we have provided below an overview of OVO Communities, drivers for market entry, the benefits this initiative will bring to consumers and local groups, the regulatory challenges we have faced in setting it up and how regulatory arrangements could change to accommodate more NTBMs being introduced in the future.

Background on OVO Communities

7. OVO has invested significantly in scalable technology systems that give every local authority, housing association and community group the opportunity to set up their own local utility company. OVO manages all regulatory compliance issues for the local company and delivers a range of back office

services that are required for selling energy, including wholesale trading, billing, metering and customer services.

8. Using this foundation the community partner can design its own energy tariffs, stipulating features such as the level of standing charges and whether it would like to sell energy that has been generated locally, or 100% green, while factoring in the amount of revenue it would like to generate. The design of the model means the tariffs that are offered can be very competitively priced. This pioneering platform gives these groups the tools they need to roll out integrated packages of energy services beyond affordable tariffs, including smart metering, energy efficiency installations and support for distributed generation.

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

9. We agree with the drivers behind the emergence of NTBMs, especially point 2.4 (Lack of consumer engagement and trust). Between 2003 and 2013, less than 1 in 5 people have switched supplier every year and switching rates have dramatically fallen since 2008.¹ Consumer trust in utilities is also at an all-time low, with 73% of households feeling dissatisfied with their dual fuel energy supplier according to the CMA.²
10. Conversely, consumers trust their communities to give them a fair deal on energy. As many as 75% of all energy customers are on expensive variable rate energy tariffs, despite the fact that they could save as much as £200 by switching to a fixed rate deal. Research by OVO Energy shows that people are three times more likely to trust a community energy company to give them a fair deal than one of the existing big suppliers. Nearly half of everyone who stated a preference said that they'd prefer to buy their energy from a community energy company, even if the price and service was the same as they would receive from other suppliers.³
11. When benefits accrue to local communities people become more engaged with energy, which in turn leads to more active decision-making – whether it is simply shopping around to get a better deal on their energy, or supporting investment in local energy projects. Communities are also uniquely placed to encourage positive changes in behaviour, such as adopting efficiency measures to keep energy bills low.
12. In addition to the demand for 'community energy' models, there is also a strong market appetite for green suppliers. Often these two drivers can be combined. Finally, technology is also a driver of innovation and market entry. The arrival of smart meters, domestic solar and various technologies that can respond to changing demand patterns could also lead to innovation from suppliers in how they deal with customers.

¹ 17.25% of the market has switched on average every year from 2003 to 2013 (taken from DECC quarterly switching statistics)

² GfK NOP report for the Competition and Markets Authority, February 2015

³ OVO Energy Community Energy White Paper, April 2014

13. Our main focus in this paper is on regulatory issues arising from future energy market transformation but we recognise that there are relevant issues within current regulation. Please let us know if there are any other issues.
14. Since launching OVO Communities, we have come across several regulatory barriers which have slowed down progress. We have documented these below:

RMR

15. The biggest barrier to innovation in the energy supplier sector are rules under RMR. For example, OVO has had to apply for a derogation for each individual community partner in order to enable them to set their own bespoke tariffs. This is the lynchpin of the OVO Communities offering as it allows these organisations to tailor tariffs to local needs and preferences. While Ofgem has significantly speeded up responses to derogation requests, filling in the requests for each tariff remains an unnecessary burden.
16. We welcome upcoming rule changes coming into force in July 2015 on white label which will remove the need to apply for individual derogations for each partner. However, it does raise the question of what is the point of keeping the four tariff restrictions in place.
17. OVO launched its prepay offer a year ago, and has now introduced a smart prepay offer. However, we currently only offer one variable tariff to prepay customers (we previously offered a fixed deal). We only have one tariff because of restrictive rules around RMR. Because any prepay tariff has to be linked at a fixed discount to any of our four core tariffs, we cannot innovate and test out potential market innovations. In our opinion, the prepay market is entirely separate to the credit market. The changing technology makes this even more significant, as the cost to serve is changing due to smart meters (and likely reducing). We would therefore like to be able to adjust our prepay tariff more regularly, or at least at a different frequency, when compared to our credit tariffs. However, under RMR rules, this is not possible. In short, we would be offering two, possibly three or four tariffs to prepayment customers, but RMR restrictions have limited us to one. As Ofgem has noted in the past, this is a part of the market that is woefully underserved. Technology has the potential to improve outcomes, but the restrictive rules are hindering progress.
18. Additionally, since July 2010 we had been paying out a 3% interest reward to direct debit customer accounts in credit. This was a unique offering in the market and was solely designed to benefit the customer. However in March 2014, Ofgem informed us that this went against a new licence condition as part of the new RMR regulations and we were instructed to remove the offer or apply for a derogation. We were pleased that Ofgem granted the derogation in this case, but the very fact that we had to apply for a derogation, which took 5 months to be accepted following our submission in August 2014, disincentivises suppliers such ourselves from offering new products in the first place.

Cheaper tariff messaging

19. Under RMR rules, we are obligated to disclose Cheaper Tariff Messaging (CTM) to all customers. However, we feel that this requirement risks increasing confusion and is not appropriate for certain customers. Unlike the Big Six, around 75% of our customers are already on our cheapest tariff. When a customer signs up with us on a 12 month fixed tariff, we buy all their energy in advance for the year and offer the best price we are able to on the day they sign up. As a result, our terms and conditions don't allow customers to "tariff hop", as it would be impossible for us to manage risk if customers were able to switch to a new "cheapest" deal a month later. This doesn't preclude them from leaving (we have no exit fees), or leaving and returning after 3 months to resign at whatever our cheapest deal is at that point. They can naturally re-fix onto our cheapest tariff from our Standard Variable Tariff (SVT) at any point.
20. As a result, being made to advertise CTM on our regular fixed statements the way we do on annual statements and on SVT statements appears bizarre. The information 'offers' a tariff which would contravene our own terms and conditions if the customer tried to act on it. This would be frustrating and confusing for the customer. Of course the customer could choose to leave and return in 3 months, but we couldn't guarantee the tariff they saw 3 months ago would still be available, or that it would be our cheapest tariff as we work hard to be cost reflective which means more frequent tariff changes than many suppliers.
21. RMR tariff restrictions also cause confusion to our PPM customers as we have to disclose cheaper deals to customers even if they are not available to PPM customers, or would require a dramatic change in behaviour in order to access.

Half hourly settlement

22. The potential benefits of time-of-use tariffs both for a customer and for the wider electricity and energy system are considerable. Changes to technology mean that capturing those benefits are even more likely. However, the way in which the electricity market is settled for domestic customers remains on a profiled basis. Therefore, there is little incentive to innovate around time of use tariffs. It seems odd that smart meters are being rolled out at such a fast pace, without there being a clear timetable for developing half-hourly settlement.

Regulatory burden

23. The overall regulatory burden is far too high in the energy supply sector. This acts as both a barrier to entry and to growth for innovative suppliers. The licence conditions should be culled, and a more principle-based approach should be taken. The Smart Energy Code is adding huge further burdens. We do not believe licence-lite rules significantly reduce the regulatory burden, or at least not enough to allow a flood of innovative new entrants into the sector. A more useful approach would be a fundamental review of licence conditions and wider regulations and a move to principles-based regulation.

What are the benefits of different NTBMs to energy consumers?

Price

24. NTBM may be able to offer cheaper prices to energy consumers if they can find new ways of reducing overall costs.

Competition and 'sticky customers'

25. NTBM may be able to access parts of the market which current competition is not helping, particularly sticky customers. Our experience with OVO Communities has shown that such customers can be reached with innovative offers.

Innovation

26. This can include innovation in green tariffs, service, technology or how the customer gets its information. All of these options are being explored by different suppliers in the current market.

Are there additional wider benefits to the energy system and beyond it?

27. We believe that bottom-up initiatives like OVO Communities can provide a co-ordinating framework that can transform the many individual initiatives across the country into more than the sum of their parts. Crucially, community energy will be able to develop self-sustaining business models that increase their market power and make them less reliant on government support.
28. From a consumer engagement perspective, OVO Communities also has the potential to close the loop between local supply and generation. By directly linking local tariffs to local projects, local suppliers will have the potential to pass through discounts to local residents, enabling them to directly recognise the benefits of living near local projects through lower bills.

How could regulatory developments change to accommodate NTBMs?

29. Simplify RMR rules and end the restriction on four tariffs. In particular, Ofgem should end the need to link prepayment tariffs to credit tariffs. This fails to reflect the learning and innovation going on in that market.
30. A general culling of regulation, especially around smart meter and smart installations.
31. A move to principle-based regulation rather than prescriptive. This would require Ofgem to move quickly and impose big fines if breaches were found.
32. A fast-tracking of half-hourly settlement.