



Dr Jeffrey Hardy  
Head of Sustainable Energy Strategy  
Consumers and Sustainability  
Ofgem  
9 Millbank  
London  
SW1P 3GE

Head Office  
Inveralmond House  
200 Dunkeld Road  
Perth  
PH1 3AQ

fiona.casey@sse.com  
01738 516920

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Dear Jeffrey,

**Non-traditional business models (NTBMs): Supporting transformative change in the energy market – discussion paper**

Thank you for providing the opportunity to respond to Ofgem's discussion paper on non-traditional business models.

This response represents the views of both SSE Energy Supply Limited (SSEESL) and Scottish and Southern Energy Power Distribution (SSEPD), together referred to as SSE in this response. The response consists of a non-confidential annex containing SSE's responses to the discussion points given in each chapter.

SSE recognises that diversification of business models may bring customer benefits and welcomes Ofgem's work in this area. SSE considers that any regulatory change resulting from this work should not be restrictive; instead, in the spirit of better regulation, it should allow all market participants to innovate as standard, rather than by exception. It is key that market players are on a level playing field and that a two-tier approach to regulation does not emerge.

SSE is supportive of Ofgem giving consideration to adopting a more principles based approach to regulation and considers that it will encourage competition by enabling a wide range of business models to develop.

We look forward to continuing to engage with Ofgem on this topic to ensure that industry arrives at the best possible outcome for customers. Please contact me if you wish to discuss further any of the points raised in this response.

Yours sincerely,

Fiona Casey  
Regulation, Markets

## Annex 1: Discussion points and responses

### Chapter 1

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

As Ofgem's current work on NTBMs is exploratory SSE is of the opinion that the broad definition in the discussion paper seems appropriate at present as it conveys both the wide range of NTBMs and the uncertainty around their potential impacts. Through the progression of Ofgem's work on NTBMs, and as more variants of NTBMs emerge, SSE would anticipate that the definition may change to reflect an updated understanding of NTBMs.

SSE is unsure whether a purely 'traditional' supply business is still in existence. Current market players have developed diverse approaches to acquiring and retaining customers; these approaches may fall within the definition of NTBM.

#### **2. How can we engage with NTBMs more effectively in the future?**

SSE would advise continued engagement through open industry forums alongside any direct engagement with NTBMs. This approach ensures there are opportunities for discussion of NTBM-related issues with a full range of stakeholders; this is important as NTBM activities may impact other industry participants and their customers. A further benefit of open forums is that an organisation currently operating a (primarily) traditional business model may have plans to expand into the NTBM sector and it would be unfortunate if such organisations had been excluded from engagement on NTBMs.

### Chapter 2

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

SSE agrees that the drivers which Ofgem has identified are a fair assumption of core drivers for NTBM market entry.

From the perspective of SSE's networks business, some of the most significant NTBM related activity SSE is seeing is the emergence of community energy schemes which are aiming to develop private wire or virtual private wire networks in areas where there are network constraints due to high levels of intermittent generation and relatively low demand. One of the key drivers for this type of business model is the potential income from export of renewable generation combined with the high cost of connection for generators in network constrained areas (larger connections would trigger reinforcement costs to the connectee).

From SSE's engagement with these types of NTBMs, SSE understands there is also often a desire to increase self-sufficiency (local use of local resources) and to enable people in the vicinity of renewable energy resources to benefit directly from these resources. There is also motivation in some third sector organisations to increase community engagement.

It is also possible for actions by traditional business models to drive creation of NTBMs. For example, SSEPD's ongoing work to tender for a third party service to reduce network constraints at particular times to ensure security of supply as an alternative to

reinforcement has generated interest from a range of potential providers including aggregators, Energy Service Companies (ESCOs), and Energy service providers who seek to realise the value of flexibility for their customers.

SSEPD is also exploring the potential value of an NTBM approach to reduce network constraints by domestic demand reduction/shifting through our Low Carbon Networks Fund innovation project SAVE. This project includes a trial with the core hypothesis that the impact and sustainability of behaviour change will be greater working collaboratively with local communities and other key stakeholders, relative to other randomised trials involving communication with individual households. The approach embodies the four NTBM drivers specified by Ofgem and seeks to balance the aspirations of the community and other key stakeholders as well as the distribution network operator (DNO) in the way it facilitates and empowers positive local transformation.

The trials are ongoing but initial learning demonstrates high levels of buy-in from stakeholders and recognition of the potential to address targets other than network constraints notably around social obligations and empowering local governance frameworks. The ability to deliver this as part of a pooled effort/sharing of resources is potentially more important than ever given the current situation of economic austerity and public expenditure constraints. The robustness of the randomised trials approach has also been praised as much existing practice lacks this level of rigour.

### **Chapter 3**

#### **1. Have we accurately described the NTBM environment? Have we missed something?**

SSE is not aware of NTBMs in operation which would fall outside of the description and thus agrees that the description appears accurate. SSE does anticipate that the understanding of the NTBM environment will evolve as Ofgem's work continues.

#### **2. We'd like to learn more about organisations using NTBMs. If you are prepared to discuss this, please contact us (see Appendix 1 for contact details).**

SSE is open to providing Ofgem with information about the NTBMs it has engaged with if this information would be useful.

### **Chapter 4**

#### **1. 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?**

From a supply perspective, many of the obligations introduced as part of the Retail Market Review (RMR) may be a barrier to entry for new entrant non-traditional businesses and a barrier to expansion for current market players. Please see examples below (we have not sought to provide an exhaustive list of examples):

- ESCOs and multi-service providers – whose proposition centres on offering energy as part of a bundle of products/services – may find the current restrictive bundling rules an issue.

- Many NTBMs may face difficulties when seeking to comply with customer information rules (such as information on bills, annual summaries and Tariff Information Labels) as the structure of their tariff does not lend itself to meeting the requirements.
- Companies will not be able to give cash benefits of DSR to customers who have reduced usage during peak times.
- The tariff cap is restrictive for all suppliers, but may be particularly onerous for existing energy firms who wish to retain their current traditional tariff offering whilst expanding into the non-traditional space.

SSE is aware that Ofgem is conducting a review of the impacts of RMR and may be inclined to roll-back some requirements but understands that any changes to requirements are unlikely to happen until at least 2017.

Recently there have been a number of firms seeking derogations from RMR rules; SSE expects these numbers to increase as more companies seek to offer innovative non-traditional products and services. The derogation process is uncertain and lengthy and can be a barrier for existing firms wishing to expand into the NTBM space; SSE presumes that new players operating on more limited resources will find this barrier even harder to overcome. In a competitive market, it is important for companies to be agile and to respond quickly to changing market environments; the derogation process does not allow for this. A large number of companies seeking derogations would suggest that the current rules are too restrictive.

From a networks perspective, SSE agrees that the issues around connections are the most relevant currently for NTBMs; community energy schemes in particular face connections issues. The current regulatory framework prohibits discrimination. This means that there can be no non-standard treatment of community schemes or other NTBMs. SSE is working to encourage NTBMs to engage with its networks businesses at an early stage of their project development process and discuss options which may reduce the cost or lead time for connections. These include flexible connections and offering to share schemes' details with other developers who may be interested in taking forward consortia connection applications to share costs.

Many community groups have difficulty in accessing all of the information they need and understanding the various obligations they may need to fulfil. SSE suggests that an Ofgem guide designed to signpost interested parties to the relevant information would be incredibly beneficial. SSE's networks business seeks to help where possible, but faces difficulty when community groups ask for advice on supply/settlement/retail issues.

SSE notes that the NTBMs described potentially challenge the current supplier hub model and that changes to this model could lead to fundamental changes to the various current systems and processes for interaction between networks and suppliers to pass network costs to consumers.

It is SSEs opinion that there should be a consistent approach to regulation and is keen that a two-tier system of regulation does not emerge with one set of rules for traditional business models and another for non-traditional business models. It also would not be appropriate for a wide-reaching revision of regulation solely to accommodate one outlying business model.

## **Chapter 5**

### **1. What are the benefits of different NTBMs to energy consumers?**

SSE is of the opinion that a key supply-side benefit of NTBMs, whether adopted by current market players or by new market entrants, is the positive effect they can have on customer choice and engagement and that they foster competition within the retail market.

There is potential for NTBMs to deliver lower prices for customers. Organisations providing energy system flexibility services (such as aggregators) may wish to pass on the resultant cost savings to the end customer. However, at present they may face difficulty in doing so should they wish to provide the benefit as a cashback payment (discount and bundling rules prohibit this).

NTBMs may also have benefits from a networks point of view. Network costs may be avoided or reduced where NTBMs are able to reduce network constraints by smoothing network load profiles through providing flexibility in demand or generation output, particularly where new demand is created in constrained network areas. However, the above would not result in any savings where the network is not constrained and would only generate savings where the technology used is reliable enough to allow the networks to defer or substitute reinforcement whilst still complying with network security requirements.

Another potential benefit from some NTBMs is the reduction of network losses, as they may enhance use of locally produced energy and reduce the transportation losses from the higher voltage levels.

Community Energy projects have the potential of avoiding reinforcement costs upstream in the network. These costs would otherwise have been socialised and picked up by all distribution use of system (DUoS) customers, therefore (in those cases where upstream reinforcement is avoided), there is a benefit to all customers.

### **2. Are these benefits experienced by all energy consumers or only those directly receiving the NTBM's services?**

Assuming that NTBM suppliers would be bound by the supply licence requirement to offer terms to any domestic customer, then a domestic customer not currently receiving the NTBM's services would benefit from increased choice. Customers as a whole will benefit from competitive pressure exerted by the new business models; pressure on cost and pressure to innovate and offer products which better meet customers' needs.

In networks, any savings on connections costs achieved by NTBMs (for example through choosing a flexible connection option or export limited connection) would accrue to the connectee directly where the connection is sole use and are shared with DUoS customers where the connection involves cost apportionment.

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

There may be additional wider benefits however SSE believes that these are unlikely to be straightforward to measure.

**4. Which of these benefits should be taken account of in regulatory policy-making and decision-taking and why?**

Ofgem should take into account the benefits which contribute to its principal objectives. It would not be appropriate for Ofgem to focus on benefits which do not fall under its remit. Furthermore, the wider benefits identified by NTBMs will, generally, be realised whether a company operates a traditional or non-traditional business model. Ergo the 'wider benefits' of NTBMs are not relevant for, and should not be an influencing factor in, regulatory policy-making and decision-taking.

**5. Are there energy system costs or risks from any of the NTBMs? How might these be addressed?**

As more firms enter the market, with different ownership structures and financing models, operating previously untested business models, there may be an increased risk of supplier failure. A supplier failure causes customer detriment and results in industry costs thus it is vitally important that Ofgem has regard to its obligation to ensure that a new entrant is financially sound before granting a supply licence, whether the new entrant in question intends to operate a traditional or a non-traditional business model.

From a networks perspective, there are potential operational risks associated with NTBMs such as community energy schemes which seek to develop private network or virtual private network arrangements. SSE is currently engaging with two community energy schemes looking at these options.

Both schemes involve export limited connections; the technical solution to providing this type of connection needs to be carefully designed and trialled to ensure network protection systems operate correctly and ensure security of supply. Similarly, appropriate commercial arrangements need to be developed and trialled to understand what additional support may be required by NTBMs.

It is also important to note that while linking new generation to existing local demand (in order for it to connect without incurring reinforcement costs in an area of the network which is currently constrained) resolves the issue faced by that individual generation project, it may create new constraints further up the network. This is because the existing demand would have been absorbing generation from an alternative source previously, and this generation could then overload the network. At a small scale, there are unlikely to be any

major issues, but this could become a problem with proliferation of private network schemes which do not create new demand.

Community applications tend to result in “non typical” connection applications which are more challenging for DNOs to progress compared with a generally better informed commercial application. This can lead to a disproportionate burden on Connections teams.

#### **6. How will NTBMs help to drive innovation within the energy system?**

NTBMs open a lot of opportunities in terms of creating a more flexible network with lower costs (potentially) to all customers. Networks could make use of NTBMs to help deploy some of the smart grid technologies trialled as part of the multiple innovation projects undertaken recently.

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

An issue from the retail perspective currently is that restrictive supply licence obligations greatly restrict innovation in customer offers and this has a resultant negative effect on customer engagement.

SSE notes that Ofgem surmises that customers may be willing to take on greater risk when using the services of an NTBM and this means that a new approach to consumer protection may be required. SSE is unsure of what form this ‘new approach’ may take, but considers that consumer protection is extremely important irrespective of whether the company is an NTBM and that a customer’s (assumed) attitude to risk should not impact the level of consumer protection they receive. SSE would note that existing consumer protection regulation is likely to provide appropriate protection for all energy customers.

A key issue from the networks perspective is that increased demand for private and virtual private networks potentially challenges the current model of socialising networks costs.

#### **8. How could regulatory arrangements change to accommodate NTBMs?**

A more principles based and less prescriptive approach to regulation in the supply side would allow for more innovation from new entrants and from established market players.

In networks, where schemes are for the benefit of communities who are disadvantaged in their access to options in terms of energy and also have a high index of fuel poverty there may be an argument for positive discrimination. If Ofgem is of the opinion that positive discrimination is appropriate in these instances, then these cases should be clearly contemplated in the licence and should not pose a risk that the DNO may be in breach if discriminating in favour of such schemes.

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



On the supply side, SSE envisages suppliers and other relevant stakeholders working constructively with Ofgem to develop principles based rules which allow a range of business models to thrive in the energy market.

Network operators will play an important role in the development of NTBMs (such as community energy schemes) since they must interact with these new players and adapt current operation to incorporate the new schemes. It is important that regulation allows for network operators' behaviour to evolve to support NTBMs, especially NTBMs which play a part in the delivery of the Carbon Plan.