

Neil Barnes
Associate Partner, Consumers & Competition
Ofgem
9 Millbank
London
SW1P 3GE

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By email: futuresupply@ofgem.gov.uk

Dear Neil,

RE: Future Supply Market Arrangements (FSMA) – call for evidence

Centrica welcomes this far-reaching call for evidence, as well as the recognition that the regulatory framework will need to evolve if it is to keep up with the pace of innovation in the energy sector. We wholeheartedly believe that increasingly innovative products, delivered by both existing suppliers and new entrants, have the potential to deliver major benefits to consumers.

The key to enabling future market models is to ensure that the regulatory framework facilitates a level playing field that allows all potential market actors to compete equally to deliver the best outcomes for consumers. It is also important that consumers can make informed choices about how they want to engage in the energy market and that any changes brought about by this programme are for the overall benefit of consumers.

We are supportive of Ofgem's work on FSMA and believe we can make a useful contribution to the FSMA programme and help shape any necessary reforms to supply arrangements.

Centrica & Innovation

Centrica has launched several pioneering initiatives looking at different market models and services so that we can remain at the forefront of the energy sector and continue to deliver compelling propositions to customers:

- We are a market leader in Connected Home products. Our Hive smart thermostat and other Hive services help our customers manage their energy use more effectively.
- Centrica has invested in LO3, a pioneer in using blockchain technologies who worked on a first of its kind blockchain microgrid project in Brooklyn, New York. This will help us explore the huge potential that blockchain technology could offer to the energy sector.
- With a £19m investment, we are creating a local energy market (LEM) in Cornwall that will include a virtual marketplace enabling domestic and

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business customers to trade energy and flexibility amongst themselves, and with the grid.

- Our Distributed Energy and Power division has been established to help customers gain competitive advantage from energy, delivering intelligent end-to-end energy solutions that power performance, resilience and growth. These solutions include working with business customers to deliver energy efficiency, demand side response, combined heat and power, back-up generation and battery storage.
- Centrica has invested over £1.2bn into our global Connected Home and Distributed Energy and Power divisions. This investment is part of our plan to transition away from being a traditional utility provider to a 21st century energy and services company.

We are constantly testing and exploring non-traditional business models so that we may deliver more innovative and compelling energy service propositions for our customers both now and in the future.

Our initiatives show that existing energy suppliers can be just as innovative and disruptive as new entrants. A regulatory framework that creates a level playing field between all market actors will give Centrica the opportunity to deliver new market models that drive benefits to consumers.

The Supplier Hub model

While it is right to explore alternative models for the way in which consumers engage with the energy market, it is important that in doing so, the benefits of the “supplier hub” model are not overlooked. The supplier hub model ensures that customers need only have a single point of contact for issues relating to their energy supply – avoiding the need to engage with multiple parties across the energy value chain.

Suppliers play a crucial and central role in the energy sector. We are responsible for delivery of the Government’s smart rollout programme that is estimated to deliver £5.3bn of consumer benefit¹. Suppliers and the supplier hub model are also central to major energy transformation projects, such as faster and more reliable switching, and settlement reform.

There are compelling arguments for elements of the supplier hub model to be reformed. For example, recovering social and environmental costs via suppliers is regressive; a more progressive alternative would be to recover such costs through general taxation. This would also help ensure a level playing field between all suppliers as currently some suppliers are not subject to passing through social and environmental policy costs. More broadly, and absent any policy change to recover costs through general taxation, small supplier exemptions should be removed. We conservatively estimate that 1.5 million domestic customers do not have to contribute

¹ Smart meter roll-out cost benefit analysis, BEIS, 2016.

to Warm Home Discount or ECO. This group of exempt customers is growing and on average is wealthier than the declining group of customers who have to bear the burden.

Many changes to future supply are likely to be more relevant for the electricity market as there is greater flexibility in both electricity generation and demand, therefore electricity is likely to be the focus of the FSMA work. However, gas will also be impacted by any reform and should be considered within this programme given that some reforms may be different or not necessary for gas consumers. A similar dual analysis is required to determine whether future arrangements may need to treat domestic and business customers separately.

The level of regulation and taking FSMA forward

Regulation can often act as a barrier to innovation. We are therefore supportive of Ofgem seeking to de-regulate where appropriate while ensuring proportionate protections are in place.

Suppliers undertake a wide range of activities at present, many driven by obligations placed on them through the regulatory framework. Ahead of any reform of supply market arrangements, each of these functions need to be analysed to understand:

- each regulatory and operational requirement that suppliers have,
- whether each function itself is necessary or mandated by the existing regulatory framework,
- any potential barriers that may be created by suppliers fulfilling the function,
- current benefits to customers from suppliers fulfilling the function,
- if there are any alternatives, and
- how any transition away from the supplier hub model could be managed.

The above should be aligned to show there is coherence and consistency in all changes to the existing supply arrangements.

The review of each function should then be prioritised based on how it may facilitate new market models, while minimising customer detriment.

To effectively undertake this exercise, Ofgem should:

- Consider how and why the current energy market model has evolved to its current state.
- Compare the GB model evolution to energy markets in other jurisdictions and markets in other sectors, such as the water and financial sectors.

FSMA ties into wider programmes of industry change including settlement reform, the smart meter roll-out, faster switching and the cost of energy: independent review

conducted by BEIS. Any decisions on FSMA should factor in the knock-on, and potentially disruptive, effects it may have on other Ofgem and Government programmes.

Any regulatory change as part of the FSMA programme should be subject to a robust cost-benefit analysis to ensure the benefits to customers outweigh the costs of implementing any requisite changes.

In the annex to this letter we have answered the specific questions set out in the call for evidence. While we may not have all the answers to all the challenges we have set out in our response, we want to work with Ofgem to see how we may overcome these challenges.

If you have any questions, please contact Tabish Khan in the first instance on 07789 575 665 or Tabish.khan@britishgas.co.uk.

Yours sincerely

Tim Dewhurst
Head of Regulatory Affairs
Centrica

Annex: Centrica answers to the call for evidence questions

Q1 What are your views on the above criteria? Are there other criteria that should guide our assessment of current and possible future market arrangements?

We broadly support the criteria set out by Ofgem and we have the following observations, suggested additions and amendments:

- The criteria suggest that customers will be consumers and will not be producing energy or offering services themselves. We suggest changing the first and fifth bullet to reflect that anyone may provide services and that individuals may offer services to other consumers.
- We agree that consumers should be adequately protected. However, it is important that customers have the right to opt out of protections if they believe they may benefit from doing so.
- Some clarity on what is meant by protecting consumers should be provided. In our view, there are three types of protection, and Ofgem's views on all three would prove helpful:
 - Price protection
 - Minimum standards of service, including safety
 - Guaranteed energy supply
- The sixth bullet should ask for transparency in the operating costs of the energy system.

Q2 What are the most significant barriers to disruptive new business models operating in the retail market? Please draw a distinction between regulatory barriers and commercial barriers (e.g. there may not be enough potential consumer demand to justify market entry).

Ofgem's criteria includes the aim to see equal competition between market actors and if commercial barriers mean that a market model is not financially viable right now, then there is a question as to whether it would be consistent with the effective promotion of competition to support one particular initiative over others. It is important that all potential market models are allowed to flourish and that the regulatory framework does not result in instances of 'picking winners'.

In terms of regulatory barriers, the level of regulation within licence and industry codes is potentially the most significant barrier. We would support any initiative to remove unnecessary regulation or consolidate existing requirements, in line with our support of Ofgem's future of retail regulation work.

We further support a move towards more principles based regulation where possible as this will provide greater flexibility for current and new market participants, and new market models. We believe that principles can promote competition and protect consumers more effectively than detailed prescription in some important ways:

- Principles are more flexible than prescription so they should enable innovation and let market participants offer more choice to customers.
- Principles place greater responsibility on considering outcomes and not applying a “tick box” approach to regulatory obligations.
- Principles provide further incentives for market participants to undertake research and to understand what customers want.

One potential barrier highlighted in the call for evidence pertains to the inability for customers to have more than one supplier. We support exploring whether multiple suppliers can be allocated to a consumer. Before any change is made to allow a consumer to have multiple suppliers, the following challenges will need to be addressed:

- How are network charges, metering costs and environmental levies recovered across multiple suppliers? How does this impact the delivery of Government policy?
- What happens to multiple supplier relationships if a customer switches supplier?
- Who is responsible for the metering equipment and its safety at any time?
- How can customer confusion be avoided so that customers are never in doubt who to contact to resolve an energy supply issue?

Access to customer data is likely to be vital for innovative propositions. It is important that any future data access regime allows for customers to easily provide their data to trusted third parties, while ensuring that customers feel in control of their data and aware how their data may be used.

It is unclear whether peer to peer (P2P) models will require P2P platforms and / or all customers on the platform to have a supply licence. We are aware that Ofgem is working with a few P2P models within the regulatory sandbox and any lessons from these pilots should be disseminated as they would prove helpful in providing certainty to other prospective P2P providers.

Q3 What other supply market arrangements would provide a better default for disengaged consumers, whereby they are protected adequately and are able to access the benefits of competition?

It is almost certain that levels of engagement will continue to vary between individuals and groups of customers, even after the introduction of new market models. When designing customer protections the regulatory framework should recognise that engagement is a spectrum and customer protections need to be flexible enough to apply for all customers. The framework should also be designed to empower customers first and foremost, with protections only used as a back stop.

Historically innovations in markets often appeal to customers who are already engaged and there is a possibility that engaged customers will be the ones to benefit first and most from new market models. We believe that competition will deliver the best outcomes for customers across the engagement spectrum and advocate for a light touch regulatory framework that empowers all customers to benefit from new market models, including those that may be digitally excluded – i.e. do not have access to the internet / digital technology.

It is important that the regulatory framework allows all market actors to operate on a level playing field. If one set of market participants, i.e. existing energy suppliers or larger suppliers, face more onerous regulations than new entrants and smaller suppliers, this would have an adverse impact on competition as the former would be prevented from innovating and customers will ultimately lose out through less attractive propositions.

There is insufficient evidence to suggest that renewables, electric vehicles and home energy storage will increase market penetration to such an extent that many customers will become fully energy independent and go 'off grid' permanently. Most customers who can become energy independent will still need energy supply at some point, e.g. if their home battery is empty and they are unable to source energy locally. Back up arrangements need to be in place for times when customers need 'emergency supply' and markets should be allowed to evolve to fulfil this role.

We have concerns around Ofgem's suggestion of opt-out collective switching as this may result in customers switching supplier before they fully realise what is happening and / or have a chance to opt-out. Opt-out collective switching sets a precedent of taking agency away from customers and suggesting that others know what is best for energy customers, and may lead to complaints. Ofgem should carry out customer feedback and liaise with consumer groups before pursuing this policy.

An opt-out collective switch further suggests that price is the only factor considered when a customer switches supplier. Ofgem's own research² has shown that customers consider more than just price when switching supplier and the recent cheapest market offer letter trial has shown that less than half of those who switch supplier go to the cheapest offer even when it is clearly presented to them.

Q4 How big an issue is it that we do not currently regulate intermediaries in the energy market? Is there a case for doing so? If so, how would we best do it? We are especially interested in frameworks that enable a wider variety and increased number of market participants to provide supply.

We do not believe in regulating unless there is a clear need to do so and that any additional regulation will deliver protections beyond those within existing consumer law. For example, if there is a lack of transparency in commission arrangements and it is unclear what part of the market is being represented – as we have seen with non-domestic brokers.

Rather than looking at existing regulation, Ofgem should take a 'blank sheet of paper' approach to determine what regulation is needed for new markets, if any.

To deliver the full benefits of open competition any licensed supplier operating in the same market as intermediaries should not be held to regulations that intermediaries do not face.

The transition to a new regulatory framework may prove difficult to manage as it is almost certain that some consumers may be operating in new markets while many are within the existing supplier hub model. The regulatory framework will need to be flexible enough to allow all service providers to operate and compete equally. As with our answer to question 2 we believe that wider principles are best suited to protecting customers and allowing innovative products to come to market.

It is important that customers can make informed decisions with a clear view of the risks they may face. The range of products in energy supply are not as diverse today as they may become in the future, therefore an adaptable framework is required. Financial markets may not provide a direct read across to the future of energy, but financial regulations have been designed to allow a wider range of propositions and so there may be applicable lessons for energy.

Ofgem has raised the concern of third parties having to interact with a customer's supplier, even if they want to offer a product directly to the customer. We do not think this should be the case unless there is an unforeseen consequence to the supplier,

² Results from the Cheaper Market Offers Letter Trial: <https://www.ofgem.gov.uk/publications-and-updates/results-cheaper-market-offers-letter-trial>

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e.g. the supplier's imbalance position is impacted. Any requirements placed on third parties should be proportionate to the risk its activities pose to the customer and the customer's supplier.