

Future Supply Market Arrangements: Call for Evidence

Energy UK response

22 December 2017

Energy UK is the trade association for the GB energy industry with a membership of over 100 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership encompasses the truly diverse nature of the UK's energy industry from established FTSE 100 companies' right through to new, growing suppliers and generators, which now make up over half of our membership.

Energy UK strongly believes in promoting competitive energy markets that produce good outcomes for consumers. In this context, we are committed to working with Government, regulators, consumer groups and our members to develop policies which enhance consumer trust and effective engagement. At the same time, Energy UK believes in a stable and predictable regulatory regime that fosters innovation, market entry and growth, bringing benefits to consumers and helping provide the certainty that is needed to encourage investment and enhance the competitiveness of the UK economy.

These high-level principles underpin Energy UK's response to the call for evidence on future supply market arrangements. This is a high-level industry view; Energy UK's members may hold different views on particular issues. We would be happy to discuss any of the points made in further detail with Ofgem or any other interested party if this is considered to be beneficial.

Executive summary

Energy UK welcomes Ofgem's call for evidence. It is right that the regulatory framework should evolve to enable a smarter more flexible energy system that allows new ways of offering energy supply and associated services, where this is in consumers' interests.

It is, however, important to note that the supplier-hub model was put in place for good reasons by Parliament. The model has for three decades provided a commercial interface for the consumer and successfully ensured that: system costs are settled; wholesale risk is managed on behalf of consumers; consumption is metered; social and environmental obligations are collected and delivered on behalf of government; and that there has been a conduit for consumer protection.

It is also worth noting that the supply market has itself evolved and grown under the current arrangements. Today the retail market is more competitive than it has ever been. As noted by the CMA, since market opening each of the Six Largest Energy Firms (SLEFs) have lost around two-thirds of their original customer base, as well as having taken customers from the other suppliers. There are now over 60 suppliers in the domestic retail market for consumers to choose from – there have long been a similar number in the non-domestic sector. This year over five million domestic consumers will have switched their energy supplier¹. As a result of such developments, the market share of the SLEF has fallen from nearly 100% in 2011, to 82%² today. According to Ofgem's own figures, five new entrants have increased their individual market shares above 1%, with one reaching over 3%.³ We have also seen the development of new business models, including Local Authority backed suppliers, suppliers specialising in green energy and suppliers offering bundled products. Such developments should not be underestimated or dismissed lightly by government or stakeholders.

¹ EUK data: electricity switches, domestic and non-domestic, Electralink

² <https://www.ofgem.gov.uk/data-portal/electricity-supply-market-shares-company-domestic-gb>

³ ibid

It is vital that any future framework builds on these developments. It is also important that Ofgem ensures that future arrangements provide for a level playing-field on which both existing parties and new entrants can compete for customers. There is a primary need for the energy system to be fair for all participants. In particular, it is vital that Ofgem ensure that: consumers, regardless of how they engage in the market, remain protected; core functions like balancing and settlement operate effectively for the benefit of consumers; and recovery of policy costs and network changes is apportioned fairly across consumers and amongst all market participants.

As Ofgem undertakes this work, we would also encourage it to carefully consider any implications for existing industry change programmes, which are currently requiring billions of pounds of investment by industry. Programmes, including the smart meter roll-out, faster switching and mandatory Half Hourly Settlement have or are being designed and delivered around the current supplier-hub market model. It also is important that the full impact of any proposed change is fully assessed and that any reform does not put the energy system at risk or increase costs for the majority of consumers.

Energy UK is currently planning on undertaking more detailed work in 2018 to consider the issues raised in the open letter and call for evidence, and more, as part of a wider look at the future energy system. We are keen to work closely with Ofgem as both organisations take work forward in this area, for the benefit of future energy consumers.

Our detailed responses to the specific questions set out in the call for evidence can be found below.

Detailed response to 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?

Energy UK broadly agrees with the criteria identified by Ofgem. We would, however, encourage Ofgem to consider the following points:

- While we agree that suppliers should treat customers fairly, principle 2 makes reference to ensuring consumers 'pay a reasonable price for their energy'. It is unclear what Ofgem mean by 'reasonable'. Reasonable is a subjective term that will mean different things to different parties and individuals. Rather than focus on what is 'reasonable' we believe Ofgem should be seeking to ensure that consumers understand the price they have to pay for their energy.
- With regards to principle 3 it is important Ofgem remains conscious of its own definition of vulnerability. Vulnerability can be transient – vulnerable customers are not a fixed group that can be dealt with or managed as such. All parties who engage with consumers are likely at one time or another to have customers in vulnerable circumstances for whom they should be expected to provide appropriate support and assistance.
- The principles are framed in terms of consumers. Given the topics discussed in the open letter and call for evidence we would encourage Ofgem to consider whether this should be 'consumers and communities'.
- The principles also make reference to 'supply' and 'services' offered by suppliers, intermediaries and others. We would welcome clarification on if this also includes new technologies like storage. We believe it should.
- Principle 6 should also make reference to the transparency around how such costs are recovered.

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).

Other parties are better placed to comment on any commercial barriers they perceive to disruptive new business models operating in the retail market.

In terms of regulatory barriers, Energy UK notes the level of prescriptive regulation in both the supply license and the various industry codes (MRA, SPAA, BSC, UNC etc.) that suppliers are required to comply with. As identified by the CMA in its independent review of the energy market, the different electricity, gas and retail codes offer a complex, resource intensive regulatory framework which can be

challenging for small and large companies alike. This becomes more challenging when multiple large changes occur across the energy industry in a short period of time without being fully considered in the whole across industry systems. We believe the framework could be simplified to help increase accessibility for all market participants, including disruptive new businesses.

This is also why Energy UK has been supportive of Ofgem's Future of Retail Regulation programme. By placing a greater reliance on principles-based regulation, we believe Ofgem can future proof the supply licence whilst also ensuring industry thinks more innovatively about how it can deliver good outcomes for customers.

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?

In any future market structure, it is vital that there are arrangements in place to ensure that consumers are always able to access supply. Energy is an essential service and Ofgem is right to acknowledge that, as in any market there will always be a group of consumers that cannot or will not engage with the market.

Competitive forces should be allowed to provide necessary default arrangements. The wider impacts on competition and innovation of potentially only obligating certain parties (i.e. traditional suppliers) to provide default arrangements need to be carefully considered. It is important Ofgem remembers that traditional supply businesses are also already reacting to the changing market and that many of their business models are already evolving to meet the needs of consumers in a smarter, more flexible, energy market.

With regards to Ofgem's proposal around opt-out collective switches, we would also ask Ofgem to carefully consider its policy objectives and what it is seeking to achieve. It is not immediately clear, for example, how an opt-out collective switch would guarantee default arrangements for customers – what if no party bids to win the customers? We also note that an opt-out collective switch would seem to suggest that the only reason to switch supplier is price. This is not consistent with the broader energy services future the call for evidence presents, where price should only be one factor in a customer's choice of how they engage with the market. It also ignores present day differentiators such as sustainability, customer service, trust etc. Ofgem must also consider if an opt-out collective switch scheme could actually reduce customers incentive to protectively engage and actually drive disengagement, because they come to expect the regulator will ensure they are on a 'good' deal. In addition, Ofgem must consider whether all suppliers will have the systems, credit and hedging strategies in place to support such a rapid influx of customers.

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 do it best? We are especially interested in frameworks that enable a wider variety and increased number of market participants to provide supply.

We believe there is a strong case for Ofgem regulating the activities of intermediaries where this is not currently already sufficiently provided for under consumer law. As noted in the open letter, it is not sustainable to keep regulating intermediaries indirectly (as suppliers' agents), particularly in a future where intermediaries undertaking wider activities may mean they have increased potential to cause customer detriment and have less, and potentially no, relationship with a customer's supplier. As a point of principle, regardless of how a consumer may engage with the market to meet their energy needs, they should receive a consistent level of protection to ensure they are not subject to undue detriment. Regulatory equivalence as an important part of a fair market.

To ensure the future regulatory regime is fit for purpose we have and continue to be supportive of Ofgem's Future Retail Market programme. By placing a greater reliance on principles-based regulation, we believe Ofgem can create a regulatory framework that covers both suppliers and intermediaries and ensures that all parties strive to deliver good customer outcomes as the supply market evolves over time.

Finally, it is important that any decisions taken by Ofgem with regards to future activity are driven by the needs of consumers and not Ofgem current organisational structure and/or level of resource.

Should you require more information please do not hesitate to contact Dan Alchin on 0207 747 2965 or at daniel.alchin@energy-uk.org.uk.