

The Office of Gas and Electricity Markets
Ofgem
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19 December 2017

Dear Sir/Madam,

RE: Future supply market arrangements – call for evidence

FSB welcomes the opportunity to provide an initial response to Ofgem’s call for evidence on future supply market arrangements.

FSB recognises that the way the UK generates, distributes and uses energy is facing the greatest transformation since the Industrial Revolution. As a country, we must now make difficult decisions about how and where we choose to invest in our critical energy infrastructure.

The vast majority of this investment will be funded through the private sector, but, ultimately, the cost burden will be passed on to domestic and non-domestic energy customers, either directly through their energy bills or indirectly through taxation. These costs must be shared out fairly and equitably across the industry, tax payers and consumers, including small businesses. For businesses – like households – what constitutes a fair cost burden depends on the opportunities and benefits they receive in return for their respective financial contribution.

In this context, FSB firmly recognises that energy is a service, rather than a product, and that the tariff that a customer agrees with their energy supplier should reflect the quality and choice of services on offer. It is important to acknowledge, then, that terms like ‘affordable’, ‘cheap’, ‘fair’ and ‘value-for-money’ do not mean the same thing. No two businesses are the same and, depending on their exact nature and circumstances, different small firms will seek different services from the market.

FSB welcomed the recent release of the Government’s Clean Growth Strategy (the re-branded Carbon Plan) in conjunction with the Industrial Strategy. These documents – alongside Ofgem’s ‘Smart Systems and Flexibility Plan’ and ‘Our Strategy for Regulating the Future Energy System’ – provide welcome clarity about the direction of travel in this area.

In the context of a changing energy system and massive infrastructure investment, what do small businesses actually want to pay for? The recent FSB report ‘[The Price of Power: Energising small businesses in the next UK Carbon Plan](#)’ set out small business views on UK energy infrastructure investment. It found that small businesses interact with the market in three key ways:

1) Generators and investors. FSB research suggests that small businesses are optimistic about the role of renewable energy generation. Twelve per cent of FSB small businesses already generate their own electricity, the vast majority of which is from solar panels. Looking to the future, 41 per cent of FSB small businesses believe renewable and low carbon energy will be cheaper than fossil fuel in future, compared to only 23 per cent who believe it will never be as cheap. Twenty-seven per cent believe that a low carbon economy will create more opportunities than threats for their business, as opposed to just 14 per cent who believe the opposite.

FSB wants to see a strong strategic UK policy direction that provides confidence and security to investors in new energy technologies, including generation, storage and efficiency. The UK needs a broad, measured and transparent strategy for promoting investment in the right places through a combination of different incentives including, but not limited to, subsidies and tax reliefs.

2) Consumers. Following the completion of a recent Competitions and Markets Authority (CMA) investigation, FSB broadly welcomed remedies for improving the retail energy market, particularly the development of published, comparable prices for microbusinesses. However, the investigation did not extend to looking at how the retail market can empower customers to use less energy or choose how and where their energy is generated. Energy reduction is the single best way that small businesses can save money on their bills, yet the post-CMA market is still not well placed to drive and support this behaviour change. FSB wants to see a new energy market that acknowledges a diverse customer base and enables smaller businesses to make holistic decisions.

Business customers must be empowered to understand and choose what services they pay for, where they can find the best deal, where they can save energy, and where and how their energy is generated. Thirty-three per cent of FSB small businesses believe that energy efficiency savings will offset the increasing cost of their energy, as opposed to just 23 per cent who don't think this will be the case. So, small businesses need support and information to help make these savings wherever possible.

Currently, many domestic and non-domestic customers are disempowered in the market because of difficulties accessing data. Although FSB recognises and supports efforts to ensure customer data is adequately protected, we believe such data should be available to the customer (and those who have been authorised to represent them) in a clear and transparent manner, ideally on the bill.

3) Suppliers of products and services. Small businesses have a major role to play in the energy industry supply chain, providing products, services, skills and innovative solutions, either directly to individual customers or indirectly via larger industry and suppliers. However, small businesses have traditionally faced a number of issues related to supply chains. Across the UK, there are relatively few appropriately sized contract opportunities as a result of contract aggregations and use of frameworks which frequently exclude small suppliers.

Supply chain processes can be overly complicated and lengthy, often with complex prequalification requirements. Eligibility often depends on small businesses holding a combination of accreditations from a wide range of schemes, each requiring time and resource to achieve and maintain. And, finally, poor payment practices continue to be a massive problem for small suppliers.

QUESTION 1 - Guiding criteria to evaluate a successful supply market. *What are your views on the above criteria? Are there other criteria that should guide our assessment of current and possible future market arrangements?*

QUESTION 3 - Alternative default arrangements. *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?*

FSB recognises Ofgem's guiding criteria to evaluate a successful supply market, and we believe many of these should be extended to cover microbusiness customers.

The majority of small businesses have negotiated a non-domestic tariff for their supply of electricity and gas. Previous research by FSB identified a number of areas where small businesses are disadvantaged compared to large businesses and domestic consumers in utility markets.

These disadvantages include the following:

- **Lack of expertise in purchasing energy.** Most small businesses have a similar level of expertise as a domestic customer when purchasing most products and services and they are far less likely than large businesses to have staff with a specific procurement role.
- **High opportunity cost of time spent making purchasing decisions.** Running a small business generally takes up the majority of the owner's time during the working week, and often the weekend. This leaves limited time to concentrate on non-core activities such as renegotiating contracts. Therefore, the 'opportunity loss' associated with searching for a new energy supplier can be high.
- **Low benefits (actual or perceived) of time spent making purchasing decisions.** A small business will typically have relatively low requirements for products and services that are not directly linked to its core trade – they want their heating to work and lights to be on. Small businesses often do not think they will benefit significantly by spending time choosing their ideal energy supplier.
- **Poor bargaining power.** Smaller businesses have far less bargaining power, especially compared to large companies such as major utility service providers.

For these reasons, FSB believes small and microbusinesses should be given an enhanced level of consumer protection, more akin to domestic customers. Without this, small businesses are at risk of being significantly disadvantaged in the market compared to domestic consumers and larger businesses.

In this context, there are a number of issues within the energy market that have posed serious challenges for small businesses for many years. Some of these – particularly issues related to unfair auto-rollover contracts and the absence of published, comparable tariffs – have started to be addressed following the recent CMA Market Investigation. However, despite improvements in some areas, the current system continues to create risks for small business customers, for example:

1. Intrusive and hard sell tactics of suppliers and some TPIs
2. Lack of cooling-off period on commercial contracts

3. Punitive out-of-contract rates that have no bearing on supplier risks and costs (although FSB recognises that suppliers do face additional out-of-contract risks related to things like customer credit, peak usage and retention uncertainty).
4. Estimated billing (FSB acknowledges that the smart meter rollout should reduce estimated billing and we also support Ofgem proposals to limit back-billing to 12 months for all smaller businesses)
5. Smart meter ineligibility
6. Obtaining data when moving new premises or new contracts
7. Lack of access to an independent arbitrator (for those larger than microbusiness)
8. Rollover contracts, which still exist for some small businesses (those larger than microbusiness)
9. Lengthy switching supplier process – 21 or 28 days in some cases (FSB recognises the work Ofgem are carrying out in this regard via their consultation on 'Delivering Faster and More Reliable Switching').

QUESTION 2 - Barriers to innovation. *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).*

The recent CMA report into the energy market provided a variety of remedies to increase transparency and fairness for customers, including microbusinesses. FSB successfully campaigned for a number of improvements to the non-domestic energy market, particularly the introduction of comparable, published tariffs and the abolition of unfair, restrictive auto-rollover contracts.

Despite these improvements, the new post-CMA energy market will still very much focus on the price that customers pay for the energy they use, rather than driving down their overall consumption. This represents a fundamental '*market barrier*' to innovation.

Energy efficiency remains the single best way to reduce consumer costs. FSB has engaged with Government around how best to promote energy efficiency among businesses. The national roll-out of smart meters across the UK, and the associated move to a smarter and more dynamic market, provides the greatest opportunity for customers to take control of their energy and reduce their consumption. If usage cannot be monitored, it cannot be managed.

Smart meters are a microcosm of the wider investment landscape. The roll-out of this new technology provides a neat example of the potential benefits that innovation and investment can provide, while highlighting the level of planning and effort required to ensure that these benefits are realised to their full potential for all those who bear the cost.

In the case of smart meters, simply installing the new technology won't automatically provide any benefits. Cost savings to the consumer will come with the behaviour change that this technology empowers and the energy savings that come with this. Without a clear strategy for ongoing customer engagement and empowerment, the benefits of this new technology will not be equitably distributed, or worse, will not justify the substantial cost of investment. Therefore, the rollout of smart meters must be supported by ambitious and holistic industry plans for ongoing energy saving support and advice to small businesses.

At a more strategic level, smart meters are the first step to building flexibility across the supply chain in the GB electricity system. FSB supports Ofgem's aim to ensure the energy system becomes sustainable while continuing to deliver resilience and value for money. Beyond the initial benefits of ending estimated bills and empowering energy use decisions for consumers, smart meters provide the foundation for a much smarter market, particularly with regard to energy grid management:

- **Demand Response**, driven by monetary rewards and penalties for using energy at certain times, will benefit from the proliferation of real time data. In this regard, it is important to acknowledge that the average energy profile for businesses – in other words, the variation in energy use during the day – may be very different to that of domestic household customers. This could represent opportunities and threats in terms of the way this sub-market is devised. The ability of small businesses to take advantage of demand side response will depend on the development of a number of sectors and technologies, including storage, microgeneration, smart meters, smart products and equipment, aggregators and price signals. The Government should set out a more detailed strategy for Demand Response.
- **Time-of-use tariffs** will undoubtedly take on increasing importance as grid infrastructure becomes more stressed. Some businesses are already accustomed to time of use charges, but many smaller firms will not be. Going forward, their ability to take advantage of these charges will be dependent on the equipment they rely on, the development of new technology and smart appliances, and the degree to which they can introduce flexibility into their day-to-day activities. It is clear that some businesses will be more able to take advantage of time of use charges than others, depending on the nature of their operation.

Many businesses operate on different cycles to the average domestic customer. So, a one-size-fits-all approach to time of use charges will not work. In order to drive behaviour change, the market will need to provide not only a price disincentive against using energy at certain times, but also a clear pathway for achieving this. For instance, it may be prudent to consider a recommendation for all users above a certain energy threshold to implement storage and management systems that allow them to run 'off line' at certain times of the day

- **Aggregators** are likely to play an important role, both in managing demand response across a wide domestic and non-domestic customer base, and also providing those customers with the necessary information, products and services to enable them to take advantage of this sub-market. It is vital that small businesses have access to a trusted aggregator service and all the benefits this potentially provides. Some small businesses may be considering the opportunities to provide this service themselves, depending on how smart technology develops. Aggregators are, essentially, a form of TPI and, as this market grows, it will be important to learn lessons from the performance of TPIs in other markets, particularly acknowledging the problems caused by a lack of regulation in the energy retail market.

Another barrier to innovation is a lack of understanding from suppliers about the diverse needs of small business and their relative drivers and barriers within the market. This represents an '*information barrier*' to innovation. Recent FSB research suggests that energy is a significant cost for almost two thirds of small businesses. For around a third of small firms, the significant cost of energy is enough to actually be a barrier to their

business. Away from these groups, however, there are also a substantial amount of businesses who do not identify energy as a barrier. So the degree to which 'price' is a factor in decision-making for businesses varies, depending on their particular relationship with energy.

Energy suppliers must improve their understanding and segmentation of diverse small business customer base so that their energy needs can be targeted in a more focused, bespoke way by suppliers and innovators. This will help to tailor their customer offers related to energy costs, contracts, efficiency support, innovation, products and services. They should hold regular customer steering panels, where the views of a wide range of customers, including small businesses, can be raised directly. Many energy companies have started to do this.

QUESTION 4 – Consumer protection. *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.*

Third Party Intermediaries (TPIs) can play an important role in helping businesses secure the best possible energy deals. But, as the energy landscape changes, the value for money that small businesses associate with their own personal energy deals will increasingly depend on the wider opportunities that come with them. The role of a TPI will become even more important as energy bills increasingly include costs associated with additional products and services, such as energy efficiency advice, renewable-sourced energy and smart technology. Even in today's market, many TPIs provide services that go beyond simple purchasing, such as managing meter installations and reporting on energy usage.

Currently, the TPI industry covers a huge variety of different individuals and organisations providing many different services – ranging from the unscrupulous to the excellent. FSB members continue to have very mixed experiences in this market, so it is critical to have a transparent, regulated TPI industry. FSB supports the introduction of a regulated TPI industry, one which builds trust by promoting the good and excluding the bad. But any regulation of TPIs must be proportionate. FSB recognises many TPIs are one-man businesses who will not be able to afford large fees.

In return for tighter regulation, FSB suggests that small business customers could receive a better service if TPIs were given greater access to the industry data held on ECOES and Xoserve, such as real time and periodic usage data. However, protection need to be in place to ensure this data is only used for the benefit of customers and not as a marketing tool.

Before the CMA investigation into the energy market, FSB supported Ofgem in the development of a draft code of practice for non-domestic TPIs, setting out customer engagement standards (professional and honest behaviour, transparency of information and effective monitoring). We were disappointed to see this work subsequently de-prioritised.

I trust this helps to adequately clarify FSB's position. If you would like any further information or input from FSB, please contact our energy and environment policy advisor, Andrew Poole, at andrew.poole@fsb.org.uk.

Yours faithfully,

A handwritten signature in black ink that reads "Allen R. Creedy". The signature is written in a cursive style with a large, sweeping flourish at the end.

Allen Creedy
Chairman of FSB Environment and Water Policy Unit
Federation of Small Businesses