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By email: futuresupply@ofgem.gov.uk

Dear Neil

Future supply market arrangements

In response to your call for evidence addressed to all interested parties dated 14 November 2017, we set out in this letter our initial views. We welcome the chance to engage with you on the supply market arrangements as part of the ongoing challenge to ensure that the current regulatory arrangements are and can remain fit for their many purposes as the energy system and stakeholder uses and interactions with the system evolve.

We are pleased that your call for evidence recognises the role for customer engagement and the initiatives being undertaken. We continue to think that this is a vital aspect for any competitive market and one worth continuing to pursue.

In our view, there are some first order questions that could helpfully also be posed, including whether the package of features making up “energy retail” are usefully packaged or could be disaggregated. This question itself leads to a potentially useful exercise of posing the question, what should in principle be competed? What services, systems or processes are contestable? Are many of the agents and third parties adding to the efficiency of the market and/or the tasks they are undertaking or are they simply adding transaction costs and risks to market participants? Has contestability itself caused what could be described as adverse effects on downstream or even upstream competition? We think that it may have done in certain areas, although the means to address it may not be simply to re-monopolise the service in question.

Further, we agree that the coming changes in data protection and privacy, as well as innovations in the home for management of resources, including energy, raise questions around use of and access to data as well as a more important question of data ownership. This dovetails with considerations around contestability of services or service provision, as well as the related



questions around the inter-dependencies of different market participants and the need to ensure that each are incentivised to act appropriately, whether or not those relying on others' participation are contractual partners or not.

Some other key first order questions could be:

- What protections are needed, over and above general consumer law and good practice, and data protection and privacy in its broadest sense, for energy consumers?
- If so, should these protections apply to all energy consumers? Could there be, for example, areas of protection that consumers could opt out of, express preferences for or otherwise self-serve?
- Is there entrenched disengagement in parts of the energy market? Or, is this encouraged by the current arrangements, any particular incentives or lack thereof?
- To what extent, if any, does a smarter, more flexible energy system require a greater proportion of active consumers and what forms of mediation or filtering would or could develop to enable this? Is there a market-based means for consumers to express preferences and outsource their activity? When would it be appropriate effectively to compel engagement (or penalise lack of engagement) as the only or most efficient means to address distributive unfairness?
- Default arrangements address post-FTE lack of action as well as providing a supplier of last resort. Is a default and scaled energy system needed centrally assuming increasingly local or otherwise non-centralised energy and if so, what arrangements are needed to ensure that "the energy system" remains in place for returning prosumers or those returning from off-grid and/or can support? Who should pay for this default if so?
- The two-tier retail market has led and continues to lead to distributional unfairness but other forms of distributional inefficacy could be envisaged if lessons from other markets are learned, e.g. customers on older technologies effectively paying for investment in the new (and not benefitting from it).
- Ofgem's many statutory aims and duties and the CMA's assessment of them grappled with the question of the hierarchy of aims and thus of outcomes and these questions remain – where is the balance to be struck or is/should there be primary and subsequent aims and duties?



Topic 1 - Guiding criteria to evaluate a successful supply market

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?

It follows that the range of possible responses to this small sample of first order questions are sufficiently broad that it is likely too early in this important exercise to establish guiding criteria against which a successful supply market could be assessed. The risk of so doing is that current structures, assumptions, issues and their potential correction are baked into the criteria, taking current issues into future arrangements.

That said, the protection of the interests of vulnerable customers should clearly be baked in to any retail layer that remains or emerges and as one of the first questions notes, there is at the very least a minimum level of consumer protection that all retail-facing entities should comply with, if not a greater level due to the specifics of the provision of energy.

Topic 2 – Barriers to innovation

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 (eg there may not be enough potential consumer demand to justify market entry).

The determined contestability of elements of the industry and the sheer number of agents, third parties and others may itself count against or otherwise restrict innovation. Scale is rewarded and commercial incentives here may need to be counteracted by access requirements for smaller and new entrants where choice of having to have an agent or third party is taken away.

Protections put in place for consumers, reflecting the very real concerns around privacy and access to data, may also work against innovation, e.g. the understandable requirement to opt in to use by a supplier of half hourly data. System development benefits may ultimately outweigh the benefits of individual protection set in this way, although it is of course necessary to ensure that personal data is protected.

Given the inter-dependencies of the industry and as noted in the call for evidence, it is important that all participants pay their fair share of the costs associated with network operations and any social and environmental obligations. These are however non-exhaustive examples, and it is essential that where e.g. rights to access data are considered, so too are equivalent and supporting duties as to quality assurance, error correction and timely insertion into any underlying system where others may rely upon that data. Intermediaries too should bear their



share of the burdens of industry participation as well as be able to garner the benefits from it. Some of the lessons from agents and other industry intermediaries could usefully be learned here, although this would likely lead to additional requirements on those entrants.

Topic 3 – Alternative default arrangements

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?

The default tariff (now either the cheapest front-of-shelf variable tariff or a fixed tariff which is not subject to exit fees) is as noted in the call for evidence intended to secure continuity of service for those not exercising a choice on expiry of their current tariff. Based on the CMA's assessment, amongst others, there is a correlation between vulnerable customers and those remaining on default tariffs. Customers remaining on the default tariff do not make up a single cohort however which needs to be borne in mind.

It would be possible to envisage a form of universal service provider that provides a default service, and onto which anyone not taking an active decision could be placed. This role or roles could be contested for via a beauty parade or auction and would itself be time limited, after which it would have to be re-contested. Part of the remuneration could be based on a reward or incentive to have customers switch away within defined periods of time. This provider or providers could offer a range of services to the default customers (and would have to inform the customer of any service offered by a supplier or intermediary that came to it).

The presence of this type of default arrangement would be a significant incentive on suppliers (and anyone providing services to a customer with an end date or whose customers had not given or made any active choice for a defined period) themselves to do whatever they could to retain those customers.

In advance of considering any such structural default arrangements (or contractual or other equivalents), we think that more continues to be necessary to foster, encourage or ultimately compel more frequent communications by suppliers with default customers, e.g. specific prompts or use of other means such as tariff names ("bad tariff", "out of contract tariff") and market cheapest tariff. Such measures could also include mandated reductions of any SVT cohort over a specific percentage for continuous default by affected suppliers, including penalties for failure to achieve these reductions. And any financial penalties levied could be used to support outreach programmes, market-wide advertising, and other more targeted measures aimed at supporting the greater engagement in the sector by customers.



Topic 4 - Consumer protection

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 think that intermediaries should necessarily be regulated directly. Those who interact for suppliers or via whom suppliers access the retail space could in principle be regulated indirectly via a standard licence condition imposed on suppliers. An alternative approach could be to focus on those aspects of service provision that for consumer protection or other reasons, anyone offering retail-facing services would have to comply with. Absent a specific licensing, registration or accreditation/approval regime, this could potentially be done by ensuring that anyone providing required wholesale or other services could only provide such services if their customer met certain specified requirements (although if they did, access could not be denied or delayed). This would require the wholesale entity/ies itself/themselves to be subject to some form of regulation that enabled use in this way. This could result in greater complexity and entry disincentive than a licensing or approval regime. However, removing the supplier hub is likely to lead - at least initially - to greater complexity in supporting wholesale and other back-off arrangements. The supplier hub itself has not resulted in a particularly straightforward set of underlying arrangements.

General authorisations, with specific conditions applying to different categories of service and/or service provider, could be useful if and when the retail elements of the market dis-aggregate. In electronic communications, the general authorisation was effectively mandated by applicable EU rules unless specific circumstances, such as market power, applied in a particular market segment. This requirement in the UK built on a background of class licences for private and other limited systems, and a model for relatively thin service provision (although this was not continuously applied from privatisation), together with an access regime for those elements needed to ensure the actual provision of service.

But as the call for evidence recognises, the question of what licence or authorisation is needed is by no means the only aspect that makes up what an energy retailer has to do obtain, set up, ensure, or otherwise arrange behind the seemingly straightforward need to purchase and account (in broad terms) for energy. Again drawing from electronic communications, new, more virtual, services such as voice over IP took time to work their way through the regulatory system, from whether it was an e-commerce service to how it fit within electronic communications. Related issues such as access to number blocks took even longer to work out, although commercial arrangements plugged the gap here to some extent.



We do think that a model based entirely on consumers' choice of how to interact with supply and energy services may be some way off based on the current industry structure and the material programmes underway to update the system and interactions with it. However, the availability of customer choice, including around ways of contracting and important elements such as customer service, is a key element of a successful supply market. It may also be the case that considering the potential mechanisms becomes easier once the various first order questions have been worked through.

As you will see, this is very much an initial set of thoughts, or more accurately, of more questions. We look forward to engaging with you and the team on the future supply market arrangements as the project unfolds.

Yours sincerely

[not signed]

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