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Future Supply Market Arrangements – call for evidence

Dear Neil,

SmartestEnergy welcomes the opportunity to respond to Ofgem's call for evidence on the future supply market arrangements.

SmartestEnergy is an aggregator of embedded generation in the wholesale market, an aggregator of demand and frequency services and a supplier in the electricity retail market, serving large corporate and group organisations.

Please note that our response is not confidential.

Summary

The time is right for Ofgem to initiate a full review, with a view to significantly changing or rewriting the BSC. Effective and fair competition cannot flourish under a set of operational rules that are no longer fit for purpose due to time and technology moving on. Simple tweaks are not appropriate due to the complex and interrelated nature of the market. Operational rules should encourage not stifle innovation that benefits the customer. We therefore invite Ofgem to initiate a complete re-write of the BSC so that there can be a wider variety of participants offering innovative services to customers in an orderly manner. This is because:

- Innovative companies are already poised to offer a greater range of services to customers. Technology and customer expectations have moved on since the core NETA principles were introduced in 2001.
- The currently defined participant roles and licensing arrangements do not support a free market which would facilitate innovation and therefore need reviewing.
- In a changing environment customers and participants alike need protection from unfair business practices and business failures.
- There is already a lot of inter-related change going on in the industry. Tinkering with the existing arrangements will lead to unintended consequences. It is time to step back and

think about where the industry is heading and provide a completely new set of arrangements

Overview of response

We note with interest the points made in Dermot Nolan's speech to Energy UK in October and to the BSC AGM earlier in the year. We welcome innovative solutions in the market such as peer-to-peer supply and other entities, such as brokers or other household brands, taking on the role of interfacing with customers. Change is happening already, and the system structure needs to reflect the new paradigm. However, it is important that any changes are robust and open to ensure the best outcome for all participants in both the short and long term. A thorough review is therefore required.

In our view, it is difficult to see how major change can be effected in the retail market, in a manner consistent with Dermot Nolan's aspirations, without a fundamental review cutting across the whole premise of the New Electricity Trading Arrangements (NETA) which have been in place since 2001; suppliers and generators are incentivised to balance their physical positions and are obliged to meet the costs of network operators. Clearly, any updated arrangements have got to ensure that these costs are met in an equitable manner and that there is no free-riding.

As the proposer of BSC Modification P332 (Revisions to the Supplier Hub Principle) SmartestEnergy has been concerned about the structure of the industry in changing circumstances for quite some time. Data Collectors/Aggregators and Meter Operators are increasingly offering services direct to customers and this requires greater scrutiny and accountability.

This whole issue of the supply market arrangements cuts across other work Ofgem are currently carrying out. For instance, the question of centralisation of agent services is being addressed under the Mandatory HH Switching Initiative. It is important that Ofgem conduct the current initiative in conjunction with this and other issues such as the future role of the DCC.

Various current initiatives attempt to provide market access to non-suppliers, e.g. the BM Lite, ABSVD and Project Terre. These are interesting developments, but leave suppliers with responsibilities which should ideally be shared with the aggregators. It is more appropriate that aggregators become balance responsible, but if not, either a centralised function or a supplier of default is going to have to ensure that supply is provided for non-designated periods and to ensure that metering arrangements are in place etc.

In short, because there is so much inter-related major change already going on a fundamental review of participant roles and arrangements is essential.

We answer the questions below in the order in which they appear in Annex 2.

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 agree that the criteria relating to access to both data and services, and removing barriers, should guide Ofgem's assessment of any arrangements. We would add something to the final two criteria mentioned: "Firms offering intermediary and other services to consumers can compete on an equal basis" and "Costs of operating the energy system are recovered in a cost-reflective manner, and risks allocated and managed effectively." This cuts both ways. In other words, whilst new entrants should not be at any undue disadvantage in respect of traditional/incumbent suppliers, they should also not have any advantages over those traditional/incumbent suppliers in respect of paying their way. For this reason we advocate balance responsibility for aggregators.

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).

Clearly, new innovative companies find the requirements associated with being a supplier highly onerous and impenetrable in terms of all the codes that exist. There needs to be a comprehensive review of all participants' roles and the licensing arrangements around those roles, so that not only can innovative companies have access only to those functions they require, there is also a level playing field.

Another significant barrier to the changes necessary is DNO systems and the rate at which they innovate/adapt. For new entrants to offer consistent services to their customers, DNOs are going to have to adapt together.

Also, if there are to be arrangements that permit more than one supplier, DNOs are going to have to be able to receive half hourly information and bill out different suppliers separately. One of the main reasons that P272 implementation was delayed was that DNOs were not able to increase the numbers of site-specific bills in their systems. It was only a matter of a two-fold increase. The change required to interface with DCC, for instance, is going to be significantly larger and DNO inflexibility should not be allowed to be a barrier again.

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?

This is really a question for the domestic market which we do not operate in, but what is true of the non-domestic market is also true of the domestic market; with the right market conditions innovative new entrants will enter the market and engage with customers because the economic opportunity will have been created.

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 feel that the scope of this question needs to be expanded to include Agents (Data Collectors/Aggregators and Meter Operators) and flexibility aggregators and we answer below in that light.

It has never been a satisfactory approach to attempt to regulate TPIs through the supplier (where the TPI is not an exclusive agent of the supplier). Licensing of TPIs would be the most appropriate way forward. However, given the potential number of TPIs in the market we can see that this may not be practical and believe that the development of a Code of Conduct has been a helpful way forward. If licensing of TPIs is to be pursued, it should be done under a rigorous regime and not as a simple box-ticking exercise, otherwise there is no point in doing it at all.

As the proposer of P332 Ofgem will already be aware that we are concerned about the way in which suppliers are held responsible for agents' performance, even where the supplier does not have a relationship with the agent because the customer has contracted directly. This has always been the case in respect of Meter Operator services in the HH market. However, we are increasingly seeing Data Collection services being sold direct to customers. Licensing of agents would be the most appropriate way forward. However, greater control of agents could be effected quite simply by placing obligations on them as a result of the accreditation they receive from Elexon.

By far and away the biggest issue on the subject of additional regulation is, in our opinion, that of independent aggregators who can very easily mislead customers into believing that their services will provide them extra revenues, without explaining what the impacts on their supply may be. Flexibility is not really something which should be disaggregated from energy; there is flexible generation and flexible demand reduction, both of which are measured in terms of energy. It is inappropriate for independent aggregators to target the valuable aspects of a customer's characteristics without taking responsibility for balancing, metering, distribution costs and all the administration and obligations associated with supplying a customer. We are of the view that aggregators need to be treated as suppliers, or rather, that suppliers should be able to compete with aggregators on a fair basis.

Should you require further clarification on this matter, please do not hesitate to contact me.

Yours sincerely,

David Cockshott
Chief Commercial Officer