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Our ref. Ofgem faster & more reliable switching consultation

DONG Energy's response to Faster and More Reliable Switching consultation

DONG Energy is one of the leading energy groups in Northern Europe. Headquartered in Denmark, we have an interest in several European markets and cover a wide range of energy sector activities. In the UK, we are the market leading developer and operator of offshore wind farms, as well as a supplier focused on the non-domestic retail market and flexibility services.

We welcome the opportunity to respond to Ofgem's consultation on Faster and More Reliable Switching programme. Our response consists of two parts. Firstly, we discuss our views on the overall programme and its costs and benefits for consumers. Secondly, within Appendix 1, we provide our views to the specific consultation questions.

DONG Energy's views on the Switching Programme

Case for change – reliability is key to consumer engagement, speed is only one element

We agree with Ofgem that not all consumers engage very well with the energy market and those who do not actively engage are more likely to miss out cheaper deals in the market. It is important for Ofgem and the industry to correctly identify the key barriers that prevent consumers from engaging with the market and address these issues in a cost-efficient manner.

Energy UK has conducted a research on consumer attitudes towards switching via YouGov. We provide a copy of this report in Attachment A for your information. The result of this research shows that:

1. Reliability is the most important factor when consumers consider switching energy suppliers

2. Only 11% of consumers said next day switching will encourage them to switch energy suppliers

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3. Only 3% consumers believed that the current switching arrangement takes too long

4. 84% of consumers would not be willing to pay more, in order to switch suppliers within 24 hours

Consumers' views are clear that they prefer to be able to switch to new suppliers reliably. However, we are concerned that Ofgem's reforms will not address the barriers that consumers see, and may instead worsen these barriers. Our view is that the current switching arrangement does not hamper reliability and we have not seen any evidence the new proposed central switching arrangements will improve reliability. In fact, we are of the view that a longer objection window will help prevent Erroneous Transfers (ET), especially for smaller suppliers with limited operational capacity.

Research shows that consumers do not consider the current switching timescale to be a barrier that prevents them from switching suppliers. We would also like to highlight that the number of consumers who have switched suppliers increased significantly in recent years. According to Energy UK's data, this number totalled 4.8 million in 2016 and is continuing to increase in 2017. This shows that the current switching arrangement is functioning well and consumer engagement is increasing.

Furthermore, the majority of consumers said that a next day switching will be 'better to have' given there will be no additional costs. We recognise that Ofgem has proposed Reform Package (RP) 2a in order to reduce the costs for implementation. However, the projected cost of approximately £375 million will be paid by all consumers. In contrary to the cost and benefit analysis presented by Ofgem, we do not believe consumers will financially benefit from this industry investment. Ofgem's projected benefit of approximately £339 million to £908 million over an 18 years' period is founded on the assumption that consumer engagement will improve due to a switching arrangement that runs faster. The survey suggests that only 11% consumers will be encouraged to switch suppliers if they can do so next day. We are concerned that the majority of consumers would not benefit from faster switching, especially those vulnerable consumers who are less likely to switch.

In line with what consumers have said, DONG Energy believes that the switching programme should focus on improving switching reliability (i.e. reducing ET) while minimising costs for the industry and consumers.

I&C consumers do not favour faster switching

The I&C sector consumes a large volume of energy. Its size is equivalent to domestic and SME segments combined in electricity market and only slightly less in gas market. We are concerned that the faster switching programme has not

considered what the change would mean for I&C consumers, who represent half of the energy market by volume.

We have not seen a cost and benefit analysis presented for I&C consumers and do not believe their views have been sought as part of the programme. In our experience, I&C consumers are knowledgeable and engage very well with the energy market. Very few, if any of them would wish to switch suppliers within one or two working days due to the potential risks and financial impacts inherent in erroneous switches.

The cost for I&C suppliers to implement a central switching arrangement is disproportional and unjustified, given that I&C consumers will always have a fixed term contract and will not switch to a new supplier next day. This cost will adversely introduce more barriers to entry for this segment of energy market.

Switching in the non-domestic market – who does it benefit?

It is important to note that non-domestic market works in a different way to its domestic counterpart. The majority of non-domestic consumers engage with the market via Third Party Intermediaries (TPIs).

- Fixed term contracts

  In the I&C market, large consumers tender for a supply contract and will often have it set up with the winning supplier months in advance before the start date. In the SME market, consumers negotiate their contracts via their authorised TPIs or directly with suppliers. In both cases, consumers are very aware of their contracts start and end dates and would have new contracts agreed in time, taking into account of the current switching timescales. We believe that faster switching will bring no benefit to those consumers who are on fixed term contracts.

- Default tariff

  The number of non-domestic consumers on default contracts is small. While we recognise there could be limited benefits for these consumers to switch to a cheaper deal more quickly, it does not justify the disproportionate cost for non-domestic suppliers to implement the switching programme.

  We also highlight that it is not to the interest of suppliers to leave these consumers on default tariffs, especially deemed tariff. This is due to the uncertainty of contract period and significant debt risks.

Reliability

We agree with Ofgem's analysis that reliability can be further improved by cleansing industry data, especially the address data. This can be a one-off exercise instead of a whole system change and should be implemented under RP1.

Under RP2a, a Central Switching Service (CSS) with a one working day objection window for domestic suppliers and a two working day objection window for non-domestic suppliers could be detrimental to reliability. Objection process is the most important part of the switching process that determines reliability and the level of ET. We cannot understand why a shortened window could help make objection process more reliable. Suppliers would have to recruit additional staff to cope with shortened objection window in order to maintain the current level of reliability.

Suppliers' Imbalance risks

We believe imbalance risk is an area being overlooked by Ofgem in the assessment of the programme. The risk would fall into two areas:

- As consumers will be able to switch to and from a supplier within 2 working days, the volume volatility will increase significantly, especially for suppliers with a small customer base. There is an increased risk for suppliers to miss the opportunity to manage this volatility in the Day-ahead wholesale market. This could be due to a last-minute objection by the losing supplier or internal processes that did not adjust quickly enough. As a result, suppliers could be exposed to imbalance price costs.

- ET of I&C consumers could have an enormous financial impact on suppliers arising from unexpected imbalance exposure. For instance, if a supplier fails to prevent an ET switching to it, the supplier will be exposed to imbalance price costs for that customer's consumption in the following day and onwards, until the ET is resolved. As GB energy market is moving into a smarter and more flexible system, market prices and imbalance prices are likely to be more extreme to reflect the supply and demand dynamics. An unexpected ET of a large I&C consumer that occurs during these hours with peak prices could put a supplier out of the business.

Detection of energy theft

Faster switching would make it more difficult to detect energy theft in the domestic market, where Standard Variable Tariffs are open to join and leave at any time. When consumers constantly switch between suppliers, the consumption data will not be consistent enough to provide useful insight for theft detection. While it is much less likely for this to happen in the non-domestic market as consumers

cannot switch between one default tariff to another, but the impact of unidentified theft volume will be shared across all suppliers and then passed on to their customers. We recommend that Ofgem consider the appropriate mechanism that will mitigate the risk of energy theft within the faster switching arrangement.

Central Switching Service via existing industry systems

We disagree with any reform package other than RP1, however, if CSS was to be procured by DCC to implement RP2a, we would like Ofgem to consider refining the existing industry systems rather than developing a new system from scratch.

A new UK Link system has recently been deployed by Xoserve, which was built with full potential to include both gas and electricity switching functionalities. Similarly, electricity Data Transfer Network (DTN), managed by Electralink, already handles industry data flows relate to switching which might require minimal changes to deliver the CSS role. We firmly believe that Xoserve and Electralink should collaborate with Ofgem to identify the best delivery solution for the CSS, at minimum costs to the industry. Since duel fuel suppliers would have both systems set up in place, it would be important for suppliers to engage and feedback into this work.

If you require further information regarding our response, please contact me.

Yours Sincerely,

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Attachment A: Energy UK research on consumer attitudes towards switching

Appendix 1: Consultation questions

***Question 1**: Do you agree with our assessment that RP2a provides the best value option to reform the switching arrangements for consumers and with the supporting analysis presented in this consultation and the accompanying IA?*

No, we believe that RP1 will be the most cost efficient reform package to improve the current switching arrangement. As noted above, reliability is the key improvement area for this programme, which is also supported by the consumer research report. Our industry recognises that ET is an issue that damages reliability of switching and it needs to be better managed. With an even shorter objection window, we struggle to understand how reliability can be improved.

We support the data cleansing exercise that will improve accuracy of industry data. This should be implemented under RP1.

***Question 2**: Do you agree that CSS should include an annulment feature which losing suppliers can use to prevent erroneous switches? Please provide evidence alongside your response. If you are a supplier, please support your answer with an estimate of the number of occasions over the past 12 months when you might have used such a feature had it been available.*

Yes, we believe that the annulment function should be made available to losing suppliers. Additionally, we support that both uses of CoT flag (from winning suppliers) and annulment flag (from losing suppliers) should be subject to compliance monitoring and reporting.

***Question 3**: Do you agree that CSS should always invite the losing supplier to raise an objection, even where the Change of Occupancy (CoO) indicator had been set by the gaining supplier? If you are a supplier, please support your answer with evidence of the number of times in the past 12 months that you have raised an objection where the Change of Tenancy (CoT) flag had been set.*

We agree that losing suppliers should be provided with the ability to object a switch when it has reasonable grounds to believe it is a ET, even when a CoT is flagged.

***Question 4**: Do you agree that use of the annulment and CoO features should be backed by a strong performance assurance regime? Please comment on ways in which such a regime could be made most effective, and back up your response with evidence.*

Yes, as noted in Question 2.

***Question 5**: Do you agree with our proposal to require DCC to competitively procure the communications network capability required to deliver the new switching arrangements?*

As noted above, we support a competitive service procurement to deliver the switching arrangements. It is important to remember that some of our existing industry systems (such as UK Link and DTN) are already capable to fulfil the CSS role, with minimal changes required.

The industry has recently implemented a new UK Link system under Project Nexus, and it will be logical to explore how this system can be refined to deliver the CSS. We do not wish to see UK Link to be abandoned and replaced by a completely new switching system, which will be wasteful of industry cost and resources spent on delivering Project Nexus.

***Question 6**: Do you agree with our proposal to have a three-month transition window (aiming to protect reliability) during which time suppliers have to meet additional requirements if switching in less than five working days? Please support your answer with evidence.*

We do not believe a three months' transitional period would be sufficient to test reliability of switching, without understanding what Ofgem would consider as a success. The industry will benefit from a transparent approach in defining the desired level of reliability.

***Question 7**: Do you agree with our proposal to change the requirement on speed of switching to require switches to be completed within five working days of the contract being entered into (subject to appropriate exceptions)? Please support your answer with evidence.*

Yes, but we believe that suppliers should be given a "grace period" to complete the transition from 21 calendar days to 5 working days. Any changes to licence conditions are significant and suppliers need time to adapt and digest what it means for them. We recommend the 5 working day condition comes into force 6 months after the implementation of CSS and that suppliers should take best endeavors to complete switches within 5 working days during the first 6 months' "grace period".

***Question 8:** Do you agree with our proposal to create a dual fuel REC to govern the new switching processes and related energy retail arrangements?*
***Question 9:** Do you agree with the proposed initial scope and ownership of the REC to be developed as part of the Switching Programme?*

We support the creation of dual fuel REC. Although there will be additional complications for suppliers to sign up and manage an additional industry code, but we see the REC as the first meaningful step to consolidate industry codes.

Our view is that, in long term, the scope of REC should go further to include other relevant retail codes, such as MRA, SPAA, SEC and SMICOP. We see this as an opportunity to simplify and shorten industry codes, which will help remove barrier to entry for new market participants.

***Other questions**: we do not have views on the remaining questions*