

**Customer Switching and Disengaged Customers
Detailed Case Studies
July 2018**

Contents

1. Pricewise Austrian Opt-in Public Auction Scheme..... 3

2. One Big Switch Mass Switching Membership Service 9

3. New Jersey BGS (Basic Generation Service) Auction 12

4. Acquirente Unico Price Control 19

1. Pricewise Austrian Opt-in Public Auction Scheme	
Country	Austria
Sector	Electricity, Gas
Key Points / Why Interesting	
<ul style="list-style-type: none"> • Opt-in auction schemes have taken place in GB before, but success rates vary. Considered a success story with more than 125,000 switchers to date (74,000 in first auction) in a market with 3-5% annual switch. • Average saving of approximately €272 per switched customer in the latest campaign. This is higher than the typical savings available in the Austrian market from switching supplier. It is important to note here that where possible Pricewise calculates the exact personalised savings based on energy profiles and the customer's energy tariff vs. the winning offer. Where that data is not available, the calculation is done by using the winning offer and the average market cost. In Austria the auction collaborates very closely with the energy market regulator, E-control, who shares with them the actual tariffs and network costs by area, which allows the auction operator (Pricewise) to have very accurate savings calculations. • Access to customer, price and contract information seems to be essential for the development of a motivating offering. It is much more motivating for a customer to know exactly how much will be saved in their case, than to be told a typical or generic saving that they are likely to get, or that other customers have obtained in the past. Easy access by the auction to customer specific data is therefore essential. If the process of obtaining the information is complex, costly, not timely, or not scalable, it will not be commercially viable to access the data. • Detailed, generic and specific information is also essential so that potential suppliers can access the value of the customer bases they are bidding for and so that they can easily onboard them if they win them. • While regulatory change in GB is not considered necessary, easier access to customer data would be advantageous. • Customer protection and trust need to be built into the Auction, without inhibiting interest from suppliers, which can be challenging. • Previously inactive customers represent around one third to half of all participants, even though switchers are more likely than non-switchers to respond to Auctions. • Auctions tend to be most successful the first time they take place. Whether this is because those customers who were emancipated by the first auction are contented following their first switch, or whether they use other channels for switching after their first switch (auction) is not clear at present. • This case illustrates the complexity of 'getting it right'. Specialisation seems to be essential. • Partnership between the regulator and auction is highly beneficial. 	
Context	
<ul style="list-style-type: none"> • <i>High-level Market/regulatory structure?</i> • <i>When was initiative begun?</i> 	<ul style="list-style-type: none"> • <i>Commercial Drivers?</i>
<ul style="list-style-type: none"> • The Austrian market is a mature, liberalised market, liberalised since 2002 in a way similar to GB, supported by a dynamic wholesale market (EPEX) that is similar in volatility to GB. • Residential electricity prices are lower than in GB, although gas prices are higher. For both gas and electricity however, the energy component of the bill is far less in Austria (and dual fuel is less common), and at least currently so are gross margins. Perhaps partly due to this, opportunities to save in Austria (the difference in price level from average to cheapest) are also less than GB, making switching less appealing to customers. However, net margins in Austria (at least for electricity) alone appear to be historically greater than GB, making market entry and competition by suppliers nevertheless attractive. • The level of politics surrounding energy, especially prices and competition, is however far lower in Austria than GB. The result is a market that is modestly active, but less so than GB, with opportunities to offer customers decent savings. But it is not the frantically active, politically driven, competitive hot spot that is GB; it is a market where customers are less likely to switch but 	

also likely to be less aware. In such a market collective switching is even more necessary than GB, but also more challenging.

- Commenced in 2013. Initiated by the Austrian consumer association VKI, with more than 50,000 members, in cooperation with a Dutch based commercial auction operator, Pricewise. The auction has run once every year in Q1 since then. The fifth ‘Energiekosten-Stop’ or EKS campaign is now running.
- The campaign in 2013 was the first in Austria.
- **Commercial drivers:** market desire to improve market transparency / competition; savings for customers; renewable energy value.

Description

- | | |
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| <ul style="list-style-type: none"> • <i>Practical workings</i> • <i>Contractual Relationships</i> • <i>Regulatory Changes Needed?</i> | <ul style="list-style-type: none"> • <i>Description against success criteria</i> • <i>Incentive arrangements and actor responses</i> |
|--|--|

Practical Workings

- Pricewise partnered with a consumer organisation bringing together the authority and reach of the association with the technical expertise of Pricewise. Pricewise takes care of the website, customer journey, auction, personalized savings, supplier relationship, and fulfilment process. The consumer association takes care of marketing and communication. The outsourced customer service is a joint operation.
- Collaboration agreement exists between Pricewise and consumer organisation. Contract exists between Pricewise and each supplier who wishes to participate in the auction against identical terms.

Headline details

- Approximately 450,000 customers have joined the schemes to date (60,000 in the latest campaign) out of the 4 million residential customers in the Austrian market.
- More than 125,000 customers have switched to date (21,000 in latest campaign)
- Average conversion rate: 35% of those who sign up to the scheme
- In the latest campaign average savings were approximately €272 per customer switched. This is higher than the typical savings available in the Austrian market from switching supplier.
- Customers also receive green energy and better-than-average terms and conditions

Keys to Success

Marketing:

- The success of the campaign is driven by the marketing and reputation of the partner (in this case VKI), advised by the auction operator (in this case Pricewise), to generate a high level of interest from consumers. This part mainly depends on the authority and reach capacity of the partner. In Austria, VKI is the biggest and most trusted consumer association.
- The marketing & communication is performed through different channels: Emails, PR, SEA, Direct mailings, the website, optional above-the-line channels, etc. Pricewise is actively involved in the marketing strategy, plans and budgets for marketing.

Supplier Management:

- A successful campaign cannot be achieved without ‘eager’ energy suppliers and raising their interest is an important part of the process. Pricewise always informs all suppliers about the campaign and invites them for a face to face meeting to introduce the campaign further and explore and stimulate the potential for their company.
- Before the auction Pricewise manages the quality of the consumer energy contract (terms and conditions) in collaboration with the consumer association (partner). It is important to keep in mind that the requirements should be good for consumer protection but shouldn’t be too restrictive for the supplier’s participation.

- Software may also be an issue (though should not restrict the choice of operators). Pricewise developed and used its own auction software.
- The criteria and product terms and conditions are the same for all suppliers which guarantees fair competition and only the price (gas and electricity) determines the winners in the auctions.
- The suppliers can see the (anonymous) bids of the other participants and have an opportunity to propose a better offer, this system brings a transparent competition. Alternative auction mechanisms have also been used in other markets, including sealed bids and multiple round descending clock.

Products:

- Options for customers need to be broad enough to appeal to a mix of customers, but simple and comparable enough to create a level playing field. In the case of Pricewise, their auctions can have several products (i.e. 2 lots/categories for 1 year and/or 3 years contracts). There is only one winner for each product category. Normally tariffs have fixed prices and fixed cost is regulated. Bonuses are optional, and restricted (i.e. not too high). Sometimes electricity and gas are bundled but not necessarily. Sometimes bundled and unbundled have the same winner. Also, Pricewise sometimes offers retention products (winning energy supplier can offer alternative tariffs to its own customers in the campaign to differentiate).
- In the Austrian case there have been 3 lots/categories for suppliers to bid for:
 - 1-year fixed prices (indefinite contract) green electricity, no bonus
 - 1-year fixed prices (indefinite contract) local green electricity + certificate, no bonus
 - 1-year fixed prices (indefinite contract) gas, no bonus
- Customers can choose between the winners of each lot by choosing between the corresponding offers. At the end of the contract period, they are free to change. Typically, customers will either be offered a new contract by the same supplier at this point or then can join another auction. They are not tied in either way.

Personalisation

- To be able to calculate personalized savings the first step is to acquire the data from the consumers (actual supplier, energy contract, consumption). So far it can only be done if the consumers give this information and Pricewise develops a website in order to obtain these. An alternative which Pricewise mentioned, could be that this information would be obtained from network companies or other entities that have accurate information.
- The second step is to calculate indicative average savings using either (1) the winning offer and the average market cost or preferably (2): personalised savings (based on energy profiles and energy tariffs).
- Pricewise faced some legal opposition from incumbent retailers in this 'domain' but managed to prove their savings were accurate.

Regulatory Relationships

- In Austria the auction collaborates very closely with the energy market regulator, E-control (which has been very supportive of parties that are trying to encourage more activity in the market), who shares with them the actual tariffs and network costs by area; this allows the auction operator (Pricewise) to have a very accurate savings calculation.

Order Fulfilment

- The order fulfilment is the most difficult part from a technical point of view. In order to have a smooth customer journey Pricewise developed knowledge in fulfilment and used their own interface to transfer the consumer data from the Pricewise systems to the winning supplier(s). Having an order and fulfilment results in control of the complete flow. In the case a customer calls about a switch Pricewise can easily help the customer and it increases the conversion rate: the customer journey only happens on the Pricewise campaign-website and they do not have to enter the same data multiple times in different websites (campaign-website and then after a click-out on supplier website for example).
- Pricewise also ensures that new customers receive the correct winning contracts and energy tariffs. Energy companies are not able to upsell or change customer choices in the campaigns – 'What-you-see-is-what-you-get' principle.

- However, fulfilment involves an important preparation in collaboration with all the participating suppliers, including those who win and those who do not (since Pricewise does not know beforehand who will win - and also there could be multiple winners if there are multiple categories/lots). This preparation requires a significant amount of work beforehand (pre-auction-day) and a substantial degree of adaptability from software and systems in order to fit with all the suppliers’ interfaces (e.g. format, data). Any mistake in this part would bring a lot of discredit on the Partner and Operator: the switching process couldn’t happen in time or at all, or new or corrupted data would need to be replaced by data obtained from the consumers. To avoid such mistakes, which would lead to a decrease in the satisfaction and conversion rates, Pricewise therefore prepares systems and performs a lot of pre-testing for all possible winners, with the aim to proceed quickly post-auction with the highest possible technical quality. Steps include:
 - Pre-auction all suppliers who are interested to participate in the auction are required to provide information that Pricewise needs to assess their capabilities for a mass switching process. Only suppliers with sufficient capabilities may participate in the auction. Specifically, for instance, pre-auction all interested participating suppliers are asked to send very detailed technical specifications of their order/fulfilment systems. This is done in order to be able to connect Pricewise frontend order/fulfilment systems to theirs. Ideally, participating suppliers are tested for order-fulfilment pre-auction.
 - Post-auction all systems can then be setup in final modus for real operations with thousands of consumer orders to winning suppliers. Pricewise works with the winning suppliers to set up an interface between Pricewise systems, and suppliers’ systems, and run tests. Technical aspects are tested, and also other elements that define the customer journey, including e.g. the layout of the automated email that customers receive about their switch.

Protection from Subsequent Price Hikes

- In Austria, in the market in general, some suppliers offer products in the energy market including a very high or hidden tariff bonus. After the first year of a contract this can lead to a big price increase (much higher than market or CPI volatility) as the bonus is clawed back, resulting in a situation where customers feel they have (or indeed have been) hoodwinked into a supplier relationship by artificially low initial prices that then turn into high prices, often without them even knowing. It is important to prevent these practices in order to protect the consumers. Therefore, Pricewise take an approach where bonuses are restricted in size or type or not allowed in the auction (sometimes moderate or fixed “welcome” bonuses are allowed since these are much more transparent and clear for consumers). This is a form of consumer protection since consumers pay lower real tariffs and do not only pay less in the first year with hidden discounted tariffs.

Regulatory Changes Needed

- This type of scheme is already proven in GB. No regulatory changes are needed for it to take place.
- For optimisation of such schemes, however, support from the regulator for the scheme and a close collaboration with the regulator is considered a key factor for a successful and transparent campaign. For instance, in this scheme the Austrian regulator, E-Control share its tariffs database with the auction partners, so they could make accurate personalized savings calculation for customers, thereby providing better motivation for them to switch.

Assessment against Criteria

Benefit	Drawback
Consumer choice and protection – customers are able to opt out if they do not want to switch but are offered competitive prices.	Consumer protection – switch rates fall off after initial scheme as not all customers remain engaged.
Consumer protection - Evidence that customers remain satisfied and some continue to switch	Consumer Protection –It is an opt-in scheme and therefore the most passive customers are

<p>(and some re-switch) in successive years, with successive auctions showing increased participation. For example: recurring consumer subscription/participation (30%+) and also much better sales conversion in this group. There are also lower volumes of incoming questions (service calls/email) for this particular groups and even lower complaints (<1%).</p>	<p>unlikely to participate – in our research the switch rate amongst subscribers is ~25%. Opt-out scheme or hybrid scheme would be likely to be more successful in reaching greater pool of consumers.</p>
<p>Competition – Initial prices are reported to be competitive (in comparison with the best offer in the market that has no hidden/misleading high bonus), with average annual saving of €272 reported per account.</p> <p>In the last campaign for the 3 lots/categories:</p> <ul style="list-style-type: none"> • Normal green electricity: winning bid was equal (delta approx. €2) to market leading price with same parameters (no hidden bonus) but approx. €150 more expensive than market leading cheapest product incl. very high hidden bonus. • Special green electricity: winning bid was lower (delta approx. -€25) than market leading price with same parameters (no hidden bonus) • Gas: winning bid was lower (delta approx. -€20) than market leading price with same parameters (no hidden bonus); but approx. €220 more expensive than market leading cheapest product incl. very high hidden bonus. 	<p>CBA – There is a mixed and limited opportunity to assess the CBA. Some marketing channels are measurable and some not. Digital marketing channels (e.g. email direct marketing and direct mail) can be measured/attributed. Prediction is based on historical statistics. The mail management system will tell how many receivers responded to the mailing. With ‘Above the line’ marketing activities or if there is success with free publicity, visitors can often be observed due to the large numbers but not exactly attributed.</p> <p>In the first Austrian auction the majority of registrations were attributed to PR/Press, for the simple reason that Pricewise did not use direct mail, and volume in other channels was low.</p> <p>It would appear that registration rates are modest as a percentage of eligible customers, but switch would we think be higher if contacted directly from the outset.</p>
	<p>Competition – small supplier participation is only possible through carefully designed lot sizes amongst other checks/balances and operational support. If new customer supply contracts are mandated for participation, suppliers may not be able to lay off all their contract risk and could lead to future price hikes after the initial contract period.</p>

Relevance to GB

What benefits for consumers would this approach deliver?

- More competition, savings/increased awareness and transparency/terms and condition validated by a trusted party active in consumer rights – a collective switch offered by a trusted body leads to a lower perceived switching risk for customers who previously had a lower propensity to switch.

How are consumers sufficiently protected from harm, either within or in the absence of the energy regulatory regime?

- The basic requirements for suppliers to join campaigns and auction participation are:
 - Supplier agreement (incl. regulation sections) incl. annexes for participation (i Supplier, ii Product, iii Auction, iv Operations, v. Other).

<ul style="list-style-type: none"> ○ The contract and guidelines are set before the auction and agreed with the participating suppliers. Customer friendly product and terms are part of the agreement. Customer friendly means: no hidden cost, high service levels, transparent bonuses (if any), no penalties, fixed prices/equal contract durations etc. ○ Fulfilling all requirements / checks / audits ○ Product prerequisites are validated/checked before auction day in order to make bids and/or win ● There appear to be no conflicts between the present market regulations in GB and the above requirements, and Pricewise base the migration journey on the regulated switching process in whichever market they are operating in for a given auction. ● Monitored and controlled customer migration journey. These journeys all take place fully on Pricewise campaign websites and not outside. Therefore, Pricewise can monitor, measure, control and support consumers or customers. This is similar to the Amazon web shop concept.
<p><i>How significant are the barriers or costs to implementation of this approach in Great Britain?</i></p> <ul style="list-style-type: none"> ● No significant regulatory barriers have been identified. ● Technical issues and implementation costs are not considered inhibitive – not significantly more challenging or expensive than in Austria. Financial costs are not disclosed, but include e.g. marketing, licencing and other IP costs, IT / technical set-up, testing, and project management, supplier management, marketing and call centre service / customer service costs.
<p>Sources:</p>
<ol style="list-style-type: none"> 1. Interview with Pricewise 2. Pricewise documentation 3. Incumbent suppliers (confidential)

2. One Big Switch Mass Switching Membership Service	
Country	Australia
Sector	Electricity, Gas
Key Points / Why Interesting	
<ul style="list-style-type: none"> • The world’s largest membership-based energy (90%) switching service with over 1,000,000 subscribers • Acts as a negotiating force for customers in the energy market • Up to 300,000 customers switched per year. • Substantial proportion of formerly inactive customers (first time switchers). • As a solution to onboarding upscaling challenges (seen as the key challenge facing large scale switching), One Big Switch (OBS) switch customers throughout the year as their energy contracts become eligible to switch. • Makes use of machine learning to refine targeting and offers and therefore improve response from customers. • Proof of concept has already been established outside of core markets, with campaigns notably in the Republic of Ireland. 	
Context	
<ul style="list-style-type: none"> • <i>High-level Market/ regulatory structure?</i> • <i>When was initiative initiated?</i> 	<ul style="list-style-type: none"> • <i>Commercial Drivers?</i>
<ul style="list-style-type: none"> • OBS operate in Victoria, South Australia, New South Wales, Queensland and Western Australia (Gas only), which represents the lion’s share of the liberalized national energy market in Australia. • Commenced in 2013. These markets are essentially all liberalised in a way that is largely similar to GB: <ul style="list-style-type: none"> ○ Complete unbundling of along the value chain ○ Smart meters partially rolled out (fully rolled out in Victoria) ○ Large incumbent retailers with significant number of new entrant challenger retailers ○ Energy is a well politicized topic and attracts significant media interest • Switching rates have been high across Australia since liberalisation, with Victoria historically being the most active electricity market in the world. • Relatively high consumption levels and volatility in wholesale and retail prices • All factors above contribute to switching and alternatives to the established status quo are often in focus, particularly from the media • Commercial drivers include taking advantage of significant savings available in the Australian market; the ability to secure greater discounts through customer aggregation; significant margins available for retailers; the untapped segment of customers on high default tariffs; and the desire of many customers to be a part of a movement for change in the energy market. 	
Description	
<ul style="list-style-type: none"> • <i>Practical workings</i> • <i>Contractual Relationships</i> • <i>Regulatory Changes Needed?</i> 	<ul style="list-style-type: none"> • <i>Description against success criteria</i> • <i>Incentive arrangements and actor responses</i>

Practical Workings

- OBS constantly negotiates with suppliers on customers’ behalf, en masse.
- The priority is to source the most competitively priced offers from suppliers and then present these offers to the membership base with a clear pathway to switch.
- OBS switches customers throughout the year, rather than all at the same time. This facilitates potential benefits including:
 - Simpler onboarding due to smaller volumes of customers, which allows for greater participation of small suppliers;
 - Diversification of risk by greater splitting of customers so that they can be switched at times that are more suitable to suppliers;
 - Better alignment to time-specific market opportunities, as they arise;
 - Better alignment of switching to coincide with end of customers contracts; and
 - Better alignment to customer segments (e.g. a regional segmentation can make it is easier to focus on one region at a time as the best opportunity in one region may come at a different time to another).
- OBS built a dedicated switch engine capable of onboarding large numbers of customers at one time
- All potential retail clients are tested for onboarding capacity and negotiations are performed with suppliers bilaterally, rather than through open procurement
- Some customers have an agency agreement where they are switched automatically with OBS having power of attorney. Most customers have to give their approval to any offer prior to the switch.

Customer Data Requirements

- Only normal switching-related information is required, such as customer ID (name and address), consumption profile and the current rate that the customer is on.

Success

- Over 1,000,000 subscribers, with approximately 300,000 customers switched each year.
- Customer satisfaction levels are considered high, demonstrated by high levels of retainment and re-switching.
- Customer savings have been proven to be substantial.
- High proportion of first-time switchers engaged in campaigns to date

Keys to Success

- Selection of the right channels is tailored to customer types and accessing a proportion of inactive customers. TV and Facebook are for instance effective for the “tyre-kickers”, customers who are not proactive but interested to know more.
- Timeliness ensures customers are approached when they are most interested (e.g. following price rises and / or media attention) and when opportunities to save are at their greatest. This is especially important for inactive customers who require greater stimulation and may only be interested at exceptional times.

Benefit	Drawback
Consumer choice – almost all customers are eligible and can opt out	CBA – An opt-in scheme, therefore the costs incurred will never reap the benefits of reaching all inactive customers. Adapting to an opt-out scheme is possible, but incurs consumer choice and consumer protection issues
Disruption and service quality (versus other collective switch schemes) - switching throughout the year, alleviating some risks of concentrated onboarding	Distortion potential – remedy has not been tested on larger volumes of switching. Designed to be capable of handling large volumes, but lack of track record means no guarantee that remedy will not introduce distortion

<p>Competition –smaller suppliers are able to participate due to the choice of regions, multiples times for switching and the fragmentation of customer numbers</p>	<p>Competition - The system is based on bilateral negotiation with interested suppliers in the market, rather than an open, public bidding available to all potential suppliers. There is therefore some lack of transparency and breadth to the negotiation process, which could harm competition.</p>
<p>Consumer protection – opt-in scheme means customers can easily choose not to participate</p>	
<p>Relevance to GB</p>	
<p><i>What benefits for consumers would this approach deliver (quantifiable and qualitative)?</i></p> <ul style="list-style-type: none"> • Ongoing, timely and highly targeted customer aggregated deal negotiation at a scalable level. • Potential for greater cost savings for customers as a result • More suppliers would be able to participate (more choice) due to the appropriateness of timing and the fragmentation of customer numbers • Adds to competition in the market and acts to drive energy prices down. Consumers can choose to take the offer presented to them by OBS, negotiate with their existing retailer for a better deal or shop around 	
<p><i>How are consumers sufficiently protected from harm, either within or in the absence of the energy regulatory regime?</i></p> <ul style="list-style-type: none"> • Customers are only offered deals that save them money on their present contract, even though it is not guaranteed that the offer is the best in the market (such a process, in its present form is not a fully transparent and open process including all potential suppliers). • Customers have full access to tariffs and Terms & Conditions and have to agree to all offers before they are switched. • Customers can cancel their membership at any time and at no cost. 	
<p><i>How significant are the barriers or costs to implementation of this approach in Great Britain?</i></p> <ul style="list-style-type: none"> • Similar, but more simple approaches have already taken place in GB and OBS is already operating in the Republic of Ireland. We are not aware of any barriers to the full implementation of this model in GB. 	
<p>Sources:</p>	
<p>1. Interview with the CEO of One Big Switch.</p>	

3. New Jersey BGS (Basic Generation Service) Auction	
Country	USA (New Jersey)
Sector	Electricity
Key Points / Why Interesting	
<ul style="list-style-type: none"> • A model that uses an auction of generation to achieve competitive prices for inactive customers • Customers are not formally switched to a new provider – their contract is still maintained with the initial supplier (their default distribution company) 	
Context	
<ul style="list-style-type: none"> • High-level Market/ regulatory structure? • When was initiative initiated? 	<ul style="list-style-type: none"> • Commercial Drivers?
<ul style="list-style-type: none"> • BGS auction started in 2002 as a means of ensuring competitive prices for a Supplier of Last Resort service • It was the first of its kind, offering a “load-slice auction” approach rather than “block and spot” (where the utility buys specific electricity volume products to meet its supply obligations), and has inspired similar procurement models in other mid-Atlantic and New England states • Several structural differences to GB <ul style="list-style-type: none"> - New Jersey is part of the eastern US PJM zone (originally named after the Pennsylvania-New Jersey-Maryland Interconnection), with single market operator and multiple transmission companies across 13 US states and District of Columbia; - Wholesale market based on day ahead and real time (5 minute ahead) trading, capacity auctions and ancillary services; - Customer bills split into delivery (i.e., distribution) charges and supplier charges; - Four regional Electric Distribution Companies (EDCs) exist in downstream and are the pre-liberalisation incumbent suppliers; - EDCs have monopoly on delivery and therefore apply pre-set tariffs for delivery; - Supply is open to competition and third parties may apply for licences and compete with EDCs for customers; - Around 32% of customer capacity is served by third parties, and the remaining 68% are supplied by their EDC with electricity bought in these auctions (see diagram below): 	
<p>The diagram illustrates the electricity supply chain in New Jersey. On the left, a map of New Jersey is divided into four regions, each associated with an Electric Distribution Company (EDC): Jersey Central Power & Light (top-left), PSEG (top-right), Atlantic City Electric (bottom-left), and another EDC (bottom-right). A large blue arrow labeled 'Electricity Delivery' points from 'NJ EDCs' to 'NJ Residential Customers' with '100%' written below it. To the right, 'NJ Residential Customers' are shown receiving electricity from 'Third Party Suppliers' (~32%) and the 'BGS Auction' (~68%). The 'BGS Auction' is shown receiving supply from 'Auction Winners (Generators, investment funds, retailers)'. Red arrows indicate the flow from Third Party Suppliers and Auction Winners to the BGS Auction, and from the BGS Auction to NJ Residential Customers.</p>	
<ul style="list-style-type: none"> - State of New Jersey Board of Public Utilities responsible for regulation. 	
<ul style="list-style-type: none"> • Smaller system: <ul style="list-style-type: none"> - Peak demand of 18GW ‘v’ 51.6GW for GB • 4 Electric Distribution Companies (EDCs) are: <ul style="list-style-type: none"> - Public Service Electric and Gas Company (PSE&G); - Jersey Central Power & Light Company (JCP&L); - Atlantic City Electric Company (ACE); and 	

- Auction participants are bidding for the obligation to supply a proportion of the total BGS RSCP load, which are allocated in “tranches”. This **includes** energy, capacity, ancillary services, firm transmission service and any congestion costs. This **excludes** costs to meter, bill, serve and distribute, which are covered by the EDC.

Tranches

- Proportion of load may vary over time as customers switch to competitive providers, or if demand changes. All such volume risks are carried by the auction winners
- To accommodate this in the auction, bidders bid on “tranches” for each EDC. These are based on the peak load of **all eligible customers** in each region, including those that have switched suppliers
- EDCs calculate this total load in their region and divide into 100MW tranches.
- The proportion of tranches won per EDC gives the proportion of BGS RSCP load that an auction winner must then supply (e.g. if an auction winner wins a 100MW tranche out of a total of 1000MWs split into 10 tranches, they must supply 10% of the BGS RSCP load)

Auction Format

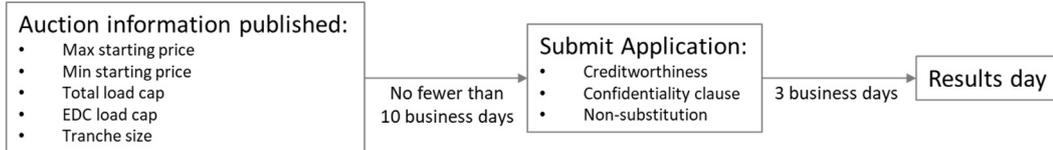
- The auction follows a “descending clock” format. The auction is structured in multiple rounds of bidding, typically taking place over the course of a day, but with end criteria based solely on auction results rather than a time limit¹
- A starting price is announced to bidders that is the same for all EDCs. Based on this price, each bidder communicates how many tranches they can supply to each EDC.
- This information is used to run a second round, where the level of oversupply from the first round bids are used to create a new set of decrement prices, specific to each of the four EDCs. Bidders again communicate the tranches they can supply to each EDC.
- This information feedback is dynamic, with each EDC price decrementing at an individual rate, but with indirect dependence as bidders choose to reallocate tranches to different EDCs between rounds. However, no bidder may reduce the number of tranches bid for a particular EDC unless the price for that EDC has been decremented in that bidding round
- This process is repeated until there is no oversupply, and the final price levels for each EDC make up the set of auction prices. Auction winners are those who have made bids for tranches in the final round

Auction Qualification

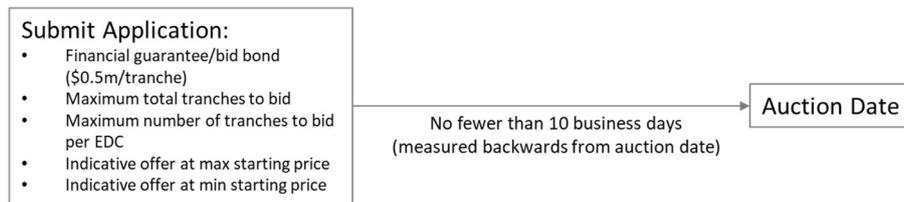
- There are no preconditions to apply for auction qualification, and in particular no requirement to be a licenced entity, and indeed non-generators do participate in auctions; the stringent financial obligations placed in the second stage of the applications process appear to provide sufficient incentive to ensure that all participants are able to meet supply requirements
- Auction application is two-stage. First stage is to qualify bidders, second stage is to ensure a participation commitment and register bidders. This follows the process below:

¹ For example, the 2017 auction began at 8.55am on Monday 6th February 2017. It required 19 rounds and finished at 11.45am on Tuesday 7th February

Application Part 1 – becoming a Qualified Bidder



Application Part 2 – becoming a Registered Bidder



Auction Experience

- Auctions are independently monitored (this role has been held by Bates White, LLC for the past 10 years) and recent experience shows good liquidity and prices are deemed consistent with market conditions (although specific data evidencing this in the auction annual reports are redacted)
- BGS tariff is based off the auction price, with EDCs’ costs to serve adding a small extra component; the auction price coming from the auction makes up ~75% of the supply element
- Auctions attract a wide range of participants. Typically, auction winners have included:
 - Generators
 - Banks and investment funds
 - Energy retailers
- Motivations for participation appear varied, but the most common is matching an upstream asset position

Implementation Options and necessary Regulatory Changes

- Fundamental differences in market structure to GB could lead to unintended consequences; particular areas of difference relate to wholesale market concentration (GB SVT base is ~30% market, whereas all domestic BGS load in New Jersey make up ~4% of PJM) and competitive environment (GB SVT suppliers can compete for customers, whereas NJ EDCs cannot)
- Additionally, some elements of the design need to be amended to align with Ofgem’s overall stances and objectives.
- This leads to several areas where attention is needed:
 - Auction timing and lot sizing needs to be carefully considered in order to avoid any potential to exhaust market liquidity or create a market moving event;
 - Measures to address incumbent response may be needed, where a supplier deliberately tries to switch an SVT customer onto a different tariff, which may increase the level of volume risk costing that is then applied in the auctions and reduces price efficiency;
 - The removal of volume risk on suppliers or consumers reduces the exposure to real time price signals, which in turn may reduce innovation and uptake of demand response in the domestic market. Ofgem would need to consider what design changes should be introduced if this is to be addressed; and
 - The potential for this to impact customer engagement negatively may need to be addressed, if as a result of competitive prices being achieved in the auction, the incentives for customer switching are reduced and the role of competition is curtailed.

- There would also be a need to define the specifics of an auction design, as well as governing arrangements (including new entities to monitor, audit and steer), and any funding considerations.
- Regulatory change may require primary legislation, if a new auctioning body is needed (as an alternative, suppliers could offer their own auctions for the SVT base, which would not require a new entity to be established, or an existing entity could take on the responsibility).

Assessment against Criteria

Benefit	Drawback
Competition – inactive customer supply contracts become open to a potentially wider market	CBA – costs would certainly be involved with no guarantee of consumer benefits a priori; only after auction outcome are benefits calculable
Service quality – consumers are not exposed to switching process, therefore service quality remains constant	Distortion of market – default rates may outcome below non-SVT tariffs. As seen in New Jersey, the default prices are competitive and frequently cheaper than third party offerings
Consumers’ personal choice – no restriction on consumers’ future ability to switch supplier	Disruption to the market – third party default is not socialised across all parties, rather it is only felt by incumbent suppliers to whom they are contracted. This is only a risk if creditworthiness requirements are not high enough, and third party default occurs
Innovation – additional route to market in upstream may lead to greater variety of commercial approaches	Competition – risk that the role of third party suppliers may be curtailed if this mechanism removes the need for customers to engage with the market in order to achieve lower prices
Consumer Protection – no change to customer-supplier relationship under this model where to access a competitive tariff the customer does not need to go through a migration journey	Innovation – risk of reduced role of third party suppliers has knock on risk of loss of innovation. Reduced ability to respond to real time signals may also reduce innovation
	Competition – potential loss of liquidity in other wholesale forward markets if large portion of GB demand is contracted through bilateral contracts with upstream players

Relevance to GB

What benefits for consumers would this approach deliver?

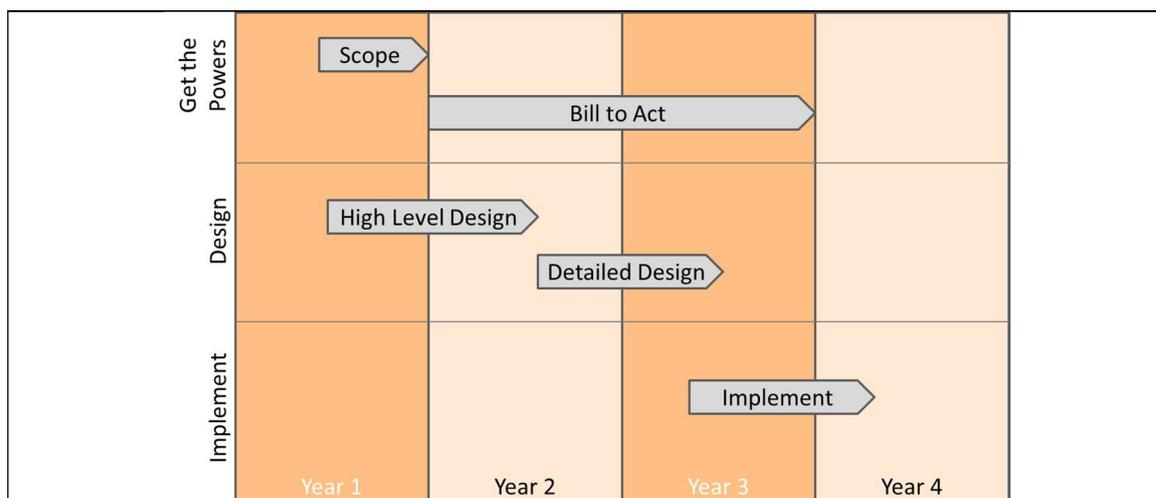
- Lower prices driven by competitive auction model
- No actual switch needed and no risk of disruption through changing customer-supplier relationship
- No limitation on future switching

How are consumers sufficiently protected from harm, either within or in the absence of the energy regulatory regime?

- Consumer-supplier relationship not fundamentally impacted, therefore low risk of consumer harm arising from a migration journey
- Current SVT prices are likely to act as a price backstop – in New Jersey, the default rate is more competitive than rates offered by some third parties, whereas in GB SVT rates are amongst the most expensive in the market. For this reason, even if the regime does not deliver the same level of relative cost benefit, it is unlikely to result in a worse cost outcome than the current regime, where SVT rates are already amongst the most expensive tariff rates in the market

How significant are the barriers or costs to implementation of this approach in Great Britain?

- If a new entity is needed as auctioneer, legislative barrier may be material, especially in terms of time required to enact change. With primary legislation needed, an indicative timeline may be as given in the diagram:



- If primary legislation is not needed, potential for far lower barriers to implement – licence change for an existing entity to assume new role and licence changes for existing suppliers to enforce purchase through the auction
- Some thought may be needed to address:
 - Barriers of incumbents switching SVT customers onto other tariffs and in so doing undermining the auction model. A licence condition may mitigate this, although capturing the details exactly so as not to prevent incumbents providing a genuinely value-generating proposition to existing customers may be difficult;
 - Barriers around the blunting of real time signals under such an arrangement – exposure to real time prices is not felt by the supplier or consumer where the auction winner accepts all balance responsibility. As a result, there would be lower DSR incentives on consumers, which may require some changes to the details of an auction design to rectify (e.g. reallocate risk so that the supplier/customer has to cover some volume fluctuations, and therefore respond to real time price signals).
- Cost barrier to implement may exist if GB regime needs either a greater volume in the auction or more frequent auctions. Given the size of SVT base, there may be a need to run a larger auction (which could impact wholesale market liquidity), or run more frequent auctions (which may increase the cost to operate the regime), Without due design consideration, this could introduce an implementation cost or barrier
- Potential cost barrier in terms of design and set up will need addressing and could be significant, including:
 - Cost to design an auction;
 - Cost to project manage a change programme;
 - Cost to create new bodies to run and monitor the auction; and
 - Cost to run new functions to regulate prices or calculate resulting tariff rates.

While estimating these costs precisely is difficult, the total number of RSCP customer accounts in New Jersey is ~2.3m, which is over five times smaller than the number of SVT accounts in the GB market. Therefore, the cost of such a remedy can be applied to a larger customer pool and will therefore be far lower on a per customer basis in GB.

Sources:

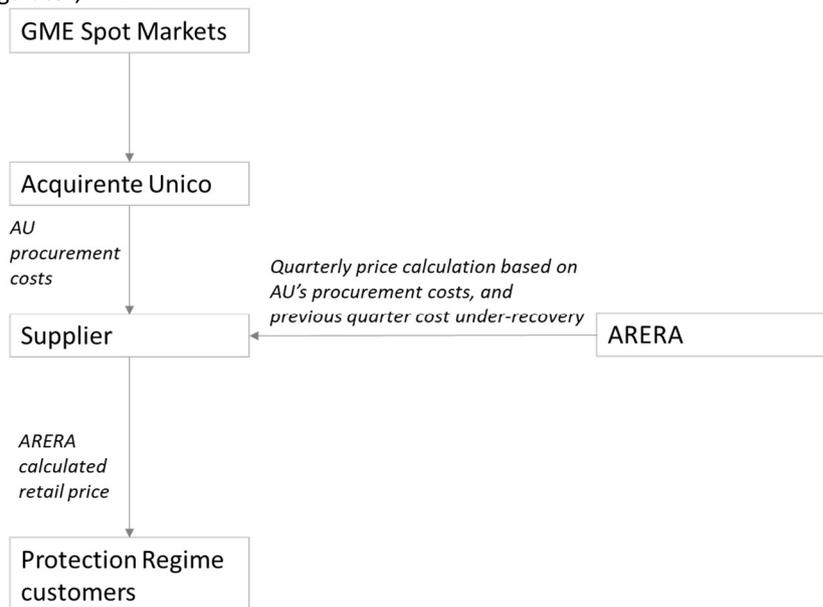
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10. https://www.eprg.group.cam.ac.uk/wp-content/uploads/2018/03/S.-Littlechild_28-Feb-2018.pdf
11. Discussions with Peter Cramton, Professor of Economics at University of Cologne and University of Maryland

4. Acquirente Unico Price Control	
Country	Italy
Sector	Electricity
Key Points / Why Interesting	
<ul style="list-style-type: none"> Regulated default tariff arrangements offered to customers either through incumbent regional DSO or a company spun off from a regional DSO Central procurement by state body, setting prices for these customer supply companies 	
Context	
<ul style="list-style-type: none"> <i>High-level Market/ regulatory structure?</i> <i>When was initiative initiated?</i> 	<ul style="list-style-type: none"> <i>Commercial Drivers?</i>
<ul style="list-style-type: none"> Key details: <ul style="list-style-type: none"> Wholesale markets able to operate with trading in forward and spot markets Retail market liberalised in 2007, with third parties able to compete for supply contracts ARERA responsible for regulation Several structural differences to GB: <ul style="list-style-type: none"> Inactive customers, i.e. those who have never switched and are still supplied by legacy incumbents, but since 2007 these legacy suppliers must purchase their supply from a central buyer, Acquirente Unico Legacy suppliers do not compete for other customers, therefore their entire supply obligation relates to this customer base Retail market dominance persists, with the formerly state-owned supplier ENEL still holding 73% of the free market share (remaining 27% has moved to third parties through competition, rather than forced divestment) System differences: <ul style="list-style-type: none"> Annual domestic load of 57TWh 'v' 108TWh for GB Gas prices far higher than in GB Threshold applied on electricity consumption with penal element for consumption over 3kW 	
Description of alternative default arrangement	
<ul style="list-style-type: none"> <i>Practical workings</i> <i>Contractual Relationships</i> <i>Regulatory Changes Needed?</i> 	<ul style="list-style-type: none"> <i>Description against success criteria</i> <i>Incentive arrangements and actor responses</i>

Overview of mechanism

- Since full liberalisation in 2007, around two thirds of customers have not switched from their incumbent provider and receive supply from either a regional DSO or a company spun off from a regional DSO
- Such customers have received the maggior tutela, or “Protection Regime”, tariff
- Protection Regime suppliers must purchase their electricity from Acquirente Unico, a public regulated central purchasing body
- Acquirente Unico’s procurement costs are passed through to customers in a tariff that is calculated by the regulator, ARERA



- Formerly, Acquirente Unico could source supply less prescriptively, engaging with third parties for long term bilateral contracts for up to 25% of the total load, alongside spot and forward market trading and cross border trades
- Acquirente Unico since 2016 is restricted to spot market purchases only – this was part of an adjustment to bring protection regimes in line with the new Tutela Simile regime and part of the wider transition to more competitive supply arrangements (see below)
- Acquirente Unico also runs the Supplier of Last Resort service, as well as portals for switching, petroleum storage and customer helpdesks

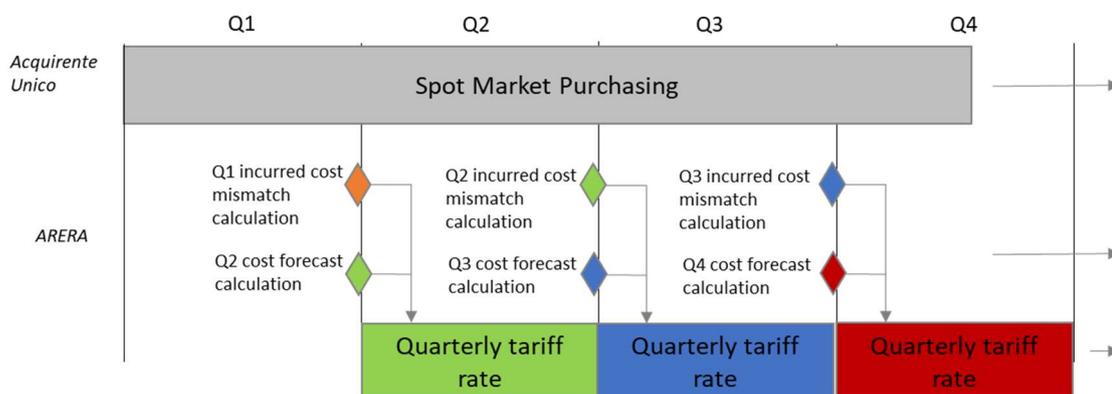
Upcoming changes to regime

- Wide-ranging Italian Competition Law has come into effect in 2017 and enforces the abolition of this Protection Regime by 1st July 2019
- To facilitate transition to fully un-protected model, Acquirente Unico offers a bridging service for customers to be introduced to the free market (Tutela Simile, the “Similar Protection” service)
- Under Tutela Simile, customers may sign up for a 12 month, non-rolling supply contract with a third party, where the contract terms are harmonised across the market. Suppliers compete by offering a discount against the Protection Regime rate
- What happens to customers who remain inactive and do not use the Similar Protection is an ongoing topic of discussion

Translation from wholesale price to tariff

- Tariff is broken into two elements: the **energy** component and **retail** component;
- The **energy** component is based on a rolling quarterly tariff calculation performed by the regulator, ARERA

- A weighted average of Acquirente Unico’s estimated procurement costs are applied to a customer’s consumption profile
- A cost recovery element is also applied for any mismatches in the previous quarter



- The **retail** component is based on supplier balance sheet analysis and aims to meet the cost of acquisition for a new entrant, including cost to bill, cost to serve and credit risk.

Implementation Options and necessary Regulatory Changes

- Primary legislation needed in order to appoint a Single Buyer
- Licence drafting will be needed for a new entity
- Possible to graft onto existing entity (e.g. local DNO, National Grid) rather than appoint a new entity
- Associated decision on the role of a default supplier needed – if a default supplier is instilled to provide all default customers, this entity may also be the single buyer
- Arrangements and governance needed to ensure that prices achieved are market-reflective. This could be through a price control or mandated purchasing approach
- Decision needed on how to translate achieved wholesale price into tariff rate (e.g. what additional cost elements to include, who is responsible for calculating, how frequently to calculate)

Assessment against Criteria

Benefit	Drawback
Consumer protection – inactive customers receive a transparent, stable market reflective price, which has been designed and calculated specifically to reduce opportunity for suppliers to make profit above wholesale price	Competition – no signal for customers to switch leads to reduced competition in retail market
Consumer Protection – no change to customer-supplier relationship in low change model	Innovation – risk of reduced role of third party suppliers has knock on risk of loss of innovation
Service quality – consumers are not exposed to switching process, therefore service quality remains constant	CBA – additional cost to consider of ongoing role of regulating purchaser and setting tariff prices
Consumers’ personal choice – no restriction on consumers’ future ability to switch supplier	Disruption – implementation of new central buyer could cause one-off disruption, or if other models with similar new entity appointments

Relevance to GB

What benefits for consumers would this approach deliver?

- Central buyer model ensures wholesale market-reflective prices and fairly set retail price element
- Quarterly tariff recalculations lead to protection from real time volatility in pricing

How are consumers sufficiently protected from harm, either within or in the absence of the energy regulatory regime?

- Consumer-supplier relationship not fundamentally impacted, therefore low risk of consumer harm depending on whether a new entity is created
- Incentive of default supplier to game or increase prices is reduced by removing ability to compete
- Wider protection of competitive market would however need to be carefully considered – Italian market demonstrates that the default price is more competitive than prices offered by some third parties, which could lead to a less competitive retail market overall. To the extent that competition delivers lower overall costs to consumers, there is therefore a risk that this loss of competition could harm consumers

How significant are the barriers or costs to implementation of this approach in Great Britain?

- If primary legislation is needed (i.e. role cannot be grafted onto existing entity), the implementation would take around 3 years
- If primary legislation is not needed, potential for far lower barriers to implement – licence change for an existing entity to assume new role and licence changes for existing suppliers to enforce purchase from the Single Buyer
- Some additional costs are likely to be incurred in overall governance (e.g. cost to implement and run Single Buyer function, extra cost to Ofgem to regulate prices/calculate tariffs)

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