

Minutes of Sustainable Development Advisory Group meeting

This is a record of Ofgem's Sustainable Development Advisory Group meeting, held 19 March 2019	From	Ian Stone and Kiran Krishna
	Date and time of Meeting	13 March 2019 10.00-12.30
	Location	10 South Colonnade

1. Attendance and apologies

1.1. See annex for those attending the March 2019 SDAG meeting.

2. Updates and agreement of minutes

3. What we did with your Advice

- 3.1. Joe Perkins (Chief Economist, Ofgem) provided an update from the Future Retail Market Design team who presented an item on future retail arrangements at the June 2018 SDAG.
- 3.2. We've published our [response to our call for evidence](#) on the current "supplier hub" retail market arrangements
- 3.3. We launched a joint review with BEIS late last year (speech from the Secretary of State available [here](#), 1 pager update on the review available [here](#), recent blog from Ofgem available [here](#)).
- 3.4. In terms of next steps for the BEIS-Ofgem Future Energy Retail Market Review, we will be continuing to engage stakeholders on our project over the spring, as we develop some reform options for a joint consultation due in the summer. Government has said that it would be ready to legislate in a subsequent session of this parliament if necessary (depending on the outcomes of the review).

4. Regulation of Heat

- 4.1. Ofgem currently has no formal role in heat regulation but the indication is that we will be given one. The team presented a presentation running through the background of heat and outlined the two key questions for the group:
- 4.2. How can a flexible approach to regulation be adopted whilst ensuring the CMA's recommendations on pricing and service quality are delivered for all heat consumers? What are the key risks?
- 4.3. To what extent should Ofgem, if appointed as sector regulator, have a role in ensuring the ongoing activities of heat network owners are aligned with evolving public policy priorities (e.g. extension to low income consumers, connection of low carbon heat sources, prevention of cherry-picking, networks joining up, etc.)?
- 4.4. BEIS are very interested in heat networks as they represent a low regrets decarbonisation option. £320m has already been committed via the Heat Networks Investment Project.
- 4.5. BEIS are looking to develop a market framework in order to attract investment. BEIS believe that £16bn will be needed to reach 17-24% of heat networks but investment

needs de-risking. With regards to regulation the framework will need to take into account consumer protection and industry standards.

- 4.6. The team also noted that in Scotland heat policy is devolved but consumer protection isn't.
- 4.7. One member queried whether any cost benefit analysis had been done regarding the £16bn figure. The team explained that the scenario comes out of the contribution to decarbonisation that these heat networks provide.
- 4.8. The member also raised the question of how many of these heat networks will be low carbon. The team responded that new networks are anticipated to be low carbon-for example they may use large scale water source heat pumps.
- 4.9. Members asked whether the team had considered other countries with more developed heat systems, such as The Netherlands or Scandinavian countries. These countries had faced issues regarding creating a transparent environment for consumers so that they are aware of what heat networks are and how they're affected by them.
- 4.10. The unbundling or separation of services was raised as something that should be considered. In the Netherlands the separation of generation and retail is key to the heat set-up.
- 4.11. Members were interested in the comparison between heat networks and gas and electricity networks. Members noted that there is a chance to learn lessons from the energy system and make sure the differences between the different sectors are known, once again highlighting the importance of transparency. Much like gas and electricity, heat networks will have separate equivalents to generation, network cables/pipes and the retail element.
- 4.12. Customer service is also a key consideration, as there is a huge change process involved when connecting customers to heat networks and it is important to ensure that customers embrace the change to make the transition easier.
- 4.13. There was some concern that the role of trusts was not mentioned in the presentation. One member stated that they currently make up 10% of the market and their role to date should be considered.

5. Ofgem's Sustainability Objective

- 5.1. Mary Starks, Ofgem's Consumers and Markets Director joined the meeting for this discussion.
- 5.2. Martin Cave introduced the item on what Ofgem should be doing with regards to its sustainability objective.
- 5.3. Members highlighted that this is a critical discussion for the regulator and that there is an absence of clarity over what is meant by sustainability in this context. As a result, discussions around sustainability tend to be relegated to the "third or fourth tier".
- 5.4. The links between sustainability and vulnerability were highlighted, along with the fact that Ofgem has made huge steps forward on vulnerability and similar steps on sustainability would be welcome.
- 5.5. In terms of social outcomes Ogem is not the main engine for change (government is). However, Ofgem should and has done its bit in this area and could do the same for sustainability, taking opportunities to move in a positive direction while recognising that Ofgem does not have a big stick to wield.

- 5.6. With regards to network companies, once again the vulnerability example was raised to show where prompts and pushes by the regulator can encourage companies to go above and beyond. Using vulnerability as an example, one member noted that networks should not be encouraged to cross subsidise but should be nudged in the right direction.
- 5.7. One member brought up the work of Sustainability First in this area who have done a lot of work looking at these issues.
- 5.8. Overall it was agreed that the sustainability question is a long discussion to unpack, and that SDAG could potentially revisit it in greater detail at a future meeting.

6. Licensing Review

- 6.1. Ofgem's licensing team took the group through the background of the licensing review.
- 6.2. The questions they posed to the SDAG were:
 - 6.3. 1. Do you think our 'theories of harm' diagram and key risk factors are a true reflection of what is happening in the market?
 - 6.4. 2. Do you have any views about whether our four areas for the 'ongoing' stage of our review are the right areas to focus on to mitigate the harms to consumers and/or market?
- 6.5. The presentation ran through the context of the licensing review, namely that we have gone through an evolving market with high volatility. This has led to a large number of supplier failures. It is normal in a competitive market for companies to fail—we do not want the retail market to be a zero failure regime. However, Ofgem does believe there are things we can do to increase scrutiny, raise standards and reduce the impacts when suppliers get into difficulty.
- 6.6. The presentation ran through a number of theories of harm and highlighted additional risk factors as part of the ongoing review.
- 6.7. In the ensuing discussion, a member suggested that it was probably clear what the issues were, with the question being whether Ofgem has learnt lessons from those. A way to approach this could be by reflecting on the warning signs.
- 6.8. Another question posed was what the optimum number of failures is. We don't want a structure where no-one fails but on other hand the number of failures has been too high.
- 6.9. It was suggested that one issue is that there is not a level playing field on entry, with obligations only coming into effect when entries reach a certain level.
- 6.10. A strain was also being seen on those who expected smart meters to be everywhere but now are still needing to use traditional metering, and there was uncertainty over whether this was captured.
- 6.11. There was a suggestion that there needs to be an easy way into a digital market. Digitisation is an easier way to get customers, and the natural result will be more firms, but also more failures.
- 6.12. A member noted that in most markets customers would take on the risk of failure, but in this market that is not possible.

- 6.13. Another said to keep a sense of balance despite supplier failures, as there have been a number of suppliers that have been a success and put pressure on the prices of the 'Big Six' as a result.
- 6.14. It was also suggested that as Ofgem has been trying to foster competition from the outset, the rules of entry have not been quite as strict as they otherwise might have been. The question is what we should do now going forward to make sure the entry process is timely and stricter.
- 6.15. Martin Cave stated that there was not much appetite for new entry in the market at the moment so it seems like a good time to be considering this.
- 6.16. Impacts of subsidies and their costs should be considered. For example, the FIT and RO schemes and the recent failures of small suppliers failing to meet them. Is this an easy stick to beat decarbonisation with by the press, as these costs are shared across all suppliers?
- 6.17. The cross subsidy point was brought up once again.
- 6.18. One attendee pointed out that vulnerable consumers are important to consider as there are issues with them being able to switch.
- 6.19. There is also the issue of the challenges suppliers face when they move from being a small supplier to a medium supplier, and the extra costs and obligations that entails.

7. AOB

- 7.1. Some points on the RHI were briefly raised.
- 7.2. A question was put forward on whether the SDAG should be more focused on sustainability or maintain its wider focus. This is something to discuss in more depth.
- 7.3. It was decided that the next meeting will be moved to 18th June.

8. Date of next meeting

- 8.1. The next meeting will be held on 18 June 2019 from 10:15 am to 12:30 pm.

9. Annex – Attendance and apologies

9.1. Those in attendance were:

Attending

- David Sigsworth
- Phil Jones (Northern Powergrid)
- Nina Skorupska (REA)
- Paul Ekins (UCL Institute for Sustainable Resources)
- Graham Edwards (Wales & West Utilities)
- Tim Rotheray (The ADE)

Dialling in

Jennifer Pride (Welsh Government) (Dialling in)

Steve Crabb (British Gas) (dialling in)

James Hemphill (Scottish Government) (dialling in)

Ofgem

Martin Cave

Mary Starks (for item 4)

Joe Perkins

Ian Stone

Kiran Krishna

Sean Heywood (for item 3)

David Hawkey (dial in for item 3)

Ruth Saunders

Phillipa Pickford (dial in for item 5)

Valerie Graham (dial in for item 5)

Apologies

Tony Grayling (Environment Agency)

Adam Scorer (NEA)

Doug Parr (Greenpeace)

Derek Lickorish (Chair, National Energy Action)

Nick Eyre (Oxford University)

Prys Davis (Welsh Government, Jennifer Pride is deputising)

Victoria MacGregor (Citizens Advice, has now left her replacement Gillian Cooper is not yet a member)

Dhara Vyas (Citizens Advice, would normally deputise for Victoria)

Stuart Matheson/ Sue Kearns (Scottish government, James Hemphill is deputising)