



Making a positive difference
for energy consumers

To: All energy suppliers,
consumer representatives and
other interested parties

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SUPPORTING RETAIL INNOVATION: POLICY CONSULTATION ON ABILITY TO PROVIDE DEROGATIONS FROM CERTAIN STANDARD LICENCE CONDITIONS (SLC); AND, GRANTING SUPPLY LICENCES FOR SPECIFIC GEOGRAPHIC AREAS OR PREMISES TYPES

1. Introduction

This open letter consultation is seeking your views on: proposed changes to supply licence conditions to enable Ofgem to provide relief from certain supplier obligations (derogations); and our approach to granting supply licences for specific geographic areas and for premises types. Our aim is to foster innovation in the retail energy market.

Our Decarbonisation Action Plan set out our priorities and the steps we will take to help achieve 'net zero' at lowest cost. One of those priorities is to accelerate innovation to create products and services that help consumers use energy more efficiently and in ways that support decarbonisation.¹ We want to help existing market participants and potential entrants to bring forward new propositions in the retail energy market by adapting regulatory requirements to enable more experimentation and innovation. In doing so, we will ensure that the interests of energy consumers remain protected, and the integrity of the system and markets are maintained.

The energy sector rulebook sets the high standards we expect of an essential service. The rules are in place for good reason, ensuring that our homes and businesses receive

¹ For further background see: Ofgem, [Decarbonisation Action Plan](#) (February 2020) and Ofgem, [Strategic Narrative 2019-2023](#) (July 2019)

the services they need, that all the players are clear about their responsibilities and how to interact and, above all, that consumers are protected. However, not all rules can be written with foresight of new technologies or business models and as we transition to a low carbon system, the rules that govern it will need to change too. Where an innovator wants to trial something novel or launch a new business, some rules might act as barriers in enabling this to happen. One way we can better enable innovation is to be more flexible in providing relief from certain obligations, where this can be demonstrated to be a way for beneficial new business models, products and services to emerge.

We outlined in February 2020² the actions we are taking using our existing powers to provide the flexibility innovators need, including: launching an expanded Sandbox service³; extending our ability to provide relief from certain supplier obligations (namely granting derogations⁴); and taking a more permissive approach to granting supply licences for specific geographic areas or premises types.⁵ This consultation is seeking views on specific proposals about the ability to grant derogations from obligations in relation to universal service and offering a wide range of payment methods (section 3) and, more broadly, on the factors we would consider in assessing requests for derogations or applications for licences for specific geographic areas or premises types (section 4).

2. Ensuring regulation supports innovation

We have taken significant steps in recent years to address potential barriers to innovation. In particular, we have sought to regulate more using high-level principles and remove unnecessarily detailed rules. Nevertheless, from the information we have gathered, we understand that there remain aspects of regulation that may unintentionally block firms from bringing potentially beneficial products and services to market. Regulations may require an activity to be done in a certain way, may prohibit certain activities or may require firms to undertake additional activities. This can rule out products or services that do not meet these requirements and may be a particular issue for firms trying to develop and apply new technologies to new markets or those that have offers focused on a particular market segment. The outcome may be that products or services which could deliver beneficial consumer outcomes are not able to come to

² Ofgem, [Supporting retail market innovation for net zero](#) (February 2020)

³ Expanded Sandbox service launched 20 July 2020 - see [Energy Regulation Sandbox Guidance Notes](#) for more information

⁴ A process through which, in some circumstances, licensed suppliers can apply for particular provisions of their supply licence to not apply to them

⁵ We have powers to award electricity and gas supply licences that are restricted to specified geographies and/or specified types of premises

market. This consultation is considering two tools we could use to foster innovation to drive consumer and decarbonisation benefits:

- **Derogations:** In some circumstances, licensed suppliers can apply to Ofgem for a 'derogation' from a particular provision of their supply licence.⁶ If granted, this means those provisions of the supply licence will not apply to them. When granting a derogation, we can place conditions and/or alternative requirements on the supplier. There is normally an expiry date as well as provisions for circumstances for revoking the derogation.
- **Supply licences for specific geographic areas or premises types:** Electricity and gas supply licences are usually granted on a GB-wide basis. However, we have powers to award supply licences that are restricted to specified geographies and/or specified types of premises.⁷ This could allow licensees to specialise and offer more targeted and potentially innovative products and services. The holder of such a licence could only supply to customers in the specified geographic area and/or to specified types of premises, with the full terms and conditions of the licence applying otherwise.

Whilst the two tools may achieve broadly the same policy aims in some cases, there are important differences between them. For example, a gas or electricity supply licence remains in force unless revoked in accordance with its terms, whereas a derogation could be time limited. Also, the implications of a breach differ: for example, not meeting the conditions of a derogation would be a breach of licence conditions, which could result in Ofgem enforcement action. Whereas, for example, supplying a customer outside of the geographic area specified in a licence would be a breach of licence terms and statutory obligations, a criminal offence. Furthermore, there is more flexibility to attach and change conditions to a derogation (eg its duration, reporting requirements) compared to a licence. Which tool may be most appropriate will depend on the circumstances of a particular case.

⁶ The applicant may already hold a supply licence or be applying for one in parallel with the request for a derogation

⁷ These powers derive from the Gas and Electricity Acts which allow a licence to have a 'specified area' and/or to include only premises that are individually specified or meet a specified description. They are applied through the application process for a supply licence set out [here](#)

3. Developing derogation provisions

A limited number of licence conditions currently include explicit provisions for us to consider granting derogations (see Annex 1). These cover a range of different obligations and have been used for various policy aims, for example, Licence Lite applications⁸ and default tariff cap exemptions for some tariffs. In general, we have granted derogations to address unintended consequences arising from compliance; in this letter, we are considering whether we can repurpose derogations to be more permissive of innovation. This is a shift from our previous approach to derogations intended to unlock benefits from innovation.

We have information from various sources about the potential benefit of using derogations to support innovation. The joint Ofgem-BEIS Future Energy Retail Market review and associated consultation considered derogations currently available in the context of incremental reform and supplier specialisation, and included discussion of the universal service provisions.⁹ Our continuing engagement with suppliers and innovators via our Innovation Link team has also provided relevant information. There are indications that those licence conditions which already have explicit derogation provisions may not be the ones preventing specialisation and that others – where there is currently no provision to provide derogations – are more problematic. The following have been highlighted:

- Universal services (SLC 22.3), which implements universal service obligations¹⁰ and requires suppliers to serve any domestic consumer who asks, ensuring consumers have access to energy, an acceptable minimum level of service, and are offered choices transparently and without discrimination.
- Payment methods (SLC 27.1), which requires suppliers to offer a wide range of payment method options and ensures consumers are able to pay for energy using their chosen method and without discrimination.

The choices and protections provided to domestic consumers by these licence conditions are fundamentally important and will remain so. We are adamant that we want to preserve the outcomes they ensure in the market – guaranteed consumer access to a wide choice of energy offers and a wide range of payment methods. However, the way in which we seek to achieve these outcomes may also prevent specialisation or make it

⁸ See: <https://www.ofgem.gov.uk/licences-industry-codes-and-standards/licences/licence-lite>

⁹ BEIS and Ofgem, [Flexible and responsive energy retail markets, Putting consumers at the centre of a smart, low carbon energy system](#) (July 2019)

¹⁰ DIRECTIVE [2009/72/EC](#) DIRECTIVE (EU) 2019/944 [Article 27 Universal service](#)

more complex or costly, thereby preventing or delaying some benefits from innovation being realised. The changes we propose are intended to widen the range of innovations offered and innovators offering them. This has the potential to benefit all consumers by making the energy system more efficient. We recognise some consumers may benefit more than others, therefore any changes we make as a result of this consultation will need to balance the potential tensions between the protections at the heart of these licence conditions with the benefits to consumers from enabling greater specialisation by suppliers. Section 4 sets out the range of factors we would take into account when considering applications.

We consider that there are benefits in using our existing powers to modify these licence conditions (and/or any others identified through this consultation process) to enable us to grant derogations from them. Subject to this consultation, we will consult on licence changes.

We also want your views on the potential effectiveness of granting a licence for specific geographic areas or premises types if the proposed changes to SLC22.3 and 27.1 are made. Provisional licence drafting is provided in Annex 2.

Question 1
What benefits (including for consumers, decarbonisation and inclusivity) and risks do you envisage if Ofgem were to have the proposed ability to provide derogations from Standard Licence Conditions 22.3 and 27.1?
Question 2
Does the proposed additional licence drafting for Standard Licence Conditions 22.3 and 27.1 set out in Annex 2 achieve the stated aims?
Question 3
Are there other Standard Licence Conditions which, in your view, would benefit from the inclusion of the ability to be derogated from? Please provide details and reasoning (including benefits for consumers, decarbonisation and inclusivity).
Question 4
Are there any circumstances you can identify that a derogation under certain Standard Licence Conditions may be more or less appropriate or effective in enabling innovation, than granting a licence for specific geographic areas or premises types? Please provide reasons.

4. Assessment considerations

The reforms we propose here would give Ofgem the ability to grant derogations in a wider range of circumstances than at present. Whether we would do so for any given application will depend on an assessment of the merits of each individual case. We would apply appropriate criteria to assess applications either for derogations or for supply licences that authorise supply by geography or premises type. These criteria will align with our policy objectives around fostering innovation and will have regard to our principal objective and our statutory duties.

At a high level, we expect that as part of the application process for a derogation or licence, suppliers/entrants would need to provide general information about their firm, the products or services they are looking to offer and to set out the reasons they believe they need relief from certain licence obligations, or a restricted licence. Our assessment would take into account a range of factors and is likely to include consideration of the extent to which the proposal:

- Would deliver something demonstrably innovative.
- Would benefit consumers, for example through lower bills or better quality of service.
- Would contribute to decarbonisation.
- Would promote inclusivity and better social outcomes.
- Demonstrates an appropriate approach to managing any risks to consumer outcomes, particularly for those in vulnerable situations.
- Would have a material impact on the effectiveness of competition between market participants, and the general functioning of the energy market.
- Would impact on energy system integrity.

We would also consider the extent to which the similar benefits could be reasonably achieved without a derogation or licence restricted by geography or premises type.

The changes we propose are targeted at accelerating retail innovation and the benefits this may bring to consumers. We recognise there are risks to manage from allowing a firm to operate in a way that others cannot and trade-offs between the potential benefits of enabling innovative products and services and the potential risks of consumer detriment or wider market impacts. The assessment criteria will, therefore, need to allow us to deal with these trade-offs. For example, the trade-offs may differ depending on the potential scale of the proposition in question – the more customers involved or the bigger the geography covered and duration will have a bearing on the related risks and

therefore on our decision-making. Similarly, our ability to impose conditions and/or monitoring arrangements could also be relevant factors. We also recognise there are inherent differences in the derogations and licensing processes to consider.

We consider that the changes proposed will better enable us to support innovation. Nevertheless, we will not allow firms to: treat customers unfairly or artificially avoid serving consumers in vulnerable situations; avoid paying their fair share of the costs they impose on the system; or leave significant costs for the market to bear if they fail.

Taking into account consultation responses as appropriate, we will further develop proposed assessment criteria.

Question 5

Do you have any comments on the high-level considerations proposed for assessing derogation requests and/or for applications for a supply licence based on geography or premises type? Do you have any views on the how the trade-offs which may arise could be suitably addressed?

5. Guidance

To provide clarity to potential applicants on our expectations and objectives for derogations, we will also consult on updated guidance relating to the granting of derogations (consolidating existing retail market guidance where appropriate¹¹). The guidance will set out more detail on proposed assessment criteria as well as information about the process we will follow for assessing derogation applications. Similarly, we would also expect to amend the relevant sections of the current guidance on applying for a gas or electricity supply licence¹² as it relates to licences for specified geographic areas or premises types, and the process for applying for a derogation alongside a licence application.

6. Next steps

We expect the proposed changes to enable and accelerate innovation in the retail market for the benefit of consumers, including promoting decarbonisation and inclusivity. In using any new abilities to grant derogations we will seek to avoid unintended consequences and will monitor and review the impact of the proposed changes.

¹¹ For example: [Guidance for derogation requests from domestic Retail Market Review \(RMR\) licence conditions](#) and ['Licence Lite': SLC 11.3 operating guidance](#)

¹² See [page 39 of Guidance Applying for a gas or electricity licence \(June 2018\)](#)

We will now take this forward by:

- Offering stakeholders an opportunity to hear about the proposals and clarify any points through a workshop.
- Offering bilateral meetings to seek views and explore issues.
- Considering responses to this consultation, publishing our conclusions and:
 - Finalising and consulting on changes to the relevant guidance on applying for a gas and / or electricity licence and on derogations.
 - Issuing a statutory consultation process in respect of proposed modifications to gas and electricity supply licence SLCs to include derogation provisions.

Our aim is to fully complete this process by early 2021. We recognise potential constraints on the industry at the current time and we are therefore allowing twelve weeks for stakeholders to respond to this consultation. Responses should be sent by 5pm on 12 October 2020. Please contact us if you are interested in being involved in our engagement activities during the consultation period – contact Rob Thornes (rob.thornes@ofgem.gov.uk).

Yours faithfully

Neil Barnes
Deputy Director, Consumers and Markets

Annex 1 – Examples of supply licence conditions that currently include specific derogation provisions

This table illustrates the range of SLCs that include derogation provisions rather than those which might have some innovation aspect. This is not necessarily an exhaustive list and we may be able to provide derogations from other licence conditions not listed here.

SLC	Title
11.1	Distribution Code and Grid Code
11.2 & 11.3	MRA, DCUSA, CUSC and BSC
21BA	Backbilling
22A	Unit Rate, Standing Charge and Tariff Name requirements
22C	Fixed Term Supply Contracts
22D	Dead Tariffs
22E	Unmetered Supply Arrangements
23	Notification of Domestic Supply Contract terms
23.3	Price increases/unilateral variations
23A	Mutual Variations
31E	Overarching requirements
31F	Encouraging & enabling engagement
31G	Assistance & advice information
31H	Relevant Billing Information, Bills and statements of account
31I	Contract changes information
48.2	Smart Energy Code

**Annex 2 – Draft Licence Condition: additions to Standard Licence Conditions
22.3 and 27.1**

Derogation

1. The Authority, following consultation with the licensee and where appropriate any other person likely to be materially affected and after having regard to any guidance issued by it in accordance with paragraph 2, may give a direction (“a derogation”) to the licensee that relieves it of its obligations under [this licence condition] in respect of such parts of the condition, to such extent, for such period of time and subject to such conditions as may be specified in the direction.
2. The Authority may issue, and may from time to time revise, guidance regarding the manner in which it will exercise its powers under paragraph 1.
3. The guidance issued in accordance with paragraph 2 may, in particular, set out:
 - (a) the process for requesting the Authority to grant a derogation under paragraph 1;
 - (b) the type of information that is likely to be required by the Authority as part of that process; and
 - (c) the criteria the Authority would have regard to in considering whether and to what extent to exercise its power to give a direction under paragraph 1.