

Sent by email

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01 March 2018

Dear Neil,

FUTURE SUPPLY MARKET ARRANGEMENTS – CALL FOR EVIDENCE

Gemserv welcome the opportunity to respond to this call for evidence and thank Ofgem for opening the debate around the Future Supply Market Arrangements and particularly the supplier hub model.

Our response draws heavily from the unique insights and energy market experience gained in our capacity as a central code governance body spanning over 15 years across electricity and gas. Our consultancy services cover a wide range of energy policy and regulatory aspects, including: price controls, customer switching, smarter markets, assurance, information and cyber security. We are at the heart of the fundamental market reforms already underway and experience first-hand the challenges and the opportunities that arise across the entire energy sector.

We would like to make the following key points:

- The supplier hub model has historically been successful in facilitating the current market arrangements, with the supplier taking prime responsibility for the consumer relationship with respect to their energy supply needs in but, it is clear that there will be future market innovations that this model will struggle to support
- We acknowledge that reform is necessary to ensure that energy markets are fit for purpose as we move towards a smart energy future, but the supplier hub model is just one area of focus, there will be other market interactions to consider
- Market arrangements for the future will need to support and not constrain further innovation
- The retail market should work for all consumers, including those consumers that choose to be actively engaged to those that do not.

Technology is moving fast, creating a system where the consumer has more desire and ability than ever to engage with the energy market and increased control over not just where their energy comes from but when and how they use it and store it. As we move towards a future where the 'prosumer' (the line between consumer and producer is merged) is king and connected devices such as electric vehicles and smart appliances are the norm, it is the right time to question whether the current market arrangements are fit for purpose.

As we consider the Energy market of the future, it is clear there will be a need for significant changes to the way the licensing and regulatory regime operates. Creating a regulatory regime that is fit for purpose over time which encourages innovation and protects the interests of consumers will be a challenge.

In our full response to this call for evidence (see appendix to this letter), we present our early thinking on ideas for exploration, centred on two key aspects:

- a) The suitability of the current supplier hub arrangements; and
- b) Where regulatory change might be focused and why.

Whatever changes are decided, the rules need to be robust enough to protect consumers from risk, but flexible enough to adapt to changing market demands and conditions to ensure an optimal outcome between market growth and consumer protection.

We therefore welcome Ofgem's Innovation Link and look forward to supporting that work. We believe it will continue to play an important role in helping new ideas and business models to engage with these complex markets to secure better outcomes.

We look forward to your proposed workshops over the coming months, and the publication of your initial views on a way forward in Spring 2018.

Please do not hesitate to contact us if we can support you in your work, to share our thoughts and ideas and to answer any questions you may have with respect to our response in the attached Appendix.

Yours faithfully

Shelley Rouse

Senior Consultant, Transformation

APPENDIX: GEMSERV RESPONSE TO CALL FOR EVIDENCE: FUTURE SUPPLY MARKET ARRANGEMENTS

1. Are the current supplier hub arrangements fit for purpose?

Gemserv supports an approach that will encourage innovation by removing barriers for new entrants as well as protecting the interests of consumers, allowing them to access energy supply and services without restriction. Striking the balance will not be easy. The role of the supplier hub model has played its part over the past 20 years in ensuring that the customer focus is not lost, and this focus must continue as markets move forward.

Customers are best protected when effective competition drives efficient costs and innovation, and where regulation and good governance steps in to ensure that customers remain proportionately protected. We must not allow consumer protection to be found wanting as energy markets strive forward with a hunger for innovation and new ways of working.

Market reform (including regulation and governance) is necessary. Energy markets must be fit for purpose as we move towards a smart energy future, to prevent them from potentially presenting barriers to innovation and change.

We are not convinced however, that a reform of the supplier hub model should be the sole focus. The ‘Supplier Hub’ model has helped over the past 20 years to clarify and define the accountability for the consumer relationship (e.g. consumer protection and safety), it continues to therefore play an important role ensuring that the responsibilities towards the consumer are understood. It could be argued that for some business models going forward, for example small suppliers, the supplier hub model will still offer the most benefit, so care should be taken that the needs of all market participants are considered and not just those pushing for innovation.

There is evidence to demonstrate that market innovation is happening under the current framework. The number of licensed energy suppliers in the UK energy market has grown dramatically from 11 in 2007 to 66 by September 2017¹ which indicating that the market is not fundamentally broken. Price Comparison websites are a recognised part of the customer switching process, acting as facilitator between the customer and the energy companies. In its investigation into the UK energy market, the CMA noted that consumer’s use of PCWs has increased to around 40% of switches being facilitated by a PCW² and as a result levels of consumer switching in both the gas and electricity markets are increasing³. The Motor Fuel Group (Britain’s second largest forecourt operator) has announced it will undertake the first ever mass rollout of rapid charging across more than 400 petrol stations⁴, and Shell recently announced the rollout of Electric Vehicle rapid charging points across some of its forecourts⁵.

¹ <https://www.ofgem.gov.uk/data-portal/retail-market-indicators>

² <https://assets.publishing.service.gov.uk/media/576bcbd4ed915d622c00007b/appendix-9-3-price-comparison-websites-and-collective-switching-fr.pdf>

³ <https://www.gov.uk/government/statistical-data-sets/quarterly-domestic-energy-switching-statistics>

⁴ <https://utilityweek.co.uk/rapid-ev-chargers-to-be-rolled-out-to-petrol-stations-nationwide/>

⁵ <https://www.shell.co.uk/media/2017-media-releases/shell-switches-on-shell-recharge-electric-vehicle-charging-service-in-the-uk.html>

Consequently, it is right to test the Supplier Hub as a principle/concept, i.e. to open up the dialogue, to determine whether it is 'the' barrier to change per se, to see whether greater efficiencies can be achieved, and if so the level of change required.

By ensuring we have the definition of the problem(s) correct, finding effective solutions will then follow and be properly targeted. We do not want to end up in a new energy world where we have successfully enabled innovation and reform, only to find that there is no clear accountability for the consumer when issues materialise -consumers as 'prosumers' will have many touch points with different parts of the market without even realising it. They will need their problems solving quickly and efficiently and need to know how/where to go in order to do so.

2. Where should any regulatory change be focused and why

Whilst we cannot be exactly sure what the energy sector of the future will look like, we can be certain it will be significantly different from today. Interconnected and renewable technology solutions, against a smart metering backdrop, will drive the coming of age of the prosumer, and as the energy system begins to react in different ways it is entirely possible that the more traditional market player roles will also need to adapt.

It is right that the role of the supplier hub model is reviewed, especially with Ofgem's move to Principle Based Regulation. It is easy to suggest that it is the supplier hub that is at fault, when really what is being articulated is the need to think differently, to ensure that within market design, systems practices and processes we do not 'design out' innovation and new ways of thinking.

A full review of the supplier hub model and its purpose will help to identify if it really is the key issue or if there are other factors in play that are more crucial, such as the complexity of the market itself, the challenges faced navigating the many regulations and obligations held within Acts, Statutory Instruments, licences, and codes.

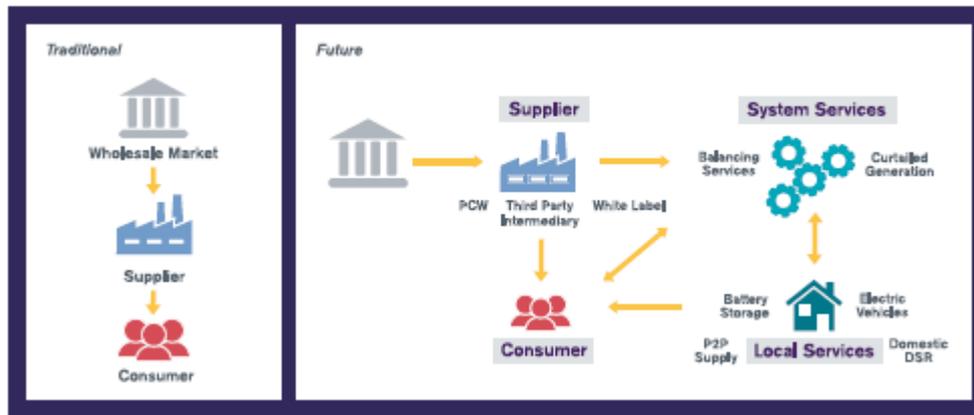
National Grids Future Energy Scenarios⁶ work alongside Ofgem's Future insights work offers us a number of well-considered views of what our energy future might look like. If we consider National Grids 'Two Degrees' scenario⁷ where the UK's Carbon reduction targets are met, consumers are making conscious choices, are engaged in the energy market and are happy to spend money on energy management systems we can begin to imagine what a consumer's supply needs may be.

It is not difficult to imagine a scenario where consumers are able to choose a supplier to provide energy to their home, perhaps multiple suppliers depending on price and the time of day at which that supply is needed. A supplier to support EV battery charging and energy export management or even Third-Party Intermediaries (TPIs) that offer to 'look after your home' and optimise costs and services without the hassle.

⁶ <http://fes.nationalgrid.com/fes-document/>

⁷ <http://fes.nationalgrid.com/media/1253/final-fes-2017-updated-interactive-pdf-44-amended.pdf>

By way of example, Fig 1: Ofgem’s Future Insights Series: The Futures of Domestic Energy Consumption⁸, articulates this transition from traditional to a new future.



In the future scenario, is it the supplier hub model that prevents innovation that will take us toward the future where a consumer has multiple access to multiple providers of energy supply?

The inception of the supplier hub model, stems from 2000⁹ and the early days of the electricity Balancing and Settlement Code (BSC). At that time, the model applied to the collection of agents that the Supplier appointed to help them meet their licence obligations. Over the years, this has been used as a guiding principle by the regulator to help define responsibility for the consumer.

Even with the future scenario (noted above), it could be argued that there will be groups of consumers, particularly those that are less engaged in the market, that still require a single point of contact with the energy market (the supplier hub in its broadest sense), be it the supplier themselves or an intermediary, and who will require the consumer protections that the supplier hub model brings.

For those consumers that wish to take full advantage of all the innovations the future energy market could offer, the market arrangements will need to be agile enough to offer the flexibility the consumer could need.

Below we provide some detail of our early thinking. We offer ideas of areas for further investigation and development, that may help to offer the required flexibility to the current arrangements or provide the starting point for move fundamental review:

A. Allowing multiple Suppliers access to the meter

The current supplier hub model (and indeed the current supplier licences) indicates that a single supplier has responsibility for the meter and therefore a single supply contract can only be applied to the meter at a time.

⁸ https://www.ofgem.gov.uk/system/files/docs/2017/03/ofg958_future_insights_series_4_0.pdf

⁹ https://www.elexon.co.uk/wp-content/uploads/2013/10/bsc_framework_agreement_simple_guide_v2.0_cgi.pdf

In a world where we could envisage a consumer requiring multiple suppliers to access the meter within a 24hr period, or indeed intermediaries whose business model is to manage a consumer's supply, the current licensing model would provide barriers to operation.

To facilitate the flexible supply model that the future may require, consideration should be given to solutions that allow multiple suppliers access to the meter and asset data.

There are a number of potential areas for exploration here including;

- the encouragement of collaboration agreements between suppliers regarding allowing access to the consumers meter for data provision, settlement. This could take the form of an additional licence condition. There is already a precedent set in this area. A supplier licence condition was added to facilitate the Alt-Han solution¹⁰. Alt-Han Co. are responsible for co-ordinating the collective action across energy suppliers to ensure the successful development and implementation of Alt-Han (Alternative Home Network) solutions.”
- A review of the current meter management model to determine whether the obligations around accessibility as defined in the relevant legislation are appropriate to facilitate the flexible models we could see in the future.

B. Meter the person and not the premise

The UK energy supply model is centred around the supply of energy being attributed to a premise and measured by an asset at a fixed address. Indeed, when we discuss change of supply and customer switching it is the change of a supply to a premise and not a person that we are considering.

As we move into a consumer driven future, and a dramatic change in energy supply and demand, it could be argued that a consumer-focused energy market requires the consumer at its heart and that now is right time to consider whether and how we move more towards a consumer centric energy market supply regime.

The potential for a disaggregation of the consumer and the premises with regard to the measurement of energy use is an area worthy of further consideration

We are already seeing innovations in the market in this area, with consumers being able to access and pay for an electricity supply in multiple locations through their mobile phone. Electric Vehicle (EV) charging solutions company 'Rolec' are just one of many who are beginning to see the benefits of allowing consumers access to an energy supply on the go. Their 'StreetCharge' scheme is allowing consumers to operate and pay for their EV charging via an App¹¹.

Gemserv are current undertaking work to further our understanding and thinking in this area and would be happy to share our findings with Ofgem when they are more developed.

C. Introducing the role of an 'Energy Carrier' in to the electricity regime

As the electricity market moves away from being purely a supply and demand regime, and electricity storage becomes more common, there may be need for a change/addition to the current licensing

¹⁰ <https://www.althanco.com/how-is-the-alt-han-company-governed/>

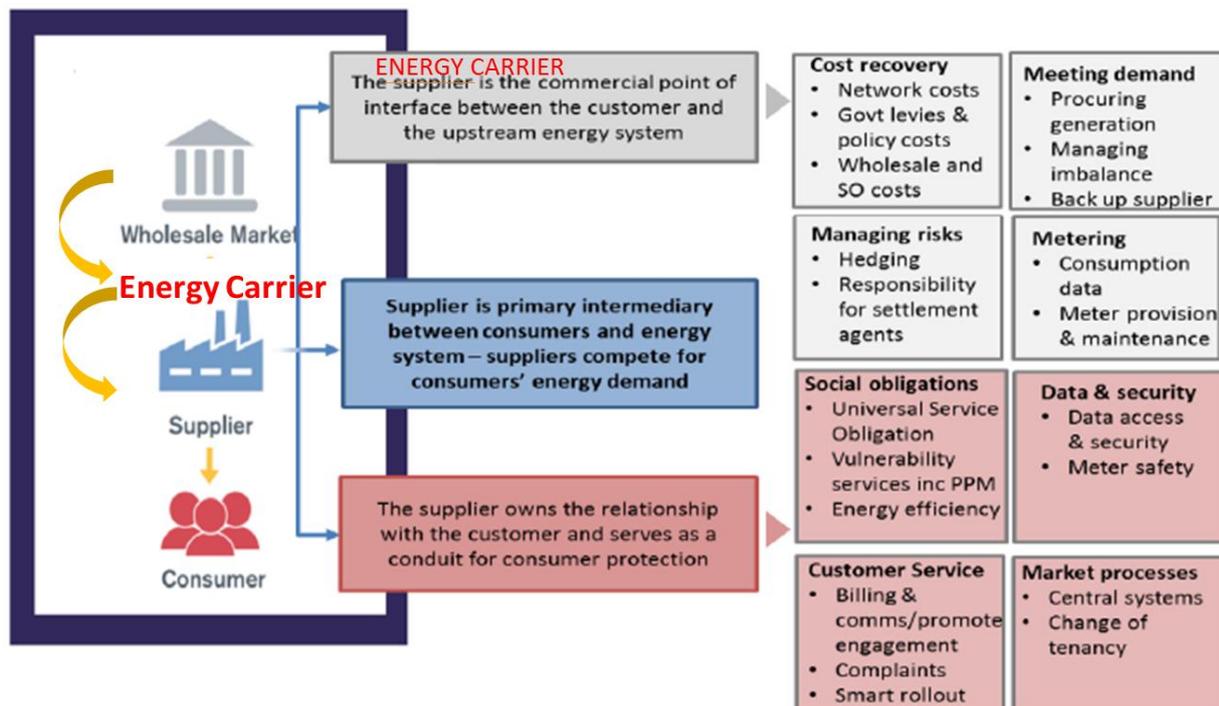
¹¹ <http://www.rolec.com/ev-charging/product/EV-Charging-Street-Light>

regime that could facilitate market entry for new business models that do not need/wish to take on consumer accountability.

The current UK Gas market model includes the role of a Gas Shipper and some elements of that model could potentially bring benefits to the electricity market. The Shipper operates between the supplier and the producer and is responsible for nominating to the system operator the amount of gas they will be entering or exiting the network to ensure that, based on supplier nominations, supply meets demand and the system is kept in balance.

To facilitate the potential for changing supply models (battery storage companies, aggregators, DSR agents) and greater innovation in the electricity market, the inclusion of an electricity 'energy carrier' licence (performing a similar role to that of the gas shipper) into the regime could be considered.

The diagram below (based on Ofgem's supplier model in the Call for Evidence)¹² attempts to demonstrate how the market structure could work:



This additional layer of licensing does not need to add complexity to the regime. A Energy Carrier licence holder could take on the aggregator/balancing responsibilities that under the current electricity regime fall into the remit of the supplier. Equally electricity suppliers could be released from some of their obligations around hedging, settlement, managing imbalances etc which could

¹² https://www.ofgem.gov.uk/system/files/docs/2017/11/future_supply_market_arrangements_-_call_for_evidence.pdf

bring benefit, especially to smaller suppliers, allowing them to become more flexible in the types of supply they offer to consumers.

D. Creation of a more sophisticated and flexible policy and regulatory regime

Ofgem's move to principle-based regulation is a welcome one. Providing a policy and regulatory framework offering clear guidelines under which companies can operate, without creating undue barriers to market entry is essential for innovators and new market entrants to create stability and offer regulatory certainty.

Complexity in both the licensing and regulatory regimes is currently recognised as an issue for new entrants especially for smaller companies with limited resource. We have noted that, from Ofgem's Innovation Link work, that out of the 30 expressions of interest received for the first regulatory sandbox (Feb-March 2017), 22 of those innovators could already operate under the current regime¹³ without the need for regulatory derogation.

The UK energy industry is currently considering a simplification of the code governance regime and looking towards creating a single code for both gas and electricity through the creation of the Retail Energy Code (REC). This simplification could also be rolled up into the licensing regime, with the creation of a single 'Retail Energy market participant licence'.

Gemserv is currently undertaking work in this area, to support our earlier thought leadership paper on 'Transforming Code Governance Arrangements'¹⁴ and our responses to industry consultations such as the CMAs recommendations¹⁵.

We will be publishing our thoughts and findings in the coming weeks. This simplified licence could contain the principles of UK energy market participation (in line with Ofgem's desire to move towards principle -based regulation) and offer better access to data and systems within the appropriate data and consumer protection boundaries. The approach would adopt a licence framework that allows for obligations, duties and rights to be 'switched on' according to a particular business need.

¹³ <https://www.ofgem.gov.uk/about-us/how-we-engage/innovation-link>

¹⁴ <https://www.gemserv.com/insights/thought-leadership-papers/transforming-code-governance-arrangements/>

¹⁵ <https://www.gemserv.com/insights/consultation-responses/industry-code-governance-initial-consultation-implementing-competition-markets-authoritys-recommendations/>