What next for retail competition in energy?

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Philip Davies
Director of Regulatory Affairs
British Gas

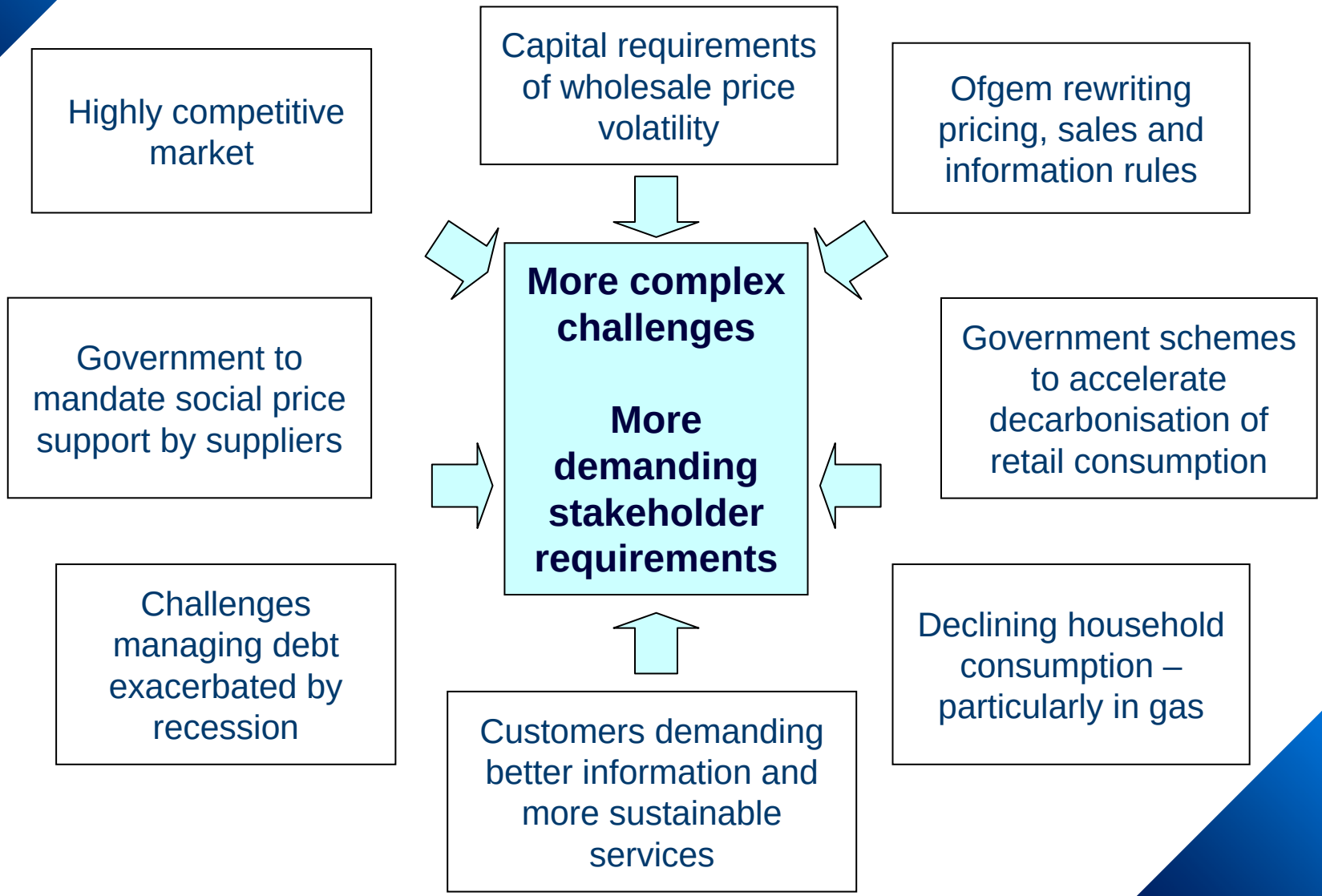
British Gas

Overview

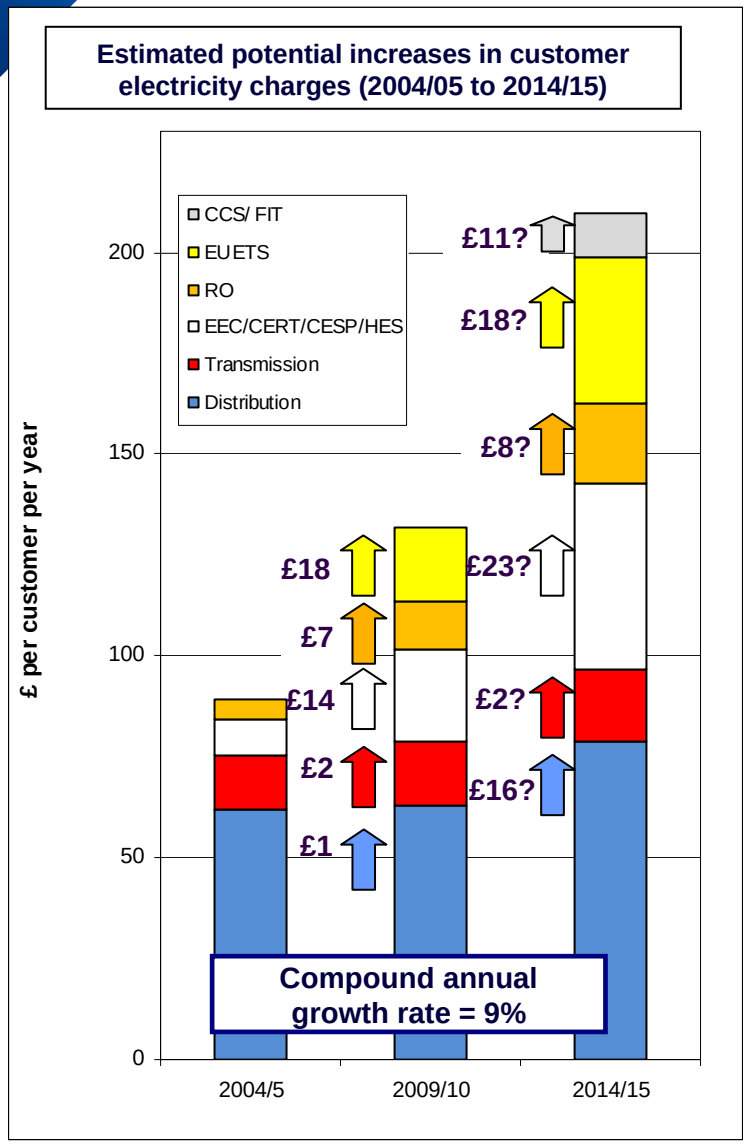
- **Market context for energy suppliers**
- **New challenges for retail competition**
- **How will the supplier/customer relationship evolve?**
- **How do market rules need to evolve?**

Market context for energy suppliers

Retailers must deliver low prices and better service while decarbonising energy supply



Retailers faced with growing network and environmental costs, which will increase bills



- Network and environmental costs associated with supplying electricity increasing about 9% year on year
- Cost of supporting low carbon and network investment is growing in absolute terms and as % of the bill
- This will help accelerate the transformation to decarbonised energy supply
- But it also increases stakeholder and customer pressure on suppliers as a whole

Vision of a retail energy services market is becoming clearer

Low Carbon Transition Plan commitment to cut emissions in homes by 29% on 2008 levels by 2020, adding 8% to household bills

Community Energy Saving Programme of £350m launched this autumn

Feed-In Tariffs from April 2010 for small scale generation

Renewable Heat Incentive to be introduced from April 2011

Smart meters in every home by end of 2020

Carbon Emission Reduction Target resulting in £1.9bn energy savings to April 2011

New challenges for retail competition

Competition has key role to play in delivering decarbonisation as efficiently as possible

Clear opportunity for suppliers to enable decarbonisation

- Low / negative cost carbon abatement opportunities in households critical to meets targets
- Suppliers will compete to provide energy services to customers, as part of richer set of customer offerings
- Ofgem and government need to align government schemes and market rules to help suppliers deliver at least cost

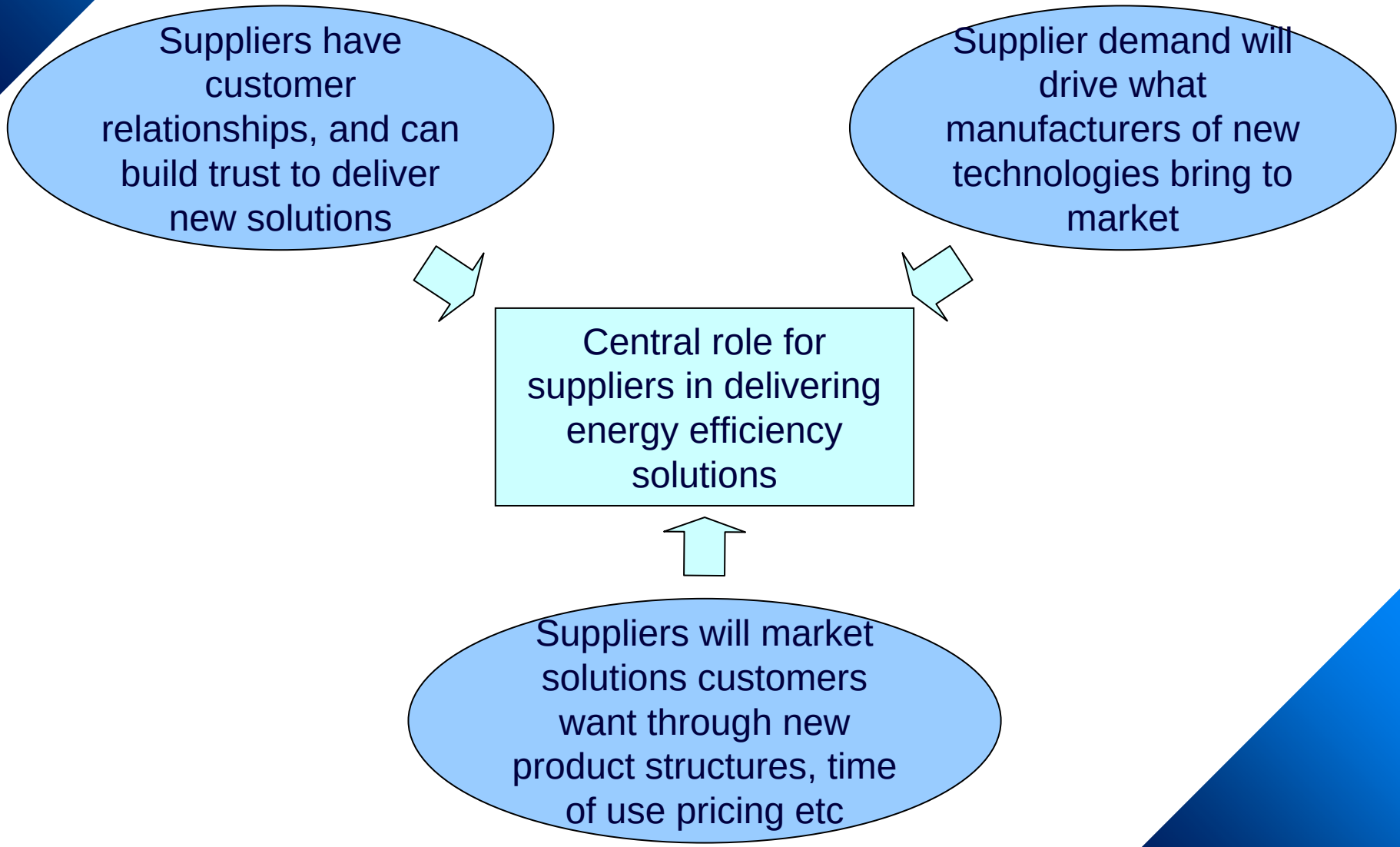
Potential of competition needs to be recognised

- Ofgem probe focused on fairness and on relative outcomes for different customers
- Role of retail competition in harnessing and delivering innovation is critical
- Competition is a resource that can help determine most effective ways of delivering energy efficiency

Competition *more* relevant as demand for transformation becomes more pressing

- Many US energy markets based on “thinner” version of retail competition
  - Retailers provide customer access to wholesale hedging and pricing options
  - Retailer has no direct relationship with the customer and operationally depends on the systems of the regulated default utility provider
- Potential offered by “thicker” GB model should be more valued given today’s challenges
  - Government is investing customer money to accelerate decarbonisation
  - Duty on all stakeholders to make sure customers get value for money for their investment
  - Success of competition should be measured in how successfully it facilitates this transformation

Suppliers are best-placed to discover the energy services customers want and value



Many questions are being raised about the correct market model for energy services

Are monopoly network operators better placed to drive energy efficiency?

Are public authorities better-placed to lead local energy efficiency initiatives?

Do roll-outs need to be street-by-street, and if so, is a centrally-led campaign required?

Do suppliers have the right incentives?

Can suppliers be trusted to deliver?

Should loans for energy efficiency investments be linked to properties, not individuals?

How will the supplier/customer relationship evolve?

Energy efficiency services are emerging as basis for differentiation between suppliers

- British Gas increasingly competing on provision of energy efficiency services – and other suppliers are responding

Supported the delivery of over 100m energy efficiency products into UK homes

Technology innovation partnerships with leading brands

BG Energy Savers report- over 2m people to date have used the report

Social housing projects, giving energy saving advice, products and funding

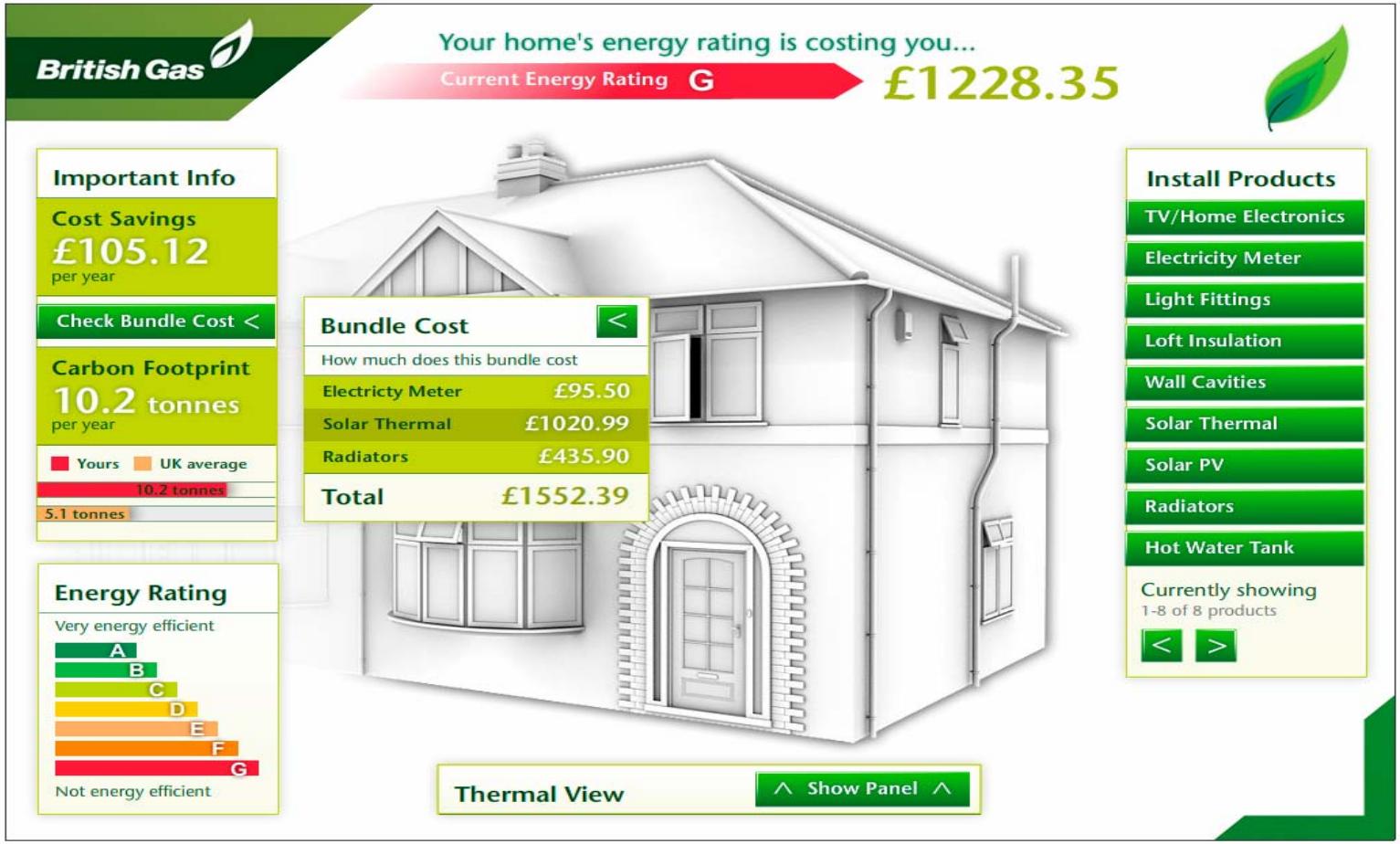
Retail partnerships – e.g. with B&Q to subsidise loft insulation prices of £1 per roll

British Gas has distributed over 55m energy saving light bulbs

Council Tax rebate scheme- working with 68 councils to provide rebates of up to £125 for loft and cavity insulation

Full energy audits an important part of our energy efficiency offering

Interface concept for British Gas sales tool - version 2_2 16th June 2008



British Gas proposes alignment of energy efficiency and smart meter activities

Integration of Energy Efficiency with Smart Metering (Central Comms Model)

2 Coordinated Workstreams

2 Deployment Methods

Smart Metering deployment to all homes

Delivery of whole house surveys and consequent action

LA area-by-area: 380 LAs, 45 concurrent per 6 month block, UK complete 1st pass over 4-5 years.

Geographic

Local authority area by area

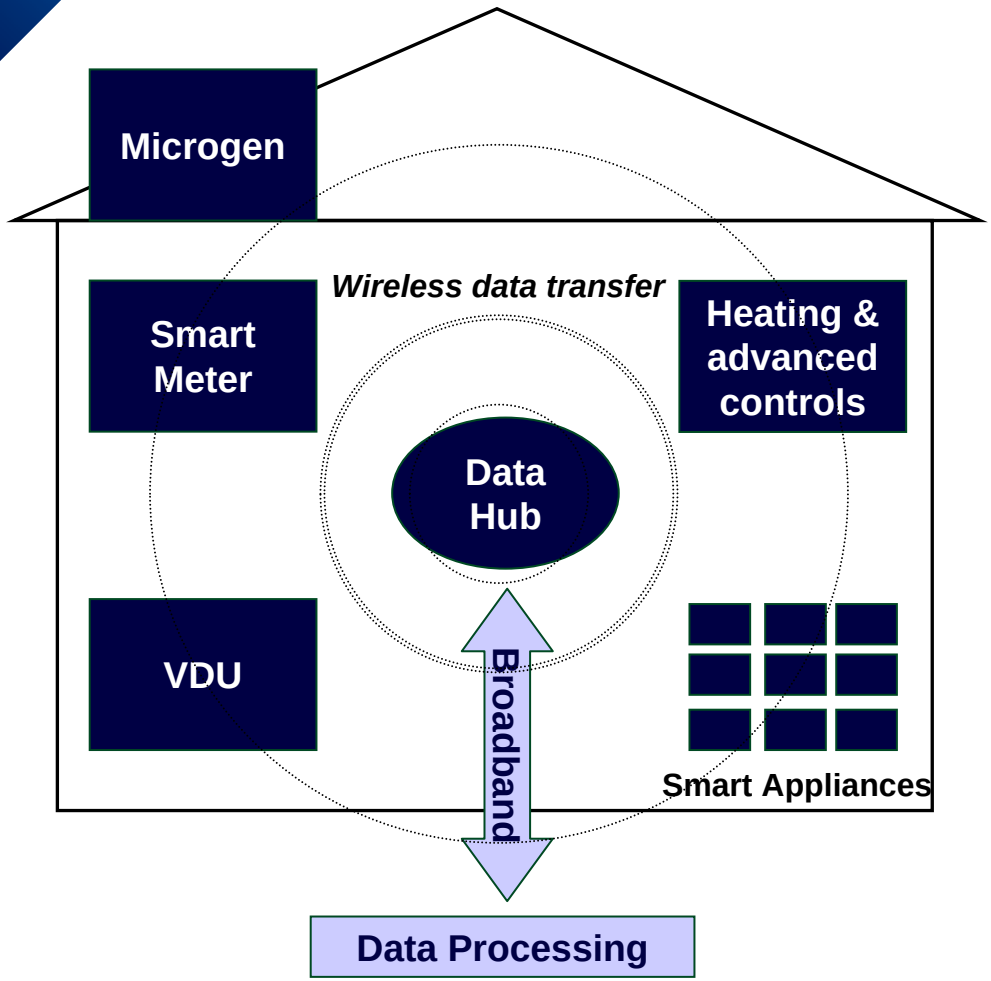
Align to Smart Meter LA blocks and timings, to achieve better experience & cost.

Scheduled meter replacements
- **Customer requests**
- **Meter failures**
- **Microgen enablement**
- **Debt treatment**

Non Geographic

Customer Focussed
- **Key events e.g. home move, new boiler, change of circumstance**
- **Mandatory for customers accessing FIT/RHI**

Smart technology we will be installing up to 2020 will enable an integrated proposition



- Roll-out of smart a key enabler of future energy efficiency innovation
- Enabler of "time of use" pricing – expected to be a major driver of customer behaviour change

Key Customer Benefits (£)

- ✓ Save energy
- ✓ Produce energy
- ✓ Provide demand response
- ✓ Access broader tariff range (including time of use)
- ✓ Get more accurate bills

British Gas Portfolio of Energy Efficiency Products and Services

Generation Green – British Gas

Since the launch in May 2008 **9,488** schools have signed up

Year 1- **64 homes in 8 streets** in UK competed to save the most energy: **25%** energy usage reduced, **89 tonnes of CO_2 saved**

Energy Experts

50k home visits planned for 2009

CESP

- Solid wall - Heating
- Partnerships

Time to get equal scope – About cerebral palsy. For disabled people achieving equality.

RNIB

HELP THE AGED WE WILL

CERT

Over **100m** Energy Efficiency products subsidised in **5 years**

Local Authority Partnerships

A British Gas Initiative – here to HELP – Improving homes. Changing lives.

Council Tax

Over **250** partnerships with Local Authorities and Housing Associations

ENERGY EFFICIENCY

B2B

Energy efficiency consultancy business acquired BMSi Building Management Systems Integrators Ltd

Energy Savers Report

Completed **2.5m** ESR's

British Gas – Your energy experts

REGULATED OBLIGATION

New Innovation

PHILIPS

GE

Retail schemes

B&Q in partnership with British Gas – Your energy experts

- First year of CERT, B&Q have delivered over **12 million m² DIY loft insulation (460k homes)**

Insulation

1.5m homes insulated in last 5 years

LOW CARBON TECHNOLOGIES

LCBP2 Framework Supplier

£7m installed in 2008

Solar Technologies – Part of British Gas

provide solutions for PV, Solar thermal installations. **£8.5m** turnover in 2009

British Gas

Solar Thermal

ASHP

British Gas bought **20%** equity stake

econergy

Semplice Energy – Reducing CO_2

provides bespoke solutions to reduce energy consumption and CO2 emissions

CeresPower

Fuel cell technology development agreement

Current offerings are only a first step towards a new customer relationship

- Existing products do not finance energy savings through the bill – the starting point for an integrated energy service relationship
- Scale of associated capital investment in supplier offerings is very small
- Supply market rules set up for energy supply (not energy management for the customer)

- Customers have new incentives to install low carbon electricity and heat production in the home (Feed in Tariffs, Renewable Heat Incentives)
- CERT can be developed so supplier manages the customer's production and consumption together to achieve optimal low carbon outcome

The lower cost, lower carbon outcome will only be unlocked with capital investment

How do market rules need to evolve?

In an industry where debt poses special challenges, market rules need to support large investments

- Government plans require £10,000 – £30,000 of works per property
- Government would like to see the low carbon technologies rolled out to 7 million properties by 2020
- Move to “pay as you save” models of long-term financing

Major questions about how this investment will be financed, given government desire to minimise up-front costs to customers and finance investment through energy savings

The right to object is an important last resort mechanism to protect good payers

- The only bill customers feel less compelled to pay than their energy bill is their water bill
- Challenges posed by debt reflected in supplier right to object to customer transfers where debt is outstanding
- If customers could switch with debt, we would have to pursue expensive, lengthy court action

Suite of **credit risk management options** already used by suppliers, including objection rights, litigation, force-fitting of pre-payment meters and higher tariffs for riskier customers

Right to object is cheap means of credit risk management, which prevents good payers further subsidising bad payers

Supplier ability to protect contract value is weaker than in other markets

- In energy, ability to recover the product (eg. insulation, microgen unit) in event of non-payment is likely to be limited or non-existent

Part or all of the investment is sunk, irrecoverable cost	Removal would increase the customer's emissions and energy consumption
In many other markets, products are retrievable (eg. car)….	… or value is not in installed product (e.g. cable TV, where value is in the content)

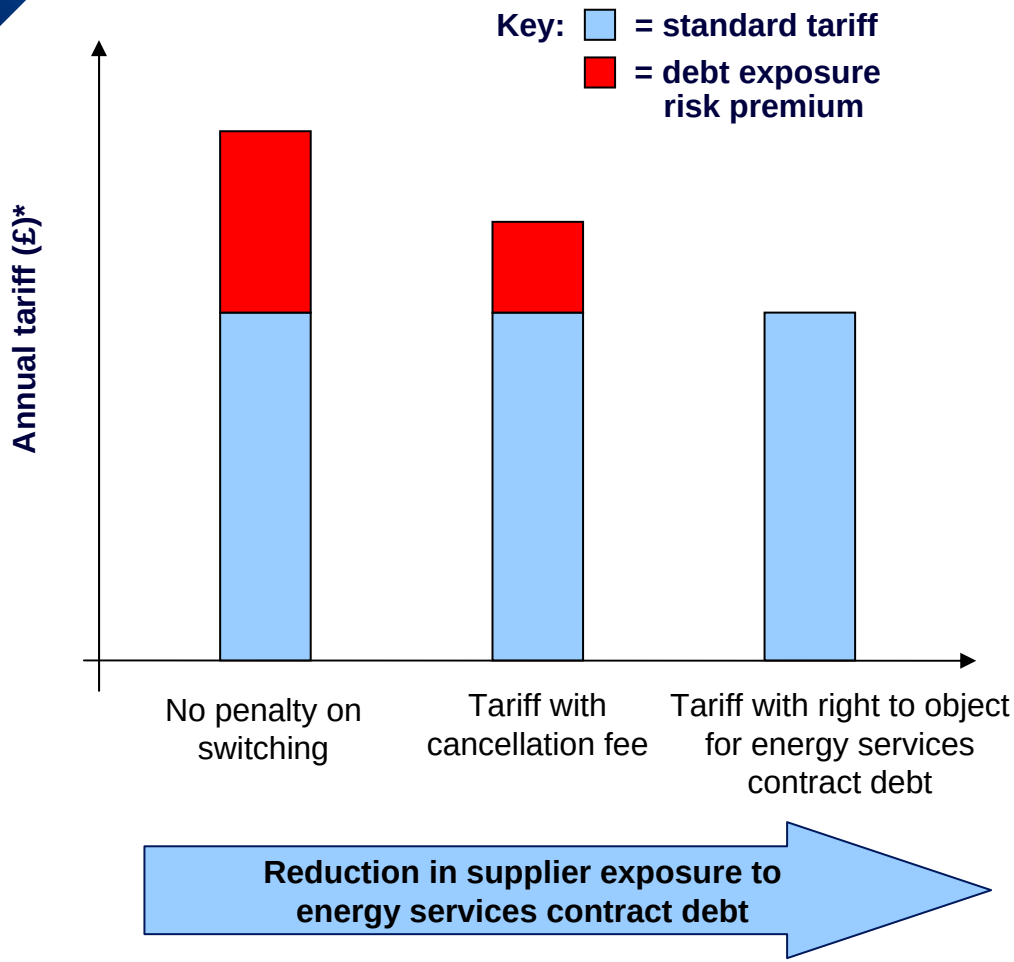
- There are limits on rights to disconnect customers, and their effectiveness in managing debt

Cable TV and broadband will immediately disconnect in event of non-payment	Supply licence requires lengthy procedures to be exhausted before we disconnect
Our customers pay in arrears and keep consuming up to the point of disconnection	We cannot disconnect some customers at some times

Sole reliance on termination fees will slow the market at time when acceleration is key

- Deploying expensive capital investments will dramatically increase our exposure to debt
- Right to object restricted to energy supply component only will not help us manage this investment
- This will lead to large risk premiums in our prices to customers for energy service offerings
- Credit vetting may lead to the more affluent receiving the most attractive offers

Supplier pricing will reflect different debt exposures with/without extended rights

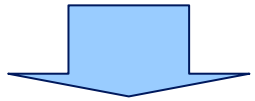


- Without any form of extended right, a premium needs to be added to tariffs to reflect risk of associated debt exposure
- Size of premium declines with introduction of cancellation fee as debt exposure reduced
- No premium necessary where right to object exists

**tariffs presented here purely for illustrative purposes*

Right to object should be extended as part of ensuring market rules are fit for new challenge

- Suppliers have right to object for energy debt, but not for capital investments – even if product sold as supply and investment package
- Customers can pay off their energy debt, switch, and leave the old supplier to chase them through the courts for capital payments



Credit risk management options must evolve, with regulatory support, to anticipate and reflect changing supplier/customer relationship

“British Gas has become an energy services company that offers energy, no longer an energy company that also offers energy services”.

Sam Laidlaw, Chief Executive, Centrica