

# Modernising Energy Governance

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**A Golden Opportunity**



**Gemserv**



## WITHIN THIS PAPER:

- We highlight that the energy market is undergoing a rapid transformation and that the current market rules/governance can't keep up;
- We share what we have learnt from other regulated markets, a range of market stakeholders and Gemserv's Innovation Forum;
- We set out our observations and findings, noting in particular, that how risk is managed is key to moving forward;
- We start to explore what a new energy retail governance future could mean for customers, businesses, markets and the regulator.

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Over the next few months, we are publishing a series of papers that will build towards setting out a possible new energy market future and how we might get there.

Please get involved and let us have your thoughts. You can contact us at [transformation@gemserv.com](mailto:transformation@gemserv.com)

## THE STATE OF THE MARKET

Reports, opinions and calls for evidence on the state of our energy market have not been in short supply. Government ministers, hot on the foot of the Competition and Markets Authority's (CMA) Energy Market Investigation which kicked off in 2014<sup>1</sup>, have not been shy in coming forth to express their frustration that 'the energy market is not working'. Indeed, Theresa May has reportedly turned the phrase 'our broken energy market' into a mantra<sup>2</sup>.

Over 20 innovators, new businesses, third party intermediaries, market associations and Ofgem joined us on the 18th April 2018 for Gemserv's<sup>3</sup> first energy Innovation Forum. Representatives commented that regulation is fit for 'yesterday's market', queried who we are trying to protect - commercial concerns or the consumer, commented that smaller businesses do not have the manpower to influence change, and that within 10 years 50% of electricity will be from distributed sources.

Gemserv's assessment is that the rapidly transforming energy sector is being hampered and frustrated by outdated regulation and governance, serving as a straight-jacket on today's innovators and businesses. It is not working as it should, and more importantly, it is not fit for a new energy future driven by data.

<sup>1</sup> CMA, 24 July 2014, energy market investigation, <https://www.gov.uk/government/news/energy-market-investigation-cma-publishes-issues-statement>

<sup>2</sup> The Economist, 19th Oct 2017, <https://www.economist.com/britain/so17/10/19/is-britains-energy-system-broken>; accessed 4th June 2018

<sup>3</sup> Gemserv is an expert provider of professional services enabling the energy market transformation and data revolution. Its vision is to ensure that complex markets work for everyone's benefit.

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## MAKING A STEP CHANGE

We could identify what is broken and find fixes, probably leading to incremental change and an increasingly complex landscape with yet more regulation and governance controls<sup>4</sup>. Or, we could step back and take a much more transformative, whole systems approach. One that delivers a high functioning, highly adaptable energy market, framed as an enabler for change, promoting competition, driving innovation and of course, protecting and supporting consumers as they themselves engage with new devices and behaviours<sup>5</sup>.

Over the next few months we shall be crystallising our thinking with respect to energy governance and especially 'energy codes' and the role of data within a digitised world. Energy industry codes have come under significant criticism in recent years, many arguing they have become overly complex and impenetrable, and that understanding is hampered by their sheer number and technical complexity. In January 2016 and February 2017, we published our initial thoughts examining the nature of codes, identifying the issues and proffering a way forward<sup>6</sup>. This includes advocating for a new Retail Energy Code (REC) to bring together the code requirements relating to retail energy activities and to govern the operation of the new switching arrangements – we are pleased that Ofgem is bringing forward the designation of the new REC in early 2019.

However, we have moved beyond simply asking what needs to change and why. Rather, we are considering the question from the perspective of, 'what would happen if the market was re-designed from scratch', i.e. if we were starting with a blank sheet of paper free from the existing constraints of today, what would we do?

This is the first in a series of thought leadership papers: 'modernising energy governance'. Starting with the consumer and the retail market, we explore how energy governance could evolve to become so much more, by confronting a number of fundamental questions, such as, 'how do we truly empower consumers and drive engagement for all?' (Diag.1).

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<sup>4</sup> Domestic gas and electricity (Tariff Cap) Bill 2017-19, <https://services.parliament.uk/bills/2017-19/domesticgasandelectricitytariffcap.html>

<sup>5</sup> PWC, 2018 Global Consumer Insights Survey, <https://www.pwc.com/gx/en/industries/consumer-markets/consumer-insights-survey.html>, accessed June 2018

<sup>6</sup> Gemserv, January 2016, 'Transforming Code Governance Arrangements: A Way Forward' <https://www.gemserv.com/transforming-code-governance-arrangements/>; and 'February 2017, From Faster Switching to a Retail Energy Code: simplifying code governance' <https://www.gemserv.com/faster-switching-retail-energy-code/>.

# Modernising Energy Governance

How do we truly empower consumers and drive engagement for all?

How do we build energy market trust for consumers, regulators and government?

How do we speed up market change and empower markets to drive strategic reform?

How do we accommodate innovation and new businesses?

How do we solve complexity?

How do we drive competitive market signals across the supply chain?

What rules do we really need?

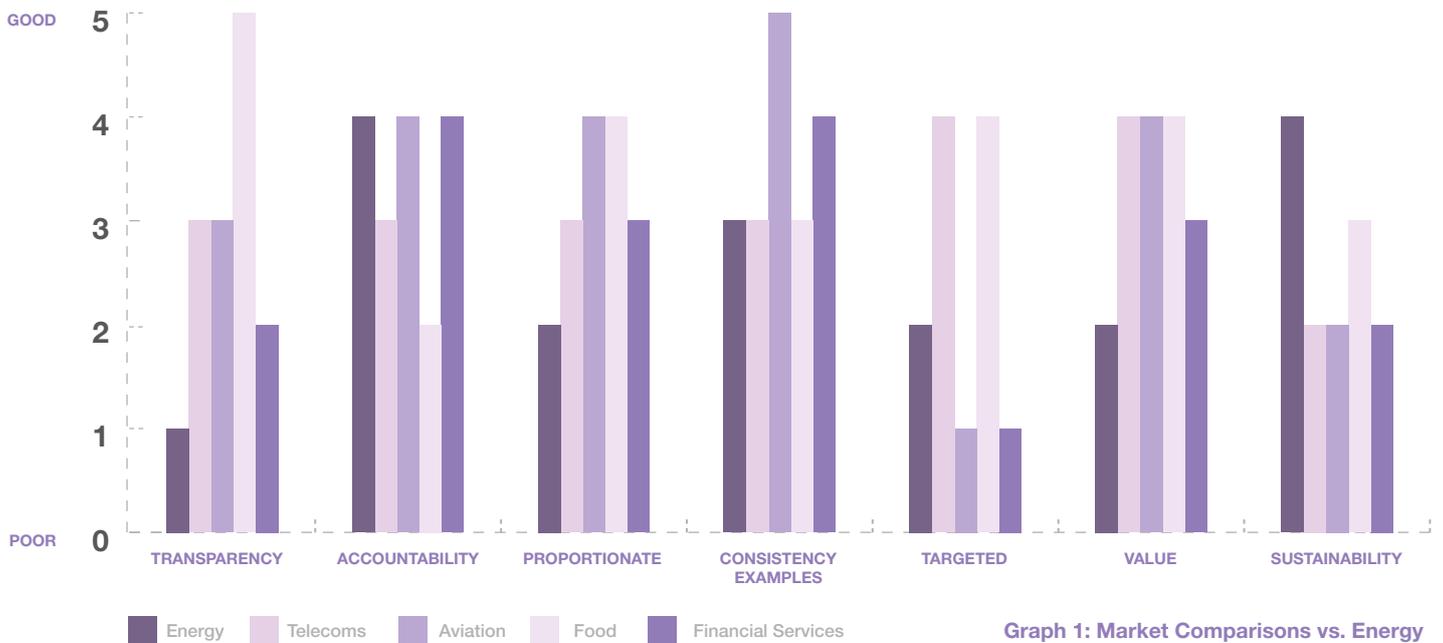
Diagram 1: Fundamental Questions

## MULTI MARKET ANALYSIS

Drawing from a broad range of Gemserv subject matter experts and external stakeholders, a set of seven principles and 15 market characteristics were defined that best set the tone for a modern retail energy market governance future. Against these were mapped financial services, food, telecommunications and aviation. The different regulatory and governance constructs were examined and a qualitative assessment was undertaken to help identify the strength and weaknesses of each

market. A simple scale of 1 to 5 was used to determine how each market measured up in relative terms against each other (Graph 1).

Feedback and examples from our energy Innovation Forum<sup>7</sup> were also used, to explore real-world challenges and road test emergent thinking and ideas. Our participation in the think tank work, spearheaded by Laura Sandys of “Challenging Ideas”<sup>8</sup>, also provided useful insights.



Graph 1: Market Comparisons vs. Energy

As a central code governance body, we acknowledge that energy market governance rules have become fragmented and unwieldy. Our work to date highlights that energy does not fare particularly well when compared with other regulated sectors. Indeed, BEIS’ recent Green Paper, ‘Modernising Consumer Markets’<sup>9</sup> notes that the Institute for Customer Service ranks energy, water and telecoms among the weakest performing markets for customer service.

<sup>7</sup> Gemserv’s energy Innovation Forum draws in a wide range of innovators, businesses and associations to explore energy governance barriers. It first met on 18th April 2018

<sup>8</sup> Laura Sandys project, in partnership with Imperial College, Reshaping Regulation, powering from the future

<sup>9</sup> BEIS, April 2018, Modernising Consumer Markets, Consumer Green paper, p.16

## THE FINDINGS

Our observations and findings indicate that the governance arrangements for each of the above sectors have some worthy aspect to them, even energy.

However, when it came to the allocation and management of risk, this above all else seemed pivotal across the five markets:

	Observation	Findings
A	All the markets are characterised by significant complexity and risk, albeit dealt with in different ways.	We conclude that energy is not necessarily a 'special case'. Consideration should be given to what we can learn from each sector.
B	Market sectors are converging, the crossover between energy and telecommunications and financial services is already happening. Different market sectors could adopt different approaches to managing risk, leaving consumers exposed in terms of where to seek redress. Innovation could be frustrated due to the challenges of the 'regulatory chain'.	We need to deal with the convergent markets in a more joined up way. Wildly differing regulatory and governance models could impede growth and complicate markets. Alignment would help.
C	Distribution of risk is different across the sectors we examined, with energy as a particular outlier when it comes to protectionist (ex ante) regulation.	We need to drive a risk assurance philosophy that is market based, not a rules based tick box mentality. There seems to be more room (at the retail end) to allow for more devolved responsibility and accountability. A more proportionate and targeted approach is warranted.
D	In the case of telecommunications, innovation, products and services drive consumer engagement	We need to supercharge the energy sector to do likewise (the pull). We need to find the space to enable products and services to flourish.
E	In financial services, a risk based regulatory approach is adopted.	Energy can learn from this and be ready for an energy future that is characterised by a huge range of products and services available to consumers who are likely to have a 'one-to-many' relationship with retailers.
F	The food retail sector drives a 'standards based' assurance (e.g. food hygiene ratings). Businesses seek out additional assurance (stars) to drive their business model.	The energy sector could encourage companies to go above and beyond a retail market baseline to drive their business models as well as inform consumers. Transparency will be key.
G	Consumers are used to and feel empowered via online feedback and scoring mechanisms (e.g. TripAdvisor, Yelp, Google Reviews, Trustpilot) to score/rate service providers.	The energy sector could introduce a similar consumer driven and consumer empowered feedback loop.

**Table 1: Observations and Findings**

An inescapable truth is that competition is still more effective at driving quality and efficiency<sup>10</sup> and that consumers receive the greatest benefits when markets are competitive<sup>11</sup>.

So how do we liberate competition and innovation without risking energy system safety and security?

Importantly, what can we learn from other markets that are just as risky and fundamental to the UK economy and well-being of its citizens?

<sup>10</sup> NAO, September 17, a short guide to regulation, <https://www.nao.org.uk/wp-content/uploads/2017/09/A-Short-Guide-to-Regulation.pdf>, accessed 7th June 2018

<sup>11</sup> BEIS, April 2018, Modernising Consumer Markets, Consumer Green paper, p.9

## A DIGITAL AGE

We are on the cusp of a significant digital revolution. Harnessing the power of data and new technology is going to be key as we move forward. Consumer behaviour is changing as they engage with a new digital, online future. We need to establish new ways for consumers to be put in control and for consumer-centric companies to be rewarded. Above all, we must put consumers in the driving seat, where they control their data, view company performance and provide a feedback loop into an integrated solution which has a direct impact on the reputation of their service providers. We should design from a healthy competitive market position, and 'design in' to cater for those that are vulnerable and remain disengaged.

Importantly, we need to enable the products and services to flourish within the energy sector that will provide the same 'pull' effect and facilitates market engagement as now takes place within the other markets such as telecommunications.

The rationale for fundamental energy market reform is compelling. However, to make it work requires a comprehensive rethink of our existing energy regulatory and governance framework. Inevitably, there will be challenges as we consider how today's model buttresses up against a new vision.

## WHAT DO WE WANT?

We are convinced there is a better way. A future where there are rules, but with no specific ‘codes’ to sign up to. Where businesses are compelled to act with the right behaviours. For consumers, a market they can trust and can truly engage in a dialogue on products, services and price.

As we develop a new retail governance future, we need to be clear and agree on the objectives. In particular, how the experience might feel for different stakeholders as we map the future market vision.



Diagram 2: How it could feel

Diagram 2 above sets out a range of illustrative benefits from a retail market perspective. These have evolved as we explored the practices of the five markets under assessment and capture what we observed as the best outcomes from each. The benefits listed are by no means exhaustive and should be considered as a whole, i.e. dependent upon each other. For example, creating a strong market space for innovation will drive new products and services, which in turn helps businesses to flourish and consumers to become more engaged.

## THE SEEDS OF CHANGE

Ofgem is now consulting on proposed modifications to regulation and governance with respect to the Switching Programme<sup>12</sup>. This includes setting out its vision for the REC, putting consumer outcomes at the heart.

We should therefore start this journey with the REC, which could be so much more than yet another code. In fact, it could cease to be a physical code altogether, becoming embodied as a set of digitised rules, intelligently laid out and customised to reflect the variety of risks that different retail market participants expose the market to.

REC digitisation is just one bit of a new energy governance future. Coupled with digitised 'wizard' style procedures and cognitive automation, market engagement as we know it today would be totally unrecognisable and totally transforming.

Ofgem needs to ensure that whomever takes on the Code Manager role for the REC embodies a truly pro-competitive market philosophy, and has the vision, means, motivation and ambition to drive this forward.

## EMBRACING CHANGE

We need to enable a new future that embraces new markets and therefore new ways of doing business, such as peer-to-peer trading, demand side management, decentralised solutions, and supporting the Electric Vehicles (EVs) revolution. All will transform how the energy market operates and help motivate consumers to engage with their energy usage via the services and products they access.

We need to establish the non-negotiable rules that maintain safety, security and consumer protections, but allow a risk-based assurance approach to do the rest.

We need to:

- Define the future market vision we want the energy sector to gravitate, or simply aspire, towards;
- Reduce market complexity and accept that risk is an indisputable fact that we cannot circumvent and find new intelligent solutions that deal with that challenge;
- Accommodate different risk profiles by adopting measures that reflect different businesses and their impacts on markets, recognising that not all businesses pose the same risk, adjusting and flexing to ensure risks are minimised and the space for innovation and growth are maximised.

<sup>12</sup> Ofgem, 5th June 2018, Switching Programme: Proposed modifications to regulation and governance [https://www.ofgem.gov.uk/system/files/docs/2018/06/switching\\_programme\\_proposed\\_modifications\\_to\\_regulation\\_and\\_governance\\_3.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/06/switching_programme_proposed_modifications_to_regulation_and_governance_3.pdf)

## UNLOCKING POTENTIAL

The importance of data (availability and access), enabling IT systems and commencing a shift from an analogue to a digitised energy governance framework should not be understated. We must evolve much simpler systems for market participants to access data and industry rules, such as a single entry point. Industry processes need to be agile and much quicker, with fair rules for all, and improved and more transparent decision-making.

We should not embark on a new way without the consumer being at the forefront of design, enabling consumer signals and feedback loops to influence market behaviour and outcomes.

**If the energy sector is to finally put to bed the 'ills of the past' and become a leading, highly competitive consumer focused energy sector fit for the 21st century, then it must change. The framework we have today is not sustainable.**

We are embedding these ideas within a future target operating model. We will then consider the building blocks and set out for each what we need to do today to deliver that future. Over the next few months, we hope to stimulate discussion around the features of what a modernised energy governance future could entail via further thought leadership.

## ENGAGING IN THE DEBATE

We encourage you to get involved and join our Innovation Forum. Please get in touch with us at [transformation@gemserv.com](mailto:transformation@gemserv.com) to find out how.

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## Gemserv

We are an expert provider of professional services enabling the energy market transformation and data revolution. Our vision is to ensure that complex markets work for everyone's benefit.

