



Department for
Business, Energy
& Industrial Strategy

Energy Retail Market Strategy for the 2020s

Helping consumers on their net zero journey

July 2021



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Contents

Executive Summary	4
2020s indicative timeline	6
What role does the retail market play in reaching net zero?	7
Our vision for a market that enables net zero	8
Key challenges to achieving this vision	11
Programme of work	14
Annex A – Wider programme of work	16

Executive Summary

Our energy retail strategy describes how, by setting a framework that incentivises energy companies to innovate for and engage with their customers, we will work with the market to take consumers on the journey to a net-zero energy system.

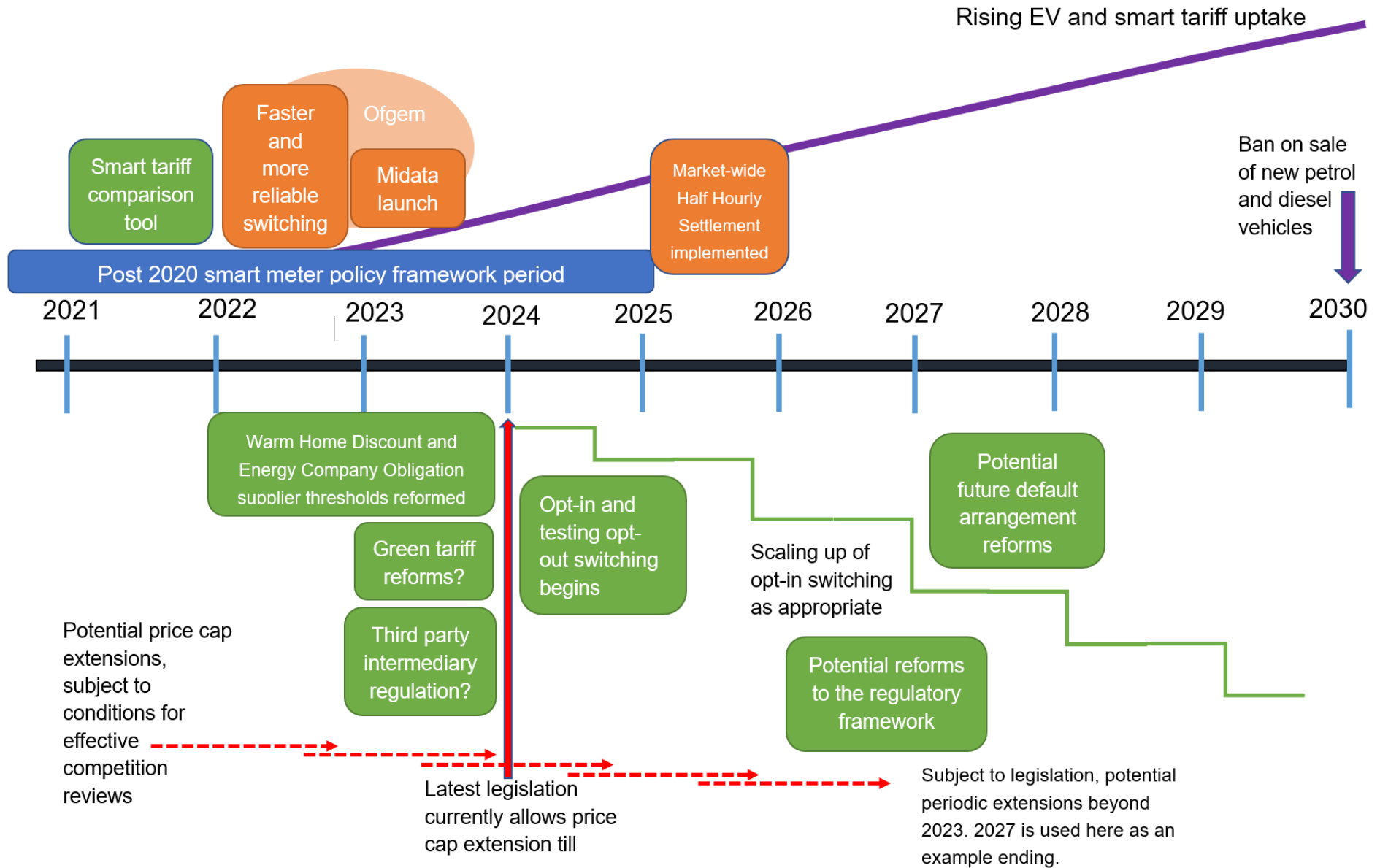
We have two high level objectives to help describe how we will deliver the strategy:

- Objective one. There is a sustainable retail market that delivers services or products that make it easy and rewarding for consumers to engage with energy and adapt their usage to support decarbonisation.
- Objective two. No matter how they engage in the market, all consumers should pay fair prices for their energy:
 - they should be protected from paying excessive charges as we build a modern and competitive smart energy system;
 - and, on an enduring basis, engagement must not be a barrier to fair outcomes or net zero, with all consumers supported and benefiting from competition.

Summary of key goals and actions		
Short term (present onwards)	Medium term (2024 onwards)	Long term (late 2020s)
<ul style="list-style-type: none"> • Protecting consumers from excessive loyalty penalties from disengagement, with a temporary price cap. • Addressing barriers to engagement with the market, 	<ul style="list-style-type: none"> • Ensure consumers are accurately informed about their personal contribution to Net Zero, with an initial focus on “green tariffs”. 	<ul style="list-style-type: none"> • Market framework supports the development of new business models that support net-zero (such as heat as a service or peer to peer energy trading), which can make use of the digitalised physical infrastructure.

<p>for instance with Ofgem’s Faster Switching Programme.</p> <ul style="list-style-type: none"> • Address market distortions, such as the Energy Company Obligation (ECO) and Warm Home Discount (WHD) thresholds, to level the playing field and improve competition. • Ensure there is suitable protection for consumers engaging with third parties (such as brokers or price comparison websites). 	<ul style="list-style-type: none"> • Significant progress on laying building blocks to enable new business models, e.g. smart meter rollout, half-hourly settlement. • Cost reduction in low carbon technologies, such as heat pumps. Continued growth in electric vehicle ownership. • Prompt consumers to consider alternative tariffs/services, improving competition and engagement, through opt-in switching. 	<ul style="list-style-type: none"> • Ensure there is an appropriate regulatory framework to facilitate this whilst protecting consumers. • System costs and price signals complement new business models and incentivise consumer behaviours that assist decarbonisation, e.g. charging of EVs overnight. • Potentially more action (e.g. through opt-out switches) to nudge consumers and suppliers towards more competitive and/or low carbon products.
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2020s indicative timeline



What role does the retail market play in reaching net zero?

The energy retail market is the main interface between consumers and the energy system, and the primary mechanism for recovering the costs of the gas and electricity systems - its stability and effectiveness is vital. This will only grow as petrol and diesel for transport are displaced by electricity. As the face of the energy system, a fair and competitive retail market is more important than ever to maintain consumer support for Government goals as we deliver net zero emissions. We now need to go further to rise to the challenges of reaching net zero, and Government and the retail market must support consumers on a journey to new ways of interacting with the energy system.

The Government and Ofgem's new Smart Systems and Flexibility Plan, published 20 July 2021¹, sets out a vision and suite of actions for delivering a digital, low carbon system that enables consumers to benefit from and support the transition to net zero – including smart meters, half hourly settlement, smart appliances and smart electric vehicle charging.

A well-functioning market that engages consumers and offers products that support decarbonisation (not simply energy as a commodity) are needed to drive consumers to make use of new infrastructure or technology, and, ultimately, could support other long-term BEIS policy goals such as deploying heat pumps or energy efficiency measures, without subsidy or obligation. The challenge is making sure we have the appropriate market design², in the form of regulation, processes and business models, in place to maximise benefits to consumers and deliver carbon reductions.

Bringing consumers on this journey could require significant change to the market structure of the past 20 years. A poorly functioning market that delivers poor consumer outcomes and fails to innovate will dent public acceptance of net zero policies – particularly if bills are too high – as well as failing to drive the use of new low carbon technology and infrastructure. Ensuring that we maintain or improve levels of fairness and consumer protection must be a priority or we risk losing support for the net zero agenda.

¹ <https://www.gov.uk/government/publications/transitioning-to-a-net-zero-energy-system-smart-systems-and-flexibility-plan-2021>

² a flexible and comprehensive regulatory framework; clear role for the regulator; transparent provision of information on emissions savings or the benefits of technology; fair distribution of system costs; and enabling the deployment of innovative business models

Our vision for a market that enables net zero

At the most basic level a market consists of consumers, vendors and rules that dictate how good and services flow from one to the other. The Energy Retail Market is no different, and there is a direct relationship, through market operators such as suppliers, from the retail market framework to the behaviours and experiences of consumers.

Since energy is a utility essential to consumers' lives, and the retail market serves as the front end of a complex and integrated energy system, the market framework plays a particularly important role in affecting consumers' experiences – the types of businesses they interact with; the products available to them; and the scope and extent of competition that ensures they face fair prices.

We want a regulatory framework that delivers good outcomes for consumers, which includes helping them decarbonise effectively. To achieve this, in our vision we define what a net-zero market should deliver for consumers; what that means for how retail energy companies should behave; and in turn what that suggests about what a modern, flexible market framework should look like.

1. Consumers in a market that supports net zero should:

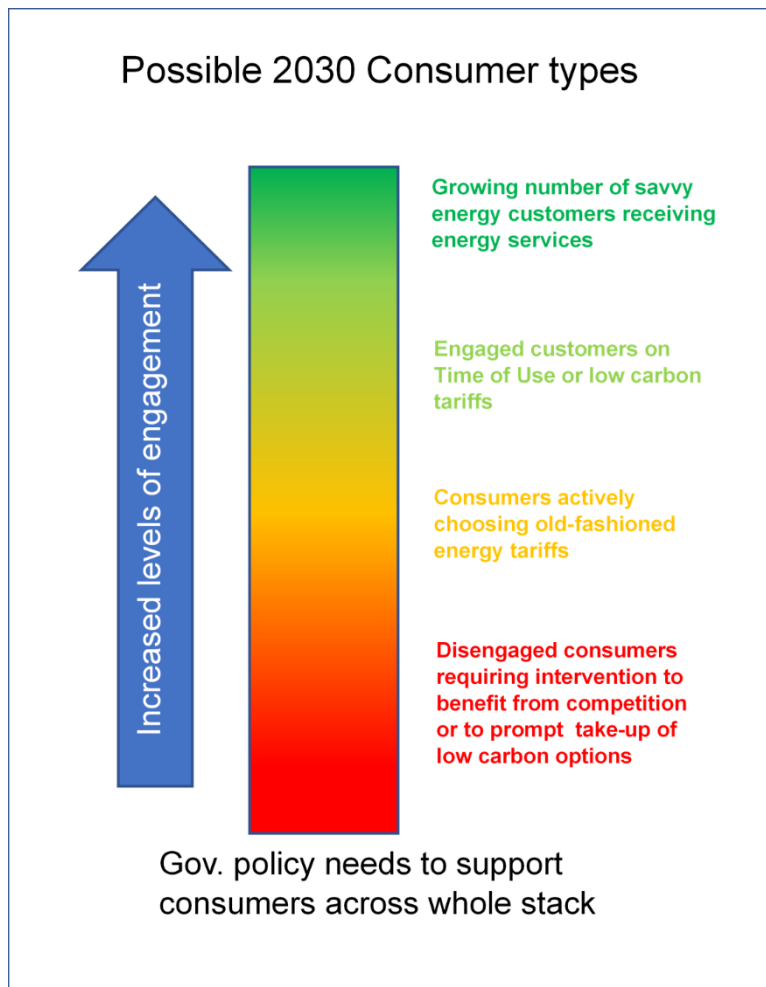
- Be able to easily engage with retail market offers to make active choices to support the adoption of innovative products, technologies, and services (supports objective one and two).
- Be provided with the necessary information to understand and take advantage of the low carbon products and services available to them and realise their benefits (supports objective one).
- Not all be expected to fully engage. Given historic levels of engagement it is unrealistic to expect all consumers to actively participate in the market and secure better value or service-based products. We expect a spectrum of consumers ranging from savvy customers on new services to those who will continue to need protection from unfair pricing. Government policy needs to support the full spectrum of consumers. (supports objective two).
- Where they are not engaged, still be taken on a journey to products and services that contribute to decarbonisation (potentially in the absence of active choice), so that engagement is not a barrier to fair outcomes or net zero (supports objective two).
- Receive appropriate levels of protection whether they obtain energy services from a traditional supplier, a third party, or a new business model (supports objective two).

2. Energy companies operating in a market that supports net zero should:

- Actively work with their customers to increase engagement in their use of energy (supports objective one).
- Facilitate consumer flexibility to help balance the energy system locally and nationally; or otherwise reduce system carbon emissions (supports objective one).
- Develop innovative products, such as energy as a service, to allow consumers to access the benefits of low carbon technologies more easily (supports objective one).
- Compete with a variety of business models, so that there is competitive pressure to continually improve quality of service and consumer choice and the market determine the best business models (supports objective one).
- Provide services to meet the needs of consumers in vulnerable circumstances to ensure they are not left behind (supports objective two).
- Be subject to competitive pressures which prevent them being able to overcharge disengaged consumers (supports objective two).

3. An energy system and market framework that supports net zero should:

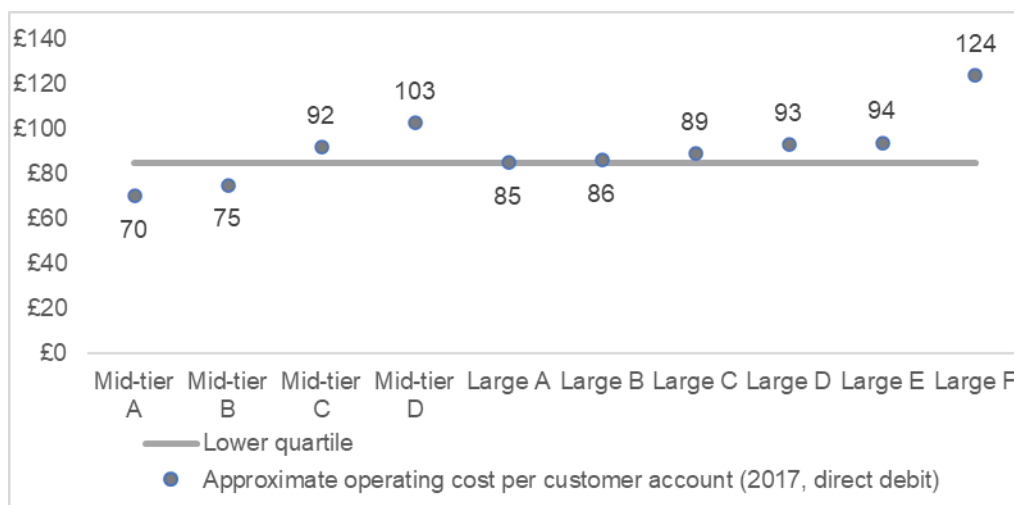
- Support the development of innovative products and services, by energy suppliers, third-party intermediaries and beyond, to match the changing nature of energy generation and use. Consumer choice and active competition through the market will be the best approach to allow winning business models to grow (supports objective one).
- Maintain market stability and ensure a level playing field for competition, including among different business models, allowing competitive companies to make a profit and therefore attract investment (supports objective one).
- Set the right price signals in the energy system. This has the potential to play a key role in meeting our net zero target cost effectively, reducing the overall costs which will need to be distributed across consumer groups or the taxpayer (supports objective two).
- Ensure that costs are fairly allocated between all consumers. We need to strike the right balance between different households, between domestic consumers and businesses, including energy intensive industries (supports objective two).



Key challenges to achieving this vision

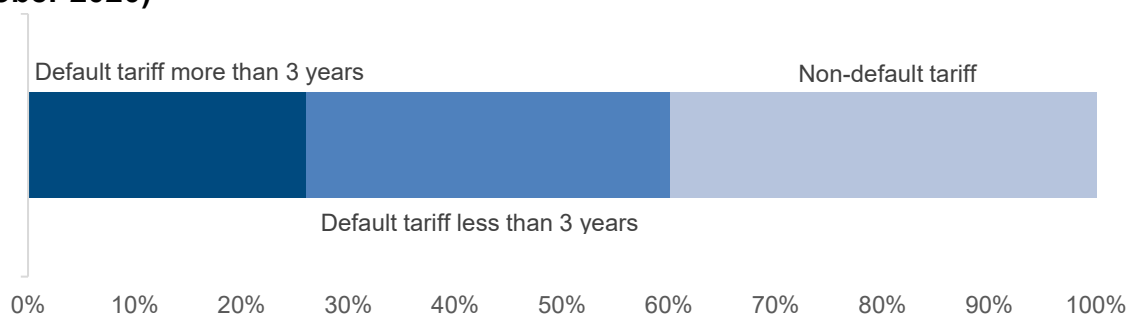
- There are large parts of the market where **out of date IT and customer management software are still in use**, affecting efficiency and standards of customer service. Before the default tariff price cap, suppliers' ability to profit from sticky default customers reduced the incentive to invest in upgrades. Many modernisation projects are now underway, but there remains a risk that **investment in improvements would fall away without a price cap in place or greater competitive pressure for consumers**.

Chart: Large and mid-tier supplier operating costs per customer pre-price cap (Source: Ofgem)



- Not all consumers currently experience **fair and affordable outcomes** nor are there **high levels of market engagement**. The energy market currently operates as a **two-tiered market**, where 60% of consumers are on default tariffs³, and 64% of default tariff customers having never switched⁴. Before the price cap, this allowed suppliers to charge these consumers a significant loyalty penalty and earn excess profit or to continue to operate inefficiently. However, the causes of the **loyalty penalty** remain. Until these causes (barriers to consumer engagement and the indefinite nature of the default arrangements) are tackled (unlikely before 2024), we do not think the price cap can be removed without risk of returning to excessive loyalty penalties.

Chart: Proportion of electricity customers by tariff type (All suppliers Ofgem RFI, October 2020)



³ Ofgem, all supplier RFI data.

⁴ Ofgem Consumer Survey (2019)

- The combination of the growth of a highly competitive tier and the introduction of a temporary default tariff price cap has seen negative margins for many energy suppliers. While part of this is likely driven largely by operating inefficiencies among legacy suppliers and upfront investments in consumer acquisition by growing suppliers, it is likely exacerbated by some aspects of the current market design, for instance the small supplier exemptions in the Warm Home Discount and Energy Company Obligation. There may also be challenges for suppliers that arise from their commercial position with respect to other parts of the energy market, such as meter asset providers and other service providers, with any excessive margins being passed through to consumer bills. **A market design that leads to expectations of low margins across the market over a sustained period could stifle innovation.**
- Renewable or 'green' energy tariffs are increasingly popular, as more and more consumers seek to play a role in tackling climate change – 'green' tariffs now represent over half of all new tariffs available. **It is critical that consumers can trust that tariffs marketed as green or low carbon will in fact make the expected positive impact for the planet, for example by stimulating additional investment in low carbon generation.** The supporting framework for these tariffs was first implemented 18 years ago and there is a risk it is no longer able to meet evolving customer expectations. Concerns have been raised in the media regarding the lack of transparency of green electricity tariffs - which can lead to the environmental impact of a particular tariff or supplier being overstated. There is a risk that these tariffs may not wholly offer consumers the service claimed, leading to either a breakdown of trust or an assumption by consumers that their energy use is already fully 'green' and they need take no further action.
- The market is still dominated by the old supply business model and traditional flat standing charge / unit cost tariffs with many barriers to change:
 - **There is limited penetration of time of use tariffs and related products in the retail marketplace today.** These tariffs reward consumers who can adjust their consumption away from periods when energy is scarce, to when it is more abundant – for example when it is windy, sunny, or there is low demand on the network. A number of technical and infrastructure dependencies are required before these products can market on scale. We expect more energy suppliers will market innovative tariffs enabled by smart meters as: smart meter coverage increases; half hourly settlement is applied market-wide; and smart technologies from EV chargers to electric heating become more commonplace.
 - New business models and innovative energy products and services are disincentivised by a complex legislative and regulatory framework, developed incrementally over the last 30 years, encompassing primary and secondary legislation, licences and industry codes. The current rules have evolved as the market has developed, and may be **preventing new products or services that**

achieve desired consumer outcomes, and could have unintentionally embedded the incumbent business models.

- **The existing framework does not easily allow energy suppliers to incentivise behaviour which can effectively minimise the costs of decarbonisation**, for example through setting price signals which promote the electrification of heating and transport, or to use the electricity system at off peak times through time of use tariffs.
- Some new products and services, such as auto-switching and broker services have emerged outside of the current regulatory framework, and new models will continue to emerge. These third-party intermediaries can bring benefits to consumers, but there are also potential harms, and **the lack of a regulatory framework for third-party services could lead to inconsistent consumer protection.**
- The way costs are allocated through the energy system has evolved over time without comprehensive review, with changes being made on a policy-by-policy basis. This has led to **market distortions which increase the total costs of the system and consumers' bills, and make achieving net zero more complex.** As we take decisions on funding Net Zero we need to avoid exacerbating existing distortions and ensure a fair distribution of costs, or we risk undermining consumer support for and the achievement of Net Zero.

Programme of work

Our programme of work aims to balance overcoming these barriers with the need for stability and continued consumer protection as the market undergoes great change over a relatively short period of time. We will take action to enable market players to deliver improvements to products and services without ongoing government intervention.

But if insufficient progress is made without intervention, we plan to have developed options which enable us to make incremental one-off or regular ‘shifts’ in the market to effect changes which will nudge consumers and energy suppliers towards further engagement, competition and lower carbon energy products.

The programme consists of the existing (pre-Energy White Paper) workstreams, some of which are summarised in the Annex, and a newer package of work. We have included headlines from both sets in the timeline at the start of this paper. New actions include:

- In the long term, **we are seeking to tackle excessive loyalty penalty charging through facilitating greater competition and market engagement**. This includes introducing opt-in switching, testing opt-out switching as part of considering how default arrangements could be reformed, and removing obligation thresholds for energy suppliers. A consultation on these schemes has been published alongside this document⁵.
- To protect consumers in the interim period, as set out in the ministerial statement published alongside this document⁶, **we will legislate, subject to Parliamentary time and approval, to allow for future extensions of the price cap beyond 2023**.
- Continued stakeholder engagement as we prepare to launch a **Call for Evidence (CfE) into Designing a Framework for Transparency of Carbon Content in Energy Products**. The CfE will seek to gather information from market participants about the need for reform to the green tariff framework and present some high-level options on the nature and role of these products in the energy system. We want to address transparency challenges within the framework as it exists today, whilst considering the role of green electricity tariffs in a world where renewable and low carbon generation become the predominant form of energy in our mix. This activity is our first step to help us understand the challenges in this area and seek views as to how we might develop a more transparent framework for carbon content of energy products to be communicated to consumers.
- By supporting engagement, opt-in switching should support the uptake of decarbonising products. More directly, we also intend the scheme’s (and any future opt-out scheme’s) design to help facilitate reaching net zero. For opt-in switching, we could prioritise prompting consumers with decarbonising supportive tariffs, and/or target which

⁵ <https://www.gov.uk/government/consultations/energy-retail-opt-in-and-testing-opt-out-switching>

⁶ An open letter to interested parties has been published with more detail at: <https://www.gov.uk/government/publications/energy-retail-market-strategy-for-the-2020s>

supplier's customers are targeted on a decarbonising performance basis. An opt-out scheme could facilitate a more radical transition, where we could specify the type of tariffs disengaged consumers are moved to, for instance, time of use. **Both schemes can be impactful tools to influence what types of tariffs many consumers switch to.**

- The retail market regulatory framework must evolve if it is to keep pace with technological change and remain fit for purpose through the energy transition. Our forthcoming **call for evidence will consider whether to regulate third party intermediaries, such as price comparison websites and brokers.** We are also considering whether and how to regulate parties that control load, such as aggregators.
- We are currently assessing what further changes may be needed to the **wider regulatory framework, including the supplier hub model and the role of the supply licence.** This is a complex piece of work, but may be required to unlock the most cost effective approaches to achieving net zero, such as business models that deliver energy efficiency measures and renewable heating technologies through the market. There is also some time pressure as the continuation of some existing policies could further embed the incumbent model, pushing back the earliest we can deliver change. For now, we will continue to assess the rationale for wider retail regulatory reform through 2021. This will involve engagement with industry and consumer groups, analysis of market developments and consideration of the impact of related policy initiatives such as the proposals for reforming the code governance framework.
- The forthcoming Call for Evidence on Energy Consumer Funding, Fairness and Affordability, will **begin a strategic dialogue between government, consumers and industry on affordability and fairness in the energy system** and to maintain public support for net zero through a transparent discussion on costs. This work will complement plans for **large scale trials of alternative policy and network cost recovery methodologies** through our Alternative Energy Markets innovation project.

Annex A – Wider programme of work

The barriers to consumer engagement with the retail market will be further reduced with the introduction of Ofgem’s faster and more reliable switching programme (2022) and smart data initiatives like Midata (2023/24), which will allow greater data portability with third parties (such as price comparison websites). This is likely to facilitate greater competition and reduce the volume of consumers experiencing a loyalty penalty. We have published the UK’s first Energy Digitalisation Strategy which sets out how we can facilitate the transition to a digitalised energy system, that lowers system costs and enables development of a broader range of innovative services for consumers.⁷

Smart meters are being rolled across Great Britain and consumers with smart meters are more engaged in their energy use. Smart metering also enables market-wide Half Hourly Settlement (implementation by Ofgem in mid-2020s), which strengthens incentives on suppliers to offer tariffs and products that reward customers for using electricity flexibly (e.g. by consuming off-peak). A BEIS innovation project is underway to develop a comparison tool that gives consumers an easy way to find the most suitable smart tariff⁸. Engagement with energy products and services is also likely to be supported this decade with the rise of EV ownership.

The expansion of the Warm Home Discount (WHD) and the Energy Supplier Obligation (ECO) schemes will provide extra support to low-income and vulnerable households. We are also using innovation funding to assess the best combination of technology and business model to help low income consumers engage with smart solutions.

Wider measures in development will also facilitate the retail market’s transition to supporting a flexible system:

- The Smart Export Guarantee (2020) will help incentivise the uptake of on-site low carbon generation, creating additional benefits to be realised from consumer’s adopting smart technologies and time of use tariffs.
- Ofgem’s ongoing reform of network access and forward-looking charges should further facilitate this shift, by enabling greater cost-reflectivity of charging signals for suppliers.
- We are enabling consumers to utilise smart technologies by developing standards to ensure interoperability and cyber security.
- We are supporting the uptake of flexibility technologies by changing the methodology (SAP) that underpins our energy efficiency and heating programmes, so that smart heat pumps and battery storage can be included in Building Regs, subsidy schemes, green mortgages and Energy Performance Certificates.

One of the key barriers to the decarbonisation of heat is the difference in price between electricity and other energy sources, such as gas. The CCC estimates that a household

⁷ <https://www.gov.uk/government/publications/digitalising-our-energy-system-for-net-zero-strategy-and-action-plan>

⁸ <https://www.gov.uk/government/publications/smart-meter-enabled-tariffs-comparison-project-smarter-tariffs-smarter-comparisons>

switching from a gas boiler to a heat pump could face an extra policy cost of over £100 per year (on average) on its energy bill. We need to address these distortions to allow low-carbon heating to compete with fossil fuel alternatives. Our Call for Evidence on Energy Consumer Funding, Fairness, and Affordability will begin a strategic dialogue between government, consumers and industry on affordability and fairness, including how price signals can encourage consumers to make choices that support the transition to net zero. We are aiming to develop future retail options that are compatible with any realignment of price signals to better provide energy consumers with incentives to decarbonise.