



Department for  
Business, Energy  
& Industrial Strategy

**ofgem**

Making a positive difference  
for energy consumers

# FLEXIBLE AND RESPONSIVE ENERGY RETAIL MARKETS

Putting consumers at the centre of a smart,  
low carbon energy system

Closing date: 16 September 2019

22 July 2019



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Any enquiries regarding this publication should be sent to us at: [energyretailmarketsreview@beis.gov.uk](mailto:energyretailmarketsreview@beis.gov.uk)

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# General information

## Why we are consulting

At this formative stage of the review, Government and Ofgem are keen to understand how best to progress with potential reforms. This document aims to inform stakeholders on the state of our current thinking and present options for discussion and provides an important opportunity to test with stakeholders the range of potential options we have considered so far.

We are keen for stakeholders to respond with their views and evidence to the questions posed in this document. Responses to this consultation and continued stakeholder engagement over the summer will inform the next stage of the review and will help shape our thinking on more developed reforms later in the year.

## Consultation details

**Issued:** 22 July 2019

**Respond by:** 16 September 2019 at 23:45

### **Enquiries to:**

Energy Markets and Affordability Team  
Department for Business, Energy and Industrial Strategy  
3rd Floor, Area Abbey 1  
1 Victoria Street  
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Tel: 020 7215 5000

Email: [energyretailmarketsreview@beis.gov.uk](mailto:energyretailmarketsreview@beis.gov.uk)

**Consultation reference:** Flexible and Responsive Energy Retail Markets

### **Audiences:**

This consultation will be of interest to individual energy companies, industry representatives, innovators, third party intermediaries in energy and/or other sectors and consumer and environmental groups.

The consultation is not limited to these stakeholders; any organisation or individual is welcome to respond.

### **Territorial extent:**

This consultation relates to the future of energy retail markets operating in England, Scotland and Wales.

Please note the opinions of others quoted in the report are not necessarily endorsed by HM Government or Ofgem.

## How to respond

Please email your responses to the Flexible and Responsive Energy Retail Markets Consultation to the following email addresses. As this is a joint review, please ensure you respond to both email addresses below:

**Email to:** [energyretailmarketsreview@beis.gov.uk](mailto:energyretailmarketsreview@beis.gov.uk) and [futuresupply@ofgem.gov.uk](mailto:futuresupply@ofgem.gov.uk)

If preferred, you may submit your full response by post by using the following addresses:

### Write to:

Energy Markets and Affordability Team  
Department for Business, Energy and Industrial Strategy  
3rd Floor, Area Abbey 1  
1 Victoria Street  
London  
SW1H 0ET

### AND

Future Retail Market Design Team  
Ofgem  
Fourth Floor  
10 South Colonnade  
Canary Wharf  
London  
E14 4PU

A response form is available on the GOV.UK consultation page:

<https://www.gov.uk/government/consultations/flexible-and-responsive-energy-retail-markets>

When responding, please state whether you are responding as an individual or representing the views of an organisation.

Your response will be most useful if it is framed in direct response to the questions posed, though further comments and evidence are also welcome.

## Confidentiality and data protection

Information you provide in response to this consultation, including personal information, may be disclosed in accordance with UK legislation (the Freedom of Information Act 2000, the Data Protection Act 2018 and the Environmental Information Regulations 2004).

If you want the information that you provide to be treated as confidential, please tell us, but be aware that we cannot guarantee confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not be regarded by us as a confidentiality request.

We will process your personal data in accordance with all applicable data protection laws. See our [privacy policy](#).

We will only retain your personal data for as long as it is needed for the purpose of this document, or what data law requires. In general, this means we will only hold your personal data for a minimum of 1 year to a maximum of 7 years.

We will summarise all responses and publish this summary on GOV.UK. The summary will include a list of names or organisations that responded, but not people's personal names, addresses or other contact details. Ofgem will publish non-confidential responses on [Ofgem.gov.uk](http://Ofgem.gov.uk).

## Quality assurance

This consultation has been carried out in accordance with the Government's [consultation principles](#).

If you have any complaints about the way this consultation has been conducted, please email: [beis.bru@beis.gov.uk](mailto:beis.bru@beis.gov.uk).

# Executive Summary

The energy system in 2050 should fully harness the power of competition, drive continual innovation, be fair, safeguard the most vulnerable and deliver clean, affordable energy consistent with our climate goals. A vital part of this is enabling the ‘energy transition’ – the shift from the traditional energy system (based predominantly on fossil fuels) to a low carbon, smarter, and electrified energy system. A dynamic, innovative and competitive retail market will help deliver the energy transition at the lowest cost to consumers.

Government has now committed to fully decarbonising the energy system by 2050, aiming to reach net zero emissions across the whole economy. This is likely to require further and faster action, and it is crucial that we deliver this transition in a way that means that costs are shared fairly, consumers and businesses are protected, and the benefits reach people right across the UK.

Well regulated, efficient markets are the best driver of results for consumers, but they must be flexible, adaptable and stay relevant for the times. The Government and the regulator, Ofgem, have identified that the energy retail market framework is not agile and risks holding back the energy transition.

Ofgem’s principal objective is to ‘protect the interests of existing and future gas and electricity consumers’ – including through greenhouse gas reduction and promoting security of supply. Ofgem is already taking a range of actions to adapt its approach to regulation in order to accomplish this goal and is considering what further it can do using its existing powers.

In November 2018, BEIS and Ofgem launched a joint review to investigate what policy, legal and regulatory changes might be needed to make sure the market framework can meet the demands of the coming decades. This document is the mid-point of our review and sets out our emerging thinking on the challenges, available options, and how they might fit together.

We want a future energy retail market where innovation brings greater choice to consumers, allowing them to take advantage of the increased flexibility and lower costs of the smart, low carbon energy system. It is also a market where a combination of healthy competition and appropriate safeguards ensure that all consumers pay a competitive price for their energy and consumers in vulnerable situations are properly protected.

The energy system is undergoing a fundamental transformation as the processes of decarbonisation, digitalisation and decentralisation accelerate. While we cannot know exactly how the future will evolve, the pace of change – driven by new technologies – is likely to increase. Over the course of the next decade, we expect markets to combine supply and demand together in new ways, enabling competitive pressures and differentiation through more of the energy value chain. There will likely be greater diversity in the types of companies operating in the sector. There will of course, continue to be those who do not make active decisions about energy, so there will be an ongoing need for protections to ensure these consumers are not left behind.



We recognise there is an existing programme of reform underway delivering improvements to the retail market, such as the rollout of smart metering, faster more reliable switching and the Energy Industry Code Review<sup>1</sup> published alongside this consultation.

These are key enablers of innovation but they will not be sufficient in and of themselves. To complement these changes, we are considering additional reforms that will help enable a wider range of new business models, products and services to come to market over the next ten years. Depending on how the market evolves, we may need further, more fundamental reforms to the structure of the market in the longer term. We will consider ways to make regulation more flexible so that government and the regulator can adapt to change more quickly.

**We have considered how the regulatory framework could be changed to facilitate the launch of products and services that may be frustrated today, and which support decarbonisation.** We are seeking views on how we might create more flexible routes to market for a wider range of innovative energy services providers. We consider how sectoral regulation could be delivered differently and discuss the merits and practicalities of widening the scope of sectoral regulation, while also making regulation more flexible for different forms of businesses providing services to customers.

**We have considered potential market distortions and where implementing reforms could improve the functioning of the retail market as a dynamic and competitive sector.** We are seeking views on how we can better align policy and other regulatory obligations to improve the landscape for competition. We also want to explore where the market can better help consumers who are struggling to afford their energy. This includes the Government exploring the viability of further reforms that would remove imbalances in obligation levels across different sizes of suppliers, while minimising barriers to entry and expansion in the retail market.

**We have considered how the retail market can deliver a good deal for all consumers, as they should not face excessive prices and should receive a good level of service.** It is critical that we address potential market distortions and increase competition, and this is our preferred approach. We recognise that even if we do this, there is a risk that without effective protections in place, customers who do not or cannot engage in the market will not get a fair deal for their energy. We will therefore continue to work with industry to explore protections where necessary to ensure that all customers are able to secure a fair deal. As such we note the proposals from the Competition and Markets Authority (CMA) on interventions to limit instances of a 'loyalty penalty', which include targeted price interventions where needed to prevent clear harm to consumers. The Government reiterates that the practice of overcharging consumers for the energy they use will not be allowed to return and is prepared to deploy such interventions, as a last resort, if necessary.

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<sup>1</sup> BEIS (2019) Reforming the Energy Industry Codes <https://www.gov.uk/government/consultations/reforming-the-energy-industry-codes>

# 1. Introduction

**This chapter describes the strategic fit of the review of the energy retail market and its interaction with the wider policy landscape**

## Energy in 2050

The energy system in 2050 should fully harness the power of competition, drive continual innovation, be fair, safeguard the most vulnerable, and deliver clean, affordable energy consistent with our climate goals.

The Government envisages a world where much of what we value today is retained – secure, affordable electricity is delivered to our homes and businesses; heating and cooling provides comfort and wellbeing – alongside a package of change to help realise our ambition.

By 2050 low carbon energy will have moved from being a ‘green’ consumer choice to the default for everyone – in their cars and vans as well as their homes and businesses. The rollout of smart technology will have changed how consumers interact with the energy system, giving them more control over their bills, with different tariffs or packages rewarding flexibility and lowering consumption. Local communities will be offering energy services tailored to the needs of local people, and in some cases benefitting from larger energy projects that deliver social and economic benefits to the local area.

We recognise that in order to meet our goals, fundamental change needs to take place and happen quickly. Efficient, well-regulated markets are still the way to deliver the best results for consumers, but government, regulators and businesses need to work together to rethink the structure of the energy system. We need market structures and regulation that allow innovation to take place and new business models and services to emerge, while protecting consumers and not throwing away the best of what we have today.

## The role of energy retail markets

Consumers engage with the energy system through the energy retail market, giving it a key role to play in determining what the path to 2050 means for individual households, communities and businesses. If the retail market is dynamic, innovative and competitive, we can achieve our goals, such as decarbonising the energy sector at the lowest cost to consumers.

At the end of the 20<sup>th</sup> century, Great Britain privatised and liberalised its energy markets, forging a path which many other countries have subsequently followed. The retail market arrangements that were put in place reflected what was needed at the time and the technology available. Large, centralised generators were linked through transmission and distribution networks to end consumers. Between generators and consumers, at the centre of the energy system, the concept of energy ‘suppliers’ was created. Suppliers remain the exclusive interface between the system and consumer, competing on how efficiently they procure wholesale energy and manage the billing relationship with end consumers. They provide a single point of contact for consumers, a standard product concerning their energy, and a tariff for metered

consumption. The supply licence, issued by Ofgem, defines the role of suppliers and is the main tool for regulating the market.

The world and the energy system have changed significantly since the privatisation of the energy market. To date, change has largely taken place 'around' the energy retail market, with the fundamental features of the market remaining broadly the same.

But this cannot continue. We both expect and need the rate of change to accelerate further. The retail market design, including the 'one size fits all' supply licence, which has for so long defined the energy system for consumers, is starting to hold back progress by preventing consumers from benefitting from innovation, and is slowing down decarbonisation. It is now time to consider what changes to market design are needed to enable the energy transition that will place us on the path to 2050.

Competition has helped and will continue to help drive down prices and benefit consumers as a whole. However, some consumers, particularly those that do not actively shop around for their energy, have consistently paid considerably more for their energy than the efficient cost of supplying it. This led to the introduction of the temporary cap on default and standard variable tariffs<sup>2</sup> (the 'price cap'<sup>3</sup>), which will be reviewed, and potentially extended, on an annual basis from the end of 2020 and will be removed by the end of 2023 at the latest. In the long-term, the market design must ensure that all consumers are able to reap the benefits of competition and get a fair deal for their energy.

## Protecting the interests of consumers

Ofgem's principal objective is to 'protect the interests of existing and future consumers'. By consumers, we refer to a number of groups including households, public sector and voluntary organisations, SMEs – including microbusinesses, and industrial and commercial companies. Consumers' interests include the reduction in greenhouse gases and maintaining security of energy supply to them. With this in mind, Ofgem's approach to regulation, as the energy transition progresses, is to act decisively wherever necessary in the best interest of consumers, as outlined in the recently published Ofgem Strategic Narrative: 2019-2023<sup>4</sup>.

In the energy retail market today, this includes ensuring energy suppliers meet consumer needs through robust compliance and enforcement action and updating the rules for how we regulate through licences when necessary. Ofgem also implements the temporary price cap as set out in the Domestic Gas and Electricity (Tariff Cap) Act 2018. Looking ahead, Ofgem is developing a strategy that sets out its priorities to help protect consumers in vulnerable situations until 2025 and is conducting a strategic review to better understand and address the issues faced by microbusinesses. This review is exploring what more Ofgem can do to protect consumers' interests in the future, both within Ofgem's current powers and through working with Government to secure new powers where necessary.

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<sup>2</sup> Default and standard variable tariffs are a basic tariff from an energy supplier. They are typically poor value and more expensive than a non-default, fixed-term tariff, which consumers can choose to switch to.

<sup>3</sup> Ofgem - The Default Tariff Cap <https://www.ofgem.gov.uk/gas/retail-market/market-review-and-reform/default-tariff-cap>

<sup>4</sup> Ofgem (2019) Strategic Narrative: 2019-23 <https://www.ofgem.gov.uk/publications-and-updates/ofgem-strategic-narrative-2019-23>

# The joint review on the future of the energy retail market

In response to these challenges, in November 2018, the Secretary of State announced a joint review of the energy retail market as part of his 'After the Trilemma' speech<sup>5</sup>. A joint BEIS-Ofgem review was required because the current retail market design is underpinned by primary legislation, secondary legislation, licences and industry codes. Making changes to this design in a joined-up way will require government, Ofgem and industry to work together to develop, test and implement ideas. The Government is committed to making changes through primary legislation if needed.

The review endorses earlier evidence that the current regulatory framework – designed to address the challenges of several decades ago – is now constraining helpful innovation and new service offerings. It requires reform to keep pace with the wider energy transformation. Change must facilitate an increase in the choices available to consumers, and complement the transition to a smarter, more flexible and low carbon energy system.

In addition to ensuring that retail market design enables the path to 2050, this review also presents an opportunity to address the root causes of the 'loyalty penalty', improve the minimum levels of service that all customers are guaranteed, and re-think how protections for consumers in vulnerable situations are delivered in practice. Alternative approaches are made more viable by reforms such as the rollout of smart metering, and faster, more accurate industry processes.

The case for reform summarised above has a strong basis in analysis and evidence. These issues have, in various ways, been considered by the Government, Ofgem and the CMA over the past few years<sup>6</sup>. These processes have already resulted in a range of initiatives and interventions, including the introduction of a pre-payment meter cap<sup>7</sup> and the temporary price cap, legislated for by the Government and implemented by Ofgem in 2019.

The focus of this review – the design of energy retail markets – is to complement these initiatives. The price cap will be reviewed, and potentially extended, on an annual basis from the end of 2020 and will be removed by the end of 2023 at the latest. In taking the decision as to whether to remove the price cap, the Secretary of State will take into account Ofgem's assessment of the conditions for effective competition<sup>8</sup>. Modernising the retail market design could play a key role in providing confidence that those conditions are in place.

There are opportunities that can be leveraged from other cross-sectoral reform work, in order to deliver better outcomes for energy consumers. This includes the forthcoming Consumer White Paper, Smart Data Review<sup>9</sup>, the CMA's work in response to Citizens Advice's loyalty

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<sup>5</sup> BEIS (2018) After the trilemma - 4 principles for the power sector

<https://www.gov.uk/government/speeches/after-the-trilemma-4-principles-for-the-power-sector>

<sup>6</sup> Through Ofgem's Call for Evidence on future supply market arrangements, the energy market investigation by CMA that reported in 2016 and the 2017 Helm Review into the cost of energy.

<sup>7</sup> Ofgem (2017) Prepayment meter price cap <https://www.ofgem.gov.uk/gas/retail-market/market-review-and-reform/implementation-cma-remedies/prepayment-meter-price-cap>

<sup>8</sup> Ofgem (2019) - Developing a framework for assessing whether conditions are in place for effective competition in domestic supply contracts

<https://www.ofgem.gov.uk/publications-and-updates/developing-framework-assessing-whether-conditions-are-in-place-effective-competition-domestic-supply-contracts>

<sup>9</sup> BEIS (2019) Smart data: putting consumers in control of their data and enabling innovation

<https://www.gov.uk/government/consultations/smart-data-putting-consumers-in-control-of-their-data-and-enabling-innovation>

penalty super complaint and the National Infrastructure Commission's Future of Regulation study<sup>10</sup>. The Government response<sup>11</sup> to the CMA's loyalty penalty work stated that it is essential that competition works for the benefit of consumers and that unfair practices are tackled effectively.

Our review will join up with the Government and Ofgem's existing work programmes. This ranges from projects that are well underway, such as the smart meter rollout, to the other projects which have either recently been published or are being announced alongside this consultation. This work includes:

- The Energy Data Taskforce<sup>12</sup>: this is looking to facilitate more open data across the whole energy system, with greater levels of standardisation, granularity and interoperability, which will enable businesses to provide new solutions.
- The Energy Industry Code Review: this will consider options for improving the existing arrangements, including the purpose of the codes and their content. These reforms, along with greater access to better quality consumer and system data, should help new entrants navigate the market more easily and help them develop and deliver their innovative propositions to meet consumer needs.
- Ofgem Consumer Vulnerability Strategy<sup>13</sup>: an updated Ofgem Consumer Vulnerability Strategy should drive the delivery of positive impacts for consumers in vulnerable situations, who may face new challenges in the future. This strategy will be underpinned by a view that consumers in vulnerable situations should not be left behind in the transition to smarter technologies and should be able to take advantage of the opportunities provided by the evolving market.
- Microbusiness Strategic Review<sup>14</sup>: Ofgem's review of the microbusiness retail market aims to better understand and address issues faced by microbusinesses. If deemed necessary, new protections may emerge for microbusinesses.

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<sup>10</sup> National Infrastructure Commission (2019) Future of Regulation Study call for evidence <https://www.nic.org.uk/publications/future-of-regulation-study-call-for-evidence/>

<sup>11</sup>BEIS (2019) Tackling the loyalty penalty [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/809592/Tackling\\_the\\_loyalty\\_penalty\\_SoS\\_letter.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/809592/Tackling_the_loyalty_penalty_SoS_letter.pdf)

<sup>12</sup> Energy Systems Catapult (2019) Energy Data Taskforce: A Strategy for a Modern Digitalised Energy System <https://es.catapult.org.uk/news/energy-data-taskforce-report/>

<sup>13</sup> Ofgem (2013) - Consumer Vulnerability Strategy <https://www.ofgem.gov.uk/publications-and-updates/consumer-vulnerability-strategy>

<sup>14</sup> Ofgem (2019) Opening Statement - Strategic Review of the microbusiness retail market [https://www.ofgem.gov.uk/system/files/docs/2019/05/opening\\_statement.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/05/opening_statement.pdf)

## 2. Overarching approach

**This chapter presents our vision for the future energy retail market and lays out the key opportunities and challenges the review wishes to address with the reforms described in this consultation.**

### Vision

The vision for a future energy retail market is one where innovation brings greater choice to consumers, allowing them to take advantage of the increased flexibility and lower costs of a smart, low carbon energy system. It is also a market where a combination of healthy competition and appropriate safeguards ensures that all consumers pay a competitive price for their energy and consumers in vulnerable situations in particular are properly protected.

To deliver this vision, the review will target five key outcomes by addressing the challenges associated with them. Although the opportunities are presented here separately, they are closely interlinked.

### Outcomes and challenges

**Wide choice of energy services** – The future energy retail market should support the development of innovative products and services that will deliver greater choice, better service and lower prices for consumers and facilitate the low carbon transition of our energy system.

Currently the route to market for companies seeking to launch innovative products and services in the retail market usually requires them to be a licensed supplier or to partner with one. Existing suppliers can find it difficult to develop specialised or innovative services because the regulatory framework is highly prescriptive in terms of how energy services can be sold. We need a regulatory framework that enables more innovation and choice for consumers, including for new sources of energy demand such as electric vehicles, while helping to lower the costs of decarbonisation.

**Consistent consumer protection<sup>15</sup>** – The future energy retail market should ensure that consumers are appropriately protected no matter what energy related products and services they choose to sign up to in the future. Levels of sectoral protection should be proportionate to the risk posed to consumers.

Some new products and services, such as auto-switching and brokering services are already emerging outside of the current regulatory framework, and new models will emerge in the future. The regulatory framework should reflect and keep pace with this to ensure consumers enjoy consistent protection across the market and that the protection framework does not distort competition between different business models.

**Minimal market distortions** – In the future energy retail market, businesses should not face policy obligations and responsibilities that distort competition between different businesses or business models. Any obligations and responsibilities they do face to deliver social and

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<sup>15</sup> Not including price protections, which we include in the fair price for all section.



environmental objectives should involve minimal administrative burden, which could otherwise disproportionately burden small businesses and hinder competition.

Suppliers carry out a wide range of functions and obligations that help meet environmental and social objectives. However, in some cases these obligations have been designed in a way that may lead to an uneven playing field between suppliers. Furthermore, the administrative costs of obligations may limit suppliers' ability to focus on bringing new products and services to market. There is also a risk that the uneven way that higher cost-to-serve customers are distributed across the market could contribute to market distortions.

**Competitive prices for all** – In the future energy retail market, consumers should not face excessive prices, meaning they should not pay considerably more for their energy than the cost of supplying that energy. We recognise that consumers will be best served by a healthy competitive market with which they can easily engage. Nevertheless, appropriate safeguards should be in place where necessary for all consumers, including those that don't engage in the market<sup>16</sup>.

Before we introduced the temporary price cap, customers who did not engage faced a 'loyalty penalty', where a typical consumer paid £75-100 more than the average efficient costs of serving them<sup>17</sup>. Reforms that minimise market distortions should reduce the incentives on suppliers to charge uncompetitive prices to consumers, but the Government and Ofgem reserve powers to ensure excessive loyalty penalties do not return to the energy retail market.

**Ensuring consumers in vulnerable situations receive services they need** – In the future energy retail market, consumers in vulnerable situations should receive the support and services they need no matter who their supplier is.

The market can handle many of the additional energy-specific needs that consumers in vulnerable situations can have – with some suppliers delivering services that meet these needs in increasingly innovative and cost-effective ways. However, this does not always happen consistently across the market. In particular, consumers who struggle to afford their energy bills and get into debt do not receive consistent levels of support.

## Regulatory simplicity

In any market it is important that firms have a clear understanding on what they are and are not required to do. A firm may find it difficult to be compliant if they are not clear on what the regulations require. The energy sector rule book can be complex and is contained in a variety of sources including, among others, the Gas and Electricity Acts, licences, industry codes and other specific regulations.

This landscape can be off-putting to both potential entrants and to incumbents who are interested in trialling new products and services. It may mean firms begin developing and investing in a new offer only to find after some time that a regulatory issue means it cannot go ahead. Regulatory complexity may mean that consumers are not fully protected if firms are

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<sup>16</sup> Section 9 of the Tariff Cap Act 2018 makes a separate provision for Ofgem to carry out a review to consider whether there are categories of domestic customers that require protection against excessive charges. This review should consider consumers that may be vulnerable financially or otherwise.

<sup>17</sup> Ofgem (2019) Energy price caps explained, p. 2.

[https://www.ofgem.gov.uk/system/files/docs/2019/02/information\\_for\\_elected\\_representatives\\_and\\_stakeholders.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/02/information_for_elected_representatives_and_stakeholders.pdf)

unable to understand the relevant customer protection rules. Regulatory complexity may also put smaller firms at a disadvantage as they may not have the in-house regulatory teams that larger firms are able to employ.

Improving clarity and regulatory certainty for firms will lower the cost of compliance, which will free resources for innovation or pass costs savings on to consumers. A clearer regulatory framework will also allow us to adapt the regime more quickly as the energy transition continues. Ofgem has already taken some steps to streamline the supply licence, most notably by moving towards a principles-based approach to regulation<sup>18</sup>.

This review alone cannot address all the remaining regulatory complexity issues within current arrangements. There are complementary initiatives underway to tackle this, in particular the Energy Codes Review<sup>19</sup>. The code review will consider the purpose of the codes and how they could be consolidated and simplified. Any regulatory reforms that we progress as part of this review should, where possible, improve clarity and simplicity for regulated businesses. This is in line with Ofgem's shift towards principles-based regulation and the Government's Industrial Strategy and objective to 'reshape our regulatory approach so that it supports and stimulates innovation that benefits citizens and the economy'<sup>20</sup>.

## Reforming regulation in a rapidly changing world

New and developing technology entering the market will create a changing platform, irrespective of implemented regulatory change, and we do not know how consumers will react. For instance, it is difficult to predict how different consumer groups will react to electric vehicles becoming commonplace. Change will impact groups of consumers differently – potentially creating new challenges for consumers in vulnerable situations. It is fundamentally important to understand these distributive impacts and for the regulation of the future to be adaptable so it can easily respond to new developments<sup>21</sup>.

As this adaptability is built into the regulatory framework of tomorrow, it is crucial to also maintain the aspects of the energy retail market that continue to work well. We are using a phased approach to reforms, in which market changes would first be introduced that seem appropriate in any state of the world, and which both address clear issues and make it easier for regulation to adapt in the future. Depending on the results of the first reforms, they could be followed by more fundamental changes if required and supported by enough evidence they would deliver benefits.

We expect that key aspects of the current arrangements will remain in place in the medium term – companies wanting to supply will need a licence and consumers will need to use a supplier. There are some challenges with the current model but, given the central role of

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<sup>18</sup> Ofgem - Future of retail market regulation

<https://www.ofgem.gov.uk/gas/retail-market/market-review-and-reform/future-retail-market-regulation>

<sup>19</sup> BEIS (2018) Energy network codes review

<https://www.gov.uk/government/publications/energy-network-codes-review>

<sup>20</sup> BEIS (2019) Regulation for the Fourth Industrial Revolution

<https://www.gov.uk/government/publications/regulation-for-the-fourth-industrial-revolution/regulation-for-the-fourth-industrial-revolution>

<sup>21</sup>To help us gain better insight into the impacts of our policy decisions on different groups of consumers, Ofgem has stated that it will look to continue to improve the distributional impact tools they have. See: Ofgem (2019) Draft Consumer Vulnerability Strategy 2025, p. 11

[https://www.ofgem.gov.uk/system/files/docs/2019/06/draft\\_consumer\\_vulnerability\\_strategy\\_2025\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/06/draft_consumer_vulnerability_strategy_2025_0.pdf).



suppliers in facilitating ongoing market programmes, we are not suggesting making fundamental changes immediately and are presenting a range of options for discussion.

In June 2019, the Government published its White Paper on Regulation for the Fourth Industrial Revolution, which sets out our vision for a more agile approach to regulation that enables innovation in a time of rapid technological change. This builds on progress made by regulators to support innovation, such as the fast, frank feedback provided to businesses by Ofgem's Innovation Link team. Support from the Regulators' Pioneer Fund has also meant Ofgem and the Energy Systems Catapult have been able to innovate in the way we make policy, for example involving consumers in co-creation early in the project, and evidence gathered in this way has fed into this review.

In the following three chapters, we discuss initial ideas for reform in various stages of policy development. The challenges of delivering a wide choice of energy services and ensuring consistent consumer protection are closely related and are discussed together in chapter three. The challenge of reducing market distortions is discussed in chapter four. The challenges of competitive prices for all and ensuring consumers in vulnerable situations receive the services they need concern ensuring all consumers get a fair deal, and are discussed together in chapter five.

- 1. Do you agree with our vision for the future of the energy retail market, the outcomes we are seeking to achieve and our characterisation of the key challenges we need to overcome?**

# 3. The regulatory framework: facilitating consumer choice

**Retail market rules must evolve if they are to keep pace with technological change and remain fit for purpose through the energy transition. This means enabling the launch of products and services that may be blocked today, and that could help reduce bills, improve security of supply and support decarbonisation. We must look for ways to ensure that the benefits of these innovations are available to as many consumers as possible, so that the most vulnerable in society are not disadvantaged.**

**This chapter sets out and seeks views on different paths to meeting this challenge. At this stage, our assessment is that the current arrangements will need to change, but we recognise the need to work closely with consumers and industry to get this right.**

## Why is regulatory reform required?

Increased variety in the energy products and services available to consumers will be critical to the successful delivery of the energy transition. For example, an electric vehicle manufacturer may be able to boost sales by including free charging both at home and on the move, and this could encourage the take-up of electric vehicles.

Firms are already launching innovative services and this is welcome. The current regulatory arrangements may, in certain cases, act as a brake on new products and services. We have seen innovation happening from within the market, but we think we may need to remove further barriers in order to accelerate the rate of innovation. We're keen to understand the different perspectives on this from existing licensed suppliers versus new entrants and prospective ones. While the arrangements have evolved over time in response to market changes, they originate from a previous era, when all the commercial players were large, relatively undifferentiated utilities.

Innovators with an idea on how they could enter the market and serve an unmet customer need usually must become a licensed supplier. This can be challenging – the licence and industry codes prescribe a complex and lengthy set of rules for how certain energy-related services can be sold to consumers. They require that suppliers take on obligations that may be outside their areas of competence, such as the delivery of environmental schemes. And they necessitate the ability to serve any and every household in Great Britain. The only alternatives to becoming a licensed supplier are to use exemptions to the supply licence (which do not allow them to grow their business) or to partner with existing licensed suppliers who have little incentive to enable a new competitor.

The ability of the existing regime to adapt to changes has been tested through Ofgem's 'Licence Lite' and Regulatory Sandbox<sup>22</sup>. Experience to date suggests that the scope for the

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<sup>22</sup> A regulatory sandbox enables innovators to trial new products, services and business models without some of the usual rules applying - <https://www.ofgem.gov.uk/publications-and-updates/what-regulatory-sandbox>  
Licence Lite is a way to apply for a licence to supply electricity and to get a direction which will relieve you from your obligation to directly fulfil Standard Licence Condition (SLC) 11.2 - <https://www.ofgem.gov.uk/licences-industry-codes-and-standards/licences/licence-lite>

existing regime to flex and adapt to new business models is limited, complex and prone to unintended consequences.

The ability of the current arrangements to provide consistent and appropriate protections is already tested by the growing role of price comparison, auto-switching and brokering services<sup>23</sup>. Sectoral regulation treats these intermediaries very differently from suppliers – as no licences apply to these parties<sup>24</sup>. This difference is already becoming blurred, as a switching service can now become the main link to the market in a consumer's mind. And in the future this blurring may go further as, for example, we may ask our digital assistant to choose the best energy deal for us.

The regulatory framework should also keep pace with the welcomed rapid change in products and services being offered to energy consumers – without locking in a specific regulatory approach too early – recognising that the product landscape will inevitably change. For example, where an energy supply contract is bundled with the installation of a high-value asset (for example a smart thermostat, battery or a smart electric vehicle charge point), a customer might in future find it hard to switch tariffs because it could mean they would have to pay high uninstallation costs or contract exit fees<sup>25</sup>.

We will also need to consider the impacts on other consumers posed by increasingly engaged 'prosumers'<sup>26</sup> active in demand response programmes. For example, where consumers participate in aggregation activities that optimise local demand in exchange for financial remuneration, they must be made clearly aware of what this service entails and risks to market and system integrity related to the recovery of network and system costs would need to be mitigated

The Government committed in the Consumer Green Paper to introducing court based fining powers for consumer law enforcers such as Ofgem, and Lord Tyrie has proposed additional consumer enforcement powers, which the Government is considering<sup>27</sup>. The strengthening of consumer law enforcement powers will complement all options discussed below – but will be particularly important under a 'do-nothing' scenario where a range of intermediaries, not directly subject to sectoral regulation, have an increasingly prominent role engaging with consumers. The Secretary of State recently announced that the Government will consult on

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<sup>23</sup> The number and reach of non-supplier business models in the retail market is rising. For example, 54% of consumers switching or comparing tariffs in 2018 used a price comparison site, increasing from 49% in 2017. See Ofgem - Consumer Engagement Survey 2018

[https://www.ofgem.gov.uk/system/files/docs/2018/10/consumer\\_engagement\\_survey\\_2018\\_report\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/10/consumer_engagement_survey_2018_report_0.pdf)

<sup>24</sup> Ofgem does impose rules on licensed suppliers that require them to take responsibility for the actions of intermediaries that may represent them in certain contexts.

<sup>25</sup> The Department for Transport and Office for Low Emission Vehicles has published a consultation on proposals for electric vehicle chargepoint smart technology regulations including a call for evidence on what is required to implement a long-term solution for electric vehicle charging. See: DfT, OLEV (July 2019) Electric vehicle smart charging. The Electric Vehicle Energy Taskforce expects to publish proposals for smart charging in autumn 2019.

<sup>26</sup> A consumer that both consumes and produces energy.

<sup>27</sup> The Government intends to introduce legislation to give civil courts the power to impose financial penalties on companies for breaches of consumer law. All consumer law enforcers, including Ofgem, will be able to ask the courts to impose fines either as a standalone remedy, or in conjunction with the existing civil remedies such as injunctive relief, enforcement orders or enhanced consumer measures. See: BEIS (2018) Modernising Consumer Markets – Consumer Green Paper, p. 57,

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/699937/modernising-consumer-markets-green-paper.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/699937/modernising-consumer-markets-green-paper.pdf)

giving the CMA new powers to decide itself whether consumer law has been broken, without having to go through the courts as is currently the case<sup>28</sup>.

These changes may also enable the scaling back of the content of the supply licence in respect of certain activity areas, on the basis that adequate protections are afforded through the application of consumer law, and the review has not ruled this out.

This section explores potential reforms to address the problems of enabling innovation and ensuring appropriate protections. It first looks at options that refine the existing regulatory framework, then at more substantial reform. Since Ofgem is leading a Future Charging and Access Reform programme<sup>29</sup>, and a joint BEIS-Ofgem review of industry code governance is underway, this review aims to explore all other areas relevant to the retail market where complementary change may be needed.

## Incremental reforms

There are a range of possible changes that we could make while maintaining the core of the existing regulatory framework, and in line with Ofgem's principal objective to protect the interests of consumers. Reforms could be aimed at both enabling greater innovation in the types of products and services that are offered to consumers and ensuring consistent consumer protections across those choices.

Separately, we welcome efforts by industry parties to address potential barriers to innovation where these sit within industry code arrangements. For example, we note the industry-led code modification<sup>30</sup> seeking to enable industry systems to support the splitting of energy volumes at a single meter, allowing consumers to have multiple electricity suppliers. This has the potential to increase the presence of innovative business models in the market and offer increased choice to consumers. Ofgem will follow the usual modification procedures and consider whether the proposal better facilitates the code objectives. If the proposal is approved and implemented, Ofgem may consider whether to make any complementary changes to rules in licences.

### Enabling innovation

#### **Enabling incremental innovation through derogations**

In some circumstances, licensed suppliers can currently apply to Ofgem and ask that standard licence conditions do not apply to them. This is formally known as seeking a 'derogation' from a particular section of the supply licence.

Ofgem planned to use derogations as part of its Regulatory Sandbox service but did not find any instances where it could enable an applicant's plan through derogations. In most cases, Ofgem provided feedback on how these businesses could go ahead without the need for a sandbox, though often with scaled-back ambitions as to how different it was possible to be

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<sup>28</sup> BEIS (2019) - New powers to fine firms that exploit consumer loyalty

<https://www.gov.uk/government/news/new-powers-to-fine-firms-that-exploit-consumer-loyalty>

<sup>29</sup> Ofgem (2019) Update on timing and next steps on Future Charging and Access reforms

<https://www.ofgem.gov.uk/publications-and-updates/update-timing-and-next-steps-future-charging-and-access-reforms>

<sup>30</sup> Elexon - Enabling consumers to buy and sell electricity from/to multiple providers through Meter Splitting

<https://www.elexon.co.uk/mod-proposal/p379/>

from existing suppliers. The remaining innovative propositions were more commonly blocked by a complex mix of requirements including industry systems, charging arrangements, codes and licences<sup>31</sup>. For many prospective entrants, ambitions are greater than derogations are capable of delivering, requiring an alternative regulatory model rather than a tweaked version of today's.

Not all rules can be derogated from, as some are required by legislation. Where offering relief could negatively impact the market or physical system, a derogation cannot be granted as one party cannot be relieved of an obligation without another taking it on, and this is rarely practical. Derogations are, therefore, limited in their scope, typically only useful in supporting innovation to the extent that a supplier's plans are blocked by a very narrow and specific issue.

## **Supporting local innovation through geographic licences**

Ofgem has existing powers to grant a supply licence that is limited to a specified geographic area, such that obligations only pertain to customers within that specified area. This has had limited use to date and Ofgem could consider how to make more use of this specific power if there is demand. An important consideration for making more use of these restricted licence types, particularly for smaller areas, is that in the current market structure suppliers need to grow to a minimum size before they can recoup the cost of entry and cover the fixed costs of operating as a licensed supplier.

## **Encouraging innovation through supply licence exemptions**

To encourage innovation, greater flexibility could be used in the way supply licence exemptions are approached. The Electricity Act 1989 allows for the Secretary of State to exempt persons from the requirement to hold a licence to carry out a licensable activity including electricity generation, distribution or supply. Exemptions are currently available to persons who fall within certain classes under the Electricity (Class Exemptions from the Requirement for a Licence) Order 2001, and the Secretary of State may also make individual licence exemption orders for specific persons (BEIS published a summary of these arrangements and responses to FAQs in June 2017<sup>32</sup>).

The purpose of the Class Exemptions Order is to enable a small number of licensable activities to take place without the requirement to hold a licence (or licences). This minimises the burden of regulation on specific small-scale examples of generation, supply and distribution of electricity. The current exemptions are quite specifically phrased, but if a party wishes to have an exemption and they do not fall within a Class (or Classes) they can apply to the Secretary of State for an individual exemption. Organisations reach their own judgement on whether they are covered by the Class Exemption Order and therefore do not need to apply for a licence.

## **Delivering universal service in the future**

Energy is an essential service, and it is critical that consumers continue to have access to energy, an acceptable minimum level of service, and to be offered choices transparently and without discrimination. To guarantee this universal service, all licensed suppliers in Great Britain must offer on request a tariff to any domestic consumer. The Universal Service

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<sup>31</sup> Ofgem - Insights from running the regulatory sandbox  
[https://www.ofgem.gov.uk/system/files/docs/2018/10/insights\\_from\\_running\\_the\\_regulatory\\_sandbox.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/10/insights_from_running_the_regulatory_sandbox.pdf)

<sup>32</sup> BEIS (2013) - Electricity licence exemptions  
<https://www.gov.uk/guidance/electricity-licence-exemptions>

Obligation (USO) is enshrined in EU Law<sup>33</sup>, and this has been implemented differently across the European Union<sup>34</sup>. Examples can be found in a report<sup>35</sup> and case studies<sup>36</sup> published by Ofgem alongside the response to a call for evidence on future supply market arrangements.

The Energy Systems Catapult has argued that the ‘people, housing stock, energy networks and opportunities for change are all unique to an individual local area’<sup>37</sup>. Businesses need to build local knowledge and relationships in order to install low carbon generation, heating and energy storage in homes and neighbourhoods.

Ofgem’s Innovation Link team hear from innovators who would like to specialise in installing assets and supplying energy to local customers. This model would provide clean, local energy to people who are not homeowners or cannot afford an up-front investment. Often these entrepreneurs have social and environmental motivations. Taking on the obligation to serve any consumer forces them away from their desired business model. It pushes them towards becoming a mainstream supplier, and away from working street by street to invest in the assets needed to aid the energy transition.

An example of how a change in the approach to delivering universal service could allow companies to specialise and innovate is a customer specific energy business model. This business model is based on understanding a specific group of consumer needs, and is not well suited to operating on a universal level, and doing so may prevent the innovative approach being cost effective.

We are thinking about these issues in the context of enabling innovation. Any changes would need to ensure consumers’ universal entitlement to energy and that an acceptable minimum level of service is upheld.

## Consumer protection

Government is considering whether to introduce a cross-sectoral regulatory regime for third party intermediaries to reflect the greater role these firms are likely to play as new forms of digital services enter regulated markets. We recognise that many intermediaries operate across markets and that new forms of intermediaries will continue to emerge. The Government has explored the regulation of intermediaries in the Smart Data consultation and set out an

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<sup>33</sup> Directive 2009/72/EC of the European Parliament and of the Council of the 13 July 2009 concerning common rules of the internal market in electricity and repealing Directive 2003/54/EC.

<sup>34</sup> On 23 June 2016, the EU referendum was held and the people of the United Kingdom voted to leave the European Union. The Government respected the result and triggered Article 50 of the Treaty on European Union on 29th March 2017 to begin the process of exit. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period the Government will also continue to negotiate, implement and apply EU legislation.

<sup>35</sup> Ofgem (2018) Retail Research into Customer Switching and Supply Disintermediation - [https://www.ofgem.gov.uk/system/files/docs/2018/07/retail\\_research\\_-\\_report\\_on\\_customer\\_switching\\_and\\_disengaged\\_customers\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/07/retail_research_-_report_on_customer_switching_and_disengaged_customers_0.pdf) note that this research is illustrative and does not necessarily reflect the views of Government or Ofgem.

<sup>36</sup> Ofgem (2018) Retail Research into Customer Switching and Supply Disintermediation - [https://www.ofgem.gov.uk/system/files/docs/2018/07/retail\\_research\\_-\\_case\\_studies\\_on\\_customer\\_switching\\_and\\_disengaged\\_customers\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/07/retail_research_-_case_studies_on_customer_switching_and_disengaged_customers_0.pdf)

<sup>37</sup> Energy Systems Catapult - Local Area Energy Planning: Insights from three pilot local areas <https://es.catapult.org.uk/wp-content/uploads/2018/12/Local-Area-Energy-Planning-Insights-from-three-pilot-local-areas.pdf>



option for a cross-sectoral authorisation regime<sup>38</sup>. This includes a cross-sectoral general authorisation regime for intermediaries in the energy and telecoms markets to provide a common set of rules across markets<sup>39</sup>.

However, energy is an essential service and vulnerable energy consumers require additional levels of protection on that basis. In light of this, the review has considered to what extent energy consumers might require additional protections over and above cross-sectoral protections (and general consumer law), as new energy-only business models gain pace. We are considering how best to protect consumers using these business models to avoid any consumer detriment. For example, we would want consumers who enter into agreements with demand side response providers to be protected. Below we discuss incremental options to address energy-only consumer protection challenges for the future energy retail market.

### **Licences for each emerging category of service provider**

This option would involve Ofgem issuing new licences for new activities. Those licences would sit alongside the supply licence<sup>40</sup>. As the market develops this could imply multiple new licences to cover new activities which are not supply, but are part of the provision of services to energy consumers (for instance for auto-switching services or aggregators, where they are not already suppliers). There may be instances where additional protections would also be appropriate in the microbusiness sector and our reforms will take into consideration any evidence and shorter-term remedies announced by the Strategic Review of the Microbusiness Retail Market<sup>41</sup>.

Suppliers are required by the Standards of Conduct to treat domestic and microbusiness consumers fairly<sup>42</sup>, and domestic suppliers must also comply with principles that require them to enable consumers to make an informed choice. Regulating intermediaries on the same basis as suppliers, where they deliver similar services that are high risk, would ensure there is a level playing field for parties with a direct customer relationship<sup>43</sup>. It would be important to ensure that the activity regulated under any new licence is clearly and carefully defined and that the obligations imposed under new types of licence are proportionate.

There are two main benefits of this approach. First, it ensures consistency in the way consumers are protected using a straightforward and transparent approach which is familiar in

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<sup>38</sup> BEIS (2019) Smart data: putting consumers in control of their data and enabling innovation <https://www.gov.uk/government/consultations/smart-data-putting-consumers-in-control-of-their-data-and-enabling-innovation>

<sup>39</sup> Note also the National Infrastructure Commission's call for evidence on the future of regulation which is considering what changes to the regulatory framework are necessary to promote greater collaboration and consistency across sectors. The study is expected to report its findings in autumn 2019. <https://www.nic.org.uk/publications/future-of-regulation-study-call-for-evidence/>

<sup>40</sup> Note the creation of any new licence would consider the findings from the current Ofgem Licensing review. <https://www.ofgem.gov.uk/publications-and-updates/supplier-licensing-review-final-proposals-entry-requirements>

<sup>41</sup> Ofgem's Strategic Review of the Microbusiness Retail Market is focussing on microbusinesses as defined in the gas and electricity supply licences and are therefore not considering larger businesses. In keeping with the long-standing approach to the regulation of the business consumer market, we believe larger businesses are well equipped to look after their own interests without needing the support of regulatory intervention. <https://www.ofgem.gov.uk/publications-and-updates/opening-statement-strategic-review-microbusiness-retail-market>

<sup>42</sup> Ofgem (2017) Standards of Conduct [https://www.ofgem.gov.uk/system/files/docs/2019/02/licence\\_guide\\_standards\\_of\\_conduct\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/02/licence_guide_standards_of_conduct_0.pdf)

<sup>43</sup> This was a view supported by some respondents in Ofgem's recent Call for Evidence on 'Potential impacts on consumers following market-wide settlement reform' <https://www.ofgem.gov.uk/publications-and-updates/call-evidence-potential-impacts-consumers-following-market-wide-settlement-reform>

the industry. New licences can be tailored to new activities with obligations that are proportionate as the market develops and give enough flexibility to ensure that the obligations are focused on mitigating the areas of greatest consumer risk. Second, it ensures that the supply licence is kept separate, which may be simpler given the number of legislative and EU law requirements<sup>44</sup> that are transposed through the licence.

The main challenge of this approach is its reactive nature, with the risk that consumers may be experiencing detriment as the new licence is implemented. We would also need to consider whether it is appropriate to make new activities licensable given the criminal sanctions that would be associated with a licence approach<sup>45</sup>.

The approach taken to create new categories of licence would depend on whether the new licensable activity is 'connected to supply' or not<sup>46</sup>. For those activities connected to supply Ofgem can apply to the Secretary of State for an order that the activities become licensable. For those activities not connected to supply, primary legislation is required to bring them within the scope of Ofgem's sectoral powers. Any changes to the scope of Ofgem's sectoral powers will create funding implications that need to be considered.

### **Authorisation regime alongside the supply licence**

This option would involve us implementing an authorisation regime for new business activities, similar to the approach in the telecoms sector, to sit alongside the current supply licensing regime. This approach means non-supplier entities operating within the energy market would be 'authorised' to pursue an activity in the market as long as it remains compliant with relevant sets of rules. This differs from the licence approach.

Primary legislation would be required to set out a new regulatory framework, and we would need to consider how this sits alongside the current licensing regime. This approach would involve a non-supplier operating within the energy market to pursue an activity in the market as long as it notifies Ofgem and complies with the relevant sets of rules. If it does not, Ofgem could take enforcement action to ensure compliance.

The principal benefit of this option is that any firm operating in the market would be required to comply with stated rules, driving greater levels of consumer protection compared to an unregulated activity. This may offer a lighter-touch, more proportionate approach to ensuring consumers are sufficiently protected when they sign up to new energy services.

The main challenge of this approach is that it is an untested regime in energy. This approach would require careful design to avoid inconsistencies in obligations for different entities covered by different regimes. For example, there may be firms within the same sector who are subject to different rules. There is also no ability to exclude anyone from the regime and monitoring those acting in the market without receiving licence applications may be an administrative challenge for Ofgem.

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<sup>44</sup> On 23 June 2016, the EU referendum was held and the people of the United Kingdom voted to leave the European Union. The Government respected the result and triggered Article 50 of the Treaty on European Union on 29th March 2017 to begin the process of exit. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period the Government will also continue to negotiate, implement and apply EU legislation.

<sup>45</sup> The undertaking of relevant activities without a licence may result in criminal court action.

<sup>46</sup> Or connected to the generation, distribution, transmission of electricity, or connected with providing a smart meter communication service, s56A Electricity Act.



This authorisation regime would need to be considered in the round with any cross sectoral reforms to avoid duplication. However, as the market develops and we see more bundled services, we may want to consider whether more fundamental change to the regulatory framework is required.

## Developing a new, overarching regulatory framework

### A modular approach to regulation

There are limits to the approaches set out so far, and we may want to consider whether a more radical change to the regulatory framework is required in the longer term. In this context we have been considering the need for a flexible, modular approach to regulation. Under a modular approach, energy retail businesses would be regulated depending on the services they offer. A retail business could focus on providing customer service, or on providing and operating meters, and only be subject to the rules relevant to that service. For any business in the sector, sections of the rule book would be turned 'on' or 'off' depending on which activities they undertake. Further, the modular approach could be designed to empower prosumers to assume responsibility for certain functions themselves, perhaps paving the way for peer-to-peer energy trading via a central platform.

A modular approach would represent an enduring and stable regulatory framework – and could remove the complexity of the framework of exempt supply. It would be easier for new entrants to understand and navigate rules, and for investors to have confidence in the regulatory risks that apply to a firm.

Modular regulation could also accommodate demand-side response services as they become more widespread. Batteries are likely to become more common in homes, offices and neighbourhoods. These might be either as stand-alone devices or in electric vehicles, and either way could be controlled to charge when electricity is cheap and sell it back to the grid when it is scarce. Smart appliances, such as water heaters and fridges, could also be controlled to help balance the demand and supply of energy. Consumers could be paid for providing this flexibility via an aggregator or flexibility platform. Giving these services a clear place in regulation could better enable their roll-out, as it would avoid uncertainty among investors about regulatory risk. It could also provide a route to rapidly react to any potential consumer harms.

We consider this to be a longer-term reform option that could both further enable innovation and address outstanding consumer protection challenges if the nearer term options discussed above do not go far enough. This would require a substantial overhaul of the existing framework and an expansion of Ofgem's regulatory remit.

Implementing a new regulatory framework represents a significant change that would require close work between Ofgem, government, and industry and necessitates a change to the Universal Service Obligation. Additional sectoral powers would need to be balanced with any new framework using consumer law, where it is more appropriate. We would need to manage interactions with the regulatory regime for transmission, distribution and generation.

Implementation would take considerable time, and reforms would need to be coordinated with proposals from the Energy Industry Code Review published alongside this consultation<sup>47</sup>.

- 2. Are there examples of new products, services and business models that would benefit current and future consumers, but are blocked by the current regulatory framework?**
- 3. Are there current or emerging harms to energy consumers which are currently out of scope of the regulatory framework? Do these differ for domestic and non-domestic consumers?**
- 4. Would it be beneficial to allow suppliers to specialise and provide products and services to targeted groups of customers? If so, how can this be delivered while balancing the need for universal service?**
- 5. Are incremental changes to regulation sufficient to support the energy transition and protect consumers? Or does this require a more fundamental reform, such as moving to modular regulation?**

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<sup>47</sup> There is currently an Ofgem proposal to carry over elements of the Smart Meter Installer Code of Practice (SMICoP), including consumer protections, in to the Retail Energy Code (REC). <https://www.ofgem.gov.uk/publications-and-updates/switching-programme-and-retail-code-consolidation-proposed-changes-licences-and-industry-codes>. Our review will be monitoring the development of this to gain valuable insights into how the regulatory framework can take a more consistent approach to protecting consumers.

## 4. Tackling distortions and complexity in supplier obligations and responsibilities

**Retail energy businesses, as a key link between end-consumers and the wider energy system, play a significant role throughout the system. Much of this is instituted through a range of obligations and responsibilities in legislation and regulation. While many of these remain crucial to system integrity and meeting core social and environmental objectives, there are some aspects where reforms could improve the functioning of the retail market as a dynamic and competitive sector.**

**This chapter sets out and explores reforms which would address these issues. It discusses reforms to suppliers' roles in meeting social policy objectives which could minimise administrative costs and remove aspects which may distort competition between different supply businesses. It sets out how longer-term reforms may consider the system-facing role of supply businesses more broadly. It also considers whether there is risk that the uneven way that high cost-to-serve consumers are distributed across suppliers could lead to further distortions, and how this could be addressed.**

### Why is regulatory reform required?

The role of the supplier has expanded over the years to include many obligations and responsibilities beyond the simple supply of energy to consumers. This model has the benefit of only requiring consumers to have one point of contact and plays a crucial role in system integrity and the delivery and funding of policies, including those which continue to facilitate the rapid decarbonisation of our energy system.

The current design of policy delivery obligations, which exempt suppliers who do not exceed certain size-based thresholds, may lead to an uneven playing field for suppliers and disrupt important price signals. These obligation thresholds may also incentivise some suppliers to set their prices in a way that means they recover the costs of some policies disproportionately from a subset of their consumers – such as those who are loyal and do not engage. More broadly, the additional complexity and range of obligations may introduce costs which inhibit the ability of energy suppliers to innovate by diverting resources away from the core work of suppliers.

Another possible distortion that may lead to an uneven playing field for suppliers is the way high cost-to-serve consumers are distributed around the market – particularly consumers in vulnerable situations with higher customer service needs and/or customers at a higher risk of indebtedness.

In any future market, the necessary policy and system costs will still need to be recovered from customers' bills. However, as the energy market continues to change, and wider energy, social and environmental policy reforms take place, it may make sense to revisit how these costs are recovered from consumers to understand the impacts they have on the energy supply market and consider whether there may be better ways to recoup necessary costs from consumers or deliver obligations. Any future scheme proposing additional obligations on the supply market should be designed with an understanding of the retail market impact in mind.

**6. Are there any other potential market distortions we should be considering as part of our review?**

## Possible areas for reform

### Energy Company Obligation and Warm Home Discount

The Energy Company Obligation (ECO) requires obligated energy suppliers to deliver energy efficiency and heating measures to homes in Great Britain. These measures help households to keep their homes warmer, reduce their energy bills and reduce carbon emissions. It was first launched in January 2013, and since then has delivered around 2.5 million improvements in nearly 2 million homes.

The Warm Home Discount (WHD) is a key policy in alleviating fuel poverty and the burden of energy bills on vulnerable and low-income households. Since April 2011, over £2.5 billion of direct assistance has been provided by participating energy suppliers to their eligible customers (over 2 million low income and vulnerable households each year).

Under both schemes, larger suppliers face disproportionately higher costs than smaller competitors with smaller or no obligations. For ECO this is the result of a combination of a size-based threshold combined with a tapering mechanism<sup>48</sup>. For WHD, this is because of a size-based threshold alone. The Government has considered this a necessary design feature in order to minimise any barriers to entry, a view supported by the CMA's Energy Market Investigation in 2016<sup>49</sup>.

However, this means different sizes of supplier face higher costs than others. These costs are recovered from the consumers of obligated suppliers through higher prices and send a price signal that does not represent the underlying efficiency of the supplier. It also means that only the customers of suppliers above the size thresholds contribute to the recovery of the costs of either scheme or that the larger a supplier is, the more disproportionately their consumers contribute to the costs of delivering ECO.

Further, since current market conditions mean these suppliers are competing for engaged customers with other suppliers facing lower or no obligation costs, competitive forces may incentivise the concentration of these costs in the prices paid by consumers who do not engage. This would lead to an unfair distribution of costs and contribute to the problem of excess prices for some consumers which is discussed further in the following chapter.

Reforms implemented through the current round of ECO (ECO3 running from 2018-2022) and the WHD will mitigate these problems. Customer account thresholds for ECO will have been lowered to 200,000 domestic customer accounts from 1 April 2019 and will be further reduced to 150,000 domestic customer accounts from April 2020. Similarly, the supplier obligation threshold for participating in the Core Group elements of the WHD scheme, where the discount is provided to those receiving Pension Credit Guarantee Credit, and for which eligibility-

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<sup>48</sup> Under the taper mechanism introduced in April 2019, all energy suppliers are entitled to a 'supplier allowance' (equal to the threshold), after which their obligations are calculated on a per unit of supply basis.

<sup>49</sup> CMA (2016) Social and environmental obligation thresholds:

<https://assets.publishing.service.gov.uk/media/576bcb6140f0b652dd0000ac/appendix-8-1-social-and-environmental-obligation-thresholds-fr.pdf>

identification is facilitated by data-matching with the Department for Work and Pensions, will be lowered from 250,000 to 150,000 domestic customer accounts by scheme year 2020/21.

These reforms have been facilitated by changes that reduce the administrative costs on smaller suppliers newly obligated under the schemes. Consecutive reforms to ECO have created and then increased the scope for suppliers to trade their obligation to other suppliers, allowing small suppliers to trade their obligation to larger suppliers with existing operations and for whom administrative costs are proportionately smaller. For WHD, while the threshold is being lowered for the Core Group elements of the scheme, it will remain at 250,000 for the Broader Group elements, where the discount is provided to a wider group of customers who are in or at risk of fuel poverty. This is because administrative costs are higher for the Broader Group since data-matching is not yet available.

However, since thresholds for ECO obligations remain in place, significant differences in obligation costs between suppliers will remain. According to the ECO3 Impact Assessment<sup>50</sup>: suppliers below the scheme threshold face no cost; the smallest twelve obligated suppliers are expected to face around £6-7 per dual fuel customer; while the largest six suppliers face £25-27. According to the WHD 2018/19 Impact Assessment<sup>51</sup>: suppliers obligated under both Core and Broader Group elements of the scheme (those with 250,000 customer accounts or more) face costs of around £14 per dual fuel customer; further Government analysis suggests those with Core Group obligations only (those with 150,000-250,000 customer accounts by 2020/21) face costs of around £7 per customer account; while the smallest suppliers face no obligation cost.

## Potential reforms

The Government will explore reforms which would remove full imbalances in obligation levels across different sizes of suppliers, while minimising barriers to entry and expansion in the retail market to ensure healthy competition. As part of this, the Government will explore reforms to minimise administrative costs. Any such reforms must ensure the primary policy intent of these schemes remains intact.

For ECO, there may be ways to better design the scheme to ensure the costs of delivery are shared proportionately across all suppliers. One potential option could be enabling suppliers to buy out of their delivery obligation. Should this be introduced, it would need to be accompanied by a mechanism, such as auctions, to deliver energy efficiency measures from the funds generated through the buy-out. This or any other options would need to be considered in detail, and consideration given to introducing any reforms in a way that ensures a smooth transition.

Subject to future decisions on funding for WHD beyond 2021, it is the Government's ambition to remove thresholds on obligations for both the Core and Broader Group. Any changes to thresholds would need to be facilitated by improvements in data matching which would reduce the burden for suppliers of identifying eligible customers. The removal of thresholds and improvements to data-matching would bring further advantages to eligible consumers, for whom switching between suppliers would become more straightforward. This is especially

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<sup>50</sup> BEIS (2018) ECO3: 2018-22 - final stage impact assessment

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/749638/ECO\\_3\\_Final\\_Stage\\_IA\\_Final.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/749638/ECO_3_Final_Stage_IA_Final.pdf)

<sup>51</sup> BEIS (2018), Warm Home Discount Scheme 2018/19: final stage impact assessment

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/716463/Warm\\_Home\\_Discount\\_FS\\_IA\\_Signed.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/716463/Warm_Home_Discount_FS_IA_Signed.pdf)

important if, in the future, local energy becomes more prominent and more consumers end up with small suppliers as a result.

- 7. Would removing the thresholds for the Energy Company Obligation and Warm Home Discount help remove imbalances in the retail market, and could this be done without significantly increasing barriers to supplier entry or expansion in the retail market?**
- 8. How could the delivery burden on suppliers from the Energy Company Obligation be reduced, for example through the introduction of a buyout mechanism?**

## Energy and Climate Change Policy Levies

The costs of several energy and climate change policy support schemes are levied onto energy suppliers, who then pass them onto consumers through their energy bills, including consumers who do not directly participate in these schemes. Examples of these schemes include the Contracts for Difference, Feed-in Tariffs, the Renewables Obligation and the Capacity Market.

All suppliers have comparable obligations to recover the costs of these schemes, with no exemptions below any minimum size thresholds, avoiding scope for distortions to competition. Many of these schemes do not have significant delivery responsibilities, and those that do – like the Feed-in Tariffs scheme, whereby suppliers with over 250,000 customers have to offer FITs to small scale generators – provide mechanisms for suppliers to recover the administrative costs from the market.

As a result, we consider it unlikely that the burden associated with any one scheme results in significant distortions to competition in the retail market. However, we are aware of concerns focused on the overall administrative complexity of participating in a range of obligations with different recovery mechanisms and methodologies for calculating obligation levels: the difficulty of forecasting some costs in advance; the impact if suppliers fail to meet their obligations; and the impact on cash flow management of obligations that are recovered on an annual or quarterly basis.

While we do not propose any scheme-specific changes in this document, we would welcome views on the interactions between the different scheme cost recovery mechanisms.

- 9. What effect does the range of Energy and Climate Change Policy Levies have on the retail market?**
- 10. What actions could government take to reduce any negative impact of Energy and Climate Change Policy Levies?**

## Recovery of Network and System Costs

There are clear advantages to the recovering of network and system costs via the bodies through which energy is purchased, and recovering these costs is unlikely to represent a significant administrative burden for suppliers. As such we have not identified any areas for reform of these obligations in the context of the retail market review.



Substantial reforms are currently underway with a view to making recovery more reflective of underlying costs through Ofgem's Future Charging and Access reform programme<sup>52</sup>. The impact of these reforms will need to be monitored as they take place, including the way suppliers respond to them. We will also look at how network and system price signals are incorporated into tariff design to incentivise customers to use energy at lower-cost times, and any resulting impacts on innovation and competition in the market. We may then revisit whether recovering these costs via suppliers is the most effective recovery arrangement.

## Provision of Metering

Metering obligations placed on suppliers since the introduction of metering competition may represent a significant responsibility which some suppliers find onerous. For example, engaging with the multiple metering agents required to deliver compliant metering services may be challenging for small suppliers. At the same time, some suppliers are large enough to develop these services in-house or have significant buying power because of their large customer numbers, which may form a competitive advantage.

Some of the metering requirements are of critical importance to the resilience of the energy system. For example, security is a key requirement of the smart metering programme and among their commitments suppliers are obliged to implement secure systems for use in communication with devices via the Data Communications Company (DCC) and are required to undergo annual user security assessments. Suppliers use digital signatures to securely communicate with smart meters for purposes such as configuring the device (setting the tariff, prepayment parameters, etc.) or reading information from it.

At the same time, metering arrangements are central to the design of many innovative products and services, for example smart time-of-use tariffs<sup>53</sup>. Given the critical importance of the smart metering rollout to the wider vision of the future energy system, we do not believe it to be an appropriate time to consider reforms to metering arrangements while significant volumes of smart meters are being rolled-out.

Suppliers are in a period of intense meter-related activity and it would be disruptive to begin discussions on amending metering requirements when continued stable and certain policy is needed to encourage and deliver an efficient rollout. For these reasons, we do not consider reform to supplier metering obligations and arrangements to be a priority reform area for the review. Once the rollout is further progressed, we may revisit the issue of supplier metering responsibilities and the metering market and consider whether arrangements are fit for purpose for the evolving retail market.

## Access to Data

Data in various forms is seen as a primary driver of innovation allowing innovators to develop targeted products for a range of consumers' needs. We have heard from many market participants that the current market arrangements limit their access to relevant data (both

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<sup>52</sup> Ofgem (2019) Update on timing and next steps on Future Charging and Access reforms <https://www.ofgem.gov.uk/publications-and-updates/update-timing-and-next-steps-future-charging-and-access-reforms>

<sup>53</sup> BEIS (2018) Smart meters: unlocking the future <https://www.gov.uk/government/publications/smart-meters-unlocking-the-future>

consumer and market) and inhibit their ability to develop innovative, specialised products and services.

There are a wide range of initiatives underway that will impact on the retail market by aiming to improve access to and availability of both consumer and system data. These include the recent Energy Data Task Force report<sup>54</sup> and the subsequent work that will stem from it, by government, Ofgem and industry to implement its recommendations; Settlement Reform; Midata; Switching Programme; Smart Metering; and Market Information Services. Code governance reforms will also impact on the use of data in the industry as arrangements are rationalised and improved.

Given the range of initiatives already seeking to tackle this issue across the energy system, we are not proposing any specific reforms related to data access and monitoring as part of this review. Introducing further change at this stage would likely complicate the policy landscape and cause confusion or undermine the reforms outlined above. We will continue to monitor the progress of the various initiatives listed above, feeding in our views where necessary and ensuring they take into account wider changes to the supply market.

**11. Do you agree that now is not the time to make further changes on system and network cost recovery, metering and access to data as part of this retail market review?**

### High cost-to-serve customers and customers in debt

The number of high cost-to-serve consumers may vary substantially between suppliers. This can include consumers with particularly high customer service needs and those who struggle to afford their energy or do not pay their bills. The market can handle many additional customer service needs consumers can have – with some suppliers looking to meet these needs in increasingly innovative and cost-effective ways. However, some stakeholders have suggested to us that the distribution of consumers who are genuinely high cost-to-serve could contribute to uneven costs between suppliers in the same manner as thresholds for obligation under the Warm Home Discount and Energy Company Obligation schemes. Some consider high costs may create incentives to avoid serving these consumers, through strategies that see suppliers ‘cherry pick’ their customers<sup>55</sup>.

As with the policy thresholds, stakeholders have also suggested that the imbalance could contribute to higher prices for other consumers. For example, suppliers may be incentivised to recoup the cost associated with bad debt<sup>56</sup> from consumers on ‘default’ or standard variable tariffs who are loyal and less likely to shop around for their energy. Consumers on default tariffs with suppliers with a greater proportion of consumers in debt would therefore face higher prices unless they shop around.

We recognise there are challenges in identifying the scale of the costs that contribute to this potential problem given differences in efficiency levels and approaches to customer service between suppliers. However, Ofgem’s work for the temporary price cap provides some illustrative evidence. It found that the average cost to suppliers of bad debt and the additional

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<sup>54</sup> Energy Systems Catapult (2019) Energy Data Taskforce: A Strategy for a Modern Digitalised Energy System <https://es.catapult.org.uk/news/energy-data-taskforce-report/>

<sup>55</sup> Ofgem (2019) Draft CVS2025: Anonymised summary of engagement activity, p. 5. [https://www.ofgem.gov.uk/system/files/docs/2019/06/draft\\_cvs2025\\_-\\_anonymised\\_summary\\_of\\_engagement.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/06/draft_cvs2025_-_anonymised_summary_of_engagement.pdf)

<sup>56</sup> Debt that an energy supplier does not expect to recover



administration cost of serving standard credit customers (much of which relates to the costs of handling debt-related issues, phonelines and similar) was equivalent to around £96 for a standard credit customer with typical dual fuel consumption levels in 2017/18<sup>57</sup>. We are interested in hearing from as many suppliers as possible about whether there is a consistent issue across the market, or whether some suppliers are able to deal with these challenges more efficiently.

There are several ways any potential issue could be addressed. For example, additional third-party support services could be provided for consumers struggling to afford their energy. Not only could this help reduce the number of consumers getting into debt, it would also help reduce the impact of any potential market distortion. We could also work with industry to explore tools which would facilitate a more equitable distribution of the costs of dealing with the most extreme cases of debt across the market.

**12. What total costs do suppliers face with regards to bad debt and supporting consumers who struggle to pay for their energy?**

**13. How could any potential distortions related to high cost-to-serve customers be addressed, for example by the provision of additional support services for customers struggling to afford their energy?**

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<sup>57</sup> Ofgem (2018) Default Tariff Cap Decision, Appendix 8: Payment Method Uplift, p. 18  
[https://www.ofgem.gov.uk/system/files/docs/2018/11/appendix\\_8\\_-\\_payment\\_method\\_uplift.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/11/appendix_8_-_payment_method_uplift.pdf)

# 5. Ensuring a good deal for all consumers

**The retail market should deliver a good deal for all consumers. Consumers should not face excessive prices and should receive a good level of service. Effective competition between suppliers, operating in a market with minimal distortions, is the best driver of value for consumers.**

**However, the Government is prepared to act to protect consumers' interests if they are being overcharged. This is why the Government has legislated for a temporary price cap while the conditions for competition are put in place to enable the market to work more effectively for consumers. This chapter explores how to make competition work more effectively and whether other interventions may be required to help ensure all consumers get a good deal in the future.**

The issues discussed in this chapter relate to domestic consumers only. We note that stakeholders are increasingly raising concerns about the way the non-domestic market is operating – specifically for some microbusiness consumers. Both Ofgem and Government recognise these concerns. Ofgem's strategic review of the microbusiness retail market is building an evidence base that will pave the way for launching targeted actions (if needed) that can help improve microbusinesses' experience in the market<sup>58</sup>.

## Case for change

### Competition not working well for all consumers

We want to ensure all consumers benefit from greater levels of competition – regardless of the length of time they've been with a supplier. In the past, competition has not been effective enough at preventing energy suppliers from charging excessive prices to their loyal domestic consumers compared to new customers or those who shop around, despite those loyal customers having similar costs-to-serve. These loyal consumers paid considerably more for their energy than the efficient costs of supplying it.

Consumers are currently protected from excessive 'loyalty penalty' prices by both the temporary price cap and safeguard prepayment meter cap. The price cap will be in place until the end of 2020 and may be extended by a year at a time until the end of 2023 at the latest. The decision to lift the price cap will be informed by a review into whether the conditions for effective competition are in place<sup>59</sup>. Meanwhile the prepayment meter cap – which was introduced because prepayment consumers had limited opportunities to benefit from competition – has also been under review<sup>60</sup>. These protections ensure consumers do not pay

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<sup>58</sup> Ofgem (2019) Opening Statement - Strategic Review of the microbusiness retail market  
[https://www.ofgem.gov.uk/system/files/docs/2019/05/opening\\_statement.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/05/opening_statement.pdf)

<sup>59</sup> Ofgem (2019) Developing a framework for assessing whether conditions are in place for effective competition in domestic supply contracts <https://www.ofgem.gov.uk/publications-and-updates/developing-framework-assessing-whether-conditions-are-place-effective-competition-domestic-supply-contracts>

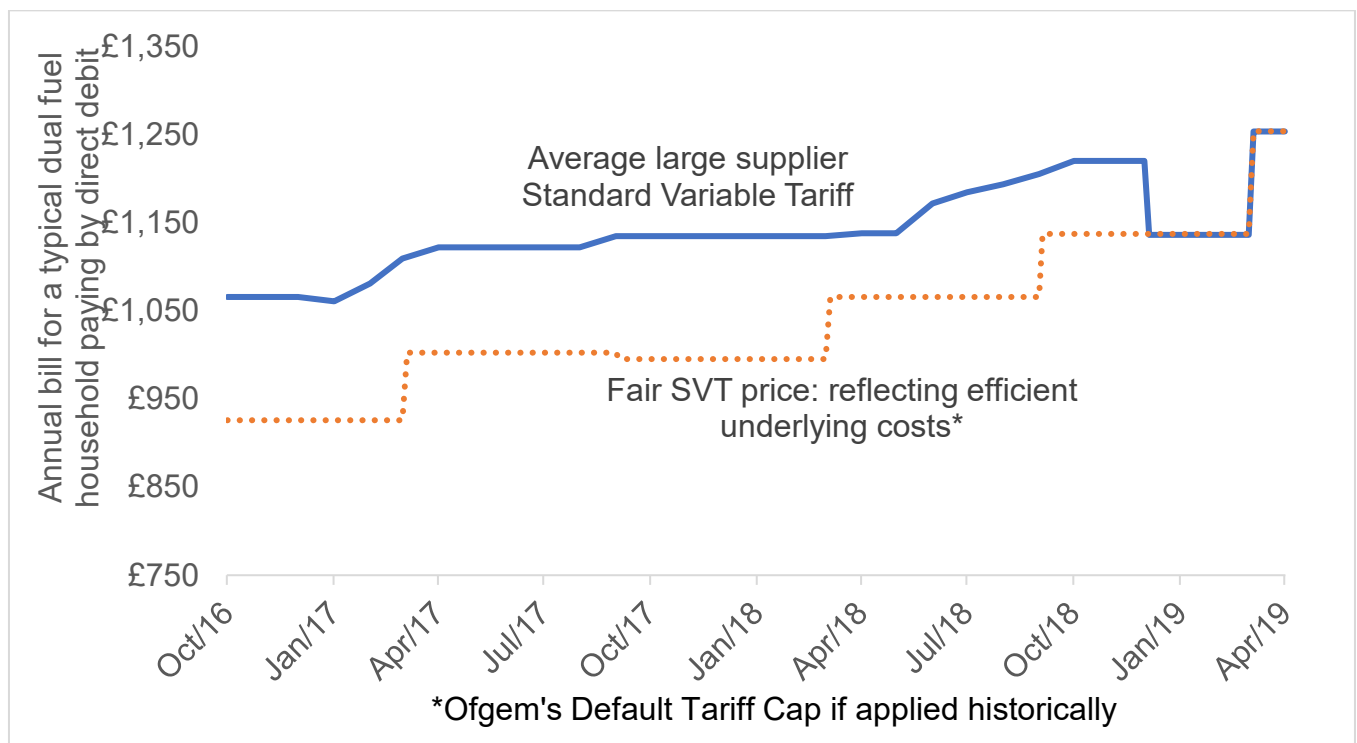
<sup>60</sup> Provisional decision regarding adjustments to the prepayment meter cap were published by the CMA on 7 June 2019 See: CMA (2019) Review of the Energy Market Investigation (Prepayment Charge Restriction) Order 2016 <https://www.gov.uk/cma-cases/review-of-the-energy-market-investigation-prepayment-charge-restriction-order-2016>

the costs of either excess supplier profits or the inefficiencies that the CMA identified as part of its Energy Market Investigation, and instead pay the fair costs which reflect the efficient costs of supplying energy<sup>61</sup>.

By capping default tariffs at estimated efficient costs-to-serve, Ofgem estimate that the temporary price cap will save about 11 million customers around £1 billion per annum in total<sup>62</sup>. The difference between historical standard variable tariffs and prices which reflect the efficient underlying costs of supply, as measured by what the price cap would have been if in place, is shown in figure 1 below.

The review will consider measures where necessary to ensure that domestic consumers are protected from the re-emergence of the excessive loyalty penalties that were seen before the temporary price cap was introduced. Persistent overcharging cannot be allowed to return to the retail market and the Government is prepared to consider new interventions again if there is evidence that loyal customers are likely to once again face unfair pricing strategies.

**Figure 1: Average SVTs for the six largest suppliers, and cap levels if the price cap had been in place (2015 to 2019)<sup>63</sup>**



There are many reasons why firms charge excessive prices to consumers. In the CMA's response to the Citizens Advice super-complaint regarding loyalty penalties across different

<sup>61</sup> CMA (2017) Energy Market Investigation Final Report, p. 39.

<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

<sup>62</sup> Ofgem (2018) Decision – Default tariff cap – Overview document, p. 6.

[https://www.ofgem.gov.uk/system/files/docs/2018/11/decision\\_-\\_default\\_tariff\\_cap\\_-\\_overview\\_document\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/11/decision_-_default_tariff_cap_-_overview_document_0.pdf)

<sup>63</sup> Ofgem (2018) Decision – Default tariff cap – Overview document, p. 15;

[https://www.ofgem.gov.uk/system/files/docs/2018/11/decision\\_-\\_default\\_tariff\\_cap\\_-\\_overview\\_document\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/11/decision_-_default_tariff_cap_-_overview_document_0.pdf)

Ofgem (2019) Data Portal (regularly updated- accessed June 2019) <https://www.ofgem.gov.uk/data-portal/retail-market-indicators#thumbchart-c7770745751913637-n95437>

markets, it considers factors that affect how likely consumers are to switch or shop around in markets<sup>64</sup>. These factors include<sup>65</sup>:

- Features of the market making it more difficult for consumers to shop around or move to get better deals
- Behaviours and characteristics of consumers making it more difficult for them to access, assess and act on information about the costs and benefits of the different options available to them
- Behaviour by businesses that makes search and switching more difficult or makes it more difficult for consumers to make effective decisions.

In his response to the CMA's investigation, Secretary of State Greg Clark welcomed the CMA's work and emphasised the Government's intention to ensure that no consumer loses out or can be exploited by companies taking advantage of their loyalty<sup>66</sup>.

The way in which loyalty penalties are experienced could also change as the market evolves, for example, as more personalised pricing emerges<sup>67</sup>. Nevertheless, without additional safeguards, the risk of many longstanding energy consumers paying excessive prices may continue to exist. This underscores the need for an agile regulatory framework and for the regulator to have powers to allow it to respond appropriately.

## Meeting the specific needs of consumers in vulnerable situations

Factors that affect how likely consumers are to switch or shop around can be more acute for consumers in vulnerable situations. This includes those who face psychological and cognitive barriers (including some mental health conditions), those with low financial resilience and those that face accessibility issues (such as restricted access to technology) or time pressures due to their circumstances<sup>68</sup>. Ofgem's Draft Consumer Vulnerability Strategy 2025 states that consumers in such vulnerable situations can face multiple barriers to participating in the market. They may have competing priorities or feel unable to make complex decisions<sup>69</sup>. Some consumers in vulnerable situations can also have complex circumstances, or their vulnerability may be temporary in nature – which may mean they are more challenging to identify. In addition, consumers in vulnerable situations may face the risk or perceived risk that by switching they will lose certain benefits or support they receive.

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<sup>64</sup> BEIS (2019) Secretary of State's response to CMA Loyalty Penalty, p.34

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/809592/Tackling\\_the\\_loyalty\\_penalty\\_SoS\\_letter.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/809592/Tackling_the_loyalty_penalty_SoS_letter.pdf)

<sup>65</sup> CMA (2018) Tackling the loyalty penalty. p.22.

[https://assets.publishing.service.gov.uk/media/5c194665e5274a4685bfbafa/response\\_to\\_super\\_complaint\\_pdf.pdf](https://assets.publishing.service.gov.uk/media/5c194665e5274a4685bfbafa/response_to_super_complaint_pdf.pdf)

<sup>66</sup> BEIS (2019), Tackling the loyalty penalty: letter from Greg Clark, BEIS, to Andrea Coscelli, CMA.

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/809592/Tackling\\_the\\_loyalty\\_penalty\\_SoS\\_letter.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/809592/Tackling_the_loyalty_penalty_SoS_letter.pdf)

<sup>67</sup> Citizens Advice (2018), The Cost of Loyalty, p. 43.

<https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Citizens%20Advice%20-%20The%20cost%20of%20loyalty.pdf>

<sup>68</sup> CMA (2018) Tackling the loyalty penalty/Tackling the loyalty penalty, Chapter 3

[https://assets.publishing.service.gov.uk/media/5c194665e5274a4685bfbafa/response\\_to\\_super\\_complaint\\_pdf.pdf](https://assets.publishing.service.gov.uk/media/5c194665e5274a4685bfbafa/response_to_super_complaint_pdf.pdf)

<sup>69</sup> Ofgem (2019) Draft Consumer Vulnerability Strategy 2025, p. 12.

[https://www.ofgem.gov.uk/system/files/docs/2019/06/draft\\_consumer\\_vulnerability\\_strategy\\_2025\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/06/draft_consumer_vulnerability_strategy_2025_0.pdf)

Some consumers in vulnerable situations struggle to afford their energy or face higher costs as a result of their circumstances. While reforms that make the future retail market more dynamic should create system-wide benefits, they could also change the nature of these affordability challenges, as affordability could be affected by customers' ability to shift their load in response to price signals. How the distributive effects of reforms will impact different groups of consumers needs to be carefully considered. In the draft Consumer Vulnerability Strategy 2025, Ofgem sets out how it intends to improve its distributional impact tools, including consumer archetypes, to gain better insights into the impacts policy decisions have on different groups of consumers, particularly those in vulnerable situations<sup>70</sup>. We want all consumers to have access to affordable energy and some of the options we are considering could decrease the scale of affordability problems. Other publications from the Government and Ofgem<sup>71</sup> discuss this important issue in more detail, in particular the Fuel Poverty Strategy, on changes to which the Government is consulting alongside this document<sup>72</sup>.

Consumers in vulnerable situations, including those who struggle to afford their bills, can require additional customer service and support tailored to their needs, for example longer phone calls and additional billing support. While many suppliers go to great lengths to support customers, across the market, extra services or support in relation to energy debt is uneven and often ineffective. Evidence shows smaller suppliers in particular can be less aware of their obligations to vulnerable customers and are less prepared to respond to their needs<sup>73</sup>. Stakeholders also report widely inconsistent levels of customer service across suppliers<sup>74</sup>.

In the preceding chapter we note that we are interested in views on whether market design may be resulting in reduced competition to gain or retain high cost-to-serve consumers. We note this could also lead to market distortions, similar to the way policy obligations may incentivise some suppliers to price in a way that means they recover the costs of some policies disproportionately from a subset of consumers – such as those who are loyal and do not shop around for their energy. The review is exploring opportunities for market design to improve incentives on firms to compete in delivering good levels of customer service for all consumers, particularly those who are high cost-to-serve.

## Areas for reform

Our ambition is that all consumers – including those in vulnerable situations – are supported and face fewer barriers to engaging with the future energy market. We acknowledge that innovation is likely to mean the market looks very different in the future. This will not be without

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<sup>70</sup> Ofgem (2019) Draft Consumer Vulnerability Strategy 2025, p. 11.

[https://www.ofgem.gov.uk/system/files/docs/2019/06/draft\\_consumer\\_vulnerability\\_strategy\\_2025\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/06/draft_consumer_vulnerability_strategy_2025_0.pdf)

<sup>71</sup> The Draft Consumer Vulnerability Strategy 2025 (p. 5) sets out that Ofgem's current role is to ensure all consumers, including those in vulnerable situations, receive a service that meets their needs and that prices and reflect the efficient cost of supplying energy

[https://www.ofgem.gov.uk/system/files/docs/2019/06/draft\\_consumer\\_vulnerability\\_strategy\\_2025\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/06/draft_consumer_vulnerability_strategy_2025_0.pdf)

<sup>72</sup> BEIS (2019) <https://www.gov.uk/government/consultations/fuel-poverty-strategy-for-england>

<sup>73</sup> Ofgem (2019) Retail Supplier Compliance and Enforcement Report: Spring 2019

<https://www.ofgem.gov.uk/publications-and-updates/retail-supplier-compliance-and-enforcement-report-spring-2019>

<sup>74</sup> Citizens Advice (2019) Increasing numbers of small and newer energy suppliers delivering poor customer service <https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/increasing-numbers-of-small-and-newer-energy-suppliers-delivering-poor-customer-service/>

risks that need to be managed<sup>75</sup>, but as more knowledge is accrued about consumers who are vulnerable and/or more likely to face loyalty penalties, our aim is that policy and regulation facilitate the delivery of innovative products and services that meet the needs of a wide range of consumers, including the most vulnerable.

As noted in the preceding chapter, an important way of reducing the incentives for suppliers to adopt pricing strategies that lead to excessive prices for loyal consumers – as well as facilitating innovation – may be to address the distortions caused by policy obligation thresholds or the distribution of high cost-to-serve consumers in the market.

We recognise that even in a market with more innovation and no distortions, there is still a risk that without additional measures in place, consumers who do not or cannot engage in the market will face excessive prices for their energy. We consider the CMA's work on loyalty penalties in other sectors<sup>76</sup> should provide lessons for the energy sector on how to prevent excessive loyalty penalties re-emerging in future. Measures set out by the CMA include:

- Targeted interventions to certain sections of the market either to limit price differences or cap prices where there is clear harm, for example to consumers in vulnerable situations
- Regulators applying principles (rather than prescriptive formulae) which describe unfair pricing approaches – with compliance demonstrated through ex post monitoring and reporting
- Actively helping people move to a better deal through the use of smart data<sup>77</sup>, intermediaries and collective switching (which can be on an opt-in or opt-out basis)
- Bolder enforcement of consumer law and sector specific rules to tackle harmful and exploitative supplier practices<sup>78</sup>.

We would welcome views on how any of these measures – or a combination of measures – could be adopted to benefit energy consumers. As discussed, some groups of consumers, particularly those in vulnerable circumstances, face additional barriers to engaging in the market. Section 9 of the Domestic Gas and Electricity (Tariff Cap) Act 2018 contains a provision for Ofgem to carry out a review to consider whether there are categories of domestic consumers that require protection against excessive charges. We would welcome specific views on what additional measures could be required to protect consumers in vulnerable situations. Notwithstanding the particular challenges with identifying consumers in vulnerable situations who are in transient or complex situations, we would appreciate views on how the use of data-matching could help to effectively target consumers who require specific support<sup>79</sup>.

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<sup>75</sup> Ofgem (2019) Draft Consumer Vulnerability Strategy 2025, p. 36.

[https://www.ofgem.gov.uk/system/files/docs/2019/06/draft\\_consumer\\_vulnerability\\_strategy\\_2025\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/06/draft_consumer_vulnerability_strategy_2025_0.pdf)

<sup>76</sup> CMA (2018) Tackling the loyalty penalty

[https://assets.publishing.service.gov.uk/media/5c194665e5274a4685bfba/response\\_to\\_super\\_complaint\\_pdf.pdf](https://assets.publishing.service.gov.uk/media/5c194665e5274a4685bfba/response_to_super_complaint_pdf.pdf)

<sup>77</sup> Government's Smart Data Review has concluded that there is considerable potential for Smart Data to support better consumer outcomes across markets

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/808272/Smart-Data-Consultation.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/808272/Smart-Data-Consultation.pdf)

<sup>78</sup> Such practices include making it hard for consumers to access the information they need, unfair or disproportionate exit fees, difficulties in switching or cancelling a contract, and practices around auto renewals and rollover processes.

<sup>79</sup> Under the Digital Economy Act 2017 data-matching with energy suppliers is able to occur if it is for purposes that include assisting people living in fuel poverty by reducing their energy costs.



Views on how further steps could be taken to support consumers struggling to afford their energy would also be welcome<sup>80</sup>.

## Reform considerations

Consumers must be protected from the re-emergence of excessive loyalty penalties in the energy market. To do this, it is likely that different solutions will be required for different groups of consumers. Any combination of options implemented must continue to support effective competition and incentives to innovate in the market. Any option should also only be pursued if it results in a positive consumer experience – and we have been mindful to ensure that consumers have an early and more frequent voice in our work.

Under consumer law and the supply licence, Ofgem has powers to tackle a range of harmful supplier practices that contribute to loyalty penalties. However, some of the other potential measures detailed above for ensuring excessive prices do not re-emerge in the energy retail market may require additional powers. We will continue to work with industry to work up these ideas and ensure government and the regulator have the powers to prevent excessive prices returning to the market if needed. We are also mindful that potential measures need to be designed in such a way that achieves an equitable solution across the market and does not encourage suppliers to reduce their efforts to support and innovate for certain groups of consumers.

We are keen for views on whether industry-wide solutions – that are complemented by regulation that incentivises all firms in the market to support consumers efficiently and effectively – could help improve how competition works for all consumers, as well help further incentivise positive and inclusive innovations for consumers with specific needs.

- 14. Would addressing market distortions (for example size-based obligation thresholds for some policy schemes, supporting those who are struggling to afford their energy bills) help reduce incentives for suppliers to adopt pricing strategies that lead to excessive prices for loyal consumers? If so, to what extent (providing quantitative evidence, where possible)?**
- 15. What are your views on the measures being considered to address loyalty penalties in different markets? What approach or – combination of approaches – would be most effective in the energy retail market?**
- 16. What other approaches could be adopted to ensure loyalty penalties do not re-emerge?**
- 17. What protections or support may be required to engage consumers in vulnerable situations in the future market?**

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<sup>80</sup> The Draft Consumer Vulnerability Strategy 2025 (p. 22) seeks views on Ofgem's strategic approach for improving the consistency and quality of service for vulnerable customers struggling to afford their energy. [https://www.ofgem.gov.uk/system/files/docs/2019/06/draft\\_consumer\\_vulnerability\\_strategy\\_2025\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/06/draft_consumer_vulnerability_strategy_2025_0.pdf)

# Consultation questions

1. Do you agree with our vision for the future of the energy retail market, the outcomes we are seeking to achieve and our characterisation of the key challenges we need to overcome?
2. Are there examples of new products, services and business models that would benefit current and future consumers, but are blocked by the current regulatory framework?
3. Are there current or emerging harms to energy consumers which are currently out of scope of the regulatory framework? Do these differ for domestic and non-domestic consumers?
4. Would it be beneficial to allow suppliers to specialise and provide products and services to targeted groups of customers? If so, how can this be delivered while balancing the need for universal service?
5. Are incremental changes to regulation sufficient to support the energy transition and protect consumers? Or does this require a more fundamental reform, such as moving to modular regulation?
6. Are there any other potential market distortions we should be considering as part of our review?
7. Would removing the thresholds for the Energy Company Obligation and Warm Home Discount help remove imbalances in the retail market, and could this be done without significantly increasing barriers to supplier entry or expansion in the retail market?
8. How could the delivery burden on suppliers from the Energy Company Obligation be reduced, for example through the introduction of a buyout mechanism?
9. What effect does the range of Energy and Climate Change Policy Levies have on the retail market?
10. What actions could government take to reduce any negative impact of Energy and Climate Change Policy Levies?
11. Do you agree that now is not the time to make further changes on system and network cost recovery, metering and access to data as part of this retail market review?
12. What total costs do suppliers face with regards to bad debt and supporting consumers who struggle to pay for their energy?
13. How could any potential distortions related to high cost-to-serve customers be addressed, for example by the provision of additional support services for customers struggling to afford their energy?
14. Would addressing market distortions (for example size-based obligation thresholds for some policy schemes, supporting those who are struggling to afford their energy bills) help reduce incentives for suppliers to adopt pricing



**strategies that lead to excessive prices for loyal consumers? If so, to what extent (providing quantitative evidence, where possible)?**

- 15. What are your views on the measures being considered to address loyalty penalties in different markets? What approach or – combination of approaches – would be most effective in the energy retail market?**
- 16. What other approaches could be adopted to ensure loyalty penalties do not re-emerge?**
- 17. What protections or support may be required to engage consumers in vulnerable situations in the future market?**

This publication is available from: [www.gov.uk/government/consultations/flexible-and-responsive-energy-retail-markets](https://www.gov.uk/government/consultations/flexible-and-responsive-energy-retail-markets)

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