

Ripping off the band-aids

Ways to reform the retail
energy market



Introduction



The retail energy market isn't working: unaffordable prices for millions of households, the majority of consumers served by a new 'Big 6', and innovation that isn't reaching far enough. As we set out earlier this year in [Future Fantastic?](#), it's vital suppliers now move beyond 'standard' energy tariffs to provide the smart, low carbon services of the future.

Current regulations require all suppliers to meet the needs of a broad range of consumers, ensuring universal access to energy, accessible customer service and extra support for people in vulnerable circumstances. These are important outcomes, but the way they are achieved can limit the ability of suppliers to specialise in certain products and services.

A market with more specialisation could deliver a broader range of services and increase engagement by providing products that better meet consumer needs.

This has the potential to enable models that support low carbon technologies, like electric vehicles, heat pumps and solar panels.

This paper reviews a range of approaches that could enable more specialisation and assesses the benefits and risks to consumers. Some of the options have already been attempted, some build on existing processes in energy and other essential services, while others are more novel.

More comprehensive options that include changes to universal service may appear radical, but could also be more effective and sustainable. Previous tweaks to the system enabled many poor quality new entrants who failed in recent years.

Some consumers are increasingly excluded from the market, and reforms could increase this risk. We've identified changes that tackle this by enabling wider market participation, upgrading consumer protections, and supporting those who struggle to engage.

There is currently no clear direction of travel for the retail market. The Government and Ofgem must confront the hard choices on specialisation and consumer protection that will enable the affordable, low carbon services we need in the transition to net zero.

How could more specialisation benefit consumers?

The current regulatory framework requires all suppliers to deliver certain standard products for any customer who wants them. The rules deliver key protections for consumers:

- ✓ ensuring that all consumers can access energy at a fair price
- ✓ delivering continuous energy supply, even after contracts lapse or when people move house
- ✓ basic service standards and extra protections for consumers who need more support
- ✓ ensuring a level playing field for competition as all suppliers provide the same standard products

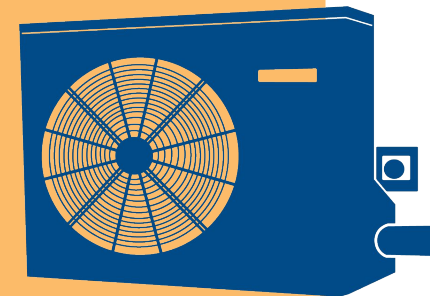
Importantly, suppliers aren't prevented from offering non-standard products to a sub-set of customers, alongside the 'standard' products required by regulation.

The requirement to serve a wider group may foster a more inclusive market. However, even under the current framework there are already risks that as suppliers offer new smart and low carbon products and services, consumers who can't or don't use these will have relatively fewer choices and face worse outcomes as a result.¹

This includes groups who can struggle to engage with the market like renters and the digitally disadvantaged, as well as people who can't afford the low carbon technologies that will help them get the best value from the market.

There are other drawbacks to the current approach. It places limits on the extent to which a company can specialise. This may make it harder for innovative services to emerge, particularly as people take up new technologies.


Illustrative example: Company X wants to focus solely on supplying people with heat pumps. They want to combine supply of energy with providing flexibility services through an 'energy as a service' model. This enables the company to cover the upfront cost of installing technology with cost recovery over a number of years. They consider that the service will not be able to comply with current rules, as they don't want to serve non-heat pump users and their service will not be able to support a range of payment methods.





It's well established in economics that if companies are able to specialise in areas where they have a comparative advantage, they will become more efficient in the areas they each choose to focus on. This could create a market where, on aggregate, products and services better meet consumer needs, consumers benefit more from engagement, and costs are lower. However, this comes with the risk that some consumers are underserved and have a worse range of choices.

To what extent are suppliers prevented from specialising?

In practice it is unclear to what extent the current rules are the key blockers to innovation and specialisation:

 Suppliers are already able to limit the extent to which they take on certain consumers, for example, by targeting specific consumer 'segments' in their marketing.

 Suppliers don't have to offer all their products to all consumers, though some rules limit this in practice. Prior to the price cap, companies had more scope to set prices of standard products at a level that consumers would not choose to take them up. A temporary rule currently bans suppliers from offering tariffs to new customers only.

 Suppliers have offered online-only service arrangements which would not be suitable for some users. This has been tolerated by the energy regulator Ofgem, though it is not compliant with rules on customer service.

Overall some consumers are already better served than others in the market - for example, there have generally been more deals for people who want online billing or payment by Direct Debit.

Some suppliers have already developed with specific areas of focus, including online-only suppliers, and those who focus on certain products (eg prepayment or smart time of use tariffs) alongside standard services.

It is clear that the current rules impose some hard limits on how much suppliers can specialise. Regardless of their area of focus, or customer acquisition strategy, suppliers need to ensure their services are suitable for a cohort of customers who have not made an active choice to use a particular product or service:

- **customers on default tariffs** who remain with a supplier after their contract ends, and whose needs may have changed since they last made an active choice
- **customers on deemed tariffs** who move into properties served by the supplier without ever having made an active choice to use their services
- **customers in debt** who might be blocked from switching away, and who need additional support and a wider range of payment options, including prepay

There is always likely to be greater regulatory and political intervention related to products and services for these consumers, in order to ensure fair and safe outcomes.

To what extent are suppliers prevented from specialising?

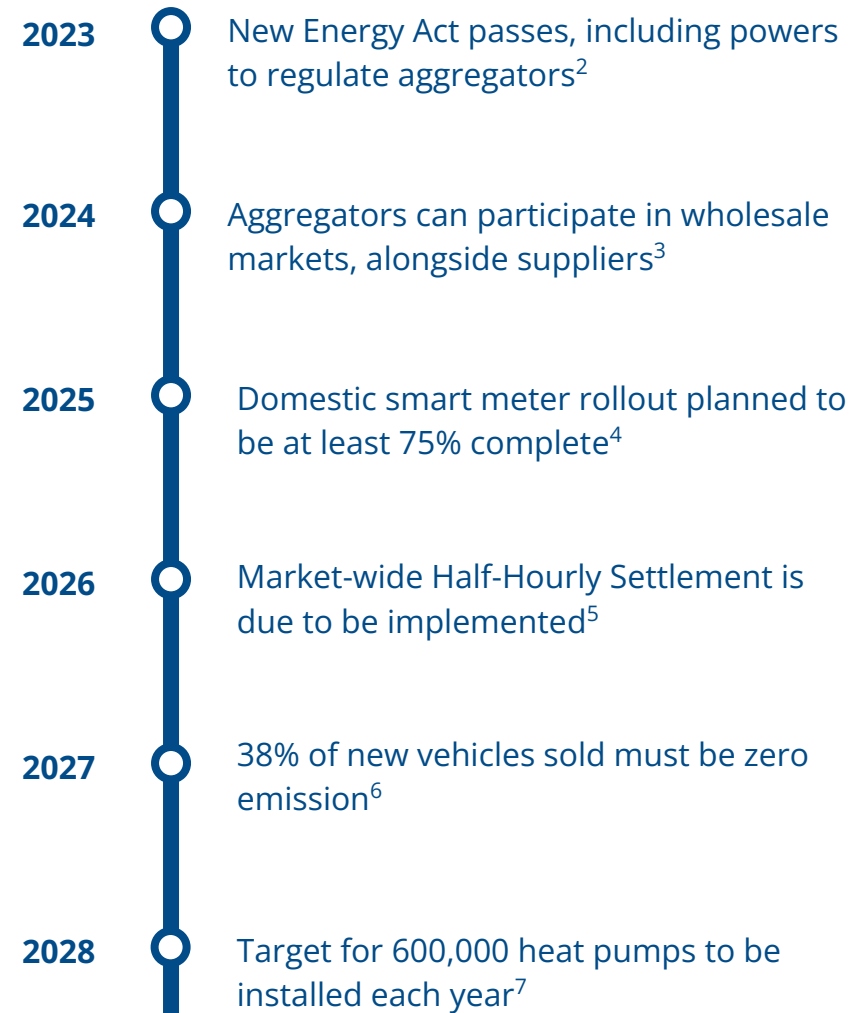
In the small business energy market far fewer rules apply and there's no universal service obligation, but it's not apparent that more specialist suppliers or innovative services have emerged.

Other factors are likely to play a role, including the commercial benefits that are available from a more specialised approach. Greater take up of low carbon technologies like EVs and heat pumps may increase appetite for specialised product offers. Market reforms are likely to have a significant impact, including:

- Rollout of smart meters, which enable more diverse tariffs and flexibility services.
- 'Market-wide Half-Hourly Settlement' (MHHS), which means suppliers are charged the cost of electricity when their customers actually use it, compared with estimates currently. This should lead to the development of more time of use tariffs.
- The Review of Electricity Market Arrangements, which is considering reforms to enable more local pricing.

Changes are also being made to enable demand side response, where consumers are paid to turn their energy use up or down in response to price signals from the energy system. This service can be offered by suppliers, but they'll also face competition in this space from 'aggregators', who may face fewer regulations.

As these changes progress the commercial and consumer benefits of specialisation may increase and retail market regulation may become a more pressing barrier to be addressed.



What rules affect the ability of suppliers to specialise?

Some key areas of the rulebook that are particularly relevant to specialisation are:

Rules about who suppliers have to supply with energy

- The Duty to Supply requires suppliers to offer any domestic consumer terms to enter a contract, but does not require them to offer all products
- Suppliers must continue to supply customers at the end of a fixed term contract, either through a variable tariff or a rolling fixed term
- Suppliers must supply people who move into properties they already supply through a deemed contract
- Suppliers can require non-prepay customers to pay a security deposit before they agree to supply them, but can only charge a reasonable amount



Rules about customer service

- There are overarching rules on treating customers fairly and narrower rules on the outcomes customer service should achieve
- The Complaint Handling Standards require that suppliers offer certain means of contact for complaints, including telephone and email

Rules about what products suppliers can offer and how much they can charge

- Energy tariffs must be made up of standing charges and unit rates, though these can be zero and can vary at different times of day
- The standing charge and unit rate that suppliers can charge customers on default contracts is limited by the price cap
- Once suppliers serve over 50,000 customers they must offer a wide choice of payment methods, including cash and prepayment

What rules affect the ability of suppliers to specialise?

Rules about how to treat people in vulnerable circumstances and in debt

- Suppliers are required to take account of customers in vulnerable circumstances in many areas of the licence
- Suppliers must support customers in financial difficulty with affordable repayment plans, and offer them the option prepayment or payment via deductions from benefits.
- Suppliers can prevent customers in debt from switching away, except those with prepayment meters with debts up to £500
- Suppliers can disconnect customers for non-payment, though this has now largely been replaced by other interventions, such as force fitting a prepayment meter (subject to protections)

Requirements to participate in government schemes

- All suppliers are responsible for the rollout of smart meters and must participate in the Renewables Obligation
- Suppliers with more than 1,000 customers must provide eligible customers with the Warm Home Discount, and make payments to help fund the scheme
- Suppliers with more than 150,000 customers must participate in energy efficiency schemes (ECO and Great British Insulation Scheme) and the Smart Export Guarantee (a scheme to purchase small scale generation from domestic consumers)
- Following passage of the Energy Act smaller suppliers will have to contribute to the funding of energy efficiency schemes via a buy-out mechanism⁸
- Suppliers with more than 250,000 customers must help administer the Feed in Tariff (though all suppliers must make payments to help fund it)

Outside of the energy supply licence there are other rules that also impact the services that suppliers provide:

- The Consumer Rights Act provides cross-sectoral protections for consumers against unfair contractual terms
- The Equality Act prevents service providers from discriminating against people with protected characteristics and can require reasonable adjustments to meet the needs of disabled people

How do other markets deliver a universal service?

The universal service obligation (USO) is often highlighted as a key factor in preventing specialisation. In energy this is delivered through the Duty to Supply rule, but it closely interrelates with other rules, including requirements to offer a wide range of payment methods.

It is common to have a USO in essential service markets, in order to ensure that all consumers can access vital services. However different markets take a range of approaches:



In banking, larger banks have to offer basic bank accounts to consumers who may struggle to access other services.⁹ These are fee-free, and must allow customers to manage their account online or at premises provided by the bank or a third party, and enable withdrawals from ATMs and setting up Direct Debits. They are designed to support people who can't access standard bank accounts, including those with a poor credit history.



In broadband, Ofcom has nominated suppliers (BT and KCOM) to connect properties to the network at a set price. These companies are able to recoup costs from an industry fund for any 'unfair cost burden' this imposes. They are also required to offer ongoing broadband service, priced at their discretion. Powers exist for the Government to direct Ofcom to introduce a mandatory social tariff, but most suppliers offer one voluntarily.¹⁰



In water, monopoly providers are required to supply all consumers in their area, and cannot disconnect for non-payment. The costs of this service are recovered via water bills across the monopoly provider's customer base. Each provider offers a social tariff, with the costs recovered from other consumers in their area.



There is no universal service obligation in the mobile market, but competitive provision of services like pay as you go can ensure access for people at financial risk. However, prices for this service have been rising and fewer operators now offer it.¹¹ Not all areas have mobile access, and there are powers for the Government to introduce a mobile USO in future for areas where there is no provider.¹²

Energy is unusual in requiring all suppliers in a competitive market to provide the universal service. This is in part because of the need to prevent people being cut off at the end of contracts, and because consumers can be served by deemed contracts when they move into a property.

Approaches that could enable more specialisation

We've assessed 8 possible approaches that could enable more specialisation, to understand the benefits, as well as any consumer and competition risks. Approaches 1-3 are already in use in the energy sector but could be used more widely.

1. Alternative routes to market

Current regulation already provides a range of alternative methods that firms can use to sell energy - besides being a fully licensed supplier.

Licence Lite enables firms to become licensed suppliers but avoid some obligations in relation to technical standards for the industry.¹³ Suppliers contract with another supplier to deliver these on their behalf.


Licence Lite has never been successfully used, in part due to commercial challenges of partnering with a licensed supplier.

White label arrangements mean a firm sells energy under a separate brand and, in some cases, a separate service offer, while a licensed supplier provides the energy and is legally responsible for meeting all the normal licence conditions.

White labels were reasonably common before 2021, but the need for commercial agreement with a licensed supplier may make this route an unstable basis for investing in innovative products.

Limited licences allow supply of energy except in specific geographical areas or to certain types of premises.


Ofgem's current approach to issuing limited licences is restrictive, though it previously consulted on a more permissive approach if companies could demonstrate consumer benefits.¹⁴ It's unclear that these licences are well targeted enough to enable specialisation around specific technologies (eg heat pumps).

 While these approaches may enable more diverse offerings at the margins, they are ill-suited to enabling market-wide reform.

2. Regulatory flexibility

Ofgem has introduced principles-based regulation into parts of its rulebook, particularly around customer service. This approach is meant to get suppliers to focus on achieving certain outcomes for their customers, rather than the regulator setting out 'prescriptively' how to do so. For example, it removed rules on how bills should be designed and instead said that these must achieve outcomes around engagement and understanding.

This can enable specialisation by enabling suppliers to design services in different ways. However, poor practice has also emerged in some areas where principles-based rules were used. In response, Ofgem has more recently proposed additional guidance and prescriptive rules in relation to areas of customer service.


 The level of flexibility that principles-based provide is limited as suppliers build up more default and deemed contract customers. Prescriptive rules are still needed in areas related to default products and universal service.

3. Limited exemptions from certain rules

Exemptions for smaller suppliers are well-established in relation to government schemes and rules on offering prepayment, and could be applied more widely.

Prior to 2021 these thresholds helped enable new entry by suppliers, but have also led to market distortions, with smaller companies being able to use them to significantly undercut their competitors. Some companies have also been unable to comply with rules once they no longer meet the exemption criteria. Ofgem has now introduced 'threshold assessments' to tackle this poor practice, and the Government has reformed its schemes so they are delivered by many more suppliers.

Derogations mean the regulator allows companies to avoid certain rules on a case-by-case basis, where there is a good case for doing so. It can impose conditions and monitoring to manage any risks. They are used widely in relation to tariff rules, and Ofgem has previously consulted on expanding their use to other areas of the rulebook.¹⁴


 These approaches don't enable market-wide reform or provide a basis for enduring specialisation.

Approaches 4-6 are similar to those in other sectors, but would require changes to the USO.

4. Suppliers can limit which customers they acquire

This approach would remove rules on customer acquisition, including the Duty to Supply, rules on tariff design for new customers and rules on payment methods.


This would give smaller and new entrant companies particular leeway to specialise. However, larger incumbent suppliers would need to continue to serve large numbers of legacy customers on deemed and default tariffs, and would continue to follow current rules in this area.

 Over time, new entrant suppliers would also build up a growing number of customers on deemed and default tariffs, limiting scope for specialisation.

5. Suppliers fully control which customers they serve


This approach goes further than the one set out above, by also enabling specialist suppliers to choose to move some or all customers on deemed contracts and default tariffs to another supplier. The new supplier would then provide the default product and additional support required to these customers.

The new supplier could be chosen through a bilateral agreement, or by the regulator. It may also require a fallback USO provider to be nominated by the regulator. The extent to which specialist suppliers seek to continue serving customers who are out of contract is likely to depend on default product rules. We explore this later in this paper.

 This option would mean suppliers could fully specialise, by ensuring they only serve customers whose needs they can meet.

6. Suppliers can only serve active customers

A more radical version of this reform would prevent suppliers from serving customers who have not made an active choice to use their service. All default customers would move to a designated USO provider, which could be another supplier, the local energy network or a not-for-profit company. The dedicated provider could deliver more support for consumers on default products, including those in debt.

 This would focus suppliers on gaining and retaining customers, and could maximise specialisation. It could also disrupt supplier/customer relationships and lead to worse outcomes if the USO provider's default product doesn't meet individual consumer needs.


Approaches 7-8 have been suggested elsewhere, but would require changes to energy market systems.

7. Separating the core and specialist supply markets

This approach would enable consumers to buy services from multiple providers at the same time.

Firms acting as an 'additional supplier' could sell electricity from local generation, or provide energy for specific technology in the home - for example, the electricity for an heat pump. These firms could be freed from many supply regulations.

Meanwhile the rest of the electricity at the same property could be provided by a 'primary' supplier. These firms would continue to provide the USO service and key consumer protections, so would have much less scope to specialise.


 This approach could enable a high level of specialisation for 'additional' suppliers. It would also enable new propositions and much greater consumer choice. However, it would apply to the electricity market only, and unlike other approaches would require changes to energy systems, which would take time and may have significant cost to deliver.¹⁵

8. Specialist suppliers sit outside the supply licence

A more radical version of the previous approach has been proposed which would remove requirements for additional suppliers to be licensed by Ofgem altogether.¹⁶ Consumer protection would instead rely on contractual obligations and basic consumer law.

This would also remove rules related to supplier resilience and failure, which may increase risks of mutualised costs. It would also make it harder for consumers to enforce their rights, unless they retain access to a redress service like the Energy Ombudsman or support from the Extra Help Unit, a service for vulnerable consumers or those with complex issues.

Consideration would also need to be given about how consumer law would be enforced. This could fall to the CMA (though it has limited scope to focus on sectoral issues), Trading Standards (which is under-resourced) or Ofgem (which may struggle without direct enforcement powers).

 This approach would enable a high degree of specialisation, but the real, or perceived, lack of consumer protection could make people more wary of using them.

Key consumer impacts in a market with more specialisation

Achieving good outcomes in a market with more specialisation will rely on consumers making high quality choices and products meeting their needs, even as more diverse offerings make the market more confusing. This will require high quality information and advice to ensure consumers can make informed choices about a service. They'll also need to have assurances that products will deliver their promised benefits.

Our previous research has shown that many consumers lack confidence to try new products, and may be put off if they perceive them as more risky.¹ The key use cases of many new energy services are likely to be focused on providing heat and mobility - both of which are essential to people's day-to-day lives - so it's vital that people can trust specialised suppliers.

Customer needs may change during their contract as a result of changing circumstances like developing a chronic illness or having children. Services will need to be flexible to changes in people's lives, and customers must be able to leave contracts that don't meet their needs.

To upgrade protections we've previously called for Ofgem to introduce a Consumer Duty. The Financial Conduct Authority (FCA) recently introduced similar rules for financial services, and there are early indications that this is leading to meaningful improvements for consumers.

Most essential services offer extra help for people in vulnerable circumstances, but it's currently too complicated for consumers to let their companies that they need more support. In [Closing the Gap](#) we set out how this could be improved with better data sharing between companies and simpler, one-time routes to inform and update their companies.

What is a Consumer Duty?

The FCA's Consumer Duty includes an overarching requirement to deliver good outcomes for customers - going further than Ofgem rules to simply treat customers fairly. It also includes specific requirements to ensure:

- Products offer fair value.
- Products are fit for purpose, meet customer needs and are targeted at those who'll benefit
- Information is provided at the right time and presented in an easily understandable way
- Support meets consumers' needs, so they can realise the benefits of services they buy

To demonstrate they are meeting these requirements, firms need to be able to demonstrate how they are monitoring outcomes and addressing harms they identify. This reform may become even more urgent in a market with more complex products and services, as this will likely increase information asymmetries between customers and suppliers.

We explored this in our paper [Raising the Bar](#).

The more radical reform options have more significant impacts on the consumer journey. Automatically moving some consumers to a new supplier may be seen by consumers as a radical change, although consumers are already automatically moved to a new supplier if their supplier fails, and there have also been instances where suppliers sold customer accounts to other suppliers.¹⁷ The Government also previously proposed opt-out switching for consumers on default tariffs.¹⁸ Regardless, if used more widely new protections would be required to ensure consumers understand the process, and more work would need to be done on how any debt would be dealt with.

Reforms to enable multiple suppliers could add further complexity, for example if things go wrong and it is unclear which party is responsible. Regulation would need to clearly set out the roles and responsibilities of different suppliers. There would also need to be systems of data sharing between primary and additional suppliers to ensure that consumers who need more support remain supported and safe.

Reforms that enable more specialisation are likely to mean that some consumers have few - or even no - choices in the market, even as others benefit from services that more closely meet their needs. Consumers at risk of missing out may be those with greater need for support, such as those in vulnerable circumstances or on lower incomes.

Consumers in debt or who are seen as financially 'risky' by their supplier may face particular challenges. In the absence of current USO and prepayment requirements, companies could increase their use of credit checks and security deposits.

In a model where consumers can be moved to a different supplier, they may terminate contracts altogether if customers get into debt. The risk of exclusion may be more limited if systems allow any debt that's built up to be collected via the new supplier. It is unclear how prepayment could work in a model with multiple suppliers, as not topping up with one supplier would automatically cut off the other's service.

Ofgem would need to closely monitor the impact on various consumer groups, and in the more radical options would likely need to designate one or more suppliers as a backstop universal service provider.

The regulator would likely need to set standards for the default product and service these providers offer, potentially to a greater degree than it already does given the loss of competitive pressure. This could provide the opportunity for higher standards and more support, but there are also risks of higher costs. We discuss these trade offs and how at risk groups can be protected later in this paper.

Key competition impacts in a market with more specialisation

Reforms that enable more specialisation are likely to make it easier for suppliers to avoid consumers with a higher cost to serve, for example because they require more expensive customer service channels, payment methods or additional support with debt.

This is particularly the case with reforms to universal service or payment method rules. This will leave a disproportionate number of these consumers with suppliers which haven't specialised. This may increase the costs faced by these suppliers, while the lower propensity of these customers to switch may also reduce the competitive pressure they face. This could drive up prices or lead to lower quality of service.

If suppliers providing the universal service cannot make a profit they may exit this part of the market entirely. In models which require the regulator to designate a USO provider (or providers) it could try to introduce competition in price setting, by using an auction to set the price of the product for these consumers.

To ensure that costs are shared fairly between all consumers and to incentivise suppliers not to avoid certain consumers, it may also be necessary to introduce new cross-subsidies. These already exist to share the cost of the Warm Home Discount, and a new cross-subsidy is planned to reduce the cost of prepay and standard credit tariffs.¹⁹ An alternative would be direct subsidy by government for provision of certain services.

Cross-subsidies could be used more widely in future to share the cost of serving consumers in debt or with higher service needs. However, these would need to be carefully considered, as they would increase costs to other consumers/taxpayers, and could incentivise the use of products that are more costly to provide, reducing efficiency overall.

Market with **less specialisation**



- customers with a **higher** cost to serve
- customers with a **lower** cost to serve



Market with **more specialisation** (and no mitigations)



Consumers who cost more to serve may have fewer choices

Key competition impacts in a market with more specialisation

Approaches which give some companies more freedom to specialise than others can mean there is no longer a 'level playing field'. For example, smaller companies were previously able to use exemptions to significantly undercut their larger competitors, but were often unable to sustain their business models once they grew larger. The Government has now generally reduced the exemption thresholds for schemes, but it is a reminder of the risks that can arise when reforms are made in a piecemeal way, rather than considering the wider market impacts.

Options which rely on regulatory discretion as to where specialisation is allowed (such as through derogations) can also distort the market, and disempower consumers from driving the evolution of products and services through their choices.

Previous attempts to enable new entry resulted in higher risk of supplier failure and mutualised costs. The failure of almost 30 suppliers in 2021/22 led to more than £2.5bn being recovered from energy consumers. These costs arise from the cost of consumers to a new supplier who has to buy their energy at short notice, protecting customer credit balances and covering some unpaid industry bills.

Ofgem has now introduced new rules that should ensure companies are financially resilient. These rules will also need to be applied to specialised suppliers, in a way that is proportionate to the risk of mutualised costs if they fail.

The option of enabling multiple suppliers introduces some additional considerations. It adds new 'volume risk', which arises if additional suppliers do not provide the energy they are due to, and the primary supplier has to provide this energy instead.

Primary suppliers may need to price this risk into products for customers using additional suppliers, in addition to recovering their fixed costs. Primary suppliers may also seek to discourage their customers from using additional supply, by charging those who do so punitive rates. It is likely that new regulation would be needed to tackle these risks and manage how primary and additional supply products interact.

What should the default product provide?

Default energy tariffs are already highly contentious, with questions around cost and, to a lesser extent, level of service. The default product is likely to come under fresh scrutiny as settlement reform increases incentives for time of use pricing.

If fewer suppliers offer standard energy products then the issue becomes even more acute. Design choices will determine how many consumers are likely to use the default, how much it costs and how much cross-subsidy may be required. We've identified 5 key factors in relation to the default product and service.

Price certainty: the current price cap is set for 3 months at a time, but the default product could move in line with the wholesale market or provide price certainty for periods up to a year. More certainty can benefit consumers, but places more cost and risk with the supplier. An exit fee could reduce these risks, but could be a barrier to engaging with the market.

Payment method: tariffs are generally priced differently according to payment method, to reflect costs like prepayment infrastructure and bad debt risk, though reforms are underway to remove this differential for prepayment customers. A future default product could return to more cost reflective pricing, to incentivise use of less expensive payment methods, or even offer a reduced range of payment methods to reduce costs.

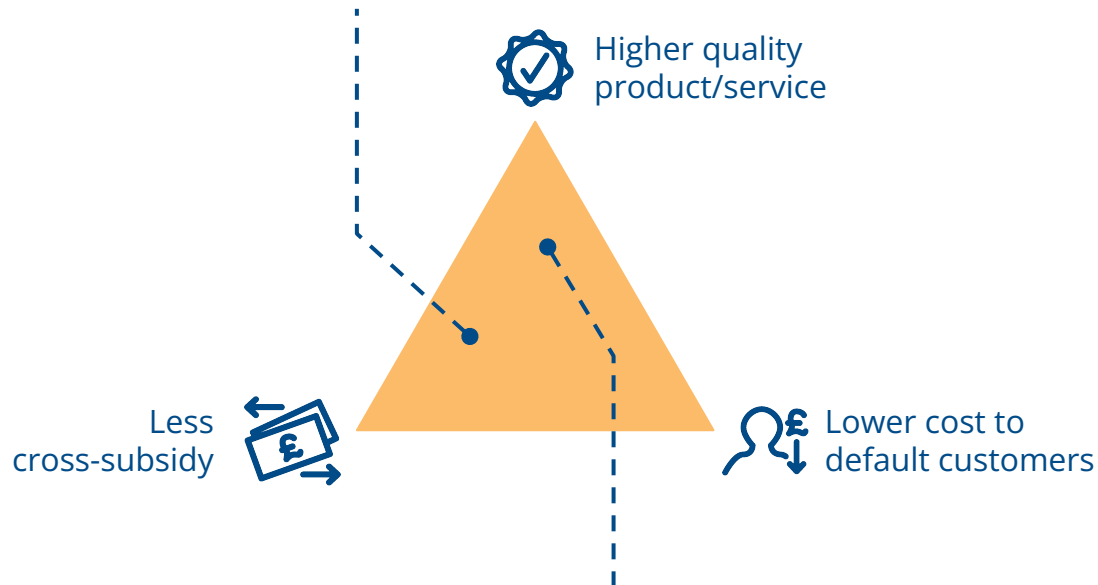
Level of debt support: some consumers are stuck on default products because they're in debt. Less debt forbearance would reduce costs, but could lead to significant harms for consumers in financial difficulties. If fewer suppliers provide universal service this could be an opportunity to put in place significantly more support for people who are financially vulnerable, though it may require new cross-subsidy.

Customer service: default products may have a disproportionate number of customers with a higher cost to serve - for example digitally disengaged customers who need to use phone lines or paper bills. Lowering standards, by allowing longer time to answer calls, or charging for these services by removing freephone options could reduce costs, but also lead to worse consumer outcomes.

Time of use: in future suppliers will be charged for electricity according to what time of day their customers use it. A default tariff that charges single rate (similar to today) could be cheaper than market offers for people who use a lot of energy at peak times. If more of these consumers use the default, it will drive the price up for everyone on that tariff. A default tariff that varies to some extent with time could reduce this risk, but may see some vulnerable consumers pay more.

What should the default product provide?

In general, a lower quality and less supportive default product would minimise costs and reduce the need for cross-subsidy. It may also prompt more consumers to engage with the market to access services that better meet their needs. However, for consumers who have limited choices this approach could lead to negative outcomes.



In contrast, a default product which maximises customer support would cost more or requires more cross-subsidy. This may reduce the incentive for engaging, reduce competitive pressure for services that meet a wide range of customer needs from developing in the market, and increase overall system costs.

These considerations generally relate to consumers who are on default products because they have relatively few options in the market or have come to the end of a standard energy contract.

It's also necessary to consider what happens to consumers at the end of contracts for non-standard products, such as tariffs designed to optimise certain technologies. The standard default product could deliver significantly worse outcomes than those intended by its design.

It's already possible for suppliers to move customers onto a new fixed term contract which meets their needs, as long as it has no exit fees and is cheaper than the standard default product. However, if specialist suppliers are no longer required to offer a 'standard' default tariff it's unclear how consumers will be protected from paying an unfair loyalty penalty once they are on a default product.

This risk could be mitigated through new rules on fair pricing, similar to those in the FCA's Consumer Duty. Specialist suppliers could also be required to demonstrate that the new fixed term contract delivers better outcomes than moving to a standard default product with another provider.

How can consumers at most risk be protected?

Some consumers who lose out under a reformed default product may be able to manage the impacts, if they can afford higher prices or are able to engage and have a range of options in the market. However, others may essentially be 'stuck' on the default product with poor choices in the market, and no ability to pay higher prices. This may include some people in vulnerable circumstances and on lower incomes.

There a number of ways these risks could be reduced:

- **Target higher level of default protection at certain consumers.** An enhanced, low-cost default could be provided for those with no, or limited, options in the market. However, in practice, distinguishing between consumers will not be perfect. The easiest groups to target may be those who are in energy debt and those on lower incomes.

It could be possible to target people with characteristics that may be associated with vulnerability or challenges engaging with the market, such as older people who are more likely to be digitally disadvantaged. However, this is quite a crude division, and could leave some without support, such as younger people or people who have transient vulnerabilities, like bereavement.

- **Give everyone a cheap/free energy allowance, through a rising block tariff.** This would imply a cross-subsidy from higher users to lower users, or government subsidy. It could protect consumers with low energy use by ensuring their essential needs are met, and increase incentives for higher users to reduce their usage.²⁰ However, there is a relatively loose correlation between income and energy usage. Analysis of this type of approach showed that 26% of households in the lowest income decile would be worse off, while 62% of the richest would gain.²¹

Certain households are less able to respond to price signals to limit usage, including disabled and older people who need to keep warmer or use medical equipment. It is likely that additional support would need to be layered on top of a rising block tariff to mitigate these risks, complicating the process.

There are also some challenges with how this approach could be delivered in practice. It's unclear how free or cheap units would be distributed through the year for customers who prepay or pay by standard credit, as they have higher energy costs in winter. It also may not work well alongside time of use products, which will become much more prevalent with settlement reform.

How can consumers at most risk be protected?

- **Target default protection based on the type of energy usage.** Consumers using technologies like EVs or heat pumps can impose a larger cost on the energy system through their usage. They could be excluded from using default products, or be placed on a different type of product with higher cost or time of use pricing.¹⁶

This may seem as fair while people with these technologies tend to be more affluent, but as more consumers take up these technologies some will also be underserved in the market due to issues like financial risk. Identifying relevant consumers may also be challenging.

To provide energy that is affordable for those at most risk of fuel poverty implies a large degree of cross-subsidy, some of which may be poorly targeted using these methods. Some of them also limit protection to default products, rather than supporting consumers to engage in the market.

A better approach would be **targeted energy bill support for consumers with low incomes and high energy needs**. In **Fairer, Warmer, Cheaper** we developed our preferred design - a lump sum discount that is automatically provided and portable between suppliers. This would enable consumers to continue to fully realise savings from engaging with the market and reducing their usage. To provide a meaningful discount, while limiting the need for regressive cross-subsidies, we think this should be government funded.

Policymakers could also take steps to enable widespread engagement, so that fewer consumers are shut out from innovative new services. Wider market participation will also incentivise suppliers to offer a broader range of services.

Some consumers face particular barriers to engaging, including:



Digitally disadvantaged consumers may not be able to use online switching services or access the best deals.²² Ofgem successfully trialled prompts to engage and simplified switching processes using offline channels, which showed some particular success with digitally disadvantaged consumers. It's also important that suppliers design their services in an inclusive way that takes account of consumers with different digital skills where possible.



Renters whose landlord controls their supply should be given the right to have a smart meter installed and take control of their energy supply, so they can engage in the market and choose services that meet their needs.²³



People without smart and low carbon technologies may have fewer options, as many of the services offered by specialist suppliers are likely to be based around flexible energy use and smart technology. Improved protections and financial support will enable a wider group of people - including those on low incomes - to have the confidence to adopt these products.²⁴

Charting a way forward

The retail energy market isn't working. There aren't enough products and services that add value for consumers, the market is dominated by six large suppliers, and current market arrangements already leave some consumers with limited choices in the market. Maintaining the status quo is unlikely to deliver the Government's stated aims of a market characterised by more competition and innovation.

More specialisation could lead to better consumer outcomes, by enabling suppliers to focus on products and services that better meet consumer needs. However, previous attempts at reform have been piecemeal and led to market instability.

Policymakers should assess the benefits and risks of more specialisation, and set a clear direction of travel. This will need to balance the benefits, including more competition and take up of low carbon technologies, with the risks of retail market instability arising from reforms and how to manage any harms for consumers who may lose out as a result.

It is unlikely that existing approaches - like exemptions and alternative routes to market - can enable significantly more specialisation. **To increase competition and innovation, policymakers should consider changes to how universal service is delivered.** This may also lead to more sustainable reforms.

A market with more specialist suppliers could deepen the existing risks that some consumers have fewer choices in the market, and there would also be significant implications for competition between suppliers. **Any retail market reforms must be accompanied by upgraded protections to manage these risks.** We think this should include a Consumer Duty and improved data sharing about vulnerability. Targeted bill support would support consumers at risk of unaffordable energy costs and continue to incentivise engagement.



All reforms are likely to require some changes to regulation or legislation. However, many of the building blocks have already been demonstrated, such as levelisation mechanisms and processes to move consumers to new suppliers. Some have been demonstrated in other markets, such as the designation of companies as universal service providers. More radical reform options like multiple supply also require changes to industry systems and more novel changes to the consumer journey. While consumer appetite for such options remains unclear, **reforms that can be delivered more quickly and have lower upfront cost are likely to be preferable.**

Reforms may still take some time to complete. It may be useful to align these with the timeline for settlement reform in 2026, when more innovative products and services will become more commercially viable. **Policymakers could support development of new entrants through interim steps as they work towards longer term reform.** This could include greater use of derogations or removing universal service rules on new suppliers acquiring customers, pending full reform - though at each stage mitigations for consumer and competition risks will need to be in place.

A market characterised by higher levels of consumer engagement with innovative products and services feels a long way off. The collapse of many suppliers since 2021, and volatile wholesale market conditions, mean that today almost all consumers are on the default product, with prices set by the price cap.

It is currently unclear when more competitive deals will return to the market and how consumers will react when they do. Meanwhile, the price cap risks becoming a 'lobbyists charter' that represents poor value to consumers. These pressing challenges exist regardless of any long term reform options. **Policymakers must ensure the current market framework delivers better outcomes for consumers in the near term.**



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