

EUK Response to BEIS Future of the Energy Retail Market Call for Evidence

14 January 2022

Introduction

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering over 80% of both the UK's power generation and energy supply for the 28 million UK homes as well as businesses. The energy industry invests £13bn annually, delivers £31bn in gross value added on top of the £95bn in economic activity through its supply chain and interaction with other sectors, and supports 738,000 jobs in every corner of the country.

This is a high-level industry view in response to BEIS' Call for Evidence on the Future of the Energy Retail Market. Energy UK's members may hold different views on particular aspects of the call for evidence. We would be happy to discuss any of the points made in further detail with BEIS or any other interested party if this is considered to be beneficial.

Executive Summary

Energy UK welcomes this early opportunity to engage with BEIS' retail strategy refresh, and supports its decision to take account of the lessons from recent months to ensure that the energy retail market is resilient, sustainable and continues to protect consumers as the whole energy system moves towards Net Zero.

The current crisis being faced in the energy sector is as clear an indication as any that BEIS, alongside Ofgem and industry, needs to look at how we create a retail sector that is able to be financially sustainable, invest in future innovative services that we will rely on to meet Net Zero such as electric vehicle charging and low-carbon heating, and allow all consumers to see the benefits of a competitive market. Developing this future retail market and the exploration of reform should not sit in isolation – there are clear links and dependencies between a successful retail market and other aspects of the wider Net Zero energy system that needs to be recognised and aligned.

In the short term, Energy UK believes that Government action will be needed to mitigate the impacts of high gas prices on consumer affordability, as well as the damaging impacts that it will have on inflation across the wider economy. The development of a refreshed retail strategy over the longer term should not preclude urgent action being taken over the coming weeks and months to address these challenges.

Alongside our members, we are keen to work closely and collaboratively with BEIS and other stakeholders to develop a refreshed strategy and develop a framework for a future retail market that meets BEIS' vision and can deliver on the needed investment and innovation to meet the Net Zero goal.

Immediate Impacts of High Gas Prices

Against a backdrop of many households already facing a cost-of-living crisis, it looks likely that continuing high and volatile gas prices will mean that the Default Tariff Cap (DTC) will need to increase by several hundreds of pounds for a typical customer from April 2022 to ensure that suppliers can recover efficiently-incurred costs. This follows the 12% rise in the DTC that occurred in October 2021.

Suppliers, of course, remain committed to helping customers who are struggling to pay, and have stepped up their efforts in line with past discussions with Government and Ofgem. However, they are also currently losing money providing energy to each customer on a Standard Variable Tariff. If the retail energy market is to remain functioning, suppliers' ability to, therefore, shield customers from significant price rises is limited. If the impacts of rising energy costs on domestic households are going to be mitigated, it will require action by Government, supported by Ofgem.

Urgent action in the immediate term is required by Government to address this affordability crisis, as well as the significant consequences that high energy costs will have on inflation. Energy UK will continue its engagement with BEIS, HM Treasury and Ofgem on this issue over the coming weeks. In developing its refreshed Retail Strategy over the longer term, we would urge the Government to ensure that it does not delay taking action until this workstream is completed, nor shy away from the necessary policy interventions and levers in the short term that are needed to address these concerns. This refresh should also not deter BEIS from progressing work it has already begun on TPI regulation to ensure that consumers are assured sufficient protections no matter the route to market they make use of for their engagement.

Energy Retail Market in a Wider System

While we welcome this workstream to refresh the previous retail strategy in light of recent events in the energy sector, we are concerned that it will stop short of what is needed if it is developed separate and in isolation from the wider energy system. Achieving Net Zero successfully and at the lowest cost to consumers will require changes across the whole energy system, and much work is already underway in other sections of the system to do so.

As a result, the retail market and its future framework should not be seen as a standalone entity. In developing its refreshed strategy, it will be important for BEIS to ensure that its thinking is not only consistent and complementary with, but also able to drive necessary change across the energy system as a whole, whether that's network charging, deployment of electric vehicles and low carbon heating, or the future power market design. The underlying drive of this refresh workstream should be that the retail market and its framework is aligned with the wider system drive towards Net Zero.

Refreshing the Strategy

Overall, Energy UK broadly agrees with the vision that BEIS set out in the Strategy, and that at a high level it sets a reasonable foundation on which a future retail market can be successfully built. However, we did have concerns that the underlying strategy and the specific policy interventions that BEIS intended to undertake were either unaligned, contradictory or just lacking detail/ambition.

For example, its previous proposals to introduce an opt-in switching scheme and trial an opt-out switching scheme were policy interventions that were not fit for the current market, let alone a future market focused on innovation and meeting Net Zero. Instead of continuing the pursuit of increased switching and the proliferation of below cost tariffs to the expense of market sustainability, the Government's strategy should be geared towards creating a sector that is encouraged through reward to innovate, provide new and better services to customers, and fits in to the wider system's overall transition to meet Net Zero. Therefore, we welcome and greatly support the decision to put on hold its opt-in/opt-out switching scheme plans. We continue to believe that these proposals should be dropped in their entirety as part of this refresh, and BEIS' attention refocused on developing a framework and policy interventions that are geared towards creating and supporting a sustainable and innovative energy retail market.

Energy UK previously outlined its vision for future retail markets in its 2019 report '*The Future of Energy: The future retail market and customers' relationship with it*'.¹ In 'Future of Energy', Energy UK set out its ambition for "a low carbon energy system that customers see as fair and which delivers excellent service, choice and value for money to all homes and businesses". The report argues this ambition will entail:

- Maximising competition, investment and innovation to realise the benefits of new technology and data opportunities as the energy system transitions.
- Recognising the successes of the current 'supplier hub' model and looking to build on the success of the model.
- Examining the impact of supplier obligations on the future retail market, either through distorting competition or deterring new entrants or innovative offerings.
- Ensuring the regulatory regime evolves to foster innovation, protect customers across converging markets and from harms emerging from new, unregulated services.
- Ensuring customers in vulnerable circumstances can be supported, protected and be viable for market players.
- Ensuring there is no free-riding by market participants or cost burdens falling unduly on specific customer segments.

Building on the 'Future of Energy' report we have also previously identified a range of key issues/barriers that we believe any robust retail strategy would need to consider and provide a steer on:

1. **What outcomes do you want to see?** – *Energy customers and retail markets are, for example, likely to be more diversified as consumers make more and different decisions about how they engage and use energy. Customer outcomes are, therefore, also likely to be more differentiated. What is/is perceived as fair?*
2. **The long-term financial sustainability and investability of the sector** – *We have seen nearly 50 suppliers exit the market over the past 3 years, with remaining challenges of profitability for many in the sector. Concerns need to be addressed to ensure enduring and future retail propositions are built on solid financial foundations and that the sector has the investment needed to innovate and drive the transition to Net Zero. This includes considerations of the implications of reformed charging regimes and changes designed to influence customer behaviour. Questions remain unanswered about the long-term future of the Default Tariff Cap and the appropriateness of placing such a high level of financial risk upon suppliers on behalf of the rest of the value chain.*
3. **The appropriate regulatory framework** – *With the continued transition to a smarter, more flexible energy system there are risks that new innovations and services to benefit customers and the Net Zero target will either not be captured appropriately by the regulatory framework, or obstructed from operating entirely. We have already seen a sharp change in the way many customers engage with their energy, highlighting the limits of the current rigid framework. A flexible and adaptive regulatory framework is needed that is capable of delivering the Government's vision for Net Zero, providing consumers and industry with the right price signals, ensuring equal consumer protection when interacting with any market participant, whilst also limiting barriers to competition, investment and innovation.*
4. **The role of customers and the retail market in achieving Net Zero** – *Retail energy markets are going to be at the forefront of enabling customers to decarbonise their homes and transportation and assisting customers with using energy more efficiently. Consideration is, as a result, needed as to how we support markets in engaging different customer groups in Net Zero and what support and advice is needed, including for those who do not want to proactively engage or change behaviours.*
5. **The roles and responsibilities of industry and Government in supporting customers in vulnerable circumstances** – *Questions around the provision of support for customers in vulnerable circumstances or fuel poverty are of growing importance, especially when we consider the new challenges being raised by the decarbonisation of heat, or the emergence of*

¹ [https://www.energy-uk.org.uk/files/docs/The_Future_of_Energy/2019/FutureofEnergy_ReportSection_Chapter1_04.19\(1\).pdf](https://www.energy-uk.org.uk/files/docs/The_Future_of_Energy/2019/FutureofEnergy_ReportSection_Chapter1_04.19(1).pdf)

new, currently unregulated, business models, services and products. A balance needs to be developed between the responsibilities of industry and the Government in supporting such customers in the future market.

There is a fundamental difference between today's world and the one in which the energy retail market makes a maximum contribution to net zero. The fundamental difference is that, in the net zero world, consumers use – and even generate - electricity in a way that minimises greenhouse gas emissions and minimises the need for grid reinforcement. Such changes would include: (a) shifting consumption – e.g. to periods of high wind; (b) reducing or eliminating consumption; and (c) on-site/in-home production and use of storage. There are a number of preconditions that will enable consumers in the energy retail market to make a maximum contribution to Net Zero, and BEIS should ensure that these are also considered within its strategy. These include the successful rollout of smart meters, the successful implementation of market-wide half-hourly settlement (MHHS), and the proliferation of Time of Use tariffs across the market following the implementation of MHHS.

We recognise that there is a wide range of work to be undertaken to ensure that the retail market is fit for a Net Zero future, by both BEIS, Ofgem and others, and we would welcome greater clarity from BEIS in setting out the roles and responsibilities of various parties, and how all stakeholders will be involved in working together. For example, we are concerned that there is no clear lead on long-term price cap reform, and where the role of Government and Ofgem sit in relation to one another. If, for example, the optimal fix for the price cap methodology sits outside of Ofgem's current powers under the Tariff Cap Act, then there is a clear need for the Government to lead on overall price cap reform. However, to date, there has been no indication the Government (via BEIS) is seeking to take on that role.

Energy UK welcomes this early opportunity to engage with BEIS on its strategy refresh, and alongside our members we are keen to work closely and collaboratively with BEIS, Ofgem and consumer advocate organisations to build upon the original vision, learn from the recent crisis, and start shaping the framework for a sustainable and innovation-friendly future retail market inside a net-zero energy system. Involving consumer representatives alongside suppliers together in these discussions will be important to ensure that considerations of a future retail market explore the impacts, barriers and benefits from all angles.

For further information or to discuss our response in more detail please contact Steve Kirkwood on 0207 747 2931 or Steve.Kirkwood@Energy-UK.org.uk.