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RECCo response to: Innovation in the retail energy market

We welcome the opportunity to respond to this consultation. Our non-confidential response represents the views of the Retail Energy Code Company Ltd (RECCo) and is based on our role as operator of the Retail Energy Code (REC).

RECCo is a not-for-profit, corporate vehicle ensuring the proper, effective, and efficient implementation and ongoing management of the REC arrangements. We seek to promote trust, innovation and competition, whilst maintaining focus on positive consumer outcomes. Through the REC, the services we manage, and the programmes we run, we are dedicated to building a more effective and efficient energy market for the future. We are committed to ensuring that RECCo is an "*intelligent customer*", ensuring efficacy and value-for-money of the services we procure and manage on behalf of REC Parties, including those which constitute the REC Code Manager.

Summary of key points:

- **Barriers and Opportunities:** we support a review of the Universal Service Obligations, as this could enable greater specialisation and improved offerings for niche markets but must not compromise the availability of appropriate consumer protections. Energy should learn from more innovative sectors, such as finance and telecoms, which enjoy a less-prescriptive and more principles-based regulatory framework.
- **Innovation and Complexity:** greater emphasis should be placed on stakeholder engagement to create a pull for innovation from consumers rather than new technologies and services having to be pushed. Prioritising the resolution of issues such as persistent smart meter performance problems is foundational, and necessary in order to increase consumer trust and adoption.
- **Default Tariff Cap:** Ofgem should place a higher priority on assessing the impact of the default tariff cap on innovation, and whether such price regulation is compatible with the transition to dynamic pricing that will underpin demand side response and its role in system transformation. Greater flexibility is needed, particularly around exemptions for dynamic time-of-use tariffs.
- **Routes to Market:** We believe that most of Ofgem's proposed routes to market have merit but caution against viewing them as a panacea. Tailored derogations, proven effective in GB and internationally, support innovation through evidence-based changes, while Restricted Supply Licences could better address local needs within Regional Energy Strategic Plans. Lessons from the financial sector on targeting regulatory obligations more effectively should also be considered.
- **Digitalisation:** digitalisation has a critical role in enhancing regulatory frameworks, streamlining processes, and improving market access for diverse participants.

We are happy to discuss any of the points raised in this response.

Yours sincerely,

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Appendix: RECCo response to consultation questions

Q1. What innovation is currently happening in the domestic and non-domestic retail markets? What is the scale of this innovation?
The consultation appropriately identifies the types of innovation currently taking place in the retail energy markets, such as Time of Use (ToU) and dynamic pricing tariffs, Energy as a Service (EaaS) and Peer-to-Peer trading. We do not have any statistics on the scale of this innovation but agree with Ofgem's assertion that the regulatory framework should not act as barrier to innovation.
Q2. What innovation should happen to meet consumers' needs and meet net zero?
Consumers' needs from the retail energy market, as it evolves, will vary widely. For example, while many consumers will seek to maintain full control over the way in which their appliances use energy, others will take advantage of increasing opportunities for automation. Many consumers will prioritise minimising their bills; others are likely to prioritise predictability or have greater regard to quality of service. Emissions reduction will be an overriding concern for some. This diversity of needs can only be met by a wide range of products and services, offered by different types of business model. Facilitating the emergence of these products and services will be the key innovation challenge in the retail energy market. Relatedly, the uptake of new products and services on a scale necessary to meet Net Zero will only be achieved through a step-change in consumer engagement and trust. The importance of innovation in this respect should not be underestimated. Increasing levels of complexity in the market through the introduction of, for example, dynamic time-of-use tariffs will need to be supported by innovative approaches to communicating to consumers the consequent opportunities, as well as the establishment of new mechanisms that allow consumers easily to compare and register for new products and services.
Q3. What will be the impact on consumers of new, innovative products and services? How can we maximise the benefits and minimise the risks?
One significant impact of market developments is the likely increase in complexity, which may exacerbate challenges for consumers who already find it difficult to engage. It is essential to ensure that consumers who are either unable or unwilling to engage with new products or services are adequately protected and not penalised for failing to invest in or adopt new technologies. As the industry continues to digitalise, it is critical to maintain accessibility by offering services and products to all consumers, including those who may be digitally excluded due to various barriers. We are concerned that the potential benefits of innovation for consumers may be undermined by persistent and widespread issues with smart meter performance. Reports from Citizens Advice highlight that consumers are encountering various technical problems with smart meters and facing significant challenges in resolving them. Additionally, extensive media coverage has drawn attention to issues such as consumers being incorrectly billed for peak-time tariffs instead of off-peak rates when charging their electric vehicles. While such reports may be disproportionate, these challenges contribute to a negative perception of this critical enabling technology, potentially hindering its adoption and the broader realisation of its benefits. Options to minimise risks and enhance consumer confidence may include: **Simplification and Transparency:** Ensure offerings are clearly explained, with simple pricing structures and transparent terms. **Testing and Feedback:** Ofgem and possible other recognised consumer advocates to be in the piloting or subsequent review of new products and services in small-scale trials, incorporating feedback from diverse consumer groups and publishing independent and reliable results.

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Robust, Targeted Consumer Protections: Strengthen protections against data breaches, billing errors, and other risks associated with digital energy solutions – but in a manner that facilitates the sharing of data rather than imposing further barriers to doing so.
Continuous Improvement: Regularly evaluate the performance of new offerings and address emerging issues promptly, and proportionately, rather than waiting for large-scale market failures and reliance upon punitive enforcement.

Q4. Are there any additional enablers or barriers to innovation?

In addition to the enablers cited, the consultation could further highlight the importance of a policy framework that helps to drive the uptake of innovative technologies. This might, for example, consider the appropriateness of the existing arrangements by which environmental levies are funded, or the sufficiency of existing schemes intended to help consumers afford low-carbon technologies.

We also consider that the consultation underplays the role of the default tariff cap. The price cap is by necessity a generalised allowance for costs incurred by a typical supplier, but as Ofgem is aware energy suppliers are not homogeneous, nor are domestic consumers. Whilst the price cap seems to be endowed with a permanency and purpose the original intent of mitigating the *loyalty penalty*, it is likely to inhibit innovation by reducing profitability, incentives, and competitive pressure. This would be a particular barrier for any (upfront) high-cost or niche offering. While there is still scope for innovation focused on efficiency and service quality, and Ofgem recognises the need to encourage investment in such innovation. We therefore welcome that Ofgem is working with government to ensure that default tariffs can balance near term consumer protection with the more flexible pricing models. We consider that a greater degree of flexibility is already available to Ofgem without legislative change. The current exemptions are restricted to tariffs explicitly linked to renewable energy. While that may have been appropriate in a market of static pricing, and supplier differentiation based on source of generated energy, it may not suit the paradigm of widespread time of use tariffs, with the source of energy being determined by timing of consumption rather than wholly by consumer choice.

The tariff cap is based on assumptions of average costs and restricts the recovery of those costs. This has contributed to the failure of many suppliers, who either failed to adequately hedge against the surge in wholesale prices or lacked the financial resilience to absorb these costs. We are concerned that the rapid increase in our dependence on intermittent generation has outpaced the electricity system's ability to respond effectively to supply shortfalls through storage or demand-side measures, potentially exposing suppliers to shorter but more frequent surges in wholesale prices.

Dynamic Time-of-Use (ToU) tariffs will play a critical role in incentivising consumption patterns that align with system needs. While ToU tariffs can exceed the default tariff cap under specific conditions, such as compliance with weighted averages, there are strict requirements. For instance, peak-period tariffs may exceed the cap if sufficiently offset by lower off-peak tariffs. However, we are concerned that this regime may no longer be fit-for-purpose if it necessitates a level of financial resilience that may only be achievable by larger, potentially diversified market operators.

To ensure both innovation and competition are preserved, it is crucial to introduce greater flexibility in price regulation. This is particularly important for newer entrants, niche operators, or suppliers catering to sophisticated consumers who may prioritise innovative offerings over predictability and/or the protections typically afforded to general retail consumers.

Ofgem should explore expanding exemptions to include innovative models like dynamic time-of-use tariffs. Additionally, greater flexibility in price regulation could support newer entrants and niche operators while ensuring continued consumer protection.

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Q5. What is the most significant barrier to innovation? Why?
We consider that one of the key barriers to innovation under the existing retail market arrangements is the requirement, set out in SLC22.3, for suppliers to contract with any domestic customers who request it. This condition has a vital role to play in protecting customers from the adverse effects of *cherry-picking*, but we agree that it may be appropriate for exemptions for niche offerings to facilitate further specialism: for example, a retailer who might seek to supply specifically for Electric Vehicle customers.
Q6. What innovation is not happening because of regulatory barriers?
We are not aware of regulation being an absolute barrier to any particular innovation but agree that it can act an inhibitor to scalability and may prevent certain innovations being introduced to the GB market.
Q7: Should we do further work to improve routes to market?
Yes – research undertaken by organisations such as Energy Systems Catapult (ESC) has evidenced the challenges faced by smaller-scale innovators in entering the retail market through the existing routes. In particular, ESC noted that the dependence of these innovators on partnering with established suppliers often resulted in unequal terms and an inability to develop scalable business models.[1] We believe that, as a minimum, Ofgem should consider the scope to improve these routes so that they become more attractive to prospective market participants. However, delivering the market-wide reforms required by Net Zero and other initiatives over the coming years is likely to require a more ambitious approach. This should seek to facilitate more innovation and specialisation whilst crucially protecting those consumers who do not engage with these propositions. We believe there is still more that can be achieved within the existing framework. For example, while Code Reform will reduce the number of industry codes from eleven to six, this still entails multiple accession processes, some of which may be contingent on qualification to access and use central systems. Additionally, several industry codes include credit rules that, when combined, may require security provisions disproportionate to the actual credit risk posed by a party to the market. We believe that improved cross-code collaboration could simplify these market entry arrangements and enhance their efficiency, reducing unnecessary burdens on market participants while maintaining robust safeguards.
Q8. What is the most attractive route to market? Why?
We are not in a position to answer this question.
Q9. If you think that we need to improve routes to market, which option do you think should be our top priority and why?
We are not in a position to answer this question.
Q10. What are your views on the options presented for amending routes to market? What would be the risks and benefits of each option?
While we support the removal of demonstrably unnecessary regulations, any revision to the licensing regime carries the inherent risk of unintended consequences. Generally, all regulations undergo thorough assessment before implementation to ensure they are necessary, targeted, and likely to be effective. The regulatory framework has been carefully constructed over time, layer by layer, to balance market stability, consumer protection, and innovation. Pre-emptively creating conditions for market operators to circumvent the regulatory framework on the assumption that flexibility alone will drive innovation, appears to lack a

[1] Energy Systems Catapult, *Towards a more innovative energy retail market: a call for input* (September, 2023), p7.

robust evidence base. A more cautious and data-driven approach would better ensure that any adjustments achieve their intended outcomes without compromising the integrity of the market or consumer interests.

Reform Derogations Regime

None of the proposed options are without risk. However, we consider that reforming the derogations regime—expanding the range of supply licence conditions eligible for temporary waivers to facilitate innovation—is the most prudent approach. This allows for a robust, controlled assessment of the impact of each derogation, enabling a temporary relaxation of specific regulatory requirements to test innovative solutions.

If these temporary waivers prove successful in stimulating innovation without causing consumer detriment, they should lead to permanent rule changes. This aligns with the original intention of the regulatory sandbox and has already been adopted at a lower level of governance by several industry codes, including the REC.

We also note that similar approaches have been successfully implemented internationally. For example, Australia's Energy Sandbox and Singapore's Regulatory Sandbox have effectively used derogation and sandbox models to trial innovative energy solutions, such as peer-to-peer energy trading and renewable microgrids, demonstrating the potential of this method to drive meaningful advancements in energy markets.

Restricted Supply Licences

Decarbonising the energy system will increasingly involve transformative changes to our homes, streets, and neighbourhoods. Consistent local and regional energy planning can play a central role in coordinating decision-making across energy vectors and scales, attracting investment, and engaging citizens and communities.

Restricted Supply Licences offer a valuable mechanism to support and implement Regional Energy Strategic Plans (RESPs) by enabling tailored, innovative solutions that align with regional energy priorities. These licences allow suppliers to operate within designated geographic areas or serve specific consumer types, facilitating alignment between supply models and the unique needs of a region's energy strategy. Their success, however, relies on clear regulatory frameworks, robust local collaboration, and effective oversight to balance innovation with competition and consumer protection.

Key risks include non-compliance, such as suppliers serving customers beyond their licence scope; market segmentation, which could reduce competition; and administrative challenges in defining and monitoring licence boundaries, all of which demand significant regulatory oversight. However, these risks are mitigated in the context of RESPs, as unlike the potential market for a commercial supplier, RESP boundaries are inherently restrictive and naturally aligned with local planning objectives.

Licence Exempt Supply

While there are current examples of licence exempt supply, these appear to be small-scale projects and an extension of this approach would seem inappropriate and ineffective for the mass market. We consider that there may be a role for licence exempt supply, but primarily as a potential incubator or pilot for schemes that may in due course be scaled up under a Restricted Supply Licence

Individually Modified Licences

Customising supply licences with tailored modifications to standard conditions can support innovative business models by aligning regulations with specific services and risks. Similar flexible licensing in finance provides long-term certainty, support unique propositions, and lower barriers for niche players.

Although managing bespoke licences could increase Ofgem's administrative burden, digitalisation mitigates this by enabling efficient publication, monitoring, and enforcement. This aligns with aspirations for a digitalised REC, where conditions and processes are mapped to individual parties' circumstances rather than broad licence categories. Additionally, adopting principles from finance—such as tailoring obligations based on customer characteristics—could enhance fairness and innovation in the energy market. For example, stricter requirements for retail clients versus sophisticated non-retail customers reflect their differing needs and protections. This could suitably be longer term aspiration of both Ofgem's work on stimulating innovation and of Code Reform.

Reform Licence Lite

We do not support reforming the Licence Lite arrangement. The framework has proven ineffective, replacing one barrier with another by requiring lite licensees to secure suitable partners to shoulder regulatory compliance and associated risks. Its inherent complexity, coupled with unclear responsibilities and difficult negotiations, has deterred adoption, limited its ability to reduce entry barriers, and failed to meaningfully drive innovation.

Q11. To facilitate innovation, which licence conditions would most benefit from being reformed?

As set out in response to Q5, we consider that the universal service obligation under SLC22.3 should be reviewed and if appropriate reformed. While it is important that consumer protections are maintained, including the original intent of SLC22.3 to promote fairness and safeguard against discrimination, it seems reasonable that suppliers who have a technology rather than solely price-based offering should be able to focus on a particular market niche. We also consider that with new financial resilience requirements, suppliers should be free to self-limit the number of customers they serve in order not to breach any regulatory thresholds or potentially be exposed to the high marginal cost of securing additional capital.

More generally, we consider that innovation could be facilitated through reduced prospection and greater use of principles-based obligations under licence. For instance, Ofgem could adopt something similar to the Consumer Duty in financial services, which sets higher standards for firms, requiring them to prioritise consumer outcomes, fairness, and transparency across their products and services. A similar obligation for energy suppliers to deliver "good outcomes" for consumer would provide flexibility to introduce innovative products and services without having to first jump through regulatory hurdles, but instead adopt a more thoughtful and consumer-centric approach to their introduction.

Q12. Are there any other improvements to routes to market which should be considered as part of enabling significant innovation in the retail market?

While acknowledging the challenges in identifying them, we believe that the most valuable feedback on this question would come from those who have considered, but ultimately decided against, entering the GB market.