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**RECCo response to: Supporting innovation in the electricity retail market: exempting small suppliers from the Universal Service Obligation (USO)**

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 the Code Manager 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, while maintaining focus on positive consumer outcomes. We are committed to ensuring that RECCo is an 'intelligent customer', ensuring the 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.

While our detailed responses to the consultation questions are appended to this letter, we highlight the following key points:

- We support the exemption and consider 50,000 domestic customers a reasonable starting point, but any fixed threshold is necessarily an approximate proxy and should be capable of adjustment in individual cases.
- The exemption should be considered alongside the Financial Responsibility Principle, Minimum Capital Requirement and wider financial resilience obligations. A supplier should be able to activate a voluntary acquisition safeguard before growth creates a compliance or capital cliff edge.
- Existing REC and Central Switching Service controls that prevent new registrations when a Market Sanction applies could be adapted for this purpose, with distinct governance so that voluntary use is not treated as a default or compliance failure.
- Ofgem should quantify the cost of the USO and monitor the cumulative effect of exemptions. Widespread use could concentrate higher-cost and more vulnerable consumers among suppliers that remain subject to the USO, with possible implications for competition and the default tariff cap.

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

Yours sincerely,

**Jon Dixon**
**Director, Strategy and Development**

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**Appendix: RECCo response to consultation questions**

| **Q1: Do you agree with our proposal to exempt suppliers with fewer than 50,000 domestic customers from the USO?** |
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| Yes. We support a targeted exemption for suppliers with fewer than 50,000 domestic electricity customers. The obligation in SLC 22.2 and 22.3 can deter entry by suppliers whose propositions are designed for a particular technology, consumer segment or service model. Removing that obligation at small scale should give new entrants room to test and refine propositions, while leaving the wider market responsible for universal access.<br><br>This is consistent with issues considered over a long period. Ofgem's 2006 Duty to Supply impact assessment, which informed subsequent proposals as part of the Supply Licence Review,[1] recognised both that the obligation could deter new or niche suppliers and that removing it could make it harder for vulnerable and higher-cost customers to obtain offers. Ofgem's 2020 consultation on retail innovation[2] returned to the same trade-off through possible derogations from SLC 22.3.<br><br>RECCo's response to the 2024 consultation[3] on innovation in the retail energy market supported review of the USO and said that suppliers should be free to self-limit customer numbers where necessary to avoid regulatory thresholds or the high marginal cost of securing additional capital.[4]<br><br>**Threshold flexibility.**<br><br>We consider 50,000 domestic customers a reasonable starting point for a test-and-learn intervention. It is large enough to permit meaningful market testing, but modest relative to the domestic market as a whole. However, any single number is necessarily arbitrary. Customer count does not by itself capture the risk, operational maturity, funding model or cost-to-serve characteristics of an individual supplier or proposition.<br><br>We therefore welcome the indication in the proposed drafting that Ofgem may direct a different number. The final licence condition and guidance should make clear that this discretion can be exercised for an individual licensee or proposition, as well as through a market-wide change. Any case-specific threshold should be transparent, evidence-based, time-limited or reviewable, and applied across licences held by the same ultimate parent so that it cannot be avoided through corporate structure.<br><br>**Financial resilience and a voluntary acquisition safeguard.**<br><br>In may be appropriate to consider this proposal together with the Financial Responsibility Principle, Minimum Capital Requirement, milestone assessments and other financial resilience requirements rather than in isolation. For instance, a supplier can remain below the USO threshold yet face a lower practical limit because further growth would require additional capital, security or operational capability. Conversely, a supplier may be ready to assume the USO at a different scale. The framework should allow growth to be managed before a supplier breaches an obligation or is forced into an abrupt withdrawal of offers.<br><br>RECCo previously suggested that a supplier should be able to self-limit the number of customers it serves. We consider that the REC could provide a backstop to make that commitment operational. The Registration Services Schedule already requires the Central Switching Service to reject a switch or initial registration where the gaining supplier is subject to a Market Sanction. That control is normally associated with default, qualification or market-exit circumstances. The same validation and messaging architecture could be adapted to support a separate, |

[1] "Supply Licence Review – Further Proposals", Ofgem Ref 217/06, December 2006
[2] "Supporting retail innovation: Policy consultation on ability to provide derogations from certain standard licence conditions and granting supply licences for specific geographic areas or premises types", Ofgem, July 2020
[3] "Innovation in the energy retail market", Ofgem, October 2024
[4] "RECCo response to Innovation in the energy market", RECCo, November 2024

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neutral status - for example, an Acquisition Safeguard - activated voluntarily by the supplier and, where appropriate, recognised by Ofgem.

The safeguard could record an agreed ceiling and prevent further gaining registrations once the relevant portfolio measure reaches that ceiling. It could support either the threshold applying under SLC 22 or a lower supplier-selected threshold justified by its financial resilience plan. Because the licence proposal is expressed by reference to domestic customers, while REC systems principally record registrations and Registrable Measurement Points, the detailed design would need an agreed counting methodology, reconciliation arrangements and a prudent tolerance for registrations already in flight.

The safeguard should be a backstop rather than a substitute for responsible sales controls. A supplier should stop making offers before the ceiling is reached so that consumers are not given contracts that cannot be registered. Outgoing switches should remain unaffected. Defined exceptions would also be needed for Supplier of Last Resort transfers, corrections to erroneous registrations, continuity arrangements for existing customers and any registration directed by Ofgem.

A voluntary status should not be labelled or reported as a Market Sanction and should not itself imply default. That distinction is important if suppliers are to use the mechanism early, when it is most likely to protect consumers and financial resilience. It would also allow Ofgem and RECCo to observe emerging constraints before they become compliance failures.

**Q2. Do you agree with our assessment of risks, and proposed mitigations?**

Broadly, but the cumulative and distributional risks require further assessment.

We agree that the risks from one supplier operating below a 50,000-customer ceiling are likely to be limited. We also support group-wide aggregation, readiness assessments, monitoring and an initial review. Those measures do not fully address the position if the exemption becomes common across a growing number of suppliers.

A series of individually modest exemptions could cumulatively remove a material part of the competitive market from the USO. Specialist suppliers may rationally focus on consumers who are engaged, digitally enabled, equipped with smart meters or low-carbon technologies, and comparatively efficient to acquire and serve. The remaining USO suppliers could then carry a disproportionate share of consumers who are more costly to serve or require additional support, including consumers in vulnerable circumstances, those with poor credit histories, less common metering or payment arrangements, or limited ability to engage with the market.

That would revive the concern which the USO was intended to address, i.e. that suppliers could effectively cherry-pick attractive segments while other suppliers retain the obligation to serve everyone. The issue is not that specialisation is undesirable; it is whether the benefits and costs of specialisation are allocated fairly, and whether all consumers continue to have access to a meaningful range of offers.

**The cost of the USO should be identified.**

The consultation states that costs are higher for suppliers offering the USO, but it does not quantify those costs or explain how they vary with supplier scale or customer mix. Ofgem's 2006 impact assessment similarly concluded that it was not clear whether maintaining the duty imposed significant costs on large suppliers, while recognising that it was likely to be more material for small suppliers. Nearly twenty years later, the case for an exemption still lacks an empirical estimate of the obligation's incremental cost.

We believe it would be informative for Ofgem to establish a baseline covering the direct cost of maintaining the capability to offer and supply all domestic customers, the effect of serving higher-cost groups, and any indirect effect on acquisition, systems, capital and compliance costs. Without that evidence it will be difficult to quantify

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either the innovation benefit of the exemption or its distributional consequences. The baseline should be updated during the test-and-learn period and used to inform any change to the threshold.

**Monitoring and review.**

Ofgem should publish the review period, success measures and circumstances in which the exemption could be narrowed, paused or made subject to additional conditions. Monitoring should cover the number and aggregate market share of exempt suppliers; the customer groups and geographies they target; changes in access to tariffs; rejection or refusal rates; the composition and cost to serve of customers remaining with USO suppliers; and any evidence of detriment to vulnerable or less engaged consumers. Monitoring should also distinguish healthy specialisation from artificial avoidance of the threshold.

The 2020 consultation proposed assessing whether a derogation would affect competition, inclusivity, energy system integrity or the fair allocation of costs, and whether comparable benefits could be achieved without regulatory relief. Those considerations remain relevant to a generally available exemption and should inform both case-specific threshold decisions and the wider review.

**Price cap implications.**

If the exemption results in non-exempt suppliers serving a materially higher-cost residual customer base, Ofgem should consider whether the default tariff cap continues to allocate efficient costs appropriately. It may in due course be necessary to differentiate the application or allowances of the cap between suppliers that benefit from the USO exemption and those that retain the full obligation, to the extent exempt suppliers are not otherwise outside the cap. Any such change would require careful design to avoid rewarding inefficiency or creating a further barrier to entry, but the possibility should be kept under review rather than allowing an unintended cost transfer to become embedded.

Subject to those additions, we agree that the proposed exemption is a proportionate starting point. Its success should be judged not only by the number of innovative entrants it supports, but also by whether universal access remains effective and the cost of delivering it is shared fairly.

**Application to gas suppliers.**

We recognise that the present focus of innovation and consumer flexibility is principally on electricity. However, gas suppliers are subject to materially equivalent duties under SLCs 22.2 and 22.3, and the consultation provides limited evidence for excluding them from the proposed threshold exemption. Applying an equivalent exemption to small gas suppliers could avoid unnecessary asymmetry between the two supply licences and support innovative dual-fuel or specialist propositions. We therefore invite Ofgem to consider extending the exemption to gas suppliers on equivalent terms, subject to the same aggregation, monitoring and consumer-protection safeguards.