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

EDF is the UK's largest producer of low carbon electricity. EDF operates low carbon nuclear power stations and is building the first of a new generation of nuclear plants. EDF also has a large and growing portfolio of renewables, including onshore and offshore wind and solar generation, as well as energy storage. EDF is therefore driving the transition towards 'an Electric Britain' – a secure, affordable, low-carbon future for everyone. As Britain's biggest generator of zero carbon electricity, we are investing more than £100 million weekly in Britain's electricity infrastructure. We supply millions of customers with electricity and help homes and businesses switch to electricity for heating, transport and industrial processes.

EDF strongly disagrees with the proposal to exempt small suppliers from the Universal Service Obligation (USO). As the regulator for the energy retail market Ofgem should be taking steps to encourage innovation and increase adoption of consumer led flexibility (CLF). However, the intervention proposed in this consultation is unnecessary, unlikely to deliver its intended outcomes, risks distorting the market and creates a perverse incentive for suppliers to remain small and selectively target profitable customer segments, rather than growing and serving the wider market.

We urge Ofgem to abandon this proposal and instead focus its efforts on more fundamental reform of the supply licences that will enable and encourage innovation by all suppliers, not just new entrants.

No evidence that the USO is a barrier to entry

The consultation does not provide clear evidence that the USO is a barrier to entry or prevents innovation in the retail energy market. The consultation relies heavily on stakeholder feedback and the views of prospective new entrants; however, these are not substantiated by any evidence. For example, there is no assessment of how many suppliers have been prevented from entering the market solely due to the USO, and no quantification of the costs of needing to comply with the USO or the benefits to be gained by it being removed.

Rather than being viewed as a barrier to entry, the USO is a fundamental protection for energy consumers, and exempting suppliers from it is likely to have wide-ranging impacts for consumers, who will be restricted in their choice of supplier. It is not appropriate or fair for consumers for Ofgem to take a 'test-and-learn' approach as the consultation suggests and react if new market entrants do not emerge. As a regulator Ofgem should only be intervening where there is a robust economic case for doing so.

Market distortion

As drafted, all new and existing small suppliers would be exempt from the USO. This creates a material risk that smaller suppliers will selectively target consumers that are more profitable and have a lower cost to serve, for example avoiding consumers with vulnerabilities, consumers in debt, consumers without smart technologies and consumers requiring additional support. Those suppliers covered by the USO will be obliged to supply those more challenging consumers and incur the associated costs, ultimately driving up bills for their customers, including the vulnerable and those on low incomes.

This creates a clear risk of market distortion and customer "cherry-picking". Rather than competing fairly on efficiency, service quality or innovation, smaller suppliers would be able to gain a competitive advantage by electing to only supply lower-cost consumers. The consultation recognises that the proposed exemption *'could result in a more uneven playing field, as costs are higher for suppliers offering the USO'*, but proposes no measures are taken to mitigate this risk other than setting the threshold for the exemption at 50,000 customers.

We disagree with Ofgem's assertion that *'level of the proposed threshold adequately mitigates the risk'*. Just one supplier with 50,000 carefully selected customers could have a significant impact on the competitive market; if you have multiple small suppliers operating near the threshold this combines to create a significant portfolio targeting the most profitable consumers. The proposal could, therefore, materially alter competitive dynamics across the market as costs are shifted towards those suppliers subject to the USO, and the consumers that they serve. The consultation does not provide a robust economic assessment demonstrating why 50,000 customers is as appropriate threshold or why lower thresholds were rejected.

Unnecessary intervention

Ofgem already has a range of mechanisms available to support innovative and specialist propositions, including derogations, individual licence modifications, amended licence conditions and other forms of targeted regulatory flexibility such as the Energy Regulation Sandbox. It can already use these existing tools on a case-by-case basis to determine whether an individual supplier should be exempt from obligations, including the USO, based on the specifics of the service and consumer proposition it is planning to bring to the market. Rather than that pragmatic approach, Ofgem is proposing to introduce a blanket exemption that all small suppliers, new and existing, will benefit from, irrespective of their service offering. While the stated aim of the exemption is to enable suppliers with specialist flexibility and low carbon technology (LCT) propositions to enter the market, there is nothing in the proposal that would secure this outcome.

As noted above, there is instead a material risk that new and existing suppliers will seek to exploit the exemption, "cherry pick" the most beneficial consumers and reap the benefits of the competitive advantage that Ofgem has handed to them. They can do this without taking any steps to increase adoption of LCTs or encourage flexible behaviours from consumers, and without supporting Clean Power 2030 and its longer-term decarbonisation and affordability goals. They can also do this without ever becoming subject to the USO as the exemption will allow them to stop new customers signing up, enabling them to stay below the threshold indefinitely and maximise their advantage. The proposals thereby also create a perverse incentive for suppliers to stay small to avoid becoming subject to the USO, which then restricts access to any innovative services that do emerge to a limited number of consumers.

The proposals may also have the unintended consequence of actually harming innovation in the retail market where organisations like EDF are already trying offer innovative products and propositions to their customers. Effectively encouraging consumers with LCTs to switch to small suppliers will potentially reduce our targetable customer base for these types of propositions. As evidenced in an LCP Delta report on flexibility propositions¹ that several suppliers (including EDF) contributed to, there is already a significant amount of innovation occurring in the flexibility proposition space that Ofgem does not have sight of, leading it to underestimate how much innovation is already taking place. Ofgem has acknowledged this and has proposed changes to their data gathering approach as a result.

An Alternative Approach

Rather than pursuing this unnecessary and potentially harmful change to the USO, there are actions Ofgem should be taking to support innovation in the retail sector, encourage investment in LCTs and support the adoption of flexible behaviours by consumers.

- **Stronger price signals to encourage flexibility** – currently, the benefits to be gained from providing flexibility are limited, both for consumers and suppliers. New entrants with flexibility propositions could be dissuaded from entering the market not by cost of the USO, but the small margins to be made from operating in flexibility markets. Organisations need to operate at scale to make reasonable margins, effectively negating the USO exemption. Ofgem needs to consider what it can do to improve the financial benefits of flexibility to consumers and suppliers.
- **Support investment in LCTs** – LCTs like electric vehicles, heat pumps and batteries provide the highest level of domestic flexibility, however the cost of investing in this technology remains out of the reach of many ordinary consumers. Rather than exempting those consumers that already have these technologies from the USO, Ofgem should consider what it can do, and what it can encourage Government to do, to help increase the adoption of LCTs, especially for low income and vulnerable consumers who could benefit most from using energy flexibly, at times when it is cheaper.
- **Reform the supply licence** – the most significant barrier to supplier innovation in the retail market is the overly prescriptive nature of the supply licence. Many of the obligations are no longer appropriate, especially as the market transitions from one largely based on simple fixed rate tariffs and supply only contracts to one where more dynamic time of price pricing and additional services like load control become the norm. EDF previously provided a detailed view of the changes that need to be made in its response to the 2024 Ofgem consultation on Innovation in the energy retail market², and we welcome and support the work that Ofgem is already doing on Consumer Outcomes which seeks to overhaul the prescription in the licence. Rather than wasting time tinkering with existing obligations for the benefit of a small number of theoretical future suppliers, Ofgem should focus its efforts on its work to reform the supply licence and transition to an outcomes-based framework that enables all suppliers to innovate while protecting the interests of consumers.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the points raised in our response or have any queries, please contact Paul Saker or myself. I confirm that this letter and its attachment may be published on Ofgem's website.

¹ <https://www.lcp.com/en/insights/publications/beyond-tariffs-gb-household-flexibility-market-monitor>

² <https://www.ofgem.gov.uk/consultation/innovation-energy-retail-market>

Yours sincerely

A handwritten signature in black ink, appearing to read "Denise Willis".

Denise Willis
Senior Manager of Industry Change

Attachment

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

EDF's response to your questions

Q1. Do you agree with our proposal to exempt suppliers with fewer than 50,000 domestic customers from the USO?

No.

The intervention proposed in this consultation is unnecessary, unlikely to deliver its intended outcomes, risks distorting the market and creates a perverse incentive for suppliers to remain small and selectively target profitable customer segments, rather than growing and serving the wider market.

There is no evidence that the USO is a barrier to entry - We do not agree that the USO is a barrier to entry as set out in the consultation, or that it inhibits innovation. Rather than presenting evidence that substantiates this claim, the consultation relies on reported stakeholder feedback and the views of prospective new entrants; there is no assessment of how many suppliers have been prevented from entering the market solely due to the USO, or of the costs and benefits associated with the proposed exemption. The USO is a fundamental consumer protection that enables consumers to choose any supplier, if Ofgem is seeking to reduce the level of choice afforded to consumers it should be based on robust evidence; not a hypothesis that it is proposing to '*test-and-learn*' to see if it produces the intended outcome.

The proposed intervention is unnecessary - Ofgem already has a range of tools it can use to support innovative and specialist propositions in a targeted way, including derogations, individual licence modifications, amended licence conditions and other forms of targeted regulatory flexibility such as the Energy Regulation Sandbox. These can not only enable the same outcome as the exemption but do so in a more targeted and controlled way.

The consultation notes that the intent of the exemption is to '*establish a permanent and consistently available route for all eligible propositions*', however no measures are proposed that would restrict the exemption to suppliers offering innovative propositions. As drafted it would apply to any supplier, new or existing, that suppliers fewer than 50,000 domestic customers, which does not align to the stated policy intent.

In addition, we note that suppliers can already influence which customers they target for specific products and services by tailoring their marketing activities and approach. Therefore, this intervention is wholly unnecessary.

The proposed intervention will create market distortion - The proposed exemption has the potential to encourage distortion of the competitive market and shift costs onto larger suppliers, and their customers. Small suppliers will be able to selectively target consumers that are more profitable and have a lower cost to serve, for example avoiding consumers with vulnerabilities, consumers in debt, consumers without smart technologies and consumers requiring additional support. This leaves larger

suppliers with the obligation to supply and support those customers and incur the additional costs associated with doing so. This will increase the cost of bills for those customers that are already least able to afford it, such as vulnerable consumers and those on low incomes.

We urge Ofgem to abandon this proposal and instead focus its efforts on measures that will directly encourage innovation by all suppliers, not just new entrants, such as its work to reform the supply licence and transition to an outcomes-based framework.

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

No.

Not only does Ofgem's assessment not cover all the risks associated with the proposal, but the proposed mitigations are also insufficient to mitigate those risks and the impact to consumers and the wider energy retail market.

Customer segmentation

The consultation recognises the customer segmentation risk associated with the proposals, but that the impact is low as a result of the 50,000 threshold. Not only is the impact on consumers unlikely to be as low as claimed, but the consultation also fails to recognise the impact of that customer segmentation risk on the other suppliers that remain subject to the USO.

As noted previously there is a material risk that smaller suppliers will selectively target consumers that are more profitable and have a lower cost to serve, for example avoiding consumers with vulnerabilities, consumers in debt, consumers without smart technologies and consumers requiring additional support. Not only will those consumers not be able to access the propositions and associated benefits offered by smaller suppliers, but those also covered by the USO will be obliged to supply those more challenging consumers and incur the associated cost. This will ultimately drive up bills for their customers, including the vulnerable and those on low incomes.

We disagree with Ofgem's assertion that *'level of the proposed threshold adequately mitigates the risk'*. Just one supplier with 50,000 carefully selected customers could have a significant impact on the competitive market; if you have multiple small suppliers operating near the threshold this combines to create a significant portfolio targeting the most profitable customers. This could materially alter competitive dynamics across the market as large numbers of consumers are able to access deals that other consumers can't. Not only is this transparently unfair to those consumers that are "shut out", but additional costs are also shifted towards those suppliers subject to the USO, and the consumers that they serve.

Fair competition

The consultation recognises the risk to fair competition arising from the proposal and suggests that this is mitigated by the 50,000 threshold. In line with our comments on customer segmentation above, this appears to be based on the unfounded assumption that a small number of suppliers, and therefore consumers, will be supplied under the exemption. However, if you have multiple small suppliers operating near the threshold the aggregate number of consumers that will be supplied under the exemption could be significant – and as noted these consumers are likely to be exactly the same ones that larger suppliers are also competing to supply as well.

By introducing this exemption for small suppliers Ofgem risks creating a material market distortion, encouraging small suppliers to enter the market and "cherry pick" the most profitable consumers, including those with LCTs. Larger suppliers that bear the costs associated with the USO will be unable to compete, creating a two-tier market that is not fair to consumers, or to suppliers.

Unintended consequences

The proposals have a significant risk of unintended consequences that is not recognised in the consultation; namely, the proposals fail to increase the overall level of innovation or worse, reducing it.

While the stated aim of the exemption is to enable suppliers with specialist flexibility and LCT propositions to enter the market, there is nothing in the proposal that would secure this outcome. Instead, what is proposed is a blanket exemption from the USO that would apply to any small supplier, new or existing, irrespective of the type of product or service they offer to consumers. Rather than encouraging innovators, this risks encouraging new entrants that mainly wish to enter the market to "cherry pick" consumers through offering a preferential tariff only available to those that are likely to be most profitable. While new entrants may enter the market, this may not result in new or innovative services being offered to consumers.

Instead, the proposed exemption may actually reduce the overall level of innovation in the retail market. Existing organisations like EDF are already trying offer innovative products and propositions to their customers, especially those that have invested in LCTs. EDF offers³ tailored tariffs targeted at the owners of EVs, air source heat pumps and solar panels, as well as its smart time of use FreePhase tariff⁴. Ofgem's proposal will effectively encourage those customers with LCTs to switch to small suppliers, reducing the number of customers available for us to target with these types of propositions. The consultation does not recognise this risk, instead wrongly assuming that giving an advantage to new entrants is the only way to deliver the innovation that Ofgem is seeking.

EDF
September 2026

³ <https://www.edfenergy.com/gas-and-electricity>

⁴ <https://www.edfenergy.com/gas-and-electricity/freephase>