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Dear Tom

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

At ScottishPower, we are committed to delivering sustainable and innovative energy solutions and we recognise Ofgem's objective of encouraging innovation.

However, the consultation has not demonstrated that the USO is creating a material barrier to innovation, nor that a blanket exemption from the USO for small suppliers is a proportionate intervention. In our view, the potential benefits of this proposal do not outweigh the risks to competition, regulatory consistency, and investment in the retail market.

Risk of customer selection and market fragmentation

The proposal would allow qualifying suppliers to refuse applications from customer groups that do not fit their commercial model. While this may facilitate propositions aimed at commercially attractive consumers, it would also allow exempt suppliers to avoid customers who are more costly or complex to support.

We consider that competition is in consumer interests when it is driven by propositions that meet customer needs, and by high standards of service and efficiency, rather than by the ability to select the most commercially attractive customers. Although other licence obligations would continue to apply, the USO exemption could concentrate customers requiring greater affordability, vulnerability and debt support among suppliers that remain subject to the USO.

A precedent for further or expanded exemptions

We recognise that, if maintained at the proposed threshold of 50,000 customers, the immediate effects of the exemption may be relatively limited. The number of suppliers currently able to benefit from the proposal is likely to be low and the near-term impact on the market may not be material. However, the proposed licence drafting would allow Ofgem to direct different thresholds in future and, if the exemption is considered

successful in supporting innovation or market entry, there will inevitably be pressure for it to be expanded. Suppliers approaching the threshold are likely to advance many of the same arguments made in this consultation in support of a higher threshold or broader application.

In our view, the key issue is therefore not the immediate impact of a 50,000-customer exemption, but the precedent that it establishes. Once a principle is accepted that certain suppliers can be exempted from regulatory obligations on the basis of size alone, there may be pressure to extend similar treatment in other areas, and to progressively larger suppliers. Ofgem should carefully consider the long-term implications of creating regulatory asymmetries that could expand over time.

At the same time, other teams in Ofgem are issuing regulatory expectations letters with interpretations of licence conditions which arguably would exacerbate this asymmetry. In particular, in the context of SLC 22B, Ofgem's current interpretation appears to suggest a limitation in how suppliers are able to target retention activities to different customer groups. Combining this with a proposal to allow new entrants to refuse to supply certain customer groups, we are concerned that in both cases Ofgem appears to be creating a regulatory framework that embeds a potential structural competitive advantage for certain suppliers.¹

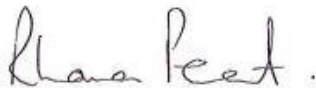
If Ofgem decides to proceed, it should provide clarity on the circumstances in which the threshold could be amended in future. In particular, any statutory consultation should set out the evidence, criteria and decision-making principles that would need to be satisfied before directing a higher threshold or introducing comparable exemptions elsewhere. This would provide greater regulatory certainty for both new entrants and established suppliers considering investment in the sector. To support this, it is important that Ofgem's licence conditions include a requirement that any change to the threshold would be subject to consultation, and we have included suggested draft licence condition amendments in Annex 1.

More proportionate alternatives are available

Ofgem describes the proposal both as a test-and-learn intervention and as a permanent, consistently available exemption route. In our view, rather than creating a permanent exemption, Ofgem should consider targeted, time-limited arrangements that support innovation while preserving a level playing field in the longer term.

Our detailed responses to the consultation questions are set out in Annex 1. Should you require any further information or wish to discuss our position in more detail, please do not hesitate to contact us.

Yours sincerely,



Rhona Peat
Policy and Regulation Director

¹ For this proposal, the structural advantage is for those smaller suppliers below the customer number threshold who do not need to offer terms to all customers. In the case of Ofgem's interpretation of SLC 22B, it exacerbates the structural advantage for those former new entrant suppliers who have less "expensive to serve" customers than former incumbent suppliers.

**EXEMPTING SMALL SUPPLIERS FROM THE UNIVERSAL SERVICE OBLIGATION –
SCOTTISHPOWER RESPONSE**

Question 1. Do you agree with our proposal to exempt suppliers with fewer than 50,000 domestic customers from the USO?

No. We support innovation and greater consumer participation in flexibility, but Ofgem has not established that a blanket exemption for small suppliers from the USO is necessary, proportionate or likely to deliver benefits for consumers as a whole.

Innovation is in the interest of consumers where it delivers better products, lower costs and improved outcomes. By contrast, allowing niche competitors to cherry pick the most commercially attractive customers may not result in innovation that benefits consumers overall. While this proposal is likely to be beneficial for some small suppliers and a relatively small cohort of highly engaged customers, it would do so by weakening competitive neutrality and increasing market fragmentation. The associated increase in regulatory uncertainty may, at the margin, make the retail sector less attractive for long term investment.

The proposed 50,000 customer threshold is sufficiently low that competitive impacts may initially be modest. However, for the same reason, the proposal is unlikely to deliver the innovation benefits that Ofgem anticipate. As currently designed, the proposal risks creating regulatory distortion without delivering significant long-term gains. Note that our comments on market distortion in this response are predicated on the potential for a significant increase in the market penetration of non-USO suppliers.

The case for an exemption for small suppliers has not been established

The consultation does not demonstrate that existing routes for regulatory flexibility are inadequate. Suppliers can already develop propositions for consumers with electric vehicles, heat pumps, batteries or flexible demand. The USO does not require every tariff or product to suit every consumer. It provides a backstop against a licensed supplier refusing to offer supply altogether.

We do not accept that compliance with the USO is incompatible with innovation. Some of the most valuable innovations in the retail market have been developed specifically to support customers in vulnerable situations, who are likely to be less commercially attractive to small suppliers. Innovative solutions in this space include digital support tools, tailored payment solutions and new approaches to affordability and debt management. These innovations provide overall benefits as they reduce the costs to be socialised across the wider consumer base.

Recent industry research further weakens the case for this intervention. A December 2025 report from LCP Delta, based on data from five major suppliers covering approximately 19 million households, identified significant existing innovation in the retail market, including 2.6 million customers on time-of-use tariffs, 500,000 customers on EV propositions and over 300,000 customers participating in supplier-managed EV charging arrangements.² The report was commissioned in part because existing regulatory data collection does not fully capture emerging flexibility offerings. This shows that energy suppliers are successfully developing and scaling innovative flexibility offerings whilst subject to the USO.

² [Beyond Tariffs: GB Household flexibility market monitor](#)

Ofgem has subsequently acknowledged that many non-tariff propositions are not routinely captured and is proposing additional data collection.³ This evidence should be gathered and assessed before Ofgem creates a permanent exemption from a core licence obligation. We understand that Ofgem will begin data collection in this area from Q4 2026 and gather data on a quarterly basis thereafter to better capture the full spectrum of innovation and customer offerings.

If Ofgem's new analysis of non-tariff propositions shows evidence of strong innovation in the sector, this should inform Ofgem's assessment of the potential overall net benefits of its proposal to exempt small suppliers from the USO. The existing market may be able to deliver the desired innovation without intervention.

The proposal would distort competition through customer selection

The proposal undermines the principle of a level playing field. Suppliers operating in the same market should, as far as possible, be subject to the same regulatory obligations. All suppliers seek to attract customers who value their proposition. However, suppliers exempt from the USO would be able to avoid serving customers or customer groups that do not fit their commercial model, while suppliers subject to the USO would remain required to serve the wider market. This affects how the costs and risks of serving less commercially attractive customer segments are distributed across the market.

This proposal risks shifting competition away from service, efficiency and genuine product innovation and towards customer selection. It could also leave universal suppliers serving a disproportionately costly or complex customer base while exempt suppliers benefit from narrower and more commercially attractive segments.

Ofgem acknowledges both that exempt suppliers could focus on customers with smart meters and low-carbon technologies and that applying the USO unevenly could result in an unlevel playing field because the costs are higher for suppliers offering universal service. Its principal mitigation is the limited size of the proposed threshold, but this limits the initial scale of the risk rather than addressing its structural cause.

Even at the proposed 50,000-customer threshold, the potential advantage could be material. By targeting engaged Direct Debit customers through specialist products, an exempt supplier could avoid much of the debt exposure borne by suppliers required to offer universal service. Applying Ofgem's current electricity debt allowance of approximately £29.20 per Direct Debit price cap customer implies debt-related costs of around £1.46 million per year for a supplier with 50,000 customers.⁴ This is a conservative comparison, as it assumes the USO supplier serves only Direct Debit customers and excludes the higher debt costs associated with Standard Credit and PPM customers. Exempt suppliers may also avoid other costs associated with serving higher-risk customers, such as specialist call centre operations. A supplier able to avoid these costs would have scope either to offer lower prices or to achieve materially higher EBIT margins, creating a competitive advantage that arises from the regulatory asymmetry rather than greater efficiency.

Regulators in other sectors have recognised that exempting some market participants from universal service obligations can create structural sustainability risks for providers that remain subject to those obligations. For example, in its July 2025 review, Ofcom altered elements of Royal Mail's USO after concluding that reform was needed to support the financial

³ Email from Ofgem's Consumer Led Flexibility team on 12 August 2026

⁴ [Ofgem Price Cap Annex 17a](#). Debt-related cost allowance based on Direct Debit with a multi-rate electricity meter to reflect electricity-only customers. Consumption is 3.4 MWh based on Ofgem's updated TDCVs.

sustainability and continued provision of the universal service.⁵ The experience underlines the importance of assessing how universal-service costs will be distributed before creating differences in the obligations applying to competing providers.

Broader social responsibilities

Ofgem's Markets Regulatory Vision and Strategy to 2030 sets out an ambition for markets that work for all consumers through regulation that balances consumer protection, innovation and investability.⁶ Suppliers of all sizes are capable of innovation. The relevant question is therefore not whether innovation occurs, but whether innovation requires relief from a core consumer protection obligation. The proposal risks creating a situation where certain customer groups benefit from a wider range of specialist propositions while customers who are more costly or complex to serve become increasingly concentrated among universal suppliers. This would be difficult to reconcile with a vision centred on outcomes for consumers overall rather than selected commercially attractive segments of the market.

Although exempt suppliers would remain subject to other applicable consumer-protection requirements, the ability to select which customers they serve could reduce their exposure to customers requiring greater vulnerability support, debt management or tailored assistance. Indeed, the existence of a USO indicates that there are market segments that would not be served without it, typically because the cost to serve customers in those segments outweighs their ability or willingness to pay.

Where the costs of universal service provision are recovered through the tariffs of suppliers subject to the obligation, the regulatory framework includes an implicit transfer between customer groups. Some aspects of the current retail framework rely on suppliers serving sufficiently broad customer portfolios across which costs and risks can be managed. Specialist suppliers targeting lower-risk or more engaged customers could weaken that model and concentrate higher-cost customers among suppliers subject to the USO.

This is particularly important because several elements of the current retail regulatory framework assume that certain costs are spread across a broad customer base. For example, Ofgem has recently taken the view that debt-related costs incurred on default tariffs should be recovered across a supplier's wider customer portfolio, including Fixed-Term Contract customers.⁷ The ability of niche suppliers to target lower-risk customer groups could weaken the customer cross-subsidisation that underpins aspects of the current regulatory framework, potentially increasing cost recovery challenges for suppliers serving a broader and more representative customer base.

We have previously argued that competitive pressure limits suppliers' ability to recover debt-related costs through the wider customer portfolio in the way assumed by Ofgem. A class of suppliers able to avoid some of the higher-cost customer segments would exacerbate this challenge. To the extent that lower-risk customers migrate towards non-USO suppliers, suppliers that are not exempt may face increasing difficulty recovering costs.

This consideration becomes materially more significant if the threshold is increased over time and/or if the number of exempt suppliers expands. In those circumstances, Ofgem may need to revisit both the approach to debt-related cost recovery and whether some costs associated with universal service should instead be funded through a more transparent market-wide mechanism.

⁵ [Consultation: Review of the universal postal service and other postal regulation](#)

⁶ [Markets Regulatory Strategy and Vision to 2030 | Ofgem](#)

⁷ [– Energy price cap: review of historical debt related costs](#)

Sustainable market entry should remain the objective

Ofgem's consultation is premised on the view that the USO may deter specialist supply propositions from entering the market. However, the consultation provides limited evidence that there is currently a material deficiency in market entry or innovation that requires intervention.

Following the supplier failures of 2021/22, Ofgem has strengthened requirements relating to financial resilience, operational capability and market entry. These reforms were designed to ensure that suppliers entering the market are capable of operating sustainably and meeting their obligations to consumers. A reduction in the number of supply licence applications may be an expected consequence of these reforms rather an indication that further concessions are required.

Before creating a new exemption from a core consumer protection obligation, Ofgem should demonstrate why existing entry requirements are preventing beneficial innovation, and why targeted relief for specific propositions would be insufficient. The consultation does not clearly establish that case.

More fundamentally, innovation does not necessarily require entry as a licensed supplier. Many energy services can be provided through partnerships, technology platforms, flexibility services and other commercial arrangements without exempting firms from obligations that apply to the wider market. The relevant question is therefore not whether a proposition is innovative, but whether innovation genuinely requires relief from a core consumer protection obligation.

The 50,000 threshold is insufficiently justified

Ofgem has identified several regulatory thresholds at around 50,000 customers. However, those thresholds were designed for different regulatory purposes and do not explain why 50,000 customers represents the appropriate point at which a supplier should cease to be exempt from a USO. More fundamentally, the consultation does not explain why customer numbers should be the determining criterion. If the policy objective is to facilitate innovation, the relevant consideration should be the nature of the innovation and the regulatory barrier it faces rather than the absolute size of the supplier.

Targeted alternatives are more proportionate

Where a supplier can demonstrate that a particular licence requirement prevents a specific and beneficial innovation, Ofgem should consider a time-limited trial, an individually modified licence, a sandbox or a derogation. Ofgem acknowledges that individually modified licences and derogations can provide effective routes for specific innovative propositions.

Such mechanisms could be linked to:

- an evidenced regulatory barrier;
- a defined proposition and target group;
- measurable consumer and system benefits;
- safeguards against customer detriment;
- reporting and evaluation requirements; and
- a clear route to full compliance or exit.

This would enable innovation to be tested without creating a general and enduring difference in core obligations between competing suppliers. We recognise that a time-limited derogation

may not provide the same level of certainty as a permanent exemption. However, that reflects an important policy trade-off. If a proposition depends on indefinite relief from a core consumer protection obligation, it is legitimate to question whether that proposition is sustainable within a competitive retail market. The objective should be to facilitate innovation where specific regulatory barriers exist, whilst maintaining confidence that successful propositions can ultimately operate within the same regulatory framework as their competitors.

If Ofgem considers that specialist entrants should not initially be required to provide universal service directly, it should also examine whether a proportionate contribution model (potentially in the form of a levy) would better preserve competitive neutrality than a complete exemption. The current consultation appears to assume that the benefits of a USO justify requiring larger suppliers to provide it. If universal service delivers benefits for consumers generally, there is a question as to whether a broader contribution mechanism would be more consistent with the principles of competitive neutrality than concentrating those costs on the larger suppliers that remain subject to the obligation.

If Ofgem remains concerned about the compliance burden on new entrants, targeted routes would be preferable to a blanket exemption. For example, suppliers could be required to demonstrate progressive readiness for full USO compliance as they scale, with clear transition requirements before reaching the threshold. Such an approach would provide greater confidence that suppliers are capable of meeting their obligations as they grow.

A regulatory precedent that affects investability of retail markets

The consultation focuses extensively on potential benefits for innovation but gives relatively little consideration to investability. Ofgem's Markets Regulatory Vision and Strategy to 2030 recognises that both innovation and investability are necessary to deliver good consumer outcomes. Introducing asymmetric obligations for suppliers operating in the same market creates additional regulatory uncertainty and may weaken incentives for investment by suppliers that remain subject to the full suite of obligations.

A blanket exemption for small suppliers from the USO also creates a concerning regulatory precedent. Introducing exemptions for particular classes of supplier raises the risk that future policy obligations will be applied unevenly across the market. This uncertainty may discourage investment and long-term planning by suppliers that remain subject to the full requirements. Increasing regulatory risk in the sector may result in less innovation, to the extent that it reduces investment.

Ofgem intends the threshold to apply across all licences held by the same ultimate parent company, however, the practical implementation is unclear. For example, Ofgem should set out how it intends to:

- measure and monitor customer numbers for supply licensees and within groups;
- manage any acquisitions and corporate restructuring; and
- determine whether avoidance actions have occurred.

These issues should ideally be resolved before we reach the statutory consultation stage.

In its low/zero standing charge work, Ofgem explicitly recognised the risks associated with exempting smaller suppliers from obligations. The working paper states:

“Smaller suppliers not subject to the obligation may be able to avoid loss making tariffs and instead target more profitable customers, leading to a distorted competitive environment. This could disadvantage larger suppliers, undermine the intended

customer benefits of the policy, and potentially lead to unintended consequences such as tariff rebalancing, reducing switching, or market consolidation.’⁸

That language is striking because it maps almost perfectly onto the concerns raised by the USO proposal and which are not adequately explored in Ofgem’s consultation.

Question 2. Do you agree with our assessment of risks, and proposed mitigations?

No. Ofgem identifies several relevant risks, but its proposed mitigations do not address the underlying structural effects of allowing some licensed suppliers to select which domestic customers they will serve, and so avoid serving those who are less commercially attractive.

Even if the proposed mitigations operate as intended, the anticipated benefits remain uncertain while the risks to competition, regulatory consistency, supplier growth and universal access may be material. We therefore do not consider that a case has been made that the potential benefits outweigh the risks. Ofgem should instead consider targeted, time-limited and evidence-led mechanisms that address specific barriers without weakening the principle of universal service.

Customer selection may result in more market fragmentation

Ofgem acknowledges that exempt suppliers could focus on customers with commercially attractive characteristics, such as those with smart meters and low-carbon technologies, but considers the impact limited because other suppliers would continue to provide universal service.

That does not address how customers and costs would be distributed between suppliers. The relevant question is not simply whether consumers retain access to at least one supplier. It is whether exempt suppliers can target attractive segments while the costs and responsibilities associated with universal supply become increasingly concentrated among others.

Suppliers remaining subject to the USO would continue to serve customers who are more costly to support. Over time, this may affect competition, increase costs for universal suppliers and ultimately worsen outcomes for the broader customer base.

Limiting the exemption to 50,000 customers does not remove the distortion

Ofgem acknowledges that the proposal could create an uneven playing field because the cost of offering universal service is higher. It considers the threshold sufficient mitigation because it limits the scope of the exemption.

This may limit the initial scale of the effect, but it does not eliminate the regulatory asymmetry or the incentive to select customers. The assessment should also consider the cumulative impact if many exempt suppliers each target commercially attractive customer groups.

Transition arrangements require clarification

We assume that Ofgem’s monitoring of supplier readiness for a transition to the USO will be included in the existing Milestone Assessment framework. However Ofgem’s consultation is silent on this more formal approach, with paragraph 2.14 providing only high level statements on Ofgem’s intentions to monitor supplier growth, and engage with suppliers approaching the threshold, and paragraph 2.5 being less clear with a statement that Ofgem “may” undertake targeted readiness assessments. It is critical that Ofgem does undertake readiness

⁸ [Mandating lower or zero standing charge tariffs: A technical working paper](#)

assessments and monitoring of suppliers benefitting from any exemption it introduces from the USO. If Ofgem moves forward with this proposal, then we believe it must consult on changes to the Milestone Assessment Framework to ensure it includes a requirement to demonstrate readiness to meet the USO, in a similar manner to the current requirements in the framework for other areas subject to a small supplier exemption.

The review framework is insufficiently defined

Ofgem describes the proposal as a test-and-learn intervention and says the exemption would be reviewed after an initial period. It does not specify the review date, success criteria, required data, counterfactual or circumstances in which the exemption would be withdrawn or amended. Elsewhere, it describes the exemption as a permanent and consistently available route and has retained flexibility to direct a change to the threshold.

A credible evaluation framework should measure:

- genuinely additional market entry and innovation;
- consumer take-up and demonstrable benefit;
- the characteristics of customers accepted and declined;
- effects on competition and supplier growth;
- distributional effects across customer groups; and
- supplier readiness on approaching the threshold.

A clearer evaluation framework would allow stakeholders to understand how Ofgem intends to assess impacts on competition, innovation and consumer outcomes.

Ofgem's draft licence conditions must include an obligation to consult

Ofgem's draft licence conditions include that Ofgem can change the customer number threshold at any point by issuing a direction. We do not consider this to be sufficiently robust as this does not require that Ofgem undertake consultation on any changes prior to issuing any direction. This is the case for certain other similar areas of the licence conditions, and if Ofgem progresses with this proposal, it must ensure that any proposed changes are subject to robust scrutiny by stakeholders otherwise the risks that we present in this consultation response become much more significant. We propose the following amendments to the draft licence conditions for 22.7 part e):

(e) if it supplies electricity to fewer than 50,000 Domestic Customers or such other number as may from time to time be directed by the Authority following consultation

ScottishPower's alternative proposal

Ofgem should not proceed with the proposed blanket exemption. It should instead develop targeted, time-limited and evidence-led mechanisms addressing specific regulatory barriers, with measurable consumer benefits and a clear route to full compliance.

We understand Ofgem's desire to encourage innovation and market entry. However, a blanket exemption below 50,000 customers appears arbitrary, risks creating incentives for suppliers to remain small, and establishes a precedent for further erosion of core consumer protection obligations.

ScottishPower
September 2026