

USO Exemptions Consultation

Stonehaven Response

September 2026

01 Our position

Stonehaven is delighted to respond to Ofgem's consultation on creating an exemption from the Universal Service Obligation for energy retailers. We have advocated significant changes to the retail market to enable genuine rivalrous competition for several years, as reflected in our 2023 paper¹. We regard Ofgem's intervention here as a welcome step towards a market that encourages innovation and drives down costs for consumers. Importantly, we also regard it as a step that should be contextualised within a wider ranging set of reforms to the retail market that are necessary to achieve this aim while protecting consumers, and we recognise that it is critical that DESNZ plays its role in delivering this change.

Before we respond to your questions, we want to set out our headline thinking on where the retail market needs to go.

The energy retail market is an extremely unusual one, inasmuch as its shape is almost wholly defined in statute. There are very few industries in which the product is specified directly by Government and regulation, and very few in which such specification drives innovation. The 'product' is a commodity that can only be sold via routes that reflect the character of that commodity. You can only buy electricity in kilowatt-hours from your retailer – not in services powered, miles driven or heat provided. In research that we have undertaken, even consumers trained to engage in this market still find it challenging².

Our view is a that genuine market needs to let businesses offer products to consumers that reflect their preferences and their needs, regardless of how an industry is currently structured. A single bill per household meter for a commodity service is not this. To deliver this, businesses need to be able to:

- a) Specialise, and;
- b) Make money if consumers like their product.

¹ Stonehaven, 2023, *Reinventing Retail Energy*. Available at: https://www.stonehavglobal.com/reinventing_retail_energy_making_the_energy_retail_market_fit_for_the_next_generation.

² Public First, 2026 *Innovation in the energy retail market: qualitative insights*. Available at: [PF_CitA_Innovation_in_energy_retail_Qual_Final_report_V1_PDF_VERSION.pdf](#)

Right now, retail businesses can do neither. There are a host of barriers that business face in this market, including the price cap, the structure of the supply licence, and of course the Universal Service Obligation.

02 Responses

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

You may therefore be surprised that our answer to this question is, “No.” But this is because we disagree with the approach taken to exemption rather than the exemption itself.

As we set out above, the key to reforming the market is permitting specialisation. This means developing bespoke offers for particular consumers, rather than being obliged to offer a product to everybody. There is no particular scale that provides advantages or disadvantages to specialisation, and scale itself is therefore not a helpful criteria to maximise innovation. Indeed, larger businesses better able to raise capital might be in a better position to develop bespoke products.

However, we note that there are two factors that tell in favour of a scale criteria:

- a) The risk that a business simply picks the most lucrative consumers and refuses to service vulnerable consumers or consumers in debt, and;
- b) The relative complexity of implementing any other form of criteria. We note that this exemption can be implemented by a single clause addition to the retail licence, making it cost very little in terms of officials’ time.

We recommend solving both of these through a reasonably simple measure: creating an Approved Products List, managed by Ofgem, and creating a hook in the licence attached to that list. Suppliers that only offer products on this list are exempt from the USO.

‘Products’ in this case means alternative routes for selling electricity to consumers. This may be, post acceptance of one of the meter splitting code modifications³, a bespoke tariff purely for the power used for an electric vehicle. It may be a smart pre-payment offer to consumers, through which that supplier directs all its business. It may be a bespoke service for vulnerable consumers, supported through non-commercial means. It may be how battery managers properly enter the retail market, rather than through the alphabet soup of VLPs and VTPs. It may be products we can’t yet anticipate. Existing suppliers may choose to create a subsidiary purely to sell that particular product.

Such an approach would enable Ofgem to undertake a light touch review of new market offers while ensuring no offer can be so comprehensive as to create ‘dumping risk’ for less profitable customers. Retailers are currently regulated at a company level inasmuch as they are obliged to offer an undifferentiated

³ Various of these are in motion but they owe a debt to P379: [P379 'Multiple Suppliers through Meter Splitting' - Elexon BSC](#).

product; in a world of multiple products, regulation sits better at the product level rather than the company level.

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

Inasmuch as we disagree with the form of the proposal, our opinion on mitigations would seem to be moot. However, there are references in the text to the idea of a 'default' supplier as a solution for a world in which USO exemptions become the norm and some customers are underserved. We think this is an area worth exploring and developing thinking on now while the carefully managed structure we suggest above is put in place.

With this in mind, we think there are two options that are particularly worth exploring.

1. The Return of the RECOs

The first is based on the example of the backstop model used in the PJM market in the USA as well as the structure that existed in the GB market prior to unbundling in the early 2000s. The Regional Energy Companies were joint distribution network and retail companies that held network assets as well as billing customers. These are attractive as backstop retailers as they have considerably higher credit ratings (AAA-BBB+ vs BBB and below) given their regulated returns and will be able to finance consumer debt at a lower cost. This option was explored in 2017 by Ofgem under the Supplier Hub workstream⁴. In this model, the 'backstop' tariff likely comprises a simple pass-through time-of-use tariff, which would not require a price cap.

2. Competition For The Market

If we assume that underserved consumers are underserved because they are expensive to service, then it is considerably fairer and more efficient that some of the costs of that servicing are paid for by the taxpayer rather than smeared over all billpayers, as they are now. Indeed, under the current framework the USO is a *de facto* tax on energy. Efficient taxation theory states that intermediate goods should not be taxed at all⁵.

We assume that at least a proportion of these customers are in some way vulnerable, and therefore we assume public welfare is maximised by not imposing this higher cost to serve on this group as a whole through higher prices. However, we do need to discover how much that additional cost to serve is; we can't guess it from the outside.

For those customers who are unable to find a supplier in an ultra-USO-exemption world, we therefore suggest bundling them up into lots to be bid for, where the bid is a stack of the pass-through cost to serve that customer *plus* an increment reflecting cost to serve, financed by the taxpayer. This is analogous to the

⁴ [Ofgem seeks views on reforms to 'supplier hub' market arrangements | Ofgem](#)

⁵ Mirlees & Diamond, 1971, "Optimal Taxation and Public Production II: Tax Rules."



approach trialled by Ofgem in 2018⁶. Unlike in that trial, however, focusing on consumers that suppliers do not *want* to serve removes any questions around contract law.

03 In summary

We would like to commend Ofgem again for launching this work. The retail market as it stands is increasingly not fit for purpose, and injecting competition – real competition, not simply publishing a database of prices to a comparison website – is necessary. Developing thinking on a USO exemption is a vital first step, but only a first step.

⁶ [Ofgem's Collective Switch trials | Ofgem](#)

