

# **New regulatory paradigms for the UK retail energy market**

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Over the past 10 years, the UK retail market has been under scrutiny by regulators. In 2008, the Office of Gas and Electricity Markets (Ofgem) undertook the Energy Supply Probe (2008) and the Retail Market Review (2010), and the Competition & Markets Authority (CMA) undertook the Energy market investigation (2016). The UK retail energy regulatory debate has focussed on making competition more effective by removing barriers to greater consumer engagement. Tariff structures and the ways in which utilities seek new customers and communicate with existing ones have changed. Nevertheless the lack of consumer engagement persists. Although the number of companies competing in the market has increased, as has the number of customers switching providers, there remains a significant segment of consumers who do not engage with the market. This resulted in the introduction of a price cap for retail customers in January 2019.

In this paper, we discuss how the existing regulatory framework—which has focussed on switching and transparency of retail energy markets—might be affected by the changing relationship between energy suppliers and consumers. Three aspects of the emerging marketplace will need attention to ensure that its benefits extend to as many retail energy consumers as possible:

- **Transparency** will decrease and the scope for anticompetitive behaviour could increase as products become more complex and, possibly, bundled together;
- **Consumer commitments** may lengthen and affect switching; and
- Communication and marketing could become more prone to neglecting the interests of vulnerable or **disengaged consumers**.

### **Complexity and lack of consumer engagement**

Today, the interaction between smaller retail consumers and utilities is largely one-way and simple. Sellers publicly announce prices on a take-it-or-leave-it basis. Retail consumers choose a supplier and a tariff and receive supply. These consumers have little or no bargaining power in this “posted-offer” market and suffer the consequences. They bear a higher mark-up on the cost of energy supply than larger commercial and industrial customers who have greater bargaining power due to significant volume of demand and access to alternative sources of supply (such as onsite generation) or both.<sup>1</sup> Insufficient engagement with retail consumers is an enduring concern.

Ofgem’s 2008 report concluded that complexity leads to consumers finding it difficult to make informed decisions about suppliers and tariffs. With evidence of a sticky customer base with the Big Six suppliers, and general low consumer engagement, the regulator

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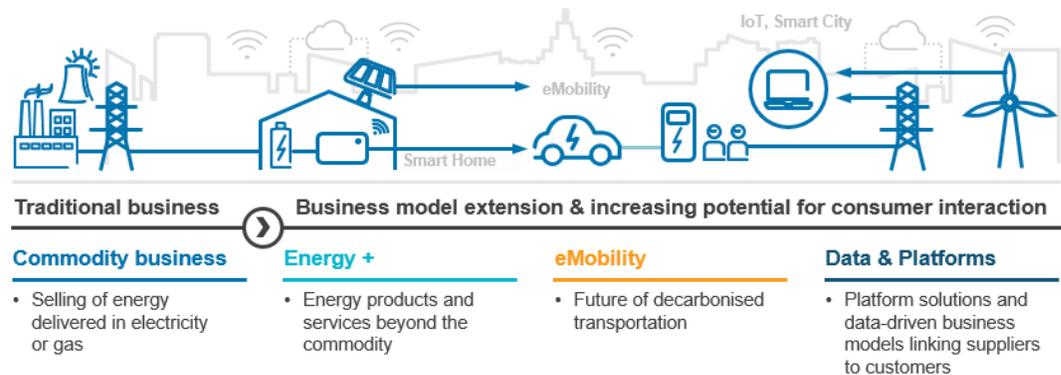
<sup>1</sup> See CMA, Energy market investigation (2016). P624, ¶ 10.94, at <https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>.

aimed to improve tariff comparability. In 2013, Ofgem introduced reforms intended to increase engagement by reducing the complexity of the retail energy market by making tariffs more consistent and easier to compare. In summary, Ofgem:

- banned complex tiered tariffs and introduced a simpler tariff structure;
- limited to four the number of core electricity and gas tariffs suppliers could offer; and
- reduced the number of different types of cash discounts suppliers could offer.

Changes in the way consumers access their energy supply, however, may offer greater bargaining power and create a two-way relationship with their utility company. Some consumers are already able to self-supply a portion of their energy needs through decentralised generation technologies such as rooftop solar PV and thermal and battery storage. In a more “double-sided” market consumers may sell some of their surplus supply back to the grid. With increased deployment of electric vehicles, consumers may also be able to provide some flexibility services. These developments have been recognised in the UK Energy white paper published by the Department of Business, Energy & Industrial Strategy (BEIS) in December 2020 as a gateway to improving competitive market outcomes for consumers. In particular, we note that the government has committed to consult on a range of those issues in 2021, including on required changes to the market framework to “facilitate the development and uptake of innovative products that work for consumers and contribute to net zero”<sup>2</sup>

**Figure 1: Increasing potential for consumer interaction**



There is a risk, however, that those who are currently “disengaged” could remain disadvantaged and fail to take advantage of such offers. Unsurprisingly, the characteristics of households most likely to adopt new energy technology correlate with those households more likely to be already engaged in the competitive retail energy market. These consumers are likely to be sufficiently engaged in energy consumption choices to be able to evaluate different technologies and technology providers and be aware of the possibility

<sup>2</sup> BEIS. “Energy white paper: Powering our net zero future,” updated 18 December 2020, at <https://www.gov.uk/government/publications/energy-white-paper-powering-our-net-zero-future>.

of securing government grants and subsidies. They are also probably sufficiently affluent to afford the upfront costs of the different technologies.<sup>3</sup> As shown in Figure 2, these are broadly the same types of households that the CMA found to be more likely to switch between current competitive energy suppliers.<sup>4</sup>

**Figure 1: Percentage of demographic group that switched energy suppliers (2014–2016)**



Source: CMA survey

New types of energy companies, however, will compete by offering a range of more complex product bundles that provide not only commodity supply but also related services, technologies, sales to the grid and flexibility. There is a risk, therefore, that the benefits of the new energy economy will be captured by only some household energy consumers.<sup>5</sup>

### **Bundling and complexity—less transparency?**

The retail energy market will become more complex and potentially less transparent because the markets for smart(er) homes, e-mobility, and energy supply are converging more than ever before. Consumer choice in any one of these markets may affect choices and outcomes in the others. Such a situation will produce incentives for suppliers to offer joint propositions across combinations of those markets, creating ecosystems of products and services.

For example, a car company could offer a new electric car bundled with an amount of free (or discounted) electricity for a predefined period. The car company may even include a

<sup>3</sup> Gianluca Trotta, “Factors affecting energy-saving behaviours and energy efficiency investments in British households,” *Energy Policy*, vol. 114, March 2018, at <https://www.sciencedirect.com/science/article/abs/pii/S0301421517308686>; Carolin Reiner et al., Behavioural Insights Team and Transport Research Laboratory, “Driving and accelerating the adoption of electric vehicles in the UK,” July 2020 at [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/914111/driving-and-accelerating-the-adoption-of-electric-vehicles-in-the-uk.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/914111/driving-and-accelerating-the-adoption-of-electric-vehicles-in-the-uk.pdf).

<sup>4</sup> X. He and D. Reiner, “Why Do More British Consumers Not Switch Energy Suppliers? The Role of Individual Attitudes,” Cambridge Working Paper in Economics, 2015, at <https://www.repository.cam.ac.uk/handle/1810/255342>.

<sup>5</sup> Adam John, “Are we sleepwalking into a two-tier energy market?,” *Utility Week*, 14 October 2020, at <https://utilityweek.co.uk/are-we-sleepwalking-into-a-two-tier-energy-market/>.

free home charging point, allowing an electricity credit to be spent at home and at public charging points. In exchange, a customer might have to sign over their domestic energy supply to the car company—at least the portion of it related to the vehicle.

Free supply of public charging point-supplied electricity to electric vehicles (EVs) has been commonplace to encourage more sales. Tesla pioneered this offering by introducing free or discounted use of its Supercharger and Destination networks, however this changed for customers who purchased a Tesla after 15 January 2017 who were then required to pay for the use of Tesla's rapid Supercharger points.<sup>6</sup> Volvo, more recently, went further by offering rebates of charging costs for up to one year with the purchase of a new Volvo plug-in hybrid.<sup>7</sup>

In the UK, Elexon has considered amending the Balancing and Settlement Code to allow customers to consume electricity from multiple suppliers.<sup>8</sup> Whilst it is conceivable that car companies might compete with traditional utilities only on the tranche of electricity supply relating to e-mobility, it seems unlikely. They already are edging toward becoming utilities of the future. Volkswagen has established an energy supply company, Elli, that aims to serve energy needs at home and on the road.<sup>9</sup> Similar offerings from other car companies are in development. Nissan<sup>10</sup> and BMW Energy Services<sup>11</sup> are pursuing the same long-term goal to integrate mobility and energy services. In May 2018, Nissan launched an integrated home energy solution, Nissan Energy Solar, in the UK.<sup>12</sup>

Joint solutions in the energy space are growing – and not only around the growth in e-mobility. For example, Centrica offers smart home solutions that bundle different smart appliances into one package, giving customers higher levels of control over their energy use as well as automatic detections of appliance breakdowns.<sup>13</sup> In 2017, Centrica also acquired Restore, a company specialising in demand response technologies. Another example is the partnership between E.ON and Berkeley Homes in a “Future Energy Home” concept showcasing innovative technology that allows customers to control their

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<sup>6</sup> Tesla Network, at <https://www.zap-map.com/charge-points/public-charging-point-networks/tesla-network/>.

<sup>7</sup> Volvo, at <https://www.volvocars.com/intl/why-volvo/human-innovation/electrification/plug-in-hybrids/electricity-offer>.

<sup>8</sup> Elexon, “Enabling customers to buy power from multiple providers,” Exelon white paper, 16 April 2018, at <https://www.elexon.co.uk/wp-content/uploads/2018/04/ELEXON-White-Paper-Enabling-customers-to-buy-power-from-multiple-providers.pdf>.

<sup>9</sup> Volkswagen, Elli, at <https://www.elli.eco/en/volkswagen>.

<sup>10</sup> Brendan Coyne, “Nissan: 2019 “breakthrough year” for EVs as power plants, eyes energy supply market,” *The Energyst*, 11 December 2018, at <https://theenergyst.com/nissan-2019-breakthrough-year-evs-power-plants-eyes-energy-supply-market/>.

<sup>11</sup> BMW Group, “Swimming with the current: Energy solutions for a stable future,” 7 February 2019, at <https://www.bmwgroup.com/en/company/bmw-group-news/artikel/e-solutions.html>.

<sup>12</sup> Dominik Wilde, “Nissan home energy system launches in UK,” *Motor1.com*, 30 May 2018, at <https://uk.motor1.com/news/243422/nissan-home-energy-uk/>.

<sup>13</sup> Centrica, Home solutions, at <https://www.centrica.com/what-we-do/centrica-consumer/home-solutions/>.

energy use (and power their own homes).<sup>14</sup> These examples highlight the shift from the traditional energy retailer model towards the creation of ecosystems of services whereby consumers have the potential to become partners with utilities.

At a minimum, this raises the prospect that the market will become more complex, making it more difficult for consumers to compare suppliers, products and prices. We know from other markets (such as financial services and telecoms) that competition can soften because of sub-optimal decisions made by consumers who cannot easily compare products.<sup>15,16</sup> To effectively participate, consumers will need to compare and understand the value of multiple components of a product bundle and how each component affects the value of the others.

### **Longer-term commitments—less switching?**

A significant barrier to deployment of decentralised energy and storage technologies is the up-front capital cost.<sup>17</sup> Consumers who are property owners, as opposed to renters,<sup>18</sup> are more likely to be confident about investing in technologies such as solar panels or EV home charging because of their longer-term commitment to the property. The temporary nature of renting brings with it the complication of landlord consent for installations.

One emerging business model provides free equipment in return for an agreed contract for supply and the rights to ancillary revenue streams, such as value created from flexibility services. An example of such a business model is one in which equipment is provided (rented) to consumers either free or at a discount in return for certain benefits being retained by the owner of the equipment, locking consumers into long-term contracts. This model was popular (in particular for solar panels) when feed-in-tariffs (FITs) were available to be traded for free equipment (and therefore generated energy) or through a “rent your roof” model whereby consumers would receive a lump sum in exchange for using the customer’s roof. Though FITs no longer exist, this type of business model might still suit

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<sup>14</sup> E.ON, “Home is where the smart is: E.ON and Berkeley Homes pilot Future Energy Home concept,” news release, 16 August 2018, at <https://www.eonenergy.com/About-eon/media-centre/home-is-where-the-smart-is-eon-and-berkeley-homes-pilot-future-energy-home-concept/>.

<sup>15</sup> ESRC Centre for Competition Policy, “Behavioural Economics in Competition and Consumer Policy,” 2013, at <http://competitionpolicy.ac.uk/documents/8158338/8193541/CCP+economics+book+Final+digital+version++colour.pdf/30214557-cace-4b0b-8aac-a801bbde87bc>.

<sup>16</sup> Patrick Xavier, “Enhancing Competition in telecommunications: protecting and empowering consumers,” Organisation for Economic Cooperation and Development Ministerial Meeting on the Future of the Internet Economy, June 2008, at <http://www.oecd.org/internet/consumer/40679279.pdf>.

<sup>17</sup> Donal Brown, Stephen Hall, Mark E. Davis, “Prosumers in the post subsidy era: an exploration of new prosumer business models in the UK,” *Energy Policy*, vol. 135, December 2019, at <https://doi.org/10.1016/j.enpol.2019.110984>.

<sup>18</sup> Karystas et al, “Factors Affecting Sustainable Market Acceptance of Residential Microgeneration Technologies - A Two Time Period Comparative Analysis,” *Energies*, 2019, p. 12, at <https://www.mdpi.com/1996-1073/12/17/3298>.

less affluent buyers and appeal to suppliers looking to aggregate and monetise the value of flexibility from decentralised energy and storage.

Anything that commits a consumer to a lengthy period runs counter to efforts to increase switching among traditional energy suppliers. In situations where grid energy supply is still independently procured from decentralised production, decentralised energy competes with grid supply, creating an opportunity for consumers to drive a better bargain.

## Sales practices

One of the features of increased competition in the UK retail energy market is the growth of sales through price comparison websites (PCWs). According to a sample survey performed for Ofgem in April 2020, 66% of consumers who switched used a PCW to compare suppliers.<sup>19</sup> In 2018, some 54% of those who had engaged with the energy market found out about deals using a PCW, up from 45% in 2017.<sup>20</sup>

PCWs effectively enable comparison of standardised contracts but are less practical for consumers trying to assess heterogenous bundles of goods. For example, they often do not include smart tariffs, meaning customers that own EVs for example are not able to access the most beneficial tariffs for their situation. In the UK Energy white paper published by BEIS in December 2020, the UK government has committed to consult by spring 2021 on “regulating third parties such as energy brokers and price comparison websites.”<sup>21</sup> They also present a new smart tariff comparison tool being developed by Vital Energi with the support of government funding.<sup>22</sup> The tool will help people find the best smart tariff to meet their needs, based on actual smart meter data for accurate comparisons. In March 2021 the findings of the research project will be made publicly available, enabling this proof of concept to be integrated into the services of suppliers and PCWs.

In the early days of deregulation, many utilities used doorstep salespeople to secure new customers. In 2010, a third of customers who switched did so due to door-to-door sales.<sup>23</sup> Door-to-door sales did allow switchers to save money, but it also led to unscrupulous sales techniques. Initial findings of the Energy Supply Probe of 2008 raised significant concern about deals agreed to on the doorstep, with many customers unaware that they

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<sup>19</sup> Accent Research on behalf of Ofgem and Citizens Advice, “Household Consumer Perceptions of the Energy Market,” Q2 2019, 5 September 2019, at <https://www.ofgem.gov.uk/publications-and-updates/consumer-perceptions-energy-market-q2-2019>.

<sup>20</sup> Bridget Williams and Gemma Waring for Ofgem, “Consumer Engagement in the Energy Market 2018,” 10 October 2018, at [https://www.ofgem.gov.uk/system/files/docs/2018/10/consumer\\_engagement\\_survey\\_2018\\_report\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/10/consumer_engagement_survey_2018_report_0.pdf).

<sup>21</sup> See *supra* note 2 at 36.

<sup>22</sup> See *supra* note 2 at 22.

<sup>23</sup> E. Moore, “British Gas ends door-to-door sales,” *Financial Times*, 2011, at <https://www.ft.com/content/c3456460-c4c7-11e0-9c4d-00144feabdc0>.

had entered into a formal energy contract or unaware of the terms of that contract.<sup>24</sup> Vulnerable consumers were found to be far more likely than others to switch as a result of doorstep selling, with 52% of those aged 65 or over and 51% of those in the lower-income social grades D and E switching as a result of a doorstep call.<sup>25</sup> Related problems affecting pre-payment customers were later found during the energy market investigation.<sup>26</sup> By 2012, all the then—Big Six suppliers had stopped doorstep sales.

However, a number of small energy suppliers are still seeking to win new business through face-to-face sales.<sup>27</sup>

The established framework for renewable energy sales is that good practices for behaviour and information are set out and consumers can complain about the installation and operation of renewable energy assets after the fact.<sup>28</sup>

Some issues that have arisen are directly related to the long-term nature of contracts and complicated terms and conditions.<sup>29</sup> For example, solar panels installed on a leasehold basis can be a liability for homeowners looking to sell, especially when the buyer's lender is unwilling to lend on properties with leasehold panels.

Therefore, the problem is perhaps less about the honesty of the sales approach and more about new energy technology largely demanding a more bespoke sales solution than is possible for the bulk sale of a commodity. First, not all technology performs equally even after accounting for variation due to site-specific issues. Second, each household sale will potentially involve a different configuration with implications for both cost and performance. Third, transactions may involve some kind of financing and long-term commitment, the value of which will vary based on the first and second elements. These factors create a greater need for industry standards of practice and consumer education to help buyers understand the economics of their energy proposition and effectively negotiate.

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<sup>24</sup> FDS International for Ofgem, 2008, Energy Supply Probe – Initial Findings Report, 6 October 2008, at <https://www.ofgem.gov.uk/ofgem-publications/38437/energy-supply-probe-initial-findings-report.pdf>.

<sup>25</sup> FDS International for Ofgem, "Research Report on Vulnerable Consumers' Engagement with the Energy Market," March 2008, at <https://www.ofgem.gov.uk/ofgem-publications/57446/vulnerable-customer-engagement-energy-market-research-report-pdf>.

<sup>26</sup> CMA, 2016, The Energy Market Investigation (Prepayment Charge Restriction) Order 2016 at [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/584888/energy-market-prepayment-charge-restriction-order-2016.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/584888/energy-market-prepayment-charge-restriction-order-2016.pdf).

<sup>27</sup> Octopus Energy, "Not leaving anyone behind," at <https://octopus.energy/blog/in-person-sales/>; see also bulb, "Door to door sales," at <https://help.bulb.co.uk/hc/en-us/articles/360044765612-Door-to-door-sales>; Mark Atherton, "The doorstep energy sellers are back ..." *The Times*, January 18, 2020, at <https://www.thetimes.co.uk/article/the-doorstep-energy-sellers-are-back-cg5khhhh>.

<sup>28</sup> For example, Renewable Energy Consumer Code, October 2014, at <https://www.tradingstandards.uk/media/documents/commercial/codes-of-practice/recc.pdf#page6>.

<sup>29</sup> Suzanna Hinson and Lorraine Conway, "Q&A: solar panels," House of Commons Library, Briefing Paper, Number 8090, 7 February 2020, at <http://researchbriefings.files.parliament.uk/documents/CBP-8090/CBP-8090.pdf>.

## Conclusion

The shift towards a more decentralised energy ecosystem in which consumers are more empowered presents interesting challenges and opportunities for regulators and incumbent energy retailers.

Consumers are no longer limited to uniform products. They may choose from heterogeneous services provided by ecosystems of partnerships between traditional energy retailers and innovative and digitalised business models. Consumers—especially those who are the most engaged in today’s market—will become increasingly independent. The combination of sophisticated consumers with more complex energy systems will challenge regulators.

Switching as a measure of engagement in the energy retail market may become less important and regulators may need to focus on consumer access to bundled solutions, including whether it is equitable.

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