

## **Energy pricing and the future of the energy market**

### **Introduction**

Prospect is the UK's union for energy specialists. We represent 25,000 professional, managerial, and technical staff working across all parts of the energy sector. Our members work in a range of key functions including planning, project management, safety, environmental impact, and network operations.

Access to energy is correctly regarded as an essential component of modern life and work, though little attention is paid to the fact that this is maintained by a diminishing and increasingly stretched workforce.

The lack of a long-term energy strategy has undoubtedly contributed to the current crisis, in retail and more broadly. There is now an opportunity, driven by that crisis, to change approach. Prospect is committed to working with other key stakeholders to create the policy framework that will deliver a resilient, secure, low carbon energy system that is fit for the future.

### **Q The regulatory requirements companies must meet in order to trade as a regulated entity in the retail energy market.**

### **Q The mandate, role and performance of Ofgem in setting regulation and supervising regulated entities.**

The current crisis has thrown a harsh spotlight on Ofgem's repeated failures to adequately regulate the energy retail market. Whilst the current spike in wholesale energy prices is exceptional, the stresses that it has placed on energy retail were entirely predictable and the fact that many suppliers were ill-equipped to face even relatively modest financial stresses has been widely acknowledged for years.<sup>1</sup>

Prospect, along with sister energy unions (GMB, Unison and Unite) have been raising concerns about the sustainability of the retail energy market for several years. For example, we wrote to Ofgem in June 2020 in the context of additional pressures resulting from the Covid pandemic, to express concern about the consequences of newer retail entrants operating at the margins of viability based on unsuitable and unsustainable business models. It has subsequently become clear that reliance on larger, well-established companies to fulfil supplier of last resort requirements has reached its limits.

Even in 2020, we were able to highlight broader implications warning, for instance, that the UK was perilously close to a situation in which a major energy retailer could exit the market. We forecast that: Firstly, this would have wider negative implications for investor confidence. Secondly, we noted that resulting job losses would mainly affect women workers, setting back the sector's need to increase workforce diversity. Thirdly, we expressed concern that this would impede the ability of the UK to reach its climate reduction targets.

Ofgem's reply referred to its detailed financial monitoring of the retail market on a weekly basis to enable it to track such impacts and gather evidence to demonstrate the need for the network charge deferral schemes. At that time, Ofgem considered that this would help minimise the destabilising effect of suppliers exiting the market in disorderly fashion. They undertook to engage proactively with suppliers and shippers who make use of the schemes, seeking evidence of their ability to meet their liabilities.

It is now abundantly clear that these measures were insufficient.

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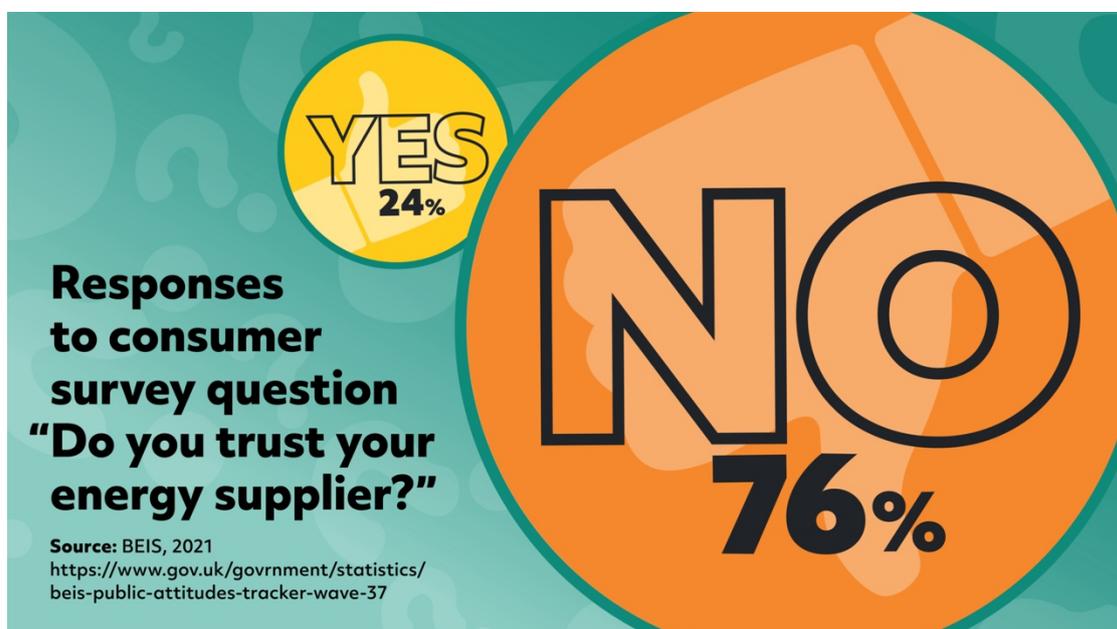
<sup>1</sup> Guardian (2019) 'Small energy companies risk going bust in financial shock' (<https://www.theguardian.com/business/2019/aug/18/small-energy-providers-fears-key-financial-deadline-renewable-subsidies>)

Having said this, it is important to understand that essentially the regulator is enacting policy decisions made by government and enshrined in legislation. The current position fundamentally arises from policy failure.

**Q The performance of previous policies introduced to stimulate effective competition within the retail energy market, and an assessment of the impact on competition of proposed future regulatory frameworks.**

There is nothing inevitable about a retail market for energy. Prior to the 1990s, energy retail was largely in the hands of regional network owners (formerly the Regional Electricity Boards). This system was gradually dismantled and, following the passage of the Utilities Act in 2000, retail operations were separated from network companies and energy retail was opened to full competition.

In response to this unprecedented retail crisis, Ofgem is now scrambling to tighten retail market rules to better protect consumers.<sup>2</sup> But, there is a real sense in which this is too little, too late. Consumer confidence in the energy retail has been dealt a serious blow, with fewer than 1-in-4 consumers now saying they trust their energy supplier.<sup>3</sup> This should be a real source of concern, as high levels of consumer trust and engagement will be critical to meeting Net Zero goals.<sup>4</sup>



Fundamentally, the current crisis has exposed the fact that energy retail is inherently ill-suited to a competitive market framework. As we enter a crucial decade for responding to the climate emergency, it is opportune to ask whether competition over price is really the best way to structure a critical sector like energy, and whether the essential functions that retailers perform as 'gatekeepers' to the energy system are too important to be left in private hands. Above all, we

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<sup>2</sup> Ofgem (2021) 'Statutory consultation on potential short-term interventions to address risks to consumers from market volatility' (<https://www.ofgem.gov.uk/publications/statutory-consultation-potential-short-term-interventions-address-risks-consumers-market-volatility>)

<sup>3</sup> Dept. for Business, Energy & Industrial Strategy (BEIS) (2021), 'Public Attitudes Tracker, Wave 37' (<https://www.gov.uk/government/statistics/beis-public-attitudes-tracker-wave-37>). Note, respondents were asked to say how much they trusted their supplier to deliver on six key obligations (such as providing accurate bills, giving impartial advice etc.); trust scores for each individual obligation were higher than scores for all six obligations together.

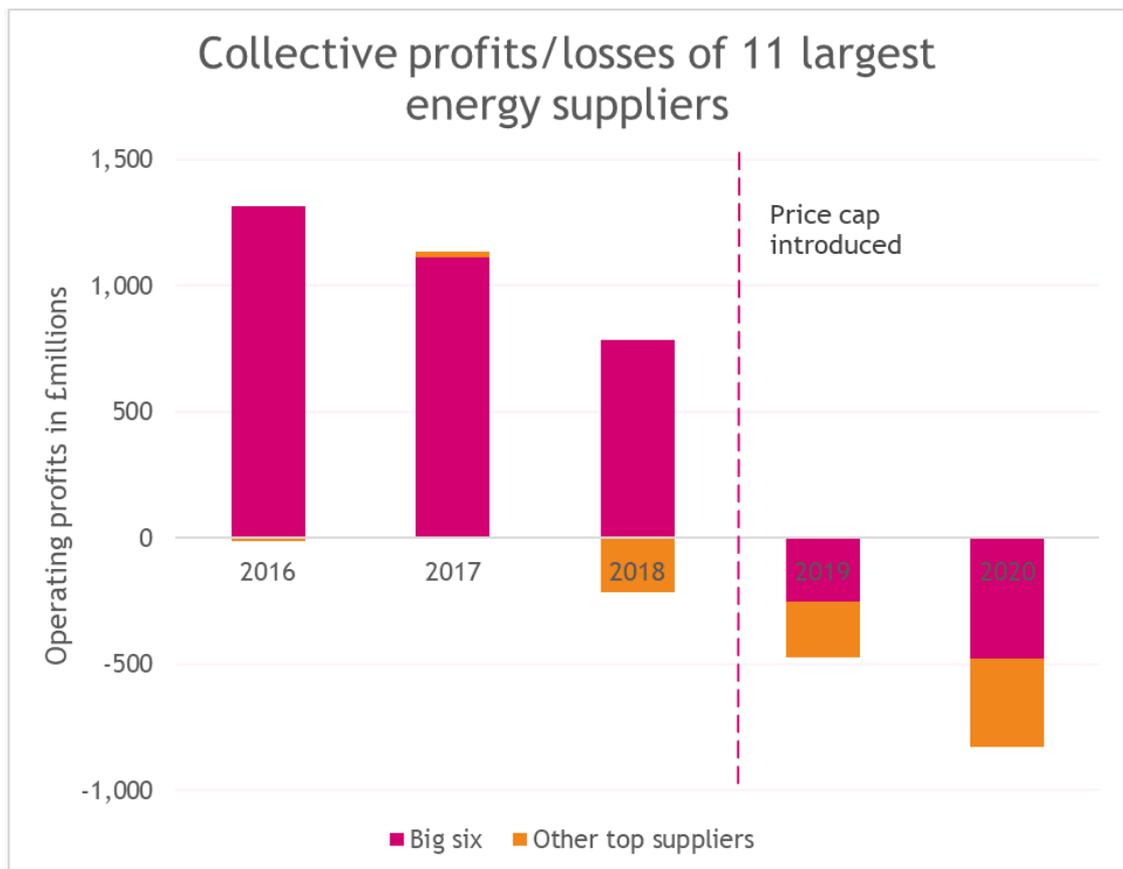
<sup>4</sup> 'Net Zero' refers to the policy goal of achieving no net emissions (after accounting for mitigation methods like carbon capture) of greenhouse gases by 2050.

need to ask whether the current model is salvageable, or whether a very different approach is needed.

Prospect believes it is time to radically rethink our whole approach to energy retail and accept that the idea of a market for energy is largely a fiction. Privatised energy retail has been a policy failure and has led to worse outcomes for consumers and workers, as well as hampering efforts to meet critical Net Zero goals. There is an opportunity now for industry stakeholders to seriously engage with the idea of dismantling the current framework and moving instead to locally organised public ownership. Alongside this, Prospect believes the private market has consistently failed to protect the poorest and most vulnerable from fuel poverty, which is why we are also proposing the introduction of a social tariff for energy.

**Q The functioning and performance of the ‘energy price cap’ and an assessment of its use in the future, and an assessment of the role of auto-switching.**

Following the introduction of the price cap, profits within the retail sector evaporated, and in 2020, the eleven largest suppliers, who collectively control around 90% of the market, had aggregate losses of more than £800 million.<sup>5</sup> This reality, coupled with lax regulation of new suppliers, whose financial resilience was not properly tested by Ofgem, was the catalyst for this year’s market crisis. As prices spiralled in wholesale energy markets, an ill-prepared retail sector has been driven to the point of collapse.

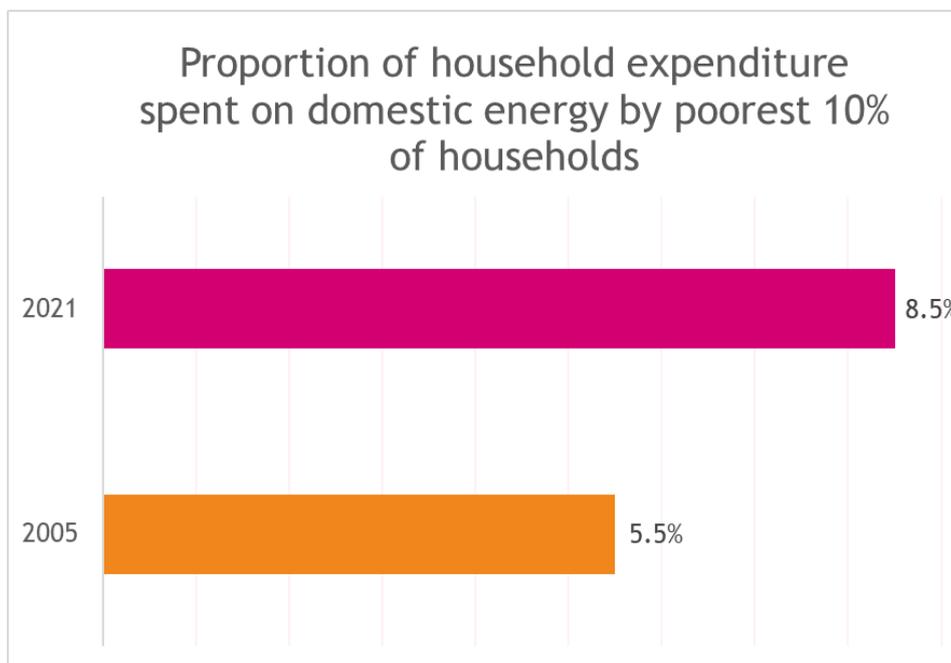


**Q The future of Bulb and the recovery of public funds and the cost to consumers of other energy supplier failures.**

<sup>5</sup> Prospect analysis of Consolidated Segmental Statements (<https://www.ofgem.gov.uk/publications/energy-companies-consolidated-segmental-statements-css>) of Big Six retailers, and financial statements of next five largest suppliers. The eleven companies are EDF, Centrica, Scottish Power, SSE, Npower, E.On, Ovo, Shell, Utilita, Bulb, and Octopus Energy.

The situation continues to deteriorate since the demise of Bulb and further large-scale redundancies in the retail sector appear inevitable.

Since the mid-2000s, the amount of money spent on domestic energy by the poorest 10% of UK households has been steadily rising. In 2005, the poorest households spent an average of 5.5% of their total expenditure on electricity and gas; by the winter of 2021, this had risen to 8.5%. The 2021 figure was down slightly from highs of over 10% a few years earlier, but the Resolution Foundation has forecast that by Spring 2022 energy expenditure by the poorest households will hit 12% of total spending, as fuel bills rise, real wages fall, and welfare benefits are cut.<sup>6</sup>

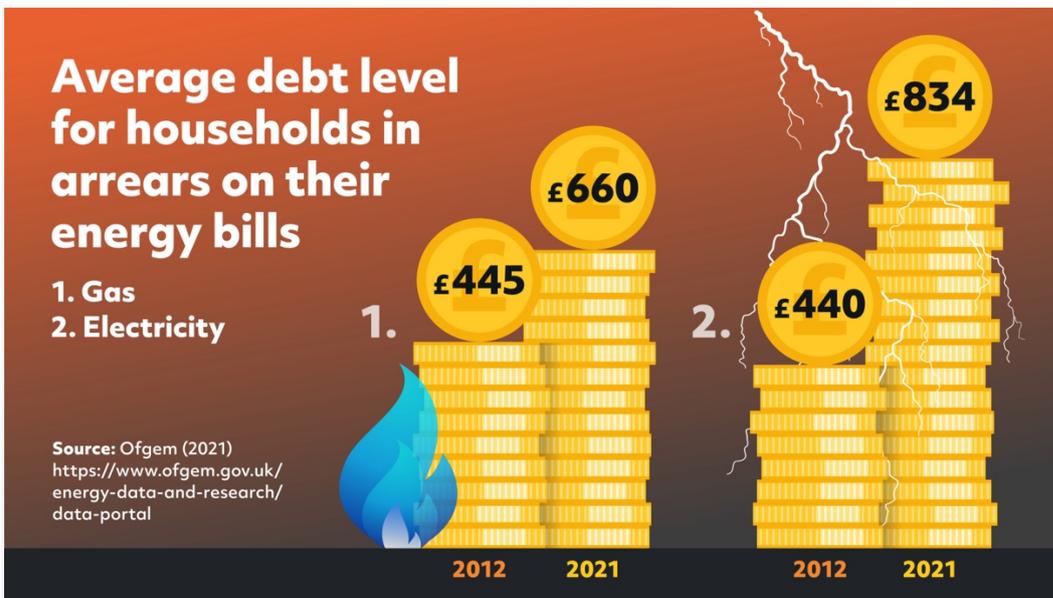


The rising exposure of the poorest households to energy costs is reflected in the failure to make inroads into reducing fuel poverty in the UK. Despite repeated pledges by successive governments to tackle this issue, the proportion of households in fuel poverty has not changed significantly over the past two decades.<sup>7</sup>

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<sup>6</sup> ONS (2021) *Family spending in the UK* (<https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/expenditure/bulletins/familyspendingintheuk/latest>); 2021 & 2022 figures taken from Resolution Foundation analysis (<https://www.resolutionfoundation.org/comment/the-year-of-the-squeeze/>)

<sup>7</sup> BEIS (2021) *Fuel poverty trends 2021* (<https://www.gov.uk/government/statistics/fuel-poverty-trends-2021>). Note, this data is based on the Low Income High Cost (LIHC) measure of fuel poverty developed in 2012; the government has recently adopted a new measure of fuel poverty which shows better progress in reducing fuel poverty since 2010.



### Q The role of retail market reform in the context of the UK's net zero transition and domestic energy security requirements.

Energy retailers have been responsible for delivering key elements of the government's strategy for improving household energy efficiency, reducing fuel poverty, and paving the way to a smarter energy system. In particular, energy retailers have been responsible for key programmes like the Energy Company Obligation (ECO), a retailer-led scheme to improve domestic energy efficiency, as well as the smart meter installation programme.<sup>8</sup>

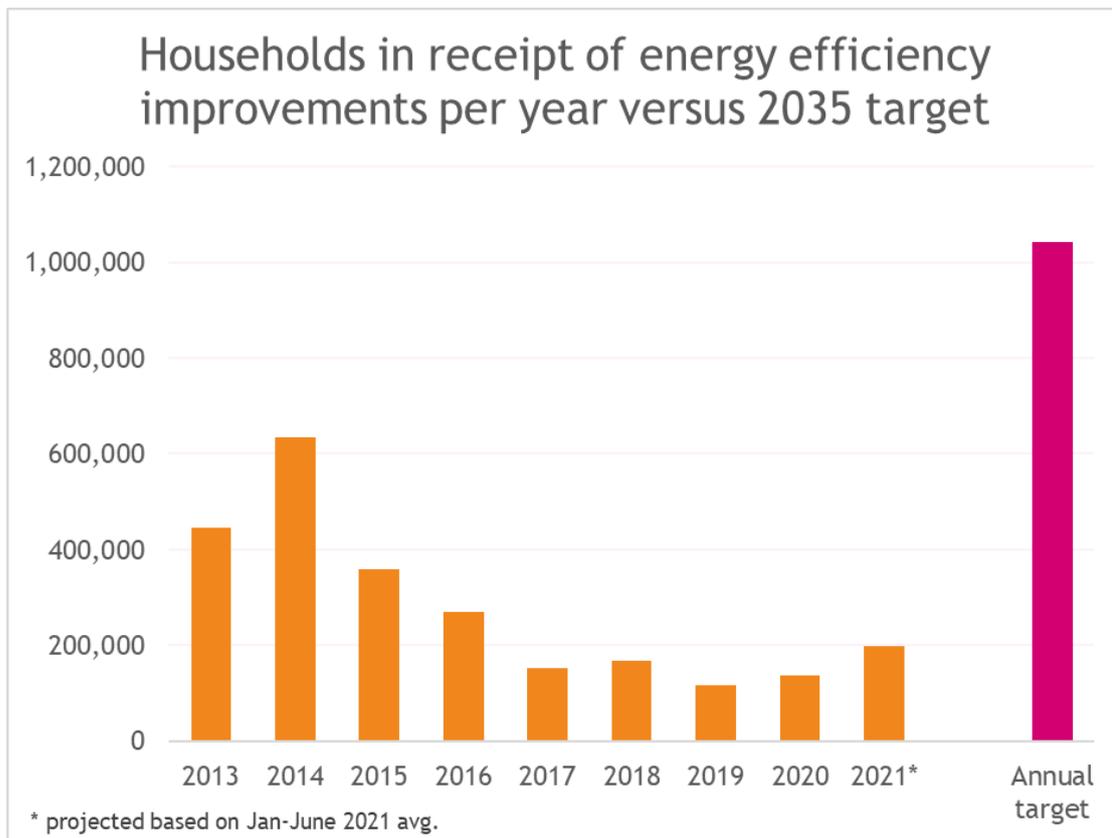
In both cases, the privatised retail model has underperformed and made it harder to progress crucial climate and energy poverty goals. Critical reports by the Select Committee and by the National Audit Office (NAO) have highlighted the shortcomings of the ECO scheme.<sup>9</sup> Since 2013, when the ECO scheme was introduced to replace similar predecessor programmes, costs have risen while installations of new energy efficiency measures have fallen dramatically.<sup>10</sup> At the same time, the funding for ECO, which is recouped via a levy on customer energy bills, effectively acts as a regressive tax which increases bills and hits the poorest households hardest.

It is certainly true that not all the blame for the failings of the ECO scheme can be placed on private energy retailers; successive governments have reduced the scope of the programme, limiting its impact. But the private sector-led design of the ECO programme, currently the only major source of funding for domestic energy efficiency upgrades in England, has led to higher costs, a regressive funding model, and a more disjointed, piecemeal approach to improving energy efficiency and reducing fuel poverty.

<sup>8</sup> Further details on the ECO scheme are available on Ofgem's website (<https://www.ofgem.gov.uk/environmental-and-social-schemes/energy-company-obligation-eco>)

<sup>9</sup> BEIS Select Committee (2019) *Energy Efficiency: Building Towards Net Zero* (<https://publications.parliament.uk/pa/cm201919/cmselect/cmbeis/124/12402.htm>); NAO (2016) *Green Deal & Energy Company Obligation* (<https://www.nao.org.uk/report/green-deal-and-energy-company-obligation/>)

<sup>10</sup> BEIS (2021) Household Energy Efficiency Statistics (<https://www.gov.uk/government/statistics/household-energy-efficiency-statistics-headline-release-october-2021>); Prospect calculation of annual requirement for 2035 target based on proportion of households below EPC C rating (see Annex A, <https://www.theeig.co.uk/media/1026/fe-energy-efficiency-final-clean-250917.pdf>)



There have been similar failings with the smart meter programme. Launched in 2011, the programme was originally intended to ensure every home and business had a smart meter installed by the end of 2019, later extended to 2020.<sup>11</sup> Smart meters are designed to have enhanced functionality versus traditional meters, including by giving consumers real-time information about their energy use and allowing usage data to be transmitted directly to energy retailers.<sup>12</sup> However, a range of technical problems have meant that many installed smart meters lose much of their functionality if consumers switch energy retailers, greatly reducing their utility.

Energy retailers have been responsible for rolling out smart meters, but progress has been far slower than anticipated, and costs have been higher. As of August 2021, less than half of domestic and business electricity and gas meters had been upgraded to smart meters, and of those smart meters that have been installed, almost 1-in-5 have already lost smart functionality. As a result of the poor performance of the programme to date, the government announced last June that the 2020 target date has now been pushed back to mid-2025.

The costs of installing and servicing smart meters are recovered via customer energy bills and, as of 2019, BEIS estimates the total costs of delivering the programme at £13.5 billion, equivalent to £459 per household.<sup>13</sup> It is argued that there will be net benefits to consumers that will outweigh these costs, though around half of all savings will accrue to retailers (for example by reducing their need for call centre staff), and less than a third will be in form of reduced consumer energy use.

Having a large number of different energy retail companies delivering the roll-out has added to the complexity and cost of the programme and has made it harder to monitor progress and delivery standards effectively. As a critical NAO report highlighted, many energy retailers have

<sup>11</sup> NAO (2018) *Rolling Out Smart Meters* (<https://www.nao.org.uk/report/rolling-out-smart-meters/>)

<sup>12</sup> Further information on smart meters is available from the official Smart Energy GB campaign (<https://www.smartenergygb.org/>)

<sup>13</sup> BEIS (2019) *Smart Meter Roll-out: Cost Benefit Analysis* (<https://www.gov.uk/government/publications/smart-meter-roll-out-cost-benefit-analysis-2019>)

failed to provide adequate advice and information to consumers on how to make the best use of smart meters, despite having a duty to do so, significantly reducing the potential benefits of the programme.<sup>14</sup>

The delays and shortcomings of these critical programmes are hampering our efforts to meet crucial Net Zero goals. Whilst the privatised market model is not the sole reason for this, it is a contributing factor, and it is making a more efficient, transparent, and coordinated approach much more difficult.

#### **Q The comparison of UK wholesale prices and additional costs with the wholesale prices and additional costs across Europe.**

#### **Conclusion**

Prospect believes that there is now an opportunity to rethink policy in a way that responds positively to the challenges of climate change and gives greater emphasis to social equity. Two measures that could help address these multiple failings are a move to local public ownership of energy retail, and the introduction of a social tariff for energy.

**Public ownership:** Under a public monopoly structure, local authorities would provide energy retail services to consumers living in their respective geographical areas. This would open energy pricing up to public scrutiny and give consumers greater confidence that their bills were fair, while also providing greater local democratic oversight of retail operations. Examples from related industries lend strength to this argument; Scottish Water, a publicly owned entity, has the highest customer satisfaction scores of any UK utility company.<sup>15</sup>

A local public ownership structure of this type would also place the sector on a more sustainable footing by creating a relatively stable customer base for public retailers, while freeing consumers of the need to keep switching suppliers. Improved financial stability would help arrest any further efforts to erode pay and conditions for energy retail workers and ensure that retail operations are properly staffed. This could potentially lead to greater job creation in the sector, especially given the recent push by many retailers to drive down costs via large-scale redundancies.<sup>16</sup>

At the same time, if local authorities were given responsibility, and the necessary funding, for delivering energy efficiency and smart meter programmes, then they could combine local housing and socioeconomic deprivation data with insights from consumer energy bills to ensure a more efficient, targeted, and consistent approach that would benefit those most in need first.

The exact structure of local public ownership would need to be considered. It is likely that, in England, ownership would be best organised at a regional level with groups of local authorities taking joint ownership, while a single public provider may make sense in each of the devolved nations. This would provide sufficient scale to allow public retailers to achieve pricing power in wholesale energy markets, while fewer, larger entities would also make regulatory oversight easier. Regional public entities making long-term purchases of energy for a relatively stable customer base may also help reduce some of the volatility in wholesale energy markets.

It may still make sense for some retail functions (e.g., energy efficiency and smart meter programmes) to be devolved to a lower administrative level, to allow for greater flexibility and responsiveness to local housing and socioeconomic conditions. Whatever the exact approach looks like, an ownership model predicated on local public ownership would likely be fairer, more transparent, and ultimately more financially resilient.

One potential counterargument to local public ownership is the recent failures of local authority-owned suppliers like Robin Hood Energy (established by Nottingham City Council) and Bristol

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<sup>14</sup> NAO (2018) *Rolling Out Smart Meters* (<https://www.nao.org.uk/report/rolling-out-smart-meters/>)

<sup>15</sup> Institute of Customer Service (2021) *UK Customer Satisfaction Index* (<https://www.instituteofcustomerservice.com/research-insight/ukcsi/>)

<sup>16</sup> See for example Independent (2020) 'E.ON to cut almost 700 jobs in the next two years' (<https://www.independent.co.uk/news/business/eon-job-losses-redundancies-renewable-energy-b1747436.html>)

Energy, both of which collapsed in 2020. But, as this briefing has highlighted, survival in the current privatised market requires suppliers to drive down costs and offer tariffs at a loss to build market share. This makes it extremely challenging for any new entrant to survive for long, especially not-for-profit and public providers, whose access to capital is typically more limited and who are driven by long-term social objectives rather than profit.

A move to local public ownership would result in entities that were fundamentally different from companies like Robin Hood Energy. With market fictions removed, and an end to an unproductive and damaging focus on competition and choice, publicly owned local monopolies could focus instead on meeting community needs, ensuring good standards of employment, and driving forward the Net Zero agenda.

One lesson that would remain pertinent though, even if private markets were dismantled, is the critical importance of good, transparent governance. In the case of Robin Hood Energy, poor governance and a failure by the local council to properly understand the nature of the energy retail market were identified by independent auditors as key factors in the company's collapse.<sup>17</sup> Clearly transparent and effective governance would still be crucial for publicly owned entities, as would guaranteeing the involvement of retail workers in governance structures (for example by ensuring workers had seats on the company board), something which was glaringly absent in the case of Robin Hood Energy.

Ultimately, the collapse of Robin Hood and Bristol Energy shouldn't be seen as examples of why local public ownership can't work. Rather they are evidence for why we need to overhaul the current retail structure and create an environment that allows providers driven by social objectives rather than profit to thrive.

**A social tariff for energy:** The poorest households in the UK are paying too much for energy and are being left dangerously exposed to the volatility in energy prices. As fuel poverty charity National Energy Action has recently highlighted, the sharp rise in energy bills this year risks plunging millions into further debt and will likely force many vulnerable households to reduce their heating use, significantly increasing risks to health and wellbeing.<sup>18</sup> Indeed, recent survey research by Citizens Advice suggests millions of poorer households are already cutting back on their energy use to make ends meet.<sup>19</sup>

In response there have been growing calls for the introduction of a social tariff for energy.<sup>20</sup> This would essentially mean providing a lower energy tariff for the poorest households, the costs of which could be met either by spreading them across other bill payers or via government funding from general taxation.

Some thought would need to be put into the appropriate level to pitch a social tariff. Historically, average expenditure on energy across all households has rarely risen above 5% of all spending, whilst (as highlighted above) spending by the poorest households has consistently been much higher. One option could be to create a social tariff for the poorest households that targets a level of around 5% of average household expenditure. A measure of this kind would likely go a long way to lifting millions of households out of fuel poverty.

The privatised model for energy retail in the UK has been a failure, and the notion of a functioning market for energy has been exposed as a fiction. Reform is needed to protect consumers and

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<sup>17</sup> Grant Thornton (2020) *Report in the Public Interest concerning the Council's governance arrangements for Robin Hood Energy Ltd* (<https://www.nottinghamcity.gov.uk/publicinterestreport>)

<sup>18</sup> National Energy Action (2021) 'Cost of living in the UK soaring up to its highest level in a decade' (<https://www.nea.org.uk/about-us-national-energy-action/media-centre/media/>)

<sup>19</sup> Citizens Advice (2021) 'The government must act now to avoid a cost of living crisis this winter' (<https://wearecitizensadvice.org.uk/the-government-must-act-now-to-avoid-a-cost-of-living-crisis-this-winter-c981842eb09b>)

<sup>20</sup> Guardian (2021) 'Calls for social tariff on UK energy bills as rises push extra half million homes into fuel poverty' (<https://www.theguardian.com/society/2021/jul/31/calls-for-social-tariff-on-uk-energy-bills-as-rises-push-extra-half-million-homes-into-fuel-poverty>)

energy workers, and to help us meet crucial Net Zero goals. Local public ownership and a social tariff for energy, could be the solutions that will help correct decades of policy mistakes.

*January 2022*