

## Written evidence submitted by E.ON (ECO0034)

### Q1. What should be the underlying principles of the UK energy market?

We generally support the principles set out by Government for the energy market in the recent Strategy and Policy Statement for Energy Policy in Great Britain<sup>1</sup>, namely:

- *Unlocking competition, investment, and innovation – empowering consumers by opening up more choice, while enabling suppliers to succeed and usher in new business models that take advantage of new technology.*
- *Helping the energy market become a positive force in achieving net zero – rewarding those who make the switch to low carbon technology, reducing system costs for all, while protecting those who need it.*
- *Protecting the most vulnerable and helping tackle fuel poverty – with targeted support with bills that will help those who need it most.*
- *Ensuring we have the right consumer protection framework for a more dynamic future market, particularly on issues beyond price protections, such as customer service.*

In particular, we believe that the energy transition required to protect our environment and reduce carbon emissions is consistent with the need for Britain to become more self-sufficient in energy supplies and less reliant on increasingly volatile global markets for fossil-based fuels, and that taking action to achieve this outcome will have additional societal benefits, such as reducing the cost of living and improving health outcomes. However, achieving all of these principles concurrently may not be possible all of the time, and policy makers and regulators acknowledge these trade-offs and be clear and transparent in how their decisions will impact them.

We believe that the action to achieve these outcomes in the energy sector require the following priorities:

- A retail system that is aligned with our net zero goals.
- A national programme of demand reduction and energy efficiency.
- A focus on electrification of the energy system.
- A more dynamic energy network that effectively accommodates more renewable and decentralised electricity generation at scale including demand shifting, turn-down and turn-up.

### A Focus on delivery

Most importantly for policymakers, we believe that energy policy must now focus on **delivery**. This will require long-term political commitment to programmes to underpin investor confidence which will help unlock billions of pounds of investment in key energy infrastructure.

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<sup>1</sup> <https://assets.publishing.service.gov.uk/media/65d4b31738fef9001ab5b0ae/draft-strategy-policy-statement-energy.pdf>

If we are to maintain public support for the energy transition, Government and industry need to deliver outcomes that work for people – that means making sure energy is affordable as well as secure and low carbon, ensuring no one is left behind.

The next Parliament also needs to factor in the limited amount of time we have to decarbonise the power system in particular. Radical reforms that could take many years to implement could slow down delivery compared to other evolutionary options which can deliver similar outcomes but can be brought in at pace.

## **Q2. Can Government deliver radical reform in the UK energy market?**

As stated in our response to Q1, we believe that energy policy must now focus on **delivery**. In the wholesale market for example, many of the ingredients required to fulfil the objectives of the REMA project are already in place and are helping to bring forward new investment. Improving on the current framework as opposed to scrapping it and moving to a completely new set of arrangements is not only our clear preference but given the timelines involved, is more likely to be a successful strategy for delivery. Where reform is needed is in the time taken to secure planning consent for energy infrastructure. This, along with the speed at which grid connections can be secured, are two areas where arguably more radical types of reform may be required.

The market must also foster innovation. The energy system today still largely resembles what was in place at the time of privatisation. The role of smart meters, half hourly settlement, and new technologies in the home will have the potential to allow customers to play a much greater role in the energy system. However, policymakers and industry must recognise that customers will respond differently to the development of new products and services, and some will be far more engaged than others. The current ‘one-size-fits-all’ approach of policy and regulation, such as the price cap, has the potential to constrain these opportunities. This is an area which the next Government should examine and decide on how radical it wants to be. Whilst we believe there is a role for long-term price protection for vulnerable customers, we believe there are other options that can deliver better outcomes for the majority of customers.

## **Q3. Is the Review of Electricity Market Arrangements (REMA) likely to deliver the necessary changes to the energy sector?**

REMA is a long-term and broadly scoped project with the aim of establishing an enduring market arrangement to enable the transition to, and operation of, our future renewables-dominated electricity system. Given the targets set for decarbonising the power system, this is the single practical opportunity to make the reforms deemed appropriate to deliver this objective.

As a retail energy supplier in the UK, E.ON uses the wholesale market to source the best commodity prices for customers, and increasingly to develop new ways to provide flexibility to the system by using our customers’ ability to flex demand and supply locally. Sources of flexibility like this are important to delivering net zero at the lowest overall cost, and could play an important role in reducing the amount of new grid and other energy infrastructure required in future, helping to mitigate the negative impacts of current planning and grid queue problems.

In recent years, power market liquidity has been poor. This is causing wholesale prices to be higher for customers that would be the case in a more liquid market. Any reforms to the wholesale market

must ensure that liquidity is improved through the forward price curve. Two solutions we have put forward to Government are:

- i. The tendering of a market maker (as is common in other traded markets) to help ensure that retailers are able to access the products required to best support their customers; and
- ii. Reform of the CfD mechanism so that generators are better incentivised to place a proportion of their generation in forward markets such that more trading can take place away from the spot / day-ahead market, helping to hedge costs over the longer-term for customers.

The Government has recently published the second REMA consultation. We welcome the narrowing down of some of the options being considered, and in particular, agree with the decision to take the radical option of nodal pricing off the table.

There remain a number of similarly radical reform options being considered, such as zonal pricing, central dispatch and shorter settlement periods of just 5 minutes. These options will all require long periods of consultation and implementation, such that delivery of new arrangements could take more than 5 years to take effect. In our view, new arrangements must be settled and delivered in the next Parliament. Waiting longer than that will result in an investment hiatus and this is time that we simply do not have.

There are policy options that will have similar outcomes to some of the more radical options with much shorter implementations times to deliver, and these should be considered a priority for implementation as soon as possible.

In particular, we believe REMA can deliver better outcomes for customers by continuing to investigate major enhancements to the current national wholesale market. This evolutionary approach would provide the best balance of risks and rewards for customers and all market participants, ensuring that wherever you lived, the wholesale market price paid by the customer is the same. Some of the solutions put forward to improve the national approach such as local constraint markets can also provide opportunities for local communities to help provide cost effective flexible solutions to the system operator. .

#### **Q4. What are the major benefits that the UK should be seeking to deliver from energy market reform?**

It is important for Britain to now move to a phase of **delivering** the energy transition. However, our current energy markets were not designed to tackle the problems inherent in a decarbonised energy system where the vast majority of production is coming from wind and solar. Reforms to the market which help drive this investment, can be delivered at pace, and keep the cost of the transition as low as possible should be developed.

Reforming the electricity market is the key first step to decarbonising the entire economy. Through the ongoing electrification of transport, space heating and where possible industrial processes, a considerable proportion of the economy can be brought within the Net Zero umbrella. The ESO in their 2023 Future Energy Scenarios have suggested that by 2050 the electricity demand of the UK could be double what we have today.

Delivering a renewables dominated system where low-cost wind and solar provide the bulk of electricity generation is a significantly different system to what we have been historically used to where generation has been able to flex to meet customer demand.

REMA has identified four key challenges that must be addressed:

1. Passing through the value of a renewables-based system to consumers
2. Investing to create a renewables-based system at pace
3. Transitioning away from an unabated gas-based system to a flexible, resilient, decarbonised electricity system
4. Operating and optimising a renewables-based system, cost-effectively

By ensuring that the low cost of renewable electricity generation is passed through to customers as quickly as possible, the UK can be more confident of being shielded from the vagaries of international fossil fuel prices. The threat of a repeat of the energy crisis of 2022-23 will have been reduced significantly, protecting customers from unavoidably high energy bills.

The UK's aspiration of 50GWs of offshore wind<sup>2</sup> by 2030 alongside 70GW of solar<sup>3</sup> by 2035 will form the backbone of a decarbonised electricity system, will mean build rates significantly higher than we have seen historically. The UK needs to create an investment environment that can deliver this, bringing with it the clear benefits of tens of thousands of green jobs (220,000 as estimated by the British Energy Security Strategy). However, the condensed timescales involved mean that radical reforms to wholesale markets (zonal, central dispatch, shorter settlement periods) are not conducive to the pace of investment needed, especially given that they are likely to take at least 5 years to implement. Taking a revolutionary route through REMA will only serve to delay (and seriously dent) the benefits that it is trying to deliver.

Whilst building the new generation and network infrastructure needed for the future, the UK must also ensure that our existing system can continue to deliver the security of supply demanded by customers. Market reform will be needed to not only ensure that the new system has sufficient flexibility to cope with periods of low and high renewable generation, but that existing sources of flexibility are incentivised to stay on the system until they can be replaced by low carbon alternatives.

One area of flexibility that E.ON is very keen to support is flexible demand where customers (domestic and industrial) are paid to adapt their consumption to support the system as a whole. We believe that customers who are more engaged with the electricity system and who have the capability to deliver the benefits of using energy more flexibly within their homes and businesses will help us deliver a decarbonised electricity system cheaper and quicker for everyone. But at the same time, we also need to accept that many customers will not have the time to consume energy more flexibly than today without some degree of automation.

Reforms that are coming in the way the industry is set up will also have ramifications for the retail market. With the Market Wide Half Hourly Settlement (MWHHS) project completing in 2026, we do not believe the price cap in its current form will be sustainable. The time is therefore right to ask which customers should be protected in the future, what they should be protected from, and how

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<sup>2</sup> [Energy UK explains: Allocation Round 6 and the UK's energy security goals - Energy UK \(energy-uk.org.uk\)](https://energy-uk.org.uk/news/energy-uk-explains-allocation-round-6-and-the-uk-s-energy-security-goals)

<sup>3</sup> [Where the UK's solar revolution stands \(openaccessgovernment.org\)](https://openaccessgovernment.org/where-the-uk-s-solar-revolution-stands/)

best to achieve that protection. We have looked at this question firstly through the lens of which customer groups require price protection.

Last winter, we introduced our own winter support package<sup>4</sup> targeted at low-income households and those with a health condition on a low income. This has helped inform our view that these customers should have stronger enduring protection arrangements regardless of who they are supplied by. But for the rest of the market, we believe there should be a debate over whether there are more effective forms of price regulation which can drive much greater innovation in the market and new business models that better meet the needs to customers such as the ability to access net zero technology for the home with zero up-front cost via 'Energy-as-a-Service'<sup>5</sup>.

Options that should be evaluated include:

- i. Excluding customers from price protection where they have already engaged and adopted new low carbon solutions in the home;
- ii. Only regulating for a very basic energy service, and
- iii. Having an enduring Ban on Acquisition Only tariffs.

We would support the next Government consulting on a replacement to the current market wide tariff cap. This should be launched in early 2025 with implementation ready by the time the MWHHS project has been completed in Q4 2026.

**Q5. What are the chief barriers to reform of the energy market and is the Government serious about addressing those?**

One of the biggest challenges facing policy makers has been how to shape the market in a way which encourages many more households to cut their energy demand. We know that the cheapest form of energy is the one that you don't need.

We also know from experience what policies have helped drive investment in the energy market. Unsurprisingly, where we have long-term political commitment and consistency in the policy framework, industry has been able to crowd-in tens of billions of pounds of investment into the UK. The Renewables Obligation (RO) and subsequently the Contract for Difference (CfD) are good examples of this, and the economic benefits that come with stable, long-term policy-making.

In sharp contrast, we have seen challenges in delivering successful energy efficiency schemes. There are a number of reasons for this including the following:

- Programmes have been too short-term in nature preventing the supply chain being able to invest in additional capacity and skills.
- Delays and U-turns on key policies which undermine the business case for further investment and innovation; e.g. abandoning plans to tighten the Private Rented Sector Minimum Energy Efficiency Standards from EPC E to EPC C, the phase- out date for oil fired boilers, etc.

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<sup>4</sup> [E.ON Next Winter Affordability Support Scheme. \(eonnext.com\)](https://www.eonnext.com/next-winter-affordability-support-scheme)

<sup>5</sup> ['Pay-monthly' project pilots sustainable home \(eonenergy.com\)](https://www.eonenergy.com/pay-monthly-project-pilots-sustainable-home)

- Energy efficiency schemes which compete with one another on the one hand, whilst on the other fail to offer opportunities for the vast majority of the market in the ability to pay market to access. For example, the Energy Company Obligation (ECO), Great British Insulation Scheme (GBIS) and Local Authority Delivery (LAD) have all targeted the same type of customers.
- There has been a lack of clear independent advice and information that is fit for purpose and trusted by the public.
- Complexity of the schemes which have been poorly designed have added unnecessary costs for installers and customers. We are seeing this today around the cost of customer assurance for GBIS which can sometimes be as much as the insulation measure being installed.

Government needs to reflect on the challenges seen in successive energy efficiency schemes and create a long-term programme under a single umbrella scheme which provides something for everyone, depending on your requirements. For vulnerable customers, they should continue to receive fully funded measures. But for other customers, the size of any financial support should be linked to their income, and for those with the broadest shoulders, access to long-term, low-cost green finance needs to be available. All of this needs to be linked to the future role of the retail market. Innovation via things like Energy-as-a-Service could help unlock investment by making the upgrade of homes affordable for the mass market. It would work by enabling the upfront costs to be financed over many years.

Policymakers must also ensure the tax system is aligned with net zero to enhance the business case for these propositions. For example, being able to pay for green investments in the home via a salary sacrifice scheme or through a stamp duty rebate for renovations that take place within the first two years of moving into a new home would provide strong carrots and a call to arms for households.

#### **Q6. Is it possible to ensure that consumers are insulated from market failures in the energy sector?**

OBR's analysis<sup>6</sup> of the 2024 Spring budget included scenario planning for a gas price shock similar to that recently experienced caused by Putin's further aggression in Ukraine or via other political instability across the globe. In this scenario, quarterly inflation spikes back up to over 7%. OBR estimate that this could raise borrowing by **£23.1 billion** on average over the five-year forecast and leave **underlying debt 0.8% higher** as a share of GDP by 2028-29.

The best way to insulate households and businesses from future energy price shocks is to deliver the key energy policy priorities set out above to shift Britain away from an overdependency on gas:

- Demand reduction through energy efficiency;
- Electrification of heating and transport, and
- The ability to flexibly shift demand.

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<sup>6</sup> OBR, March 2024

The market failures caused by poorly judged energy policy and regulation during the energy supplier crisis of 2021-22, ahead of the Ukraine crisis, have been well investigated by numerous authorities, including the BEIS Select Committee<sup>7</sup>, National Audit Office<sup>8</sup>, and Oxera's report for Ofgem<sup>9</sup>. We strongly support these findings and Ofgem's subsequent action to ensure energy retailers have the expertise and financial resilience to operate effectively. Whilst Ofgem's new rules are a significant step in the right direction, they do largely rely on Ofgem's own discretion in a number of areas. It is important that Ofgem acts robustly and consistently where suppliers do not meet requirements.

It should also be noted that, whilst the mechanisms for market failure in the energy retail market, namely the *Supplier of Last Resort* and *Supplier Administration scheme* for larger failures, do well in protecting the customers of a supplier that fails (i.e. customers should see no disruption to their energy supply). They do not necessarily do as well in protecting other customers in the energy market.

Precisely because customers are protected to ensure they suffer no disruption in their supply if their supplier fails, a significant check and balance of competitive markets has been removed from the decisions those customer make as to where they decide to place their money and trust in taking services from new providers. In other markets, customers may have a different view of the risks associated with placing their trust in a supplier with no track record in a market. This lack of a vital check and balance in the way normal competitive markets function put further pressure on Ofgem as the regulator to ensure that new entrants into the supply market have sufficient expertise and financial resilience to operate sustainably.

*April 2024*

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<sup>7</sup> [Energy pricing and the future of the Energy Market - Committees - UK Parliament](#)

<sup>8</sup> [The energy supplier market - National Audit Office \(NAO\) report](#)

<sup>9</sup> [Ofgem publishes report into its regulation of the energy market | Ofgem](#)