Written evidence submitted by Centrica (EPM0024)

Business, Energy and Industrial Strategy Committee: Inquiry into Energy pricing and the future of the Energy Market

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Centrica plc
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Executive Summary

Centrica welcomes the Committee's decision to hold an inquiry into energy pricing and the future of the energy market. We believe it provides a real opportunity for timely and constructive dialogue across Government, Parliament, consumers, and energy suppliers to identify and resolve some of the critical challenges facing the energy market.

Recent events have clearly demonstrated the urgent need for changes in the UK's energy supply market and its regulation. Since 2017, 50 suppliers have failed – including more than 28 suppliers in the last six months alone – in a crisis we estimate could end up costing consumers more than £3.5 billion. A new approach is required to ensure we develop a market that is resilient enough to protect current and future customers, while providing a solid basis on which suppliers can invest and innovate to deliver key policy objectives like net zero. We hope the comments and observations we make below help to prompt a dialogue that will lead to enduring solutions, so we do not see a recurrence of recent events.

In our submission, we have set out our responses to the issues highlighted in the terms of reference of the inquiry's call to evidence.

- Many of the energy supplier failures in recent months might have been avoided if a robust framework for financial resilience had been in place. The current system makes it too easy for people to walk away when their business fails, leaving consumers to cover the cost of their losses.
- There is no current evidence to suggest recent increases in wholesale gas prices are a temporary phenomenon and we support Government's intervention to help consumers cope with significant increases in energy bills. We have proposed reducing VAT on energy bills, moving green and social levies into general taxation, as the way they are currently collected via energy bills is regressive. We also believe that targeted support for those who need help most with their energy bills would be more impactful, which could, for example, include an increase to the scope and amount of the Warm Home Discount.
- In addition, consumers should be protected from the significant cost of putting Bulb into a special administration regime – which currently stands at around £2 billion – by recovering the costs from general taxation over the longer term.
- As we have seen recently, energy supply and security are subject to geopolitical influence and the consequences if things go wrong are significant. It therefore requires a robust regulatory framework similar to those seen in equivalent sectors, such as banking.
- Ofgem and the Government must oversee a fundamental and far-reaching overhaul of the regulatory system for the energy supply market. We support the introduction of prudential-style regulation, including making senior executives more accountable for failures; proper monitoring of risk management, including hedging against future price rises; mandatory capital adequacy requirements for suppliers; and maintenance of sufficient liquid capital to refund all customers' credit balances on demand.
- The core policy objective of the energy supply retail market should be to protect current and future consumers, including the reduction of greenhouse gas emissions. This objective can be delivered by building a resilient market made up of well-capitalised suppliers; encouraging vigorous and responsible competition between suppliers; developing a stable and predictable regulatory and policy framework that will encourage investment; and ensuring help is targeted at those most in need.
- We support the concept of using price regulation to help protect consumers but believe the current price cap needs to be reformed to create a new model of price regulation that is

more capable of adapting to changing circumstances, promoting sustainable competition, building consumer confidence, and encouraging the future investment necessary for the net zero transition.

- It is important that any action undertaken by Government and Ofgem to reform the retail energy market and resolve the energy price crisis does not impact the move to net zero. Net zero can only be achieved by joint working across industry, the regulator and policy makers.
- If we are to achieve net zero by 2050 the UK needs a strong energy market where suppliers are financially resilient, there is adequate infrastructure and a robust supply chain to meet net zero, and customers have transparency about what the journey to net zero will mean for them.
- Net zero brings significant opportunities for growth and jobs in the energy sector. Centrica has committed to hire 3,500 apprentices by 2030 and we are already upskilling our engineers for the green transition, so they have the skills to install heat pumps and Electric Vehicle charging points.

Questions

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

- The energy regulator, Ofgem, sets out the requirements companies must meet in order to be granted a licence to run an energy supply company. Whilst this includes things like operating in a financially responsible manner and ensuring only fit and proper persons are appointed to positions of significant managerial responsibility, there are no ongoing requirement for these conditions to be met, and no sanctions or personal liability for those people in charge when things go wrong.
- These regulatory gaps have meant that, until recently, it was possible in the UK to set-up as an energy supplier with limited capital, and should that business fail, walk away with the cost of failure (including customers' credit balances lodged with that company) being met by consumers. This aspect of the market – where the cost of failure is mutualised - creates moral hazard, meaning that when a supplier fails, it is the solvent bystanders who make good the losses.
- As the current system allows for costs of failed suppliers to be spread across all consumers, it is vital that we introduce reforms that make the likelihood of these costs materialising remote.
- Since 2017, there have been 50 supplier exits and, in the second half of 2021 alone, customers of 28 suppliers have been assigned to Suppliers of Last Resort, while Bulb has entered Special Administration. We estimate the total cost to consumers of supplier failures over this period will be in excess of £3.5 billion. Approximately £340 million of this was customer's credit balances. Failure to properly regulate the energy sector will simply see a repeat of this pattern in future price fluctuation situations.
- As we have set out in detail in response to question 2, we believe it is essential to protect consumers from the cost of future supplier failures by introducing prudential-style regulation in the energy retail market, similar to that brought in for the banking sector following the financial crisis.

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

Mandate and performance

- As the energy sector regulator, Ofgem is responsible for protecting consumers, implementing regulation and supervising the activities of energy suppliers. Government is responsible for setting the policy framework.
- The current situation has occurred, in a large part, as a result of an insufficiently robust regulatory framework, which has allowed a number of suppliers to operate unsustainable and reckless business models; these suppliers were unsurprisingly and quickly vulnerable to a large increase in wholesale energy prices.
- In our views, there was a lack of sufficient examination by Ofgem into the practices and management of suppliers, including the extent to which they were hedging and, therefore, their ability to meet their customer commitments. There were also insufficient sanctions in place to create a deterrent for non-compliance or incorrect use of customer funds. For example, smaller suppliers have not incurred fines for missing smart metering targets, yet recent failures have shown their smart meter penetration was far below others in the market, and customer credit balances lost to insolvent suppliers was approximately £340 million.
- In addition, we are concerned that Ofgem does not have the resources required to perform the level of supervision required of the sector. By way of example, the Prudential Regulation Authority (PRA), who regulate the financial services industry have an annual budget of £296.6 million compared to Ofgem, who had an annual expenditure of £121.1 million in 2020/21.

Proposed changes

- Centrica would advocate a fundamental overhaul of the current regulatory regime for the retail energy sector. We believe the objective should be to deliver a fit for purpose prudential-style regulatory framework that promotes market stability, incentivises prudent risk management by suppliers and minimises socialisation of the costs of supplier failure. This already exists in the financial services sector and can easily be replicated. This will help customers have the confidence that they need in an energy market that is fair and reliable for them.
- We believe this can be achieved through the adoption of the following four measures by Government and Ofgem, which should be implemented as soon as possible:
    - **Fit and Proper Person Testing.** An authorisation regime that creates sufficient accountability for the most senior executives through personal liability for failures to manage systemic failures and/or consumer harm;
    - **Proper Monitoring of Risk Management (including hedging).** The provision of additional resources to the sectoral regulator to support enhanced supervisory and enforcement capability.
    - **Capital Adequacy.** Mandatory capital adequacy requirements for all suppliers to ensure suppliers have appropriate capital to make good customer commitments, which take into account both market and weather stress testing, discounted only where suppliers are effectively hedged; and
    - **Ability to refund Customer Credit Balances.** Maintenance of sufficient capital to refund all customer deposits on demand. Customer deposits are in effect short term

prepayments for energy and should be repayable on demand, not used to fund day to day operations.

- Ofgem's recently announced 'Action Plan' in this space is welcome. However, we believe there is an opportunity for Ofgem to approach its regulatory reforms in a more holistic way and move more quickly in order to preserve the integrity of the market.
- We also urge Government to provide the regulator with the necessary resources and powers to ensure that a new supervisory regime will be fit for purpose and that appropriate sanctions are in place.
- We are also disappointed in Ofgem's ongoing failure to ensure credit balances are used for their purpose and can be refunded on demand, particularly given they first consulted on the Supplier Licensing Review, including protections for credit balances, in November 2018. As we argued then, allowing energy suppliers to use customer credit balances to fund day to day activities is unacceptable. Suppliers do this in the knowledge that, if they fail, the cost will be spread across all consumers. It should be a matter of considerable concern that around £500 million pounds of credit balances have already arguably been misappropriated in recent supplier failures. We believe this offers a clear solution which can be rapidly implemented.

3. 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.

- Recent years have been characterised by frequent policy interventions in the energy supply market. The focus of energy market policy has been to push suppliers and consumers to focus on price above all, and on levels of customer switching as the best measure of both competition and a well-functioning market. This has not taken into account the viability and health of the supplier and has arguably encouraged suppliers not to hedge their commitments to customers, which in a large part has led to the current situation.
- In the recent crisis we have seen that those suppliers that frequently set prices near the bottom of the market have been far more likely to fail than those that have not. The form of competition promoted by previous policy has been damaging to consumers when the costs of supplier failure borne by consumers are fully appreciated. Our objective should be to create a policy framework that promotes stable and sustainable competition for all energy consumers.
- The most recent Government intervention of this type was a proposal to introduce opt-in and opt-out collective switching, whereby energy customers would be automatically switched to energy companies offering the lowest prices. This policy incentivises more irresponsible commercial practices, including not hedging commitments to customers in the event they would be switched away, and would encourage entrants to offer unsustainably low prices to gain market share. This would in turn, lead to yet more suppler failures and additional costs to consumers. We are therefore pleased Government have decided to pause this piece of work. We believe that the Government should go further and remove the collective switching policy entirely; it is only ever going to undermine the interests of consumers by perpetuating the "switching and price above all else" market model that has already been shown as unsustainable.
- Previous policies have also made new energy suppliers exempt from paying policy obligations, such as Warm Home Discount (WHD) payments and the Energy Company Obligation (ECO), which has distorted competition.
- In addition, there has been no sanction for companies who failed to meet these obligations. This is despite the clear correlation between non-compliance and subsequent energy

company failure. In this context, we believe changes to renewables obligations payments, which were first considered by Government in the summer of 2021 should be implemented without delay, requiring all suppliers to make payments at least quarterly and preferably monthly (removing the current cliff-edge created by annual payments). BEIS should require suppliers to keep up with Energy Company Obligation (ECO) delivery either by:
    - (a) notifying Ofgem of sufficient measures each quarter that is commensurate with the pro-rata delivery rate, or
    - (b) setting aside funds commensurate with the pro-rata delivery rate or through the provision of a performance bond from a reputable financial institution.
- The other significant intervention has been the energy price cap. Retail price regulation is playing an important role protecting consumers and should be retained to provide certainty to consumers at a time of volatility. However, the current price cap structure is clearly one which requires reform. The price cap is currently causing heavy losses for suppliers and price spikes for customers when a new level is set.
- Going forwards, the energy price cap will need to be redesigned to resolve these issues. Our views on possible short term and longer-term changes to the cap are set out below in our answer to question 4.

<u>A future regulatory framework for energy</u>

- It is clearer than ever that a structural shift in energy policy is required, through the introduction of a new stable and predictable policy framework. Only with this will be able to encourage the investment and innovation needed to meet net zero. It will only be achieved by joint working across industry, the regulator and policy makers.
- We suggest that the overarching policy objective for the retail market should be the protection of current and future consumers, which includes the reduction of greenhouse gas emissions. Underneath that overarching objective, we would suggest the following characteristics of the market that will best protect current and future consumers:
    - A resilient market, where suppliers are well-capitalised and able to withstand the kinds of wholesale price shocks that occurred at the end of 2021.
    - A competitive market in which suppliers with sustainable business models compete vigorously and responsibly and can recover their efficient costs.
    - A market underpinned by a stable and predictable regulatory and policy framework that gives suppliers the confidence to invest in technology, customer service and other innovations that will be crucial to meet customer needs and deliver net zero at lowest cost.
    - A market that targets help at those most in need.

4. **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.**

<u>Price cap</u>

- Retail price regulation is playing an important role protecting consumers and should be retained to provide certainty to consumers at a time of volatility. However, the current price cap structure is clearly one which requires reform. The UK energy retail sector is collectively loss making and has been since the introduction of the price cap - for the past three years, sector margins have been negative on average. Average pre-tax domestic supply margins were -1.48% in 2019 and -1.02% in 2020. This was a warning sign of a market that was potentially unsustainable.

- There are two core issues with the price cap as it is currently structured. Firstly, the price cap acts as a backstop and protection for consumers - while we support this policy aim, when the policy is then to socialise the costs of failed suppliers across other customers, we need to do more to minimise the chance of failures occurring. This is why we advocate for the protection of customer credit balances and a prudential-style regulatory system. Secondly, the current design fails to provide appropriate incentives and certainty for suppliers to manage risk – by way of example suppliers are currently unsure how to hedge for customers on the cap when prices could fall dramatically and leave suppliers exposed to significant costs. An improved price cap design should look to avoid this issue, which in turn leads to sharp increases in prices for consumers, which reduces trust in the sector.
- We believe the energy price cap will need to be redesigned so that it is more capable of adapting to changing circumstances, promoting sustainable competition and the future investment necessary for the net zero transition. In the short term, it may be necessary to make amendments to the current price cap to try and remove the most immediate issues, which are resulting in heavy supplier losses and Ofgem are currently consulting on these options. Longer term, we believe a new model of price regulation should be designed to deliver a fairer market for consumers, which recognises the need for participants to recover efficiently incurred costs and make an appropriate return on capital invested. Without this we are concerned that we will not have a market that is fit for the future.
- While it is important that price cap reform better ensures that prices reflect underlying costs, this it is not a panacea on its own. When underlying costs are high – as they are now – those costs will ultimately be reflected in consumer prices, so affordability challenges remain and will need to be addressed through other well designed policies targeting help where it is most needed.
- As discussed above, the price cap as it is currently structured makes it difficult for suppliers to manage risk, particularly around hedging. As the cap is set for 8 months ahead of fixed term contracts that are bought in the spot market, there is misalignment between wholesale costs in the cap and between wholesale costs in the competitive fixed tariff market. The impact of this is that suppliers are exposed when wholesale prices rise, and when they fall, and these risks cannot both be managed at the same time.
- Ofgem is currently consulting on options to address this in the short term. One of these options, which we believe has significant potential, is a 12-month fixed term fixed price cap where each customer would pay no more than a set amount for a given consumption. There would be a cap on the pence per day standing charge, and a cap on the pence per kWh unit rate and there would be a new cap level for each customer after 12 months. The 12-month fixed term fixed price cap would enable suppliers to buy energy in advance and give them certainty over the volumes they need, whilst still providing consumers with certainty and peace of mind over their energy bills.
- Ofgem's consultation considers what reforms can be made to the cap by 1 October 2022 and under current legislation. Any longer-term reform will need to consider a wide range of options and will also need to take into account the conditions for meeting net zero including time of use tariffs. Possible longer-term options which Government and Ofgem may consider include a relative price cap, a capped price for certain consumers i.e. those who are most vulnerable, and a fixed term cap as illustrated above. There are likely pros and cons with all these approaches which Government and Ofgem will need to consider these carefully.

- Whichever option is chosen, it must be well thought through and cognisant of all of the risks in the market to ensure that we never see the current situation repeated as it is costly and distressing to consumers.

Auto Switching

- In 2021 Government consulted on regulation in the Third Party Intermediary (TPI) market, such as Price Comparison Websites (PCWs).
- In our response to this consultation, we highlighted that whilst consumers have benefited from the huge growth in TPIs over the past decade, leading to many of them being more informed about price, it would seem sensible to review the interaction between markets in which prices are regulated to protect consumers and the unregulated intermediaries who extract material sums from these markets (and ultimately consumers) without recourse when the products they sell fail.
- We would support improved regulation of such TPIs in a similar manner to the regulation of financial intermediaries to align accountability with advice. Financial intermediaries promoting products and services from companies which are clearly very high risk without adequate warnings is hopefully a thing of the past – this should also be the case for other markets such as energy retail. Specifically, any regulatory changes should ensure that these third parties operate in a way that does not undermine market stability or promote flawed business models.
- We believe auto-switching services should be included in improved regulation of TPIs and we believe these services have accelerated the failure of some suppliers. Within the recent wave of supplier failures, four failed suppliers had 40% or more of their customers on such schemes. There are currently no requirements for market-driven collecting switching services to ensure that the chosen supplier is financially secure or able to provide adequate levels of customer service. Without these protections in place customers risk being moved to a supplier that will subsequently fail.

5. The future of Bulb and the recovery of public funds and the cost to consumers of other energy supplier failure

- Since 2017, there have been 50 supplier exits and in the second half of 2021 alone, customers of 25 suppliers have being assigned to Suppliers of Last Resort, while Bulb has entered Special Administration. We estimate the total cost of supplier failures over this period, to be borne by consumers, will be in excess of £3.5bn, which ultimately consumers will pay for.
- When Ofgem placed Bulb into a special administration regime in November 2021, it was the seventh largest energy supplier in the UK with over 1.5 million domestic customers. Whilst the Supplier of Last Resort regime has generally been appropriate for most of the recent supplier failures, it was decided by Ofgem that no one company could feasibly onboard 1.5 million new customers, due to the costs involved in administration and the costs of purchasing energy for the Bulb customers.
- Running energy companies in Special Administration is incredibly costly and requires HM Treasury and ultimately the taxpayer to step in and pay the full costs of running an energy supply company. This includes, but is not limited to, fulfilling wages and hedging and trading costs.

- To shield consumers from the significant costs of the Bulb special administration, we believe it would be most appropriate to recover the costs via general taxation over the long term. This method will ensure that those who are least well-off shoulder less of the burden of these costs and will help to mitigate what will already be an incredible difficult winter for some households.
- Given the costs of the Special Administration regime, we believe this emergency measure should only stay in place for as long as necessary.

6. **<u>The role of retail market reform in the context of the UKs net zero transition and domestic energy security requirements.</u>**

- Our priority is to protect consumers and support them through this turbulent time. However, the market needs fundamental reforms to ensure this situation never arises again and that the retail energy market is sustainable, secure and is capable of delivering net zero.

<u>Net zero</u>

- Delivering net zero and reducing carbon emissions is an essential objective of competition in energy retail markets. In the context of net zero and energy retail, electricity supply is of special importance: not only must today's electricity demand be decarbonised, huge amounts of additional demand from electrification of transport and heat must also be delivered from carbon-free sources.
- For the energy retail market to make a maximum contribution to net zero, consumers will need to use – and even supply - electricity in a way that minimises greenhouse gas emissions and minimises the need for grid reinforcement at the same time as adopting new low carbon fuels, such as hydrogen. Such changes would include: (a) shifting consumption – e.g. to periods of high wind; (b) reducing or eliminating consumption – e.g. energy efficiency; and (c) on-site/in-home production and use of storage – e.g. solar and batteries.
- We believe there are three key conditions that need to be met when balancing reform of the energy market with the need to meet net zero:

- **Firstly, energy companies must be financially resilient**. As we have outlined in question 3, the retail market needs a fundamental overhaul with the objective of delivering a prudential-style regulatory framework that promotes market stability.
  - We also need to ensure energy companies are able to make an acceptable return on their capital so they have the incentive to invest in products and services that will support the transition to net zero and the financial strength to do so. We support continued price regulation, but the price cap will need to be redesigned so that it is more capable of adapting to changing circumstances and promoting future investment necessary for the net zero transition.

- **Secondly, we need to ensure key strategic enablers are in place, such as the roll-out of smart meters and half hourly electricity settlement** and that suppliers are properly funded to meet these obligations through sufficient allowances in the price cap and that policy incentivises the take up of strategically important technology.
  - Currently, customers are not incentivised to shift their consumption to periods where electricity is relatively abundant, because they are not exposed to the real economic costs of supply and demand e.g. electricity costs less when the wind is

    blowing or is more expensive at peak times. With half hourly settlement, customers will be much more exposed to these economic signals and will change the way they consume energy in response.
  - The combination of smart meters and half hourly settlement means suppliers will be able to offer time of use tariffs that encourage shifting energy usage, which is vital if our electricity system is to cope with the increased demand from electrification.
  - Nearly 50% of all meters are now smart meters, but those that are left are likely to be the most difficult to install – there remains significant apathy towards smart meters and we believe now may be the right time to introduce policy measures, to increase their uptake. This could include mandating landlords to accept meters as a condition on tenancy or eventually moving to an opt-in policy.
  - The Government's successful switchover from analogue to digital TV signals may offer some insight into how to do this.

- **Finally, as we continue the transition to net zero, we need to ensure the policies are in place to encourage consumers to move to low carbon energy sources** and that producers and manufacturers are encouraged to develop low carbon technologies and drive down costs.
  - **Green tariffs -** the industry needs to promote transparency around green tariffs, our consumer research and interactions with consumers suggests that the majority do not understand what a tariff being labelled green means in practice which can damage trust in the system.
    - The fuel mix disclosure encourages the purchase of green certificates, which play little part in increasing the amount of renewable energy on the grid and leads to a lack of trust in the system. In order to deliver net zero, we need to build trust with consumers, and we can only do that if we are honest with them about what makes up their energy bills.
    - A centrally managed tiering of green tariffs would help customers understand which tariffs are the 'greenest'. This should be based on how that tariff allows customers to contribute to decarbonisation and net zero – not whether it's through certificates or buying from renewable generators.
    - In order to deliver net zero, we need to build trust with consumers, and we can only do that if we are honest with them about what energy sources make up the energy they consume. We support Government's ongoing consultation into green tariffs and in particular any measures to increase transparency for consumers.
  - **Paying for net zero** – we need to support consumers with the costs of net zero, particularly those who are most in need.
    - The transition to net zero will ultimately come down to people being active and willing participants and if people are worried about the costs involved, they will not actively engage in making greener choices. In order to support consumers with decarbonising their energy, we need to be upfront and transparent about the costs involved, both existing costs and future costs, and have an informed debated about how and by who these costs are best paid for.
    - Policy costs are a critical part of the debate about the affordability of net zero – not least because of the impact on the running costs of different heat

systems. Currently, around 23% of electricity bills are made up of environmental and social levies and 2% of gas bills.

    - Energy bills are a regressive way of paying for net zero as everyone pays the same, whether they are on high incomes or in fuel poverty. We believe the Committee should use this opportunity to look carefully at whether bills are the best mechanism for collecting green and social levies, particularly given their upwards trajectory over the coming years.
    - An alternative proposal suggested by some suppliers and which Government is actively considering, is shifting policy costs from electricity bills to gas bills to incentivise the take up of electric sources of heating e.g. heat pumps. With the vast majority of households (approx. 85%) connected to the gas grid, not every household will be able to transition to an electricity-based solution and this policy would therefore penalise those people who cannot afford to make these changes. It is important that we avoid more market distortions which could have unintended consequences, and which would impact more on lower income households. Solutions which propose full electrification favour the well-off and we must not have a two-tier energy transition.
    - Linked to the above, we would also be interested in a debate in further compensating some customers for any increases in costs due to the drive to achieve net zero. The Warm Home Discount, as a good proxy for low income, high energy cost households, could be used as a mechanism to do this, or a more progressive option would be a direct payment via DWP or another Government body. Either of these solutions would help ensure that all consumers benefit from competition, and protect the most vulnerable, but without undermining the competition that incentivises low prices, good service, and innovation.
- **A policy framework that incentivises investment in low carbon products and infrastructure**
    - Heat accounts for approximately 40% of energy consumption. We agree with Government and some others in the industry, that there will not be a single technological solution in transitioning to low-carbon heat and instead a mixture of technologies will be needed. Where these technologies will be deployed will depend on the local infrastructure available, the housing stock of local areas, the costs of these technologies and the level of disruption involved.
    - We will need millions of heat pumps, both air and ground source to be deployed along with millions of hydrogen boilers. Both are essential for decarbonised heat in buildings, with hydrogen likely to prove less expensive and less disruptive for lower income consumers in the longer term.
    - In addition, it is widely acknowledged that if we are to reduce emissions from homes, then the energy efficiency policy landscape must be vastly improved. Installation of energy efficiency measures reduces energy demand, leading to a reduction of residential emissions and is critical in preparing the building stock for the transition to low-carbon heating technologies.
    - We welcome Government's Home Upgrade Grant, which provide grants of £5000 for the installation of heat pumps for low-income households.

However, if we are to support consumers with the transition to net zero and low carbon technologies, which are substantially more expensive than traditional gas boilers to both install and run, Government need to encourage consumers via a long-term commitment to supplementary grant funding as a stimulus and help for those who simply cannot afford to pay.

- We also need to ensure there is a long-term energy efficiency framework for both the fuel poor and the able-to-pay market as both markets will be crucial for the successful roll-out and adoption of low carbon heating technologies.
- Currently the Energy Company Obligation targets support at those in fuel poverty. However, going forwards, the transition to net zero will only be possible if all households reduce their emissions, not least because heat pumps require significant amounts of insulation to work effectively.
- Centrica has started the journey to decarbonise our customers' homes and we are already installing heat pumps and investing in hydrogen technology. The combination of a detailed roadmap for the transition to lower carbon technologies and the policy leavers needed to drive consumer demand will help to increase investment in these technologies, which in turn will drive the creation of green jobs across the sector – for our part, we have committed to hire 3,500 green apprentices by 2030 and we have already started upskilling our engineers for the green transition so they can install heat pumps and EV charge points.
- A hydrogen economy is an essential part of the transition to net zero and Government policy will need to provide the incentives required for investment in the infrastructure required, including hydrogen storage. As an example, a regulatory support mechanism model providing for regulated returns could unlock the investment needed to repurpose Centrica's Rough asset.
- Rough's size and unique geological features mean it is ideally suited for hydrogen storage and investment in its future will mean we can upskill employees in the oil and gas sector to give them long term careers in our net zero energy system.
- Repurposing Rough could support up to 2,000 green skilled jobs in the North-East during construction and 350 direct jobs during operations, plus an estimated 1,900 more indirect and induced supply chain roles, which would help to level up the local areas.

<u>Security of supply</u>

- Energy security is a vital part of a healthy and robust energy market and the greatest resilience is achieved through diversity of supply. The UK has a strong track record in this respect.
- There has been much commentary in recent months about the UK's energy storage and in particular, the closure of Centrica's Rough storage facility.
- By way of background, the decision was made to close Rough after maintenance issues were identified and at the time it was not economically viable to make the repairs needed.

- The Government and Ofgem were consulted before the closure of the Rough storage facility, and at the time there were little concerns over security of supply due to the UK's diverse energy supply.[1]
- The UK generally has less gas storage than European countries. Whilst additional storage would have been unlikely to reduce materially the overall level of gas prices we've seen in recent weeks and months globally, it would increase the market's confidence that the UK has some resilience to periods of high demand and is therefore likely to be helpful in reducing stressed prices in the UK.
- We believe it would be prudent for the UK to invest in additional gas storage as an additional buffer to help make the supply chain more robust and reduce the impact of further price volatility. The flexible nature of Rough means it could be used as methane gas storage to help ease some volatility in prices as the UK transitions to low carbon fuels such as hydrogen.
- In the longer term, as highlighted above, Centrica is hoping to repurpose the Rough field to a hydrogen storage facility, which is vital for a transition to a hydrogen-based economy.

7. The comparison of UK wholesale prices and additional costs with the wholesale prices and additional costs across Europe.

- Over the last 12 months wholesale gas prices have increased by over 300%. A number of worldwide factors have contributed to the rise in energy costs, including the Covid pandemic, Europe's cold winter, an unforeseen demand for liquefied natural gas from states such as Brazil and China, and the low renewable generation during the summer across Europe, which had to be replaced by power generated by CCGTs.
- As one of the Europe's largest importers of gas, with over 85% of UK homes reliant on gas central heating and gas required to generate a third of our electricity, the UK has naturally been impacted. We currently produce around 50% of our gas domestically, we import 30% from Norway, and the remaining 20% from Qatar, USA, Russia, and Europe.
- Around 5% of the UK's gas is imported from Russia, this compares to the EU which collectively imports over 20% of its gas supply from Russia. The current geo-political tensions between the EU and Russia impacting the Nord Stream 2 pipeline are well documented and create increased volatility in wholesale markets.
- Recent market developments are unlikely to be a temporary phenomenon. The world's major economies are being driven to move away from hydrocarbon production abruptly and accordingly some of the constraints on natural gas supplies may increase in the near term; when combined with economies switching from coal and oil fired power generation to gas fired generation to substantially reduce carbon emissions on the journey to net zero it is not hard to see the reduction in supply and the increase in demand is likely to create future price volatility events, with adverse consequences for consumers.
- We fully support Government intervention. It is clear consumers need support in the short term to cope with the significant energy price increases. We believe it is necessary that these actions can happen quicky, are fairly easy to implement and unwind and do not risk creating longer term market instability or unintended consequences.

[1] Rough gas - Final decision (publishing.service.gov.uk)

- We have proposed a combination of reducing VAT on energy bills, moving green and social levies to general taxation and increasing the scope and amount of the Warm Home discount – these interventions would provide vital support for consumers and fast, but without storing up potential problems further down the line.

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