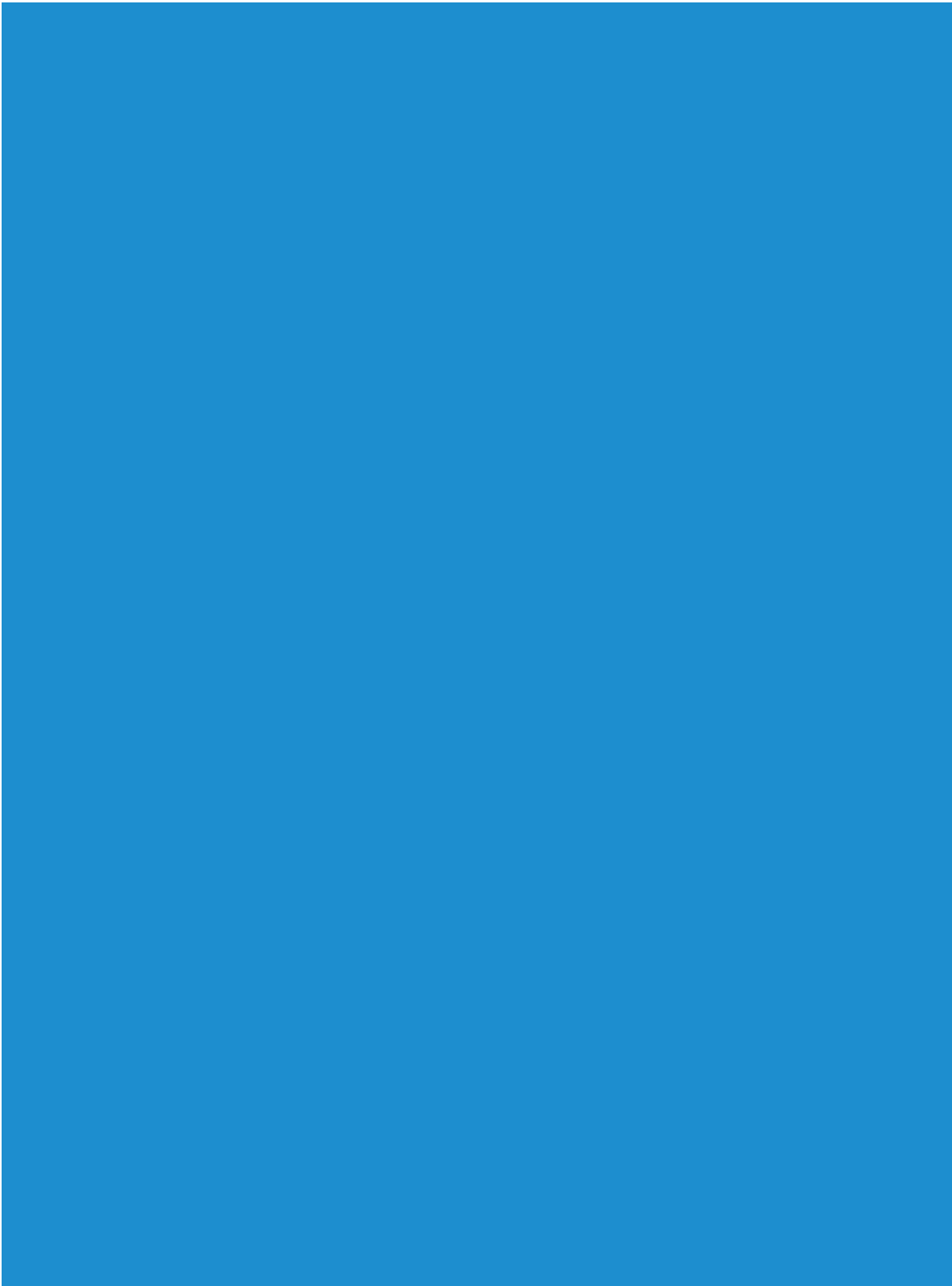


Powering Britain:  
One Nation Labour's  
plans to reset the  
energy market



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## Foreword



**One Nation Labour is determined to tackle the cost of living crisis. Millions of families right across our country are seeing their wages rising more slowly than prices. Millions of businesses are struggling to succeed, with their costs going up and the odds stacked against them.**

Energy that is affordable is essential for all of these families and businesses. The energy market, above all markets, must work for all. But Britain's energy market is broken.

When the gas and electricity businesses were privatised in the 1980s, the Conservative government promised a competitive market that would deliver a better deal for consumers, competitive prices and sustained investment. Over 25 years later, it is acutely clear that privatisation has failed to deliver on this promise. Gas and electricity prices are uncompetitive. Bills are rising year on year. The market has failed to unlock the investment the country needs. Public trust and consent has been lost.

A One Nation Labour Government will reset this market to ensure we deliver on the original promise of privatisation. We will create a genuinely competitive market that works for Britain's families and Britain's businesses. And government will take greater responsibility for enabling the investment that will guarantee our energy for generations to come.

Britain deserves better than a government that stands up for a privileged few and an economy that doesn't work for millions of working people. That's why this plan is part of One Nation Labour's plan to build a different type of economy. One where the British people feel the country is run for them, in their interest and for their future.

*Ed Miliband* *Rachel Reeves*

## Executive Summary

Heating our homes, turning on the lights, cooking our food, all these are essential to people's day to day lives. The gas and electricity that make these things possible are essential goods that people have no choice but to consume. It is therefore critical that we have an energy market that is fair and works in the interest of ordinary people. This means a market that delivers fair value for consumers and confidence for investors. But the energy market is not functioning properly. Consumers are paying more than they would do in a truly competitive market and investment in the low carbon energy we need has stalled. Some suggest that a trade off exists between a market that works for consumers and one which delivers the investment Britain requires. The opposite is the case. This is a market that has lost the trust of consumers and the confidence of investors. Resetting it will be a priority for a One Nation Labour government in 2015.

Household energy bills have increased by over £300 a year since 2010 whilst a typical small business has seen their energy bills rise by more than £13,000. Rising bills are a symptom of a poorly functioning market that has allowed consumers to be overcharged. Lack of competition in the retail market has resulted in consumers paying £3.6m more than they need to each year.<sup>1</sup> Lack of transparency in the wholesale market has led to a growing gap between retail prices and wholesale costs. Since 2011, wholesale costs have risen by an average of 1 per cent a year according to one supplier but retail prices across the industry have spiked by 10.4 per cent a year.

At the same time, the market has failed to deliver the low carbon investment and back up capacity we need for the future. Large scale clean energy investment has fallen from £7.2 billion in 2009 to under £3 billion in 2012 – and is heading below £1.9 billion in 2013. Lack of policy certainty from the Coalition has hampered the acceleration in investment that we need. And so too has the lack of trust in the market. In a world where the private sector requires the public to share the risks associated with many forms of energy investment it is all the more important that the energy market that they experience as consumers is one they trust.

David Cameron has failed to take decisive action to tackle these problems. But a One Nation Labour Government will act to create a fairer energy market that works for ordinary people and delivers investment for the future. We intend to take 10 key actions to reset the market:

1. End operational vertical integration by ring-fencing supply and generation businesses
2. Improve competition and transparency in the wholesale electricity market through an open pool
3. Increase transparency in the wholesale gas and electricity markets by formalising uncleared over the counter (OTC) trading
4. Simplify tariffs so consumers can compare prices and engage with the market
5. Abolish Ofgem and create a tough new energy watchdog
6. Deliver value for money on policy costs that impact on bills
7. Take forward the system of contracts for difference to encourage investment

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<sup>1</sup> Which?, Analysis on Household Overpayment, 2013. <http://www.thesun.co.uk/sol/homepage/news/politics/5153649/Ed-Milibands-on-the-wampath-in-vow-to-curb-power-bills.html>

8. Set a 2030 power sector decarbonisation target to boost investor confidence
9. Create an Energy Security Board to plan for and deliver on our energy needs
10. Give the Green Investment Bank the power to leverage new investment

These reforms will create a fairer more competitive market. Putting them in place will be a priority for the next Labour government. But whilst our reforms are being legislated for and implemented, we will prevent further overcharging by freezing energy prices until January 2017.

Finally, action from a One Nation Labour Government to reset the market must be matched by action from everyone to reduce the energy we use so that we can keep bills affordable in the future.

## I. A BROKEN ENERGY MARKET – THE CASE FOR CHANGE

The energy market is not working for consumers or investors

1.1 Heating our homes, turning on the lights, cooking our food, all these are essential to people's day to day lives. The gas and electricity that make these things possible are essential goods that people have no choice but to consume. It is therefore critical that we have an energy market that is fair and works in the interest of ordinary people. This means a market that delivers fair value for consumers and confidence for investors. But the energy market is not functioning properly. Consumers are paying more than they would do in a truly competitive market and investment in low carbon energy has stalled. The energy market, in turn, has lost the trust of consumers and the confidence of investors.

### Lack of Fairness for Consumers

Since 2010, household energy bills have gone up by over £300 a year whilst small businesses are paying over £13,000 a year more

1.2 Household bills have increased by over £300 since 2010, whilst a typical small business has seen their energy bills rise by over £13,000. Retail prices should be set by a competitive market. But lack of competition and transparency has resulted in consumers' being over-charged.

**Table 1 Average Annual Dual Fuel Bill for Different Users (£) in cash prices**

Year	Typical Household	Small Business User	Medium Business User
2010	1,076	63,063	391,629
2011	1,172	66,214	443,237
2012	1,279	72,774	513,181
2013E	1,394	76,676	572,090
Rise	£318	£13,613	£180,461

Source: DECC, Quarterly Energy Prices, various years. 2013 figure for household is a House of Commons Library estimate based on announced price rises of 9 per cent in 2013. 2013 figure for businesses is based on prices for first half of the year.

Lack of competition in the retail market has resulted in consumers paying £3.6 billion more than they need to

1.3 The retail market in the UK is dominated by six companies, all of whom were originally regional monopoly suppliers. Together these companies supply 98 per cent of the domestic market and 82 per cent of the smaller business market.<sup>2</sup> Much of this market share is based on the old regional monopolies. The fact that no new entrant has managed to challenge this dominance suggest that there are significant barriers for new comers that inhibits competition.

<sup>2</sup> Ofgem, Retail Market Review: Updated Proposals, 2012; Retail market Review: Updated Proposals for Businesses, 2012.

**Table 2. Market share of the largest supplier in August 2010 in each of the former electricity regions (electricity only).<sup>3</sup>**

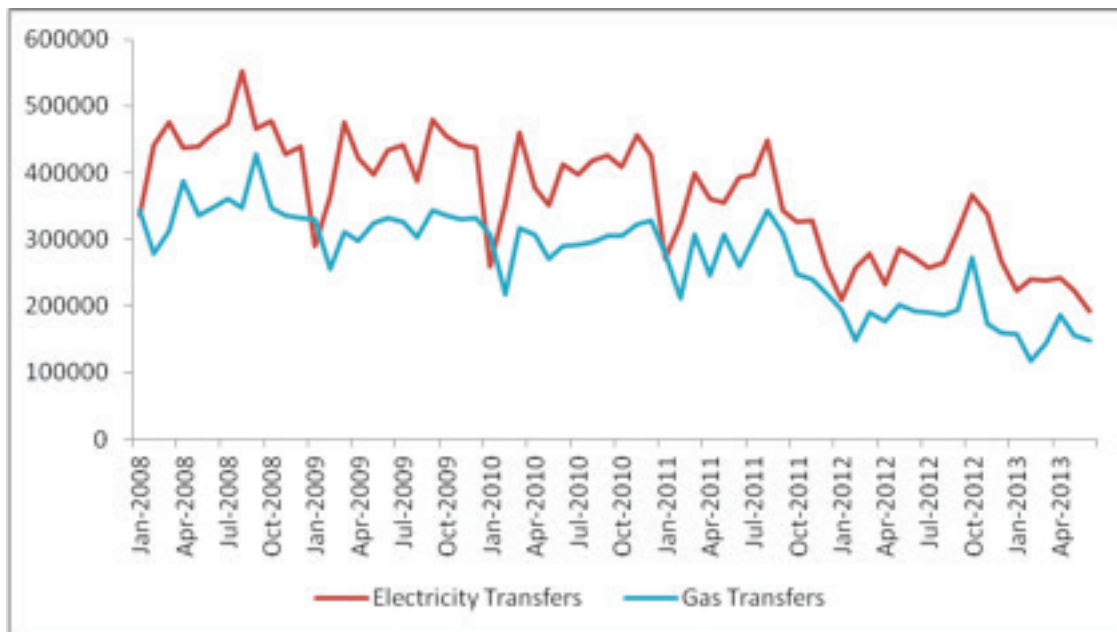
Region	Largest supplier	Former regional electricity board	Market share
Eastern	E.ON	Formerly Eastern Electricity Board acquired by Powergen and now part of E.ON	68%
East Midlands	E.ON	Formerly East Midlands Electricity Board acquired by Powergen and now part of E.ON	69%
London	EDF	Formerly London Electricity Board acquired by EDF	74%
North wales	Scottish Power	Formerly Merseyside and North Wales Electricity Board acquired by Scottish Power	73%
West Midlands	Npower	Formerly Midlands Electricity Board acquired by RWE Npower	65%
North East	Npower	Formerly North Eastern Electricity Board acquired by RWE Npower	64%
North West	E.ON	Formerly North Western Electricity Board acquired by E.ON	67%
Northern Scotland	SSE	Formerly North of Scotland Hydro Board which became Scottish and Southern with SSE's purchase of Southern Electric	85%
Southern Scotland	Scottish Power	South of Scotland Electricity Board became Scottish Power PLC	82%
South East	EDF	Formerly South Eastern Electricity Board acquired by EDF.	73%
Southern	SSE	Formerly Southern Electric Board acquired by SSE.	80%
South Wales	SSE	Formerly South Wales Electricity Board acquired by SSE.	82%
South Wales	EDF	Formerly South Western Electricity Board acquired by EDF.	71%
Yorkshire	Npower	Formerly Yorkshire Electricity Board acquired by Npower.	65%

<sup>3</sup> Source: HC Deb, 10 September 2012, c62W <http://www.publications.parliament.uk/pa/cm201213/cmhansrd/cm120910/text/120910w0002.htm#12091037001701>



1.4 Moreover, a confusing system of 900 tariffs <sup>4</sup> makes it hard for consumers to actively engage in this market. Since 2008, the number of people switching energy supplier has fallen by over 50 per cent, and switching levels are now at the lowest level on record. <sup>5</sup> Low levels of switching means that the big energy companies have a 'captured market' which reduces the incentives to keep prices competitive.

**Figure 1 Number of customers switching from one energy supplier to another.<sup>6</sup>**



1.5 The consumer group Which? found that 75 per cent of customers are on the most expensive tariffs offered by suppliers – their standard tariff - and are not getting the cheapest deal in the market. <sup>7</sup> They estimate that since 2011, families across the country have paid £3.6 billion a year more than they need to as a result. <sup>8</sup> That means that households are on average paying £136 each year because the retail market is not working in the way that a competitive market should. If this market was genuinely competitive, energy companies would face stronger incentives to drive their costs down and pass savings to consumers through lower prices and cheaper tariffs; but this is not happening.

<sup>4</sup> According to Ofgem at the end of August 2012 there were 900 'live' tariffs in the market including from small suppliers. Ofgem, The Retail Market Review – Updated Domestic Proposals, October 2012.

<sup>5</sup> <http://www.consumerfutures.org.uk/news/consumer-futures-energy-complaints-league-table-shows-a-marked-increase-in-customer-complaints-for-the-big-six>.

<sup>6</sup> Source: Table 2.7.1 Transfer statistics(1)(2) in the domestic gas and electricity markets in Great Britain <https://www.gov.uk/government/statistical-data-sets/quarterly-domestic-energy-switching-statistics>.

<sup>7</sup> Which?, Analysis on Household Overpayment, 2013. <http://www.thesun.co.uk/sol/homepage/news/politics/5153649/Ed-Milibands-on-the-wampath-in-vow-to-curb-power-bills.html>

<sup>8</sup> Ibid.

1.6 The Government committed to legislate to require energy companies to put all their customers on the lowest tariff. However, the Energy Bill requires energy companies to simplify and reduce the number of tariffs on offer and to provide more information on their deals. And it only gives the Secretary of State the power to require a supplier to change a customer's tariff when a customer is on a 'closed tariff'.<sup>9</sup> As a result, only people who are on dead tariffs which are more expensive than the standard evergreen tariff will actually be moved to a cheaper tariff. Based on figures provided by the big energy companies this is estimate to affect less than 10 per cent of people.<sup>10</sup>

#### Lack of transparency in a poorly functioning wholesale market has kept the prices consumers pay for energy artificially high

1.7 Wholesale costs are the largest component of the energy bill. Therefore, the way the wholesale market works has a significant impact on the prices consumers pay for their electricity and heat. Ofgem's most recent assessment was that the wholesale market, particularly for electricity, 'inhibits competition and imposes costs on consumers.'<sup>11</sup> Poor liquidity, the prevalence of bilateral over open market trades, and the lack of transparency on pricing have resulted in a poorly functioning wholesale market.

1.8 In the absence of a well-functioning wholesale market which gives correct price signals we cannot tell whether the prices being passed on to consumers are fair. In a proper competitive market you would expect to see cost reductions passed on as quickly and as fully as cost increases. However, there is evidence that when wholesale costs drop, consumers do not see the full benefits of this through reductions in bills.<sup>12</sup> In recent years, fluctuations in wholesale prices have been used to keep retail prices artificially high.

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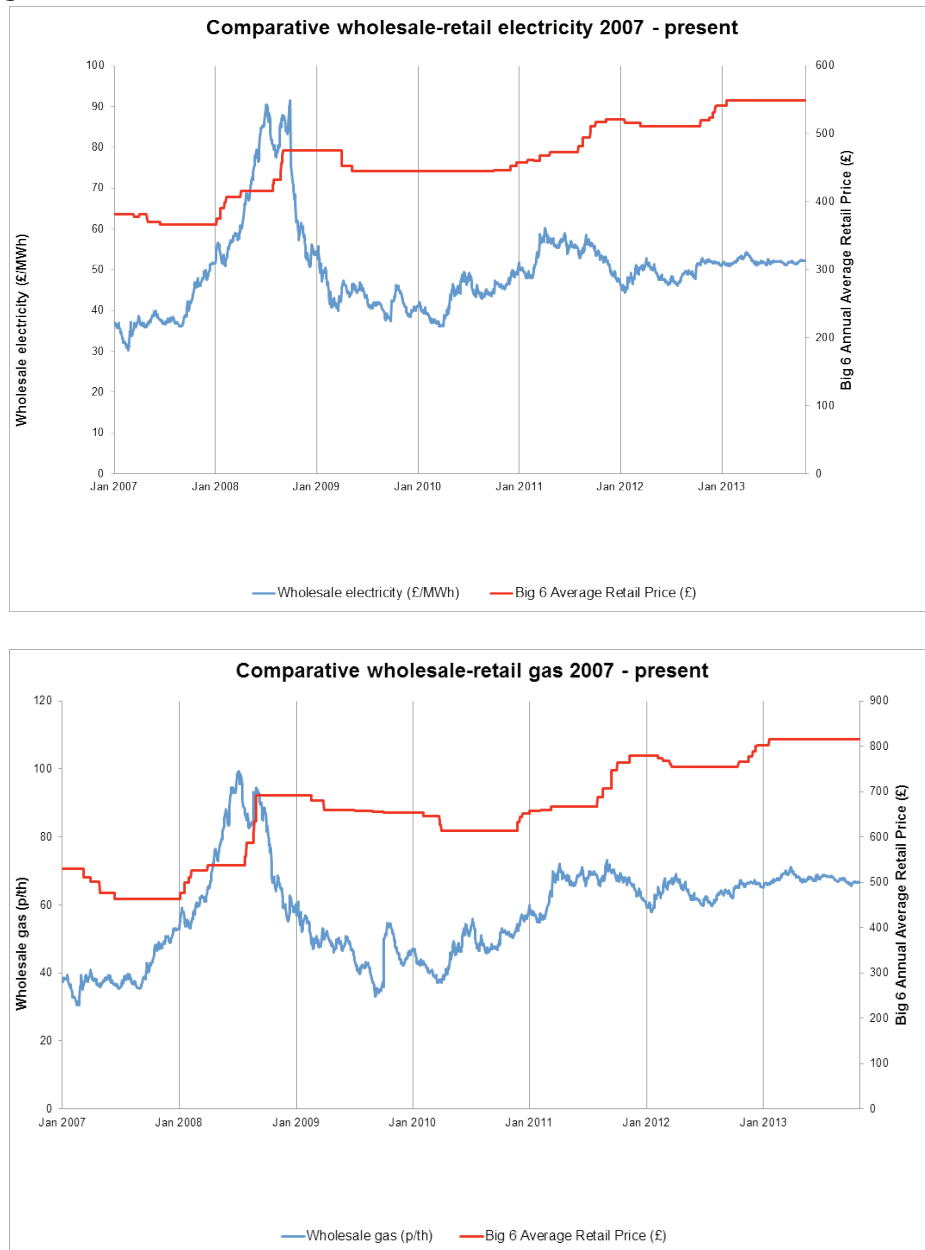
<sup>9</sup> A closed tariff is defined as an evergreen tariff (i.e. non-fixed) that is no longer available to new customers to enter into. These are also known as dead tariffs.

<sup>10</sup> In July 2013, Caroline Flint wrote to all of the Big Six energy companies to ask them how many customers they had on closed or dead tariffs. The companies responded that an estimated 2.5 million customers were on closed or dead tariffs. Based on DECC estimates there are over 27 million households with gas or electricity accounts, which suggests that over 90 per cent of customers will not be affected by the policy.

<sup>11</sup> Ofgem, Wholesale Market Liquidity: Final Proposals for a Secure and Promote Licensing Condition, 2013.

<sup>12</sup> Which?, The Imbalance of Power; Wholesale Costs and Retail Prices, 2013; Consumer Focus <http://www.consumerfocus.org.uk/policy-research/energy/paying-for-energy/wholesale-retail-prices>

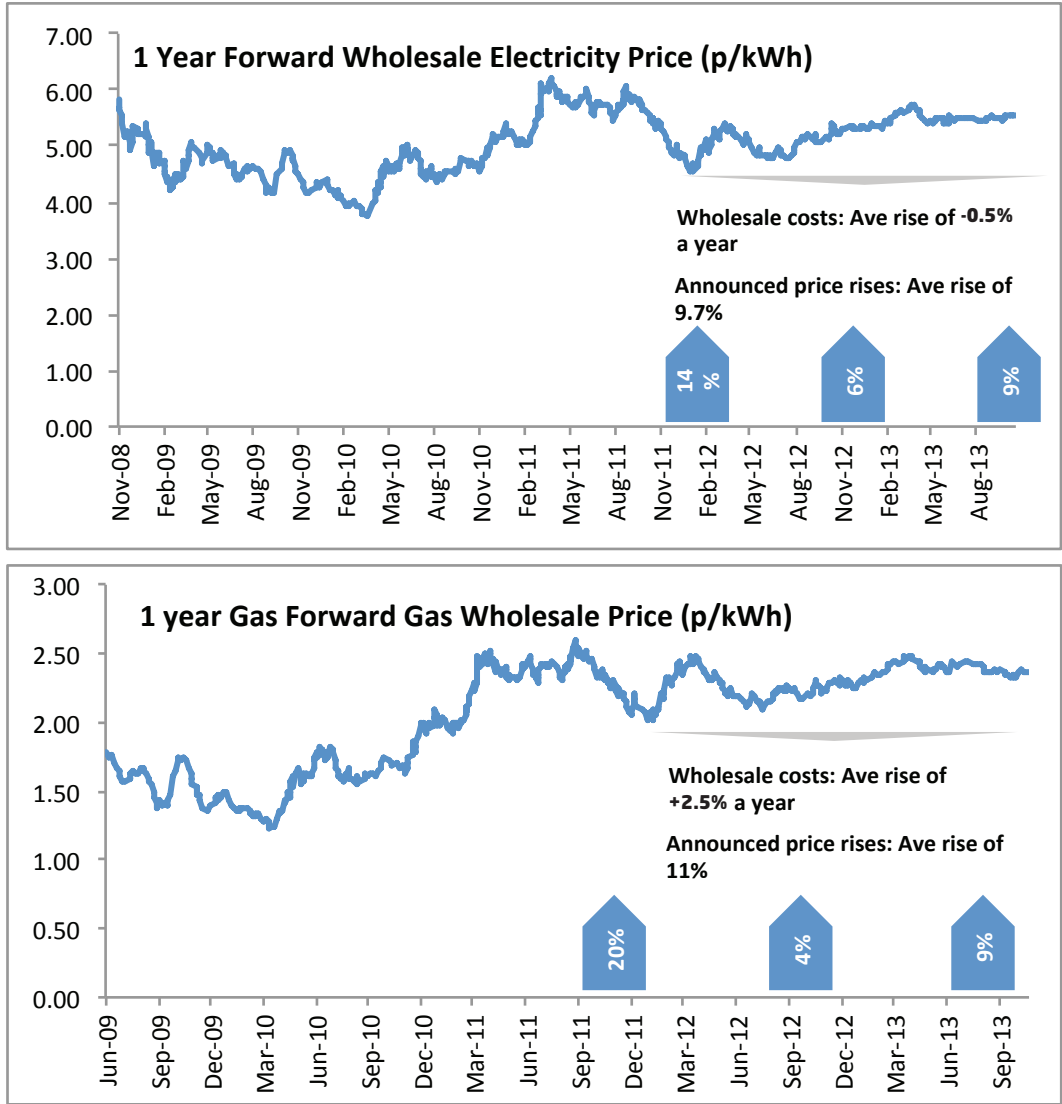
**Figure 2 Comparison of Wholesale and Retail Electricity and Gas Prices, 2007-13**



1.9 This has been particularly pronounced in the last three years. Wholesale energy prices <sup>◇</sup> have been relatively stable since the winter of 2011, rising by an average of 1 per cent a year. However, the large energy companies have increased energy prices by an average of 10.4 per cent a year over this period (Figure 3). This has led to a growing gap between wholesale and retail prices that cannot be explained by the growth in network costs or policy costs which account for 20 per cent and nine per cent of the bill respectively.

<sup>◇</sup> Wholesale prices quoted are based on 1 Year Forward Electricity and Gas price paid by an independent supplier (First Utility) for a typical domestic consumer. This is used as a proxy for a competitive prices for wholesale energy.

**Figure 3 Comparison of wholesale costs and price rises announced by the six big energy companies**



Source: Wholesale prices are based on One Year Forward Electricity and Gas price for a typical domestic consumer for First Utility. This is used as a proxy for a competitive price for wholesale energy. Retail price rises based on Consumer Futures, <http://www.consumerfutures.org.uk/our-work/project4/retail-price-information#Bookmark3>.

I.10 A comparison of the domestic wholesale prices paid by the large energy companies and those paid by an independent supplier, First Utility, through the open market shows a consistent gap over time. Since 2010, the large energy companies have paid 27% and 16% more on average for their wholesale electricity and gas. If the wholesale market was functioning properly, you would expect to see wholesale prices converge at the lowest possible level. But this has not happened and wholesale prices have remained artificially high.

**Table 3 Breakdown of costs on the average bill in 2011 and 2013**

	Electricity £ MWh			Gas p/therm		
	2010	2011	2012	2010	2011	2012
Centrica	53.7	58.7	63.5	56.4	62.4	69.9
EON	57.6	61.8	59.4	58.2	63.3	69.1
EDF	58.2	57.8	60.7	51.3	60	66.4
Npower	59.6	57.3	58.4	51.7	51.7	64.7
Scottish power	68.3	78.2	59.2	58.6	53.6	62.2
SSE	60.9	66.4	67.1	57.3	64.3	67.7
Average for 6	59.7	63.4	61.4	55.6	60.1	66.7
Small supplier price	46	45	55.5	45.8	46.7	67.2
Percentage Mark-up	30%	41%	11%	21%	29%	-1%

Source: Consolidated Segmental Statements, various. Wholesale prices for small supplier are based on 1 Year Forward Electricity and Gas prices for a typical domestic consumer for First Utility. This is used as a proxy for a competitive price for wholesale energy.

### Lack of Confidence for Investors

The energy market has also failed to create the low carbon investment and back up capacity we need for the future

1.11 We need to invest up to £200bn by 2020 to deliver clean, secure energy.<sup>13</sup> Much of our fossil fuel and nuclear generating capacity is approaching the end its working life. We will need to replace a quarter of our ageing capacity by 2020.<sup>14</sup> Investment in a mix of low carbon energy sources is the only way in which we can ensure our future energy security and guarantee affordable energy prices in the long-run. But the current market structure has been unable to deliver the scale of investment at the pace that is needed. Traditional investors, like the big energy companies, have invested £8 billion a year on average since 2007<sup>15</sup> but to deliver the clean capacity we need, we must unlock more than double this amount. Those who argue that the current market should be left to get on and deliver the investment needed should reflect on its failure to deliver investment to date.

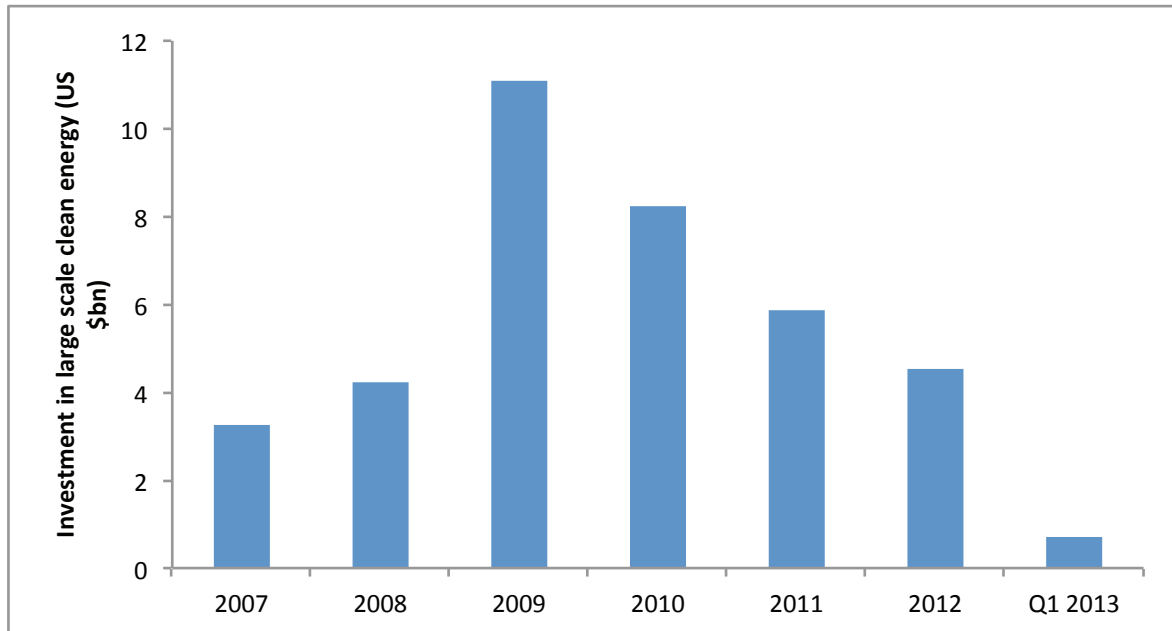
1.12 Large scale clean energy investment accounted for 29 per cent of the total investment across the energy sector in 2012.<sup>15</sup> This investment has fallen from its peak of £7.2 billion in 2009 to under £3 billion in 2012 – and is heading below £1.9 billion in 2013.<sup>16</sup>

<sup>13</sup> Ofgem, Project Discovery, 2009.

<sup>14</sup> DECC, Planning our Electric Future: A White Paper for Secure, Affordable and Low Cost Energy, 2011.

<sup>15</sup> Ernst & Young, Powering the UK, 2012.

<sup>16</sup> Ernst & Young, Powering the UK, 2013.

**Figure 4 Large scale clean energy investment, 2007-2013**

Source: Bloomberg New Energy Finance, 2013

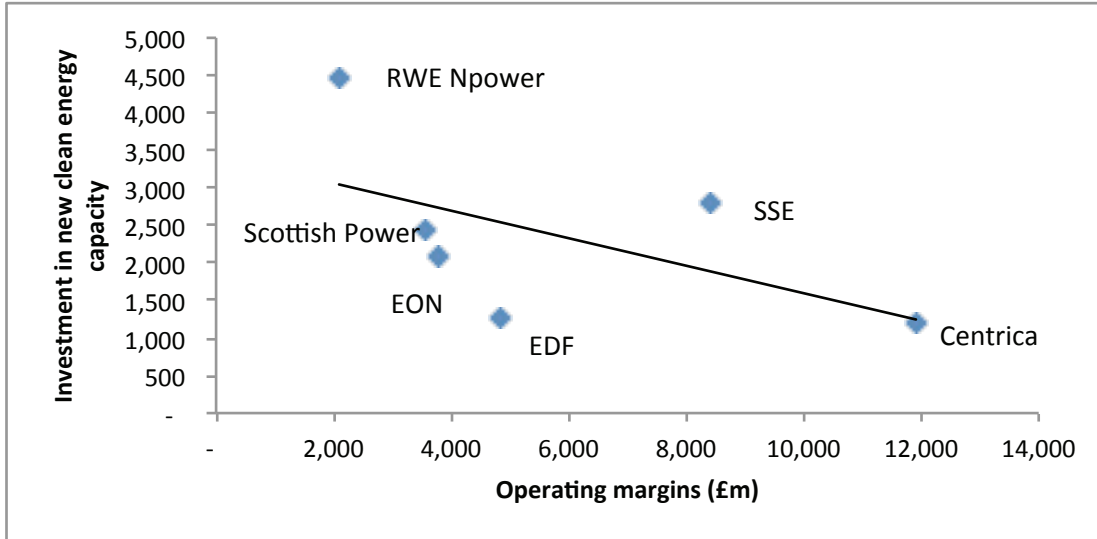
I.13 The fall in investment, at a time when it should be accelerating, is a result of the policy environment and protracted decision-making by Government. The Government has been widely blamed for failing to provide the policy certainty needed to de-risk investment. The details of the deals available under the Electricity Market Reform and the uncertainty about how the strike price mechanism in Contracts for Difference would work have frustrated investors. An unwillingness to commit to the 2030 decarbonisation target supported by the energy companies and others like Siemens, Alstom and Unilever; signals that the Government would unpick the Fourth Carbon Budget; an implicit policy bias towards gas over low carbon alternatives; and the slow pace of energy market reform have all combined to destabilise the investment climate.

I.14 At a time when the big energy companies have seen a growth in profits across their generation and supply business from £3 billion in 2009 to £4 billion in 2012,<sup>17</sup> it is worrying that investment in large scale low carbon energy has declined. Particularly given that some of the companies that have made the highest profits over recent years appear to be investing the least in new clean energy capacity.<sup>18</sup> This directly contradicts the argument that rising profits are merely the necessary corollary of needed investment. Financial returns now are not being adequately ploughed back into the investment we need for future capacity.

<sup>17</sup> Consolidated Segmental Statements, various.

<sup>18</sup> Bloomberg New Energy Finance, UK Big 6 Utility Investment Trends, 2012.

**Figure 5 Comparison of Operating Profits and Investment in Clean Energy, 2007-11**



Source: Bloomberg New Energy Finance, UK Big Six Utility Investment Trends, 2012. Note that investment does not reflect total investment only investment in low carbon generation capacity.

## 2. A ONE NATION LABOUR'S PLAN FOR REFORM

A One Nation Labour Government will act to create a fairer energy market that works for ordinary people and delivers investment for the future.

2.1 Our goal is to deliver a fairer energy market that works for ordinary people and secures investment for the future. This will rebuild trust for consumers and confidence for investors. Without this, we will fail to get the public consent we need to support investment in future energy capacity.

2.2. A One Nation Labour Government intends to take a series of actions to reset our energy market. **We will introduce an Energy Reform Bill in 2015 to legislate for our market reforms.** Through these reforms we intend to deliver five key outcomes:

- **Transparent and fair energy prices** and tariffs for domestic consumers and businesses;
- **Greater competition in both the retail and wholesale markets**, reflected by larger numbers of market participants and greater volumes traded in the open market;
- **More effective regulation** to give consumers faith in a market they have no choice but to use;
- **Transparent energy company accounts** to create trust amongst both consumers and investors; and
- **Greater investment certainty** to ensure long term security of energy suppliers.

2.3 **Action from a Labour Government to deliver a fairer, better functioning energy market must be matched by action from everyone to reduce the energy we use.** Reducing our demand for energy is the only way that we can ensure that bills will remain affordable in the long-run. To support this, we will in future be setting out plans to overhaul the failing Green Deal and replace it with a new Energy Save scheme.



#### Action from a One Nation Labour Government

1. End operational vertical integration by ring-fencing supply and generation businesses
2. Improve competition and transparency in the wholesale electricity market through an open pool
3. Increase transparency in the wholesale gas and electricity markets by formalising uncleared OTC trading
4. Simplify tariffs so consumers can compare prices and engage with the market
5. Abolish Ofgem and create a tough new energy watchdog
6. Deliver value for money on policy costs that impact on bills
7. Take forward the system of contracts for difference to encourage investment
8. Set a 2030 power sector decarbonisation target to boost investor confidence
9. Create an Energy Security Board to plan for and deliver on our energy needs
10. Give the Green Investment Bank the power to leverage new investment

#### We will end operational vertical integration by ring-fencing generation and supply businesses

2.4 Vertical integration is where different functions in a supply chain are united through a common owner. In the energy market vertical integration refers to companies that both generate power and also supply it directly to the public. When the electricity industry was privatised in 1989, a clear separation was established between generation and supply. However, in the 1990s restrictions on suppliers also being generators were removed. This enabled companies to integrate in order to manage market volatility and uncertainty. It is now clear, though, that this vertically integrated structure not only hampers competition but undermines transparency within the wholesale market.

2.5 Energy suppliers essentially have three ways to source the electricity they supply: they can trade via the wholesale market, contract bilaterally with a generator or self-supply via their own generation. The big energy companies can supply most of their domestic and small business customer base from their own generating capacity, so they have less incentive to trade in the open market. Where companies do self-supply, there is little transparency on pricing. Self-supply also lowers the volumes being traded, which reduces liquidity in the wholesale market and the availability of products for other market participants. As a result, independent generators find it difficult to secure long-term deals to sell their generation, which in turn inhibits future investment. And independent suppliers are prevented from expanding because they find it difficult to access forward contracts that provide the volume and shape to meet their customers' needs. Lack of transparency and competition in turn reduce the incentives to keep wholesale prices as efficient as possible.

**2.6 We will ring-fence supply businesses from generation businesses within vertically integrated companies.** This is similar to the steps that the Labour Government took to separate out distribution from energy supply businesses in 2000.<sup>19</sup> This will mean that each part of the business will need to operate as a separate legal entity within the group, with a distinct licence and separate information, governance and reporting arrangements. This will ensure that the interests of the supply business are better aligned with those of its customers, which will create much stronger incentives to keep wholesale costs down.

<sup>19</sup> Clause 30 (2) of the Utilities Act 2000 states: "The same person may not be the holder of both a distribution and supply licence."

2.7 As with the unbundling of networks for suppliers, common ownership would still be permitted (two suppliers for instance are owned by companies that also operate distribution networks), but these businesses would have to be held by separate companies within the same group.

**How would a ring-fence between generation and supply businesses within vertically integrated companies work?**

The Utilities Act 2000, which put a statutory prohibition on the same legal person holding both an electricity supply licence and an electricity distribution, provides a blueprint for how a ring-fence between generation and supply businesses could work. The separation of distribution from supply was enacted in the following way:

- The same legal entity cannot be the holder of a distribution licence and a supply licence;
- Where company groups have distribution and supply licences, one legal entity will be the holder of the supply licence and a separate legal entity will hold the distribution licence;
- Ofgem currently regulates the separation of distribution and supply licensees through conditions in the distribution licence (SLC 29B and 31C) which set out amongst other things the obligations around appropriate treatment of confidential information, audit and compliance statement/compliance officer requirements and the obligation to report to Ofgem annually on compliance including on the practices, procedures, and systems to ensure appropriate separation. The reports are published on distributors' websites.

2.8 Ring-fencing supply and generation businesses should counter the natural conflict of interest within vertically integrated companies and enable supply businesses to seek out the best possible prices for their consumers. Moreover, as self-supply would no longer be possible, this should increase the volume of energy being traded on the open market.

**Question 1:** Do you think that ring-fencing supply and generation businesses will be sufficient to restrict self-supply and improve competition in the wholesale market?

**Question 2:** Do you think the ring-fencing of supply from distribution is an appropriate blueprint for separating generation from supply?

**Question 3:** Do you believe that the existing regulation on no cross-subsidy between entities and non-discrimination needs strengthening so that there is a clear prohibition of cross-subsidy between the generation and supply activities that are within the same group?

**Question 4:** Do you believe that any additional measures will be needed to implement a ring-fence between the generation and retail arms of vertically integrated energy companies?

### We will increase competition and transparency in the wholesale electricity market by introducing a pool

2.9 Most of the electricity that is traded is done via over the counter (OTC) trades rather than on the open market. The Financial Conduct Authority (FCA) most recent estimate is that OTC trading, where electricity is traded bilaterally between a buyer and seller, usually through an intermediary, accounts for around 95 per cent of trades.<sup>20</sup> When energy is traded OTC, only the two market participants directly observe the quote and execution (i.e. others in this market are not privy to the trade). In other words, the details of these bilateral deals are never made public, so we do not know how much energy suppliers are paying for most of the energy they procure. This prohibits price discovery, which would enable independent suppliers and generators to compete more effectively. More transparent wholesale markets would result in accessible and robust wholesale prices.

2.10 Similarly, while some brokered over-the-counter markets quote prices at which they will sell or buy to other dealers (and may even set out post execution prices and the size of the trade after the fact), they do not necessarily quote the same prices to all dealers or all customers and not everyone has access to the broker screens through which this information is transmitted. As a result, this market information is not open to all participants equally.

2.11 To strengthen the wholesale market, **we will require all energy companies to buy and sell 100 per cent of their power via an open exchange, or pool.** A pool could be introduced by establishing a separate stand-alone mechanism. However, there are currently two power exchanges in Great Britain where these trades can take place: APX and the N2EX. If all generators and suppliers were required to trade 100 per cent of their output and supply via the day-ahead exchanges, this would have the same effect as introducing a pool. Given that the volumes being traded on the day-ahead exchanges are already increasing, this could be a way of increasing liquidity and transparency in line with existing market developments.

2.12 Requiring all electricity to be traded via an exchange would centralise the communication of bid and offer prices, communicate those prices throughout the market and, therefore, create a level playing field which would allow any market participant to buy as low, or sell as high, as anyone else. It would also improve liquidity. In other European markets, there is much more exchange based-trading, such as in Nordpool. This has been cited as reason a why other European markets are more liquid, competitive, transparent and provide more robust reference prices and have more market participants.

2.13 To ensure that the open market is as robust as possible **we will create a two-way pool so that both generators and suppliers are able to submit bids.** This is to reduce the scope for gaming and mitigate some of the shortcomings of the pool that was abolished in the Utilities Act 2000.

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<sup>20</sup> Financial Services Authority, Analysis of activities in the Energy Markets 2011, 2011.

2.14 This pool will have indirect benefits on liquidity further along the curve by producing a more robust reference price against which longer-dated contracts could be settled. But there may be additional measures needed, including more exchange-based trading further along the curve, in order to improve liquidity for longer-dated products.

#### **How does the Nord Pool work?**

The Nord Pool arrangements cover electricity trading in Scandinavia and several Baltic countries and operate over four main stages and timescales.

1. Six years out up to day ahead: There is a market in financial hedging products referenced against the price in the day-ahead market, Elspot. Parties agree these instruments with each other either bilaterally or through an exchange.
2. Day ahead: The Nord Pool day ahead auction, Elspot, takes place. Buyers and sellers submit bids and offers which are used to create demand and supply curves and set the market price for each hour settlement period. The volumes sold are physical and are used towards calculating each party's imbalance position, along with any trades which take place intraday. The market price is used as a reference price for financial hedging products and for imbalance pricing purposes.
3. Within day: The continuous intraday market Elbas allows parties to refine their physical positions further. Parties offer and bid on a continuous basis up to 30 minutes before delivery, with trades being made on a first come, first served basis.
4. 30 minutes before and up to real time: Individual Transmission System Operators (TSOs) in each country ensure that supply and demand balance locally. Parties' volumes traded through Elspot and Elbas, as well as actual consumption and generation volumes, are used to calculate imbalance positions which are paid or charged imbalance prices depending on whether parties are in surplus or deficit.

Even though it is voluntary, around 80 per cent of power is traded openly in the day-ahead market. In addition, a more mature futures market has developed because of the increased confidence in the day-ahead price. Prices are calculated on the basis of a double auction, as both the buyers and the sellers have submitted orders (for many other auction types, only the buyers submit orders).

**Question 5:** Do you believe that the objectives for the introduction of a pool – increased access to energy for all suppliers and increased transparency, including on price formation – could be met by requiring all market participants to trade 100 per cent of their output via a day-ahead exchange?

**Question 6:** Do you believe that further measures will be needed to improve liquidity for longer-dated products?

**Question 7:** Do you believe that additional interventions to address (a) imbalance risk and (b) collateral requirements of market participants will be needed alongside the introduction of a pool type arrangement?

### We will increase transparency in wholesale gas and electricity markets by formalising uncleared OTC trading

2.15 The gas and electricity markets are distinct and separate, and will require different reform packages. One significant difference is that whereas all of Britain's six energy companies are vertically integrated for electricity, only three of the six – Centrica, E.ON and RWE npower – also have upstream gas production businesses. Liquidity is also recognised as less of a problem in the gas market. The churn rate is increasing, and the bid-offer spread is significantly tighter than for the wholesale electricity market.<sup>21</sup>

2.16 But as with the electricity market the FCA estimate that between 75 per cent and 80 per cent of trades in the gas market are done via uncleared OTC trading.<sup>22</sup> This reliance on uncleared OTC trading reduces price transparency and potentially leaves the market vulnerable to manipulation. Last year allegations of price-fixing in the wholesale gas market were made. Although Ofgem and the FCA could find no evidence in this particular case, it nonetheless raised serious questions about the integrity of the market and its vulnerability to this kind of abuse.

2.17 Moreover, with OTC trades, market participants are reliant on data from price reporting agencies. But price reporting agencies are currently not regulated and produce price assessments according to their own methodologies. This will often include information gathered from an informal survey of market participants on the phone or even via a form of online chat known as instant messaging. This system is entirely voluntary and depends on market participants providing accurate information.

2.18 Ofgem is currently undertaking a call for evidence on pricing benchmarks in gas and electricity markets and the REMIT regulations recognise providing false information to price reporting agencies as a form of market manipulation.<sup>23</sup> However, we believe that proactive steps need to be taken to formalise the data from OTC trading activities, so that it can be made publicly available. To do this, **we will require all participants in uncleared OTC gas and electricity trading to allow OTC brokerages and platforms to publish anonymised details of all transactions.**<sup>24</sup>

**Question 8:** Do you believe that further measures are needed to improve competition and transparency in the wholesale gas market?

### We will introduce a simplified tariff structure so consumers can compare prices

2.19 Ofgem will have already taken steps to reduce the number of tariffs in the market by 2015.<sup>25</sup> This will limit suppliers to four “core tariffs” per fuel and per payment type which will contain one standard variable rate tariff, and one fixed term fixed price tariff. Suppliers will then have the freedom to offer the remaining two tariff types as they wish, to preserve customers' choices. But to make the market easier still for consumers to navigate, and to drive competition, we need to improve the comparability of tariffs, as well as reducing their number. This means creating a consistent system of pricing and standardising the structure of tariffs.

21 Ofgem, Liquidity in the GB wholesale energy markets, 2009.

22 Financial Services Authority, Analysis of activities in the energy markets 2011, 2011.

23 Ofgem, Pricing benchmarks in gas and electricity markets - a call for evidence, 2013.

24 This was recommended by Which?, The imbalance of power wholesale costs and retail prices, 2013.

25 Ofgem, Retail Market Review The Retail Market Review - Final domestic proposals, 2013.

**2.20 We will require all energy companies to introduce a new simple tariff structure.** This would have two charges:

- A daily standing charge: These costs would be set by the regulator and would be a standard charge applied by all companies.
- A cost per unit for your energy: Energy companies would decide their own unit price and consumers would be able to compare these prices and go for the best deal for them. The unit price will need to reflect the cost of paying by direct debit (the most common and lowest cost payment method) with any surcharges a supplier chooses to levy on other payment methods presented as an annual amount priced in pounds and pence and chargeable on a daily basis. This surcharge must be the same for all of a supplier's tariffs. In addition, any discounts that apply to dual fuel or online customers should be presented as a universal amount priced in pence and pounds and available on all tariffs offered by a supplier.

**Question 9:** Do you support the introduction of a standardised tariff structure comprising a single unit price and regulated standing charge?

**Question 10:** Which costs do you believe should be recovered through (a) unit price and (b) standing charge?

**We will create a new regulator with a remit to deliver fair value to consumers**

2.21 Structural reforms will deliver the market conditions we want, including transparency and greater competition. But we need a tougher regulatory environment to sustain this. We have been clear that the current regulator, Ofgem, has failed to protect the interests of consumers in the energy market. However, the problem goes beyond the failings of the current regulator; there are serious shortcomings with the entire regulatory framework.

2.22 The existing model relies on consumers, rather than regulation, to keep prices efficient. At the moment neither government nor Ofgem consider end-user prices as their responsibility which, in turn, reduces any sanctions for raising prices above levels which could be considered reasonable. And the lack of transparency in the wholesale market means that the regulator has insufficient information to effectively monitor and regulate the market. As a result, consumers are left without the protection of a properly functioning market or that of effective regulation.

**2.23 We will create a new regulator with a primary remit to protect the interest of existing and future consumers by ensuring they get fair value from the market.** The new regulator will be an independent economic regulator. It will be accountable to, and scrutinised by, Parliament.

**2.24 We will set a proper framework, through the Strategy and Policy Statement introduced in the Energy Bill, in which the role of the regulator and government are more clearly defined.** The role of government will be to set the policy objectives of regulation and to create a framework which ensures regulation is consistent with these objectives. The role of the regulator will be to fulfil its duties within the framework set. **The regulator will be required to report annually on how it is delivering the policy and strategic objectives set by the government of the day.**

2.25 Ofgem has responsibility for regulating the networks, generation and supply businesses and administering Government policies through E-Serve. Regulation of distribution and transmission will be retained, as will responsibility for license codes and standards across generation and supply. In addition, the regulator will:

- Play a greater role in monitoring the market and ensuring it is functioning properly and be responsible for reporting to Parliament on the effective and efficient working of the energy industry as a whole;
- Have additional powers to penalise anti-competitive behaviour and to use price interventions to ensure that consumers are getting what would be expected from a functioning competitive market. So if wholesale prices fall and this is not passed on fairly to consumers, the regulator would have the power to cut prices. The separation of supply and generation, alongside the use of a pool and price data from OTC trading, will make it possible for the regulator to deliver on this clear remit because of significantly increased price transparency;
- Provide greater protection to non-domestic customers, including through improvements to contracting and by ending punitive back-billing with enforceable industry wide standards of conduct, as exist for domestic customers;
- Regulate the off-grid market for the four million (15 per cent) households in the UK that are not connected to the mains gas grid; and
- Have greater clarity on its role and that of the Energy Ombudsman (in light of new powers in the Energy Bill given to Ofgem to require suppliers to compensate consumers directly).

**2.26 The regulator will play a key role in driving transparency in the market.**

Companies are required to publish consolidated segmental statements with company data on revenue, costs, profits and volume for the supply and generation businesses. This has created much greater transparency and enabled a level of scrutiny that was impossible before. However, there are significant weaknesses with the existing framework. There is no fixed definition of what constitutes generation or supply; the outcome of transfer pricing remains publicly invisible; and energy companies are not required to report their trading function, which means there is the scope for companies to give a misleading picture of their genuine generation costs and under-report overall profitability.



2.27 To support transparency, **all energy companies will be required to present their accounts** with additional information showing retail, generation and trading activities as if they were separate companies. In addition:

- Trading businesses will be required to show the regulator what they are trading and the basis of their profitability;
- Generators will be required to show the regulator the average cost of their fuel, the proportion bought in intra-group trading along with the average cost of each category;
- The regulator will produce data on the market in order to more effectively monitor its performance including volumes and products traded on the open exchange and data on the movement of retail and wholesale prices; and
- For all domestic and SME customers, retailers will be required to show the average costs per a unit for electricity and gas and the breakdown of cost on every bill in a standard way set out by the regulator.

2.28 Arrangements will be put in place to ensure the smooth transition from Ofgem to the new regulator. This will be driven by a new executive structure which will be appointed in the first 6 months to plan and manage the transition.

**Question 11:** Are there any additional powers you believe are needed to regulate effectively the retail and wholesale energy markets?

**Question 12:** Do you believe that the scheme of redress for energy customers currently provided by the Energy Ombudsman could be delivered by a new regulator?

**Question 13:** Do you believe that off-grid customers should be brought under the remit of a new regulator?

**Question 14:** Do you believe the regulator's network regulation should be separated from its competition functions?

**Question 15:** Do you believe Ofgem's functions under E-Serve should be separated from its core regulatory functions and performed by an administrative body or by private company under contract?

**We will also ensure that Government is doing its part to deliver value for money on all policy costs that impact on bills**

2.29 Resetting the market will put downward pressure on bills and deliver fairer prices. But government will also need to do its part to bear down on costs that come from policy. These policies serve an important purpose and are critical if we are to keep energy bills affordable in the long run. Global demand for fossil fuels oil, coal, gas is growing at the same time as the supply of oil and gas is tightening. This will push upward pressure on the cost of energy, and therefore bills, unless alternative sources are found (nuclear CCS and renewable energy) and we reduce the amount of energy we use. This is why it is so important that we invest in low carbon energy and energy efficiency schemes like home insulation. But we must do this in the most cost effective way.



**2.30. We will ensure that every scheme and intervention that is funded by either the consumer or taxpayer is as cost effective as possible.** The Energy Company Obligation (ECO) introduced by this government, for example, is completely inefficient and bureaucratic. The government calculated the total cost at £1.3 billion a year. But the industry has argued that the costs will ramp up beyond this.<sup>26</sup> The scheme is poorly targeted with just £540 million of the total budget going to people in fuel poverty.

**2.31. We will overhaul ECO and replace it with an 'Energy Save Local' scheme.** Under our plans, we will use money currently spent on energy efficiency to better target the fuel poor. We will deliver it more efficiently through area based programmes led by local authorities and companies in partnership. This will bring down costs, deliver better value for money and reduce the pressure on bills.

2.32 Under this scheme, local authorities and other trusted local organisations will play a much greater role in delivery, with the companies no longer fronting the scheme. Energy efficiency programmes like Warm Zones have worked well at a local level, when a local council or charitable organisation has been the face of the scheme, working with energy companies to deliver energy efficiency. By taking an area based approach, we will help drive demand for energy efficiency improvements. People who see their neighbours installing energy efficiency measures are more likely to be interested in taking these up themselves. This will also reduce costs through economies of scale achieved by doing multiple houses at once rather than individual homes. In addition, an area based approach led by local organisations will open up access to delivery contracts to small and medium energy efficiency installers.

2.33 Analysis by IPPR suggests that, for the £540 million currently spent on low income households under ECO, an area based scheme like 'Energy Save' could provide 197,000 fuel poor households with energy efficiency improvements every year (based on bringing households up to EPC 'D' rating) – 117,000 more than under the ECO model.<sup>27</sup>

### **Warm Zones**

Warm Zones aim to tackle fuel poverty and improve energy efficiency through a comprehensive area based delivery approach. Warm Zones work with local authorities and energy companies, together with a range of other local organisations. Each Warm Zone is adapted to local circumstances, to meet local needs and policy priorities. Local partners, trusted by the local community, help to promote the Zone and to refer households for assistance.

Each Warm Zone programme takes a street-by-street approach, working in close partnership with trusted local organisations – this maximises the take-up of the assistance available as households see the benefits to their friends and neighbours. The approach also delivers economies of scale by delivering energy efficiency improvements more effectively.

Warm Zones identify, access and deliver individually tailored packages of energy efficiency measures to each household, to ensure the best outcome for each household that receives assistance.

Warm Zones is a Community Interest, not for profit Company, and has been operating since 2001. There are now 14 Warm Zones in total delivering area based schemes across the country.

<sup>26</sup> NERA, The Cost of the Energy Company Obligation, 2012.

<sup>27</sup> Platt et al Help to Heat: A solution to the affordability crisis in domestic energy, 2013.

**Question 16:** Do you support the delivery of energy efficiency for the fuel poor through an area based approach?

**Question 17:** Are there additional measures that should be taken to deliver value for money across other policies?

We will deliver a better deal for investors by providing policy certainty and the support they need to unlock investment

2.34 Radical reform must be combined with strong action to ensure increased investment in our future energy supply. We need to create stable, long term and predictable market arrangements which are attractive to a range of small, institutional and international investors. This is critical as the six big energy companies are unable to fund the scale of investment at the pace that is needed. 53 per cent of the recent investment in clean energy has come not from the major energy companies but from a more diverse range of international and domestic investors – a trend that is set to grow in the coming years.<sup>28</sup> To help these businesses have the confidence they need to invest, we will set out a clear long term policy framework. **We will continue the new system of contract for difference and capacity auctions being introduced through the Energy Bill** to ensure that future contracts for investment in energy assets are protected.

2.35 In line with the advice from the Committee on Climate Change, we will set a quantified 2030 power sector decarbonisation target and a clear delivery plan to achieve this goal. A decarbonisation target is fundamental to our low carbon, low cost energy future. It will provide clarity and certainty for investors, encouraging investment in low carbon generation and the supply chain. The renewable industry currently supports 110,000 jobs, and across the supply chain could support 400,000 by 2020. A decarbonisation target would help create the long term certainty needed to achieve that. And according to the Committee on Climate Change, decarbonising the power sector will lead to lower bills than alternative higher carbon scenarios.

**Question 18:** Do you believe that a target to decarbonise the power sector by 2030 will encourage investment?

**Question 19:** Are there additional measures you believe should be taken to provide greater certainty and encourage investment in our energy infrastructure?

We will create an Energy Security Board to plan and deliver our future energy needs

2.36 Currently no single institution has responsibility for establishing what our future capacity needs are and developing a strategy for meeting them. This is divided up between DECC, Ofgem and the systems operator within the National Grid. Given the pressures on our existing generation capacity, there is an urgent need to create a 'guiding mind' that can coordinate the system operator and infrastructure planner with the strategic direction set by the Secretary of State on a long term basis.

2.37 **We will create an Energy Security Board with statutory responsibility for identifying our energy needs, taking co-ordinated action to meet this need and providing a clear framework for investor certainty.** The Energy Security Board (ESB)

<sup>28</sup> Green Alliance, The Future of UK Infrastructure, 2013.

will be established as an independent body drawing on lessons from the creation of the Office for Budget Responsibility. The Board will work with the system operator (currently in the National Grid), the new regulator and senior officials from DECC and will work within the wider infrastructure framework set out in the Armitte Review.<sup>29</sup> We propose that the 'Counter Body' that is currently being created to implement Contracts for Difference and the Levy Control Framework will also be bought into the Energy Security Board to enable better development of long term investment plans and their operation.

### 2.38 The Energy Security Board will:

- Work closely with the regulator and National Grid to ensure that there is a clear understanding of medium-term capacity requirements and the need for new investment well in advance of the natural investment and construction timetable;
- Ensure that capacity is contracted, constructed and operational in good time;
- Drive policy development focused on creating the cheapest cost energy for the consumer and the national economy with careful regard to policy choices and the risk to these businesses to drive down the cost of capital for future investment;
- Have a duty to ensure that there is adequate security and enough major generators with complete independence from each other to ensure competition between them; and
- Support demand-side reduction as a route to energy security.

**Question 20:** Do you agree that the establishment of an Energy Security Board will give security of supply a clear institutional focus?

**Question 21:** Are there additional functions that should be bought into the Energy Security Board from other institutions?

**Question 22:** Should the Energy Security Board be able to let concessions to ensure that adequate capacity is available over the long term?

### We will give the Green Investment Bank the Powers to Leverage in new Investment

2.39 Finally, to meet the investment challenge, it vital that we secure the finance to create and de-risk investment. The Green Investment Bank should play a key role in this but is currently hampered in its ability to operate. The GIB claims to have leveraged in £3 from the private sector for every £1 that they have invested and has the potential to do so much more. So we will give it the powers to borrow and the freedom to act as a bank capable of attracting new investment. This will enable the GIB to offer a range of financial solutions to accelerate the rate of private sector investment in clean energy.

**Question 23:** What more could be done to strengthen the operation of the Green Investment Bank's operation?

<sup>29</sup>The Armitte Review, An Independent Review of Long Term Infrastructure Planning Commissioned for the Labour Party's Policy Review (2013).

Our market reforms will create a fairer, more competitive market. But whilst our reforms are being implemented, we will freeze prices

2.40 Our reforms will deliver a radical overhaul of the energy market, reintroduce proper competition and create a system with fairness to consumers at its heart. But these measures will take 20 months to put in place. **We will, therefore, introduce emergency legislation upon entering office to freeze prices through to January 2017.**

2.41 **The emergency legislation will enable the Secretary of State to modify supplier licensing conditions to implement the freeze.** It will:

- Require energy companies to freeze unit rates and annual standard charges on the tariffs and payment plan their customers were on at a specified date;
- Stop prices rising but enable prices to fall and consumers to switch; and
- It will specify that the freeze is temporary, when it will come into force, and when it will cease (i.e. 20 months after the commencement date).

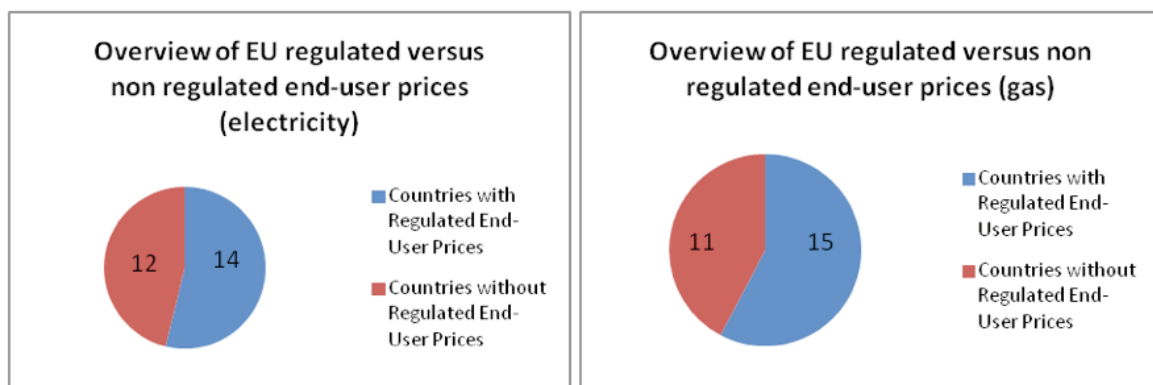
2.42 Based on House of Common Library modelling, we estimate that the freeze will save a typical household £120, a small business user over £5,500 and medium sized business over £34,500.

### Busting the myth on price controls

The idea that energy prices cannot be controlled or capped is inconsistent with the evidence. Energy markets across the world are regulated with different countries using various forms of end user price controls to regulate the prices consumers pay.

In March 2012, in response to high market concentration, weak competition in the wholesale and retail energy markets and sharply increasing prices, the Belgian government introduced a temporary freeze in energy prices. The freeze lasted for 9 months from April to December 2012 and covered domestic customers and small and medium sizes businesses. The freeze was a temporary measure to provide time to implement structural measures to stabilise prices and foster greater competitiveness.

In addition, it is worth noting that in 14 EU member-states there are permanent regulated end-user prices for electricity, while 15 also have permanent end user-prices for gas.



### 3 NEXT STEPS

3.1 At the Labour Party Conference in 2013, Ed Miliband and Caroline Flint announced the package of measures we would introduce to reset the energy market, developed through work undertaken as part of Labour's Policy Review and drawing on discussions within the National Policy Forum. The purpose of this Green Paper is to set out in more detail the nature of Labour's plans and to provide an opportunity for interested parties to engage in the development of those proposals.

3.2 Prior to and following on from the announcement of our energy market proposals we have engaged closely with a wide range of stakeholders, including trade associations, consumer groups, large and small energy companies, investors and NGOs to gather views and evidence on our policy proposals. We want to continue to work with the industry and beyond on the detailed mechanics of implementation so that we can move at pace when we enter office. We therefore seek detailed comments and views on the proposals outlined in this Green Paper from all interested parties. Responses should be sent to [yourbritain@labour.org.uk](mailto:yourbritain@labour.org.uk) by 31 May 2014, with the subject heading "Energy Green Paper". Please respond to the questions in the consultation as fully as possible, and attach any supplementary information as appendices.

3.3 During the consultation period, we will hold a series of focussed roundtable meetings. These will provide opportunities for stakeholders to ask us about our policy proposals, and feed back to us directly. If you would like to be involved in these discussions please contact [yourbritain@labour.org.uk](mailto:yourbritain@labour.org.uk).

3.4 In addition to the proposals contained in this document we will come forward with further plans to replace the Green Deal with a more effective Energy Save scheme. This is a critical part of our overall package to reset the energy market. We are clear that the way we keep bills affordable in the long term is to get everyone to play their part in reducing the energy we use as a country. And we need a better way to achieve this than the Government's failed Green Deal.