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Ensuring the wholesale markets works for consumers

Government steps in to “de-link” power prices to protect Britain from energy price shocks

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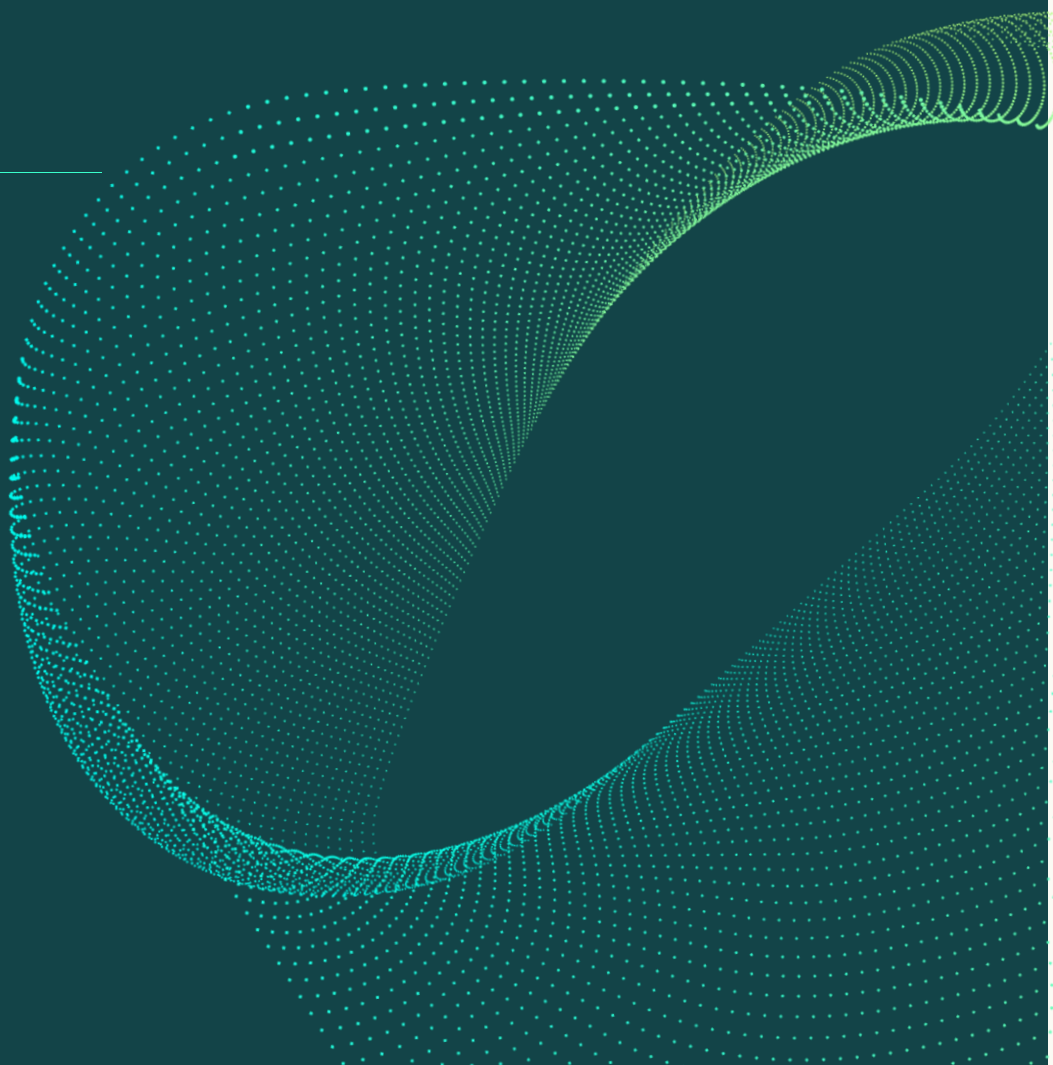

Government steps in to “de-link” power prices to protect Britain from global energy shocks

Faced with the second energy crisis in five years, the government has announced a further package of policy interventions to accelerate the net zero transition and the clean power plan, while providing greater resilience for consumers from future energy shocks.

Notably there are two measures that are intended to “de-link” the cost of low carbon power generation from the volatility of the gas market and help to ensure that the value of lower-cost renewables is passed through to bill payers, rather than being captured as excess profits by generators and traders.

These measures follow announcements to shift some of the legacy subsidy costs from billpayers into general taxation and to remove the Carbon Price Support (CPS) that added to the carbon prices paid by fossil fuel generators.

The package also includes measures to accelerate the build of new energy infrastructure and to encourage the electrification of heat and transport. A key change that will resonate with rural households is raising the Boiler Upgrade Scheme grant from £7,500 to £9,000 for oil- and LPG-heated homes.

Regen welcomes that the government is looking at practical measures to deliver lower wholesale prices rather than trying to “split the market” by separating gas power prices from the rest of the wholesale market. While such proposals are headline-grabbing, there isn’t a durable market design to prevent gas from setting marginal prices, and if there were, it would almost certainly lead to further market distortion, loss of price signals and inefficiency.

The “de-linking” proposals centre around two main interventions that would reduce the impact of volatility of gas prices on the final cost of electricity for the consumer, but without changing the underlying market structure and marginal price signal.

1. **An extension and deepening of the Electricity Generator Levy** (EGL windfall tax) with an increase in the marginal tax rate to **55% from 1st July 2026**
2. **Introducing a Wholesale Contract for Difference (WCfD)** contract for legacy renewable generators with a plan to run the first auction in 2027

The two measures are intended to work together as a carrot and stick approach. A higher revenue tax for projects without a CfD to encourage more developers to accept a CfD contract.

These solutions would seek to bring more generation under long term CfD contracts, which provides a two-way hedge for consumers and generators against volatile power prices, and create a back-stop EGL tax levy that would prevent non-CfD renewable and nuclear generators

making super-high profits on the back of rising gas prices. If the revamped EGL goes beyond a excess revenue tax and begins to look like a clawback of legitimate earnings, then it would have a bigger impact for the market and risks dampening investment. This is a key balancing act for the Treasury.

In this short paper Regen considers the merits and challenges of both the EGL and legacy WCfD proposals and asks what else the government could be doing to reduce power market prices.

Another energy crisis highlights the need to reduce gas demand and accelerate the decarbonisation of our energy system

The loss of life, displacement of people and destruction of civilian infrastructure are the primary outcomes of the Israeli/US conflict with Iran and in Lebanon. The human cost and suffering is there for all to see and must be paramount for international leaders.

In terms of energy, the disruption of oil and gas supply through the Strait of Hormuz has created a second global energy crisis in the last five years, revealing once again that the UK and Europe are extremely vulnerable to fossil fuel supply shocks and price volatility.

So far, we have not seen the very steep rise in electricity prices that occurred around the time of Russia's attack on Ukraine. Daily average wholesale power prices have risen to over £100 per MWh since the beginning of March 2026. Higher than before the conflict, but nowhere near the average prices above £250 per MWh that occurred in March 2022, near the start of the Ukraine War.

One obvious reason is that gas prices have not yet reached the peak that they did in 2022. Another is that, even in just four years, we have more renewable capacity, more storage and more interconnectors. So, while Great Britain is not enjoying the super-low prices of renewables-dominated Spain, we are beginning to see evidence of greater competition in the wholesale market and gas generation beginning to lose its grip as the marginal price-setting technology.[1] [2]

However, this is not the time to be complacent. The conflict with Iran is ongoing and could still result in a major gas supply disruption, or at the very least drive-up LNG prices at a time when

[1] Figures from the 2022/23 energy crisis suggested that gas assets may set the day-ahead price in 85-90% or more of price periods More recently, Modo has completed an analysis using a marginal cost estimate for a low-cost CCGT plant as a proxy threshold to estimate when gas plants are the marginal generator. Their snap-shot analysis suggests that the periods in which gas set the price may have fallen from over 90% of periods in March 2022 to around 67% in March 2024/25 . If this analysis reflects a broader trend it may indicate that GB wholesale market, like Spain, is becoming less dependent on the position of gas in the merit order.

[2] Analysis from Ember Energy Clean Power Fortifies Britain Against Gas Price Shocks April 2026

both the UK and Europe are increasingly dependent on LNG imports[3]. With European gas storage levels nearing historic lows, prices are likely to remain high through the summer season of storage replenishment.

Looking to the future, the UK government has said that it intends to "double down" on its Clean Power mission by continuing to develop alternative energy sources, such as wind, hydro and solar that use domestic energy resources and embarking on a renewed drive towards the electrification of heat, transport and industry. The transition is coming, but the Clean Power Plan will take time to deliver, and we are further behind in decarbonising heat and transport. A more immediate concern is the potential for gas and electricity price rises, which would likely kick in over the autumn and winter of 2026 and could once again lead to a prolonged period of high energy bills.

It is good that the focus is on practical measures

The prospect of high electricity prices has led to calls for the government to do something radical. It has been suggested that the government should take over the electricity market completely with a return to a central pool and central dispatch. Others have called for a market reform that would decouple high gas power prices from lower cost generation thereby reducing price volatility and preventing gas generators from setting the marginal price in the short-term market. However, while gas price decoupling might seem attractive at first glance, the various split-market proposals lack a workable market design. Some do not even align with how the market actually works.

The view from most market analysts is that while market decoupling schemes might offer some relief as a short-term crisis response, the market distortion and inefficiencies they would introduce would quickly outweigh the benefit. Incentives to develop other flexibility assets that reduce the market power of gas, such as batteries or interconnectors, would be severely disrupted under such proposals.

For example, during the last energy crisis, the EU allowed Spain and Portugal to implement the "Iberian Exception", a temporary form of gas price cap in the wholesale market. This was seen as a temporary success. It did hold down power prices, but it also had unintended consequences, including an uplift in gas demand and the leakage of much value to consumers in neighbouring markets who could import power at artificially low Iberian wholesale prices subsidised by Iberian consumers.[4] As the name implies, it was considered an exceptional measure, not a long-term solution. It was their equivalent of our retail Energy Price Guarantee.

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[3] Regen discusses the risk of UK's LNG dependency and the need for demand reduction in our recent paper: https://www.regen.co.uk/insights/could-expanding-north-sea-gas-production-cut-gb-energy-bills

[44] See analysis of the Iberian Exception success and consequences Centre f0r Global Energy Policy 2023

A small carrot and a big stick

Having looked at and rejected split market reforms as part of the Review of Electricity Market Arrangements, the government announcement has two alternative market interventions:

1. An extension and deepening of the Electricity Generator Levy (EGL windfall tax) with an increase in the marginal tax rate to 55% on revenues over £82 per MWh from 1st July 2026
2. Introducing a Wholesale Contract for Difference (WCfD) contract for legacy renewable generators with a plan to run the first auction in 2027

Taken together these measures would not split or decouple the market and would not directly affect marginal price signals, although they may have secondary impacts in the wholesale market. They would instead seek to "de-link" the revenues retained by lower cost generators (renewables and nuclear) from high wholesale prices set at times when gas prices are high, or indeed for any other reason.

While both these interventions have merit and could save consumers money, there are pitfalls and risks that policymakers need to consider. There are also complementary interventions that need to be taken to ensure that the policies work in practice and really do deliver value to the consumer.

1) Extension and deepening of the Electricity Generator Levy (EGL)

No industry likes a windfall tax, but some windfall taxes are better than others.

Energy markets are inherently volatile, with good times and lean times for generators who have invested capital and are taking significant investment risk. High prices affect consumers, but we are also beginning to experience periods of very low wholesale prices. Hence, the attractiveness of the CfD scheme. Unless we decide to support every project within a revenue support scheme, we still need some investors to be prepared to build projects and take merchant-market risk. Risks and rewards must be aligned.

The risk with a windfall tax is that, if badly applied, it can easily spook investors and signal the government's willingness to tax legitimate earnings during good times without providing equivalent support when prices are low.

The Electricity Generator Levy introduced in 2022 and amended in 2023 is a relatively well-designed windfall tax. Generators may feel differently but, unlike some similar taxes in Europe, at least it targets excess profits with a marginal rate that allows some revenue upside.

Regen's main concern at the time it was introduced was that it would also apply to new investments built during the energy crisis that did not gain a windfall profit but rather faced

higher supply chain and capital costs. This seemed illogical, and so we were pleased to see the tax amended in November 2023 to remove new investments.

The key features of the current EGL tax are that:

- It applies to renewable and nuclear generators who do not have a CfD contract and who produce over 50 GWh of energy per annum (c. 20 MW of onshore wind)
- It is a revenue tax (not a profit tax) on earnings above a threshold revenue per MWh
- The threshold was set at £75 per MWh and has risen with inflation to c. £82 per MWh
- The marginal tax rate is 45% on revenue, and there are then further taxes applied to company profits, which takes the marginal tax rate to over 70%
- The EGL will apply until April 2028
- As of November 2023, new investments are excluded
- EGL revenue currently goes to HM Treasury

The EGL is due to end in 2028, and in normal times, we would recommend that it do so. However, given the renewed crisis in the Middle East, and the ongoing vulnerability of the UK to future hikes in gas prices, it is sensible for the government to consider extending the scheme for legacy projects who are still earning Renewable Obligation payments. An essential change would be to explicitly redirect revenue from the Treasury's coffers to the consumer, either by using it to reduce the consumer electricity levy charges or to fund a social tariff. Either way, the EGL revenue should form part of a consumer bill saving package not a new tax grab.

The same design principles should apply to an amended EGL as any windfall tax. It must be targeted and proportionate. It should explicitly target "excess" profit caused by exceptional market conditions and not become a general disincentive for investment.

The government has indicated that it intends to revamp the EGL and has today announced that the marginal tax rate will increase from 45% to 55% from 1st July. So far, they have not indicated any change to the threshold or other design elements. New investments would still be exempt.

This increase is intended to both increase the tax revenue take, which could be passed to consumers, and encourage generators to accept a legacy WCfD. In other words going well beyond the usual remit of a windfall tax and towards a direct revenue clawback. We can see why the government would seek to do this in the face of rising consumer bills but there is clearly a risk that investors will react negatively. The government should be very wary if making changes to the threshold and marginal tax rates if that would then eat into legitimate profits, especially given that the EGL is a revenue tax to which corporate profit taxes are then added. There must also be a way to protect new investments.

A challenge for policymakers is that while the EGL carries an investment risk downside, unless there is a very significant increase in wholesale prices, the tax revenue made by the current EGL could be quite modest. In 2023/24, the EGL brought in just over £1.4 billion for the Treasury. In

2024/25, this fell to £0.7 billion, reflecting that wholesale prices were below the threshold price for most of the year, the forecast for 2024/25 could be around half a billion.[5]

Part of the missing tax revenue problem is that while the EGL targets profits made by renewable generators who are not already on a CfD, what we are finding is that these companies are often not the main profit takers during high price periods. A lot of renewable energy is sold in forward markets and then retraded in day-ahead and intraday markets. It is these traders and resellers who are often able to capture scarcity and inframarginal profits. So, if the government wants to look at windfall profits in the round it probably needs to cast a wider net across the trading market.

Another option to increase consumer benefits would be to look at other sources of generation that may also be enjoying very high profits. The early CfD projects – those who gained their CfD in the investment support (FIDER) round - benefit from very high CfD strike prices. If not a windfall profit there is at least an argument that some portion of the CfD payments made to them should also be removed from the environmental levies paid by consumers and instead treated as a form of industrial and innovation subsidy. The investment support projects could also be invited to renegotiate their remaining CfD strike price in exchange for a longer term CfD contract.

EGL: Regen snap-shot view

Even if the revamped EGL makes a modest contribution to consumer bills, it would reassure consumers and policymakers to know that a mechanism is in place should electricity prices suddenly increase. The challenge for policymakers, as with any windfall tax, is to balance the need to rein in excess profits with the need to maintain investment and market confidence.

Generators and investors will be concerned if the purpose of the EGL switches from a clear windfall tax on exceptional revenues to become an enduring revenue clawback aimed at coercing generators into a new CfD scheme. That depends of course on how attractive the new legacy CfD scheme is.

We don't know how the industry will respond, share prices of some generation asset owners fell last week, perhaps because they were expecting an even more radical market redesign. A 55% marginal tax rate is an increase but probably retains its core purpose as an excess revenue tax.

[5] For revenue details see Office of National Statistics Corporation Tax Statistics 2025 - GOV.UK

2) A new wholesale CfD (WCfD) scheme for legacy renewable projects

An effective solution to address the problem of renewables earning inframarginal rents in a "gas sets the price" market is to expand the use of long-term revenue stabilisation contracts, such as the Contract for Difference, Cap and Floor or Regulated Asset Base schemes.

Participation in a CfD scheme means that generators are prepared to give up some of their upside revenue during high price periods in exchange for a more stable and enduring revenue stream. The scheme also provides consumers with a degree of price certainty, serving as a hedge against future price rises. Whilst this doesn't decouple the market, as CfD generators still trade in the wholesale market, it does delink the revenue earned by renewable generators from the short-term market price.

Whether this is a good deal for the consumer depends on the degree of competition and price discovery within the CfD scheme. For new projects, the sweet spot is to find a CfD strike price that maximises value for the consumer while still leaving projects with sufficient returns to be investable. In recent CfD auctions, we have seen prices for onshore wind and solar CfD contracts below the prevailing wholesale price. After several very low-price rounds, offshore wind CfD prices have been slightly higher or roughly on a par with (pre-crisis) wholesale price forecasts, reflecting cost increases and expectations of negative price periods[6]. Of course, the real measure of value only comes with hindsight; the CfD is, by its nature, a hedge against uncertain future market prices.

So, if it works for new projects, why not extend the CfD scheme to legacy projects that are currently trading in the market and potentially making inframarginal rents when prices are high?

Wholesale CfD proposals

This idea of a legacy CfD is not new. It came to prominence during the last energy crisis in 2022/23 under what was termed the "pot zero" proposal. It was also discussed right at the start of the Electricity Market Reform (EMR) development (2012), when policymakers considered whether to roll the existing Renewable Obligation projects into the new CfD scheme.[7]

The proposal to extend a CfD offer to existing legacy projects as announced today faces two main challenges:

[6] During negative price periods, generators with newer CfD contracts do not receive a CfD payment. They are then exposed to a negative price risk. If negative prices are set to increase, we would expect CfD strike prices to rise to compensate developers for lost revenue. See Simon Gill Working Paper 2025.

[7] EMR Consultation on RO

1. **How to set a fair price for the consumer**, recognising that these projects are already built, and assets will have been depreciated, and so this is not about providing revenue support for investment. Officials who looked at the "pot zero" option in 2022 concluded that, if the option was voluntary, there was almost certainly a zero-sum outcome. If the strike price was high enough to encourage developers to accept a CfD contract, it must, by definition, be a bad deal for consumers.

2. **Related to point 1, if the legacy CfD is not mandatory, what leverage or incentive can be used to encourage participation?** To have a real impact the legacy CfD needs to secure around 5-10 GW of capacity. The natural incentive is that future wholesale prices are uncertain, so generators may prefer a fixed CfD strike price. On the other hand, the RO-backed generators do have a fixed RO subsidy which provides a degree of revenue security. That's where the revamped EGL may have an impact.

Inevitably, legacy CfD options get discussed at times when wholesale prices are high. So, just at the time when generators are unlikely to rush into a CfD scheme unless the scheme is advantageous to them in some other way, or they are compelled/incentivised to participate.

A significant change from the Pot Zero discussions that occurred in 2022/23 is that the government has already taken steps to move the legacy RO payments from the electricity bill levy and into general taxation.

What this means is that while there may still be a fiscal benefit to negotiating RO payments into a legacy CfD scheme, if it results in a higher CfD strike price, the outcome could add RO costs back into the electricity bill. Partly for this reason, the 2nd reincarnation of a legacy CfD is likely to exclude the RO element, setting the strike price based solely on the wholesale electricity price. This has been termed a "wholesale CfD" for legacy generators.

A secondary advantage of a wholesale-only legacy CfD is that it could simplify the scheme design by allowing greater competition (and liquidity) between projects bidding for a CfD. The optics of the scheme may also look better since the strike price, without seeking to replace the RO, ought to be significantly lower.

The problem, however, remains: how to set a fair strike price for the consumer? We don't think that the legacy CfD scheme can be made mandatory. Whether set by auction or bilateral negotiation a carrot and stick approach may be needed, hence the rise in the EGL tax take.

The carrot would be to ensure that the CfD scheme offer is attractive to generators not just in terms of its strike price but because it helps generators to manage risk and/or reduce capital costs. One option to explore is whether the terms of the legacy CfD could be developed to provide a bridging function to enable repowering. Regen's recent paper, "Repowering : A second wind", sets out there is considerable interest in repowering of older renewable projects and a lot of capacity that could be coming up for repowering within the next eight years.

A stick could come in the form of the Electricity Generation Levy, already discussed, which would reduce the upside for non-CfD generators and may make the CfD a safe-haven for generators to avoid EGL taxes.

If officials can design a workable scheme and get to a strike price that really does transfer value to consumers then the legacy CfD could be a very positive addition to the GB energy landscape. It's hard to say what that strike price should be, but it needs to pass the sniff test which probably puts it well below the last AR7 auction price for onshore wind and solar and should be less that current PPA market forecasts. An approach could be to engage with energy supply companies and major energy users to find out how much they would be willing to pay for what is, in effect, a long-term market hedge.

Even if the price is right, one possible issue however is that, if the scheme is (too) successful, we end up with even more capacity operating under a CfD contract. This adds to the existing market distortion of increasing volume in day-ahead markets while reducing liquidity for forward markets and long term PPA trades. It may also exacerbate the sort of disruptive and unpredictable market behaviour that we expect to see during periods of oversupply, economic curtailment and negative prices. It is important, therefore, to also get the design right and to use the legacy CfD to consider alternative scheme arrangements including, for example, offering a variety of CfD term periods and changing the basis of the CfD reference price to represent a basket of trades over different time periods.

Wholesale CfD: Regen snap-shot view

The legacy CfD is not a new idea but its time may have come. It would offer a practical way to hedge consumers and generators against volatile wholesale prices. The key challenge however is to come up with a strike price that is fair for consumers and does not lock future consumers into higher prices, given that we expect wholesale prices to fall over the coming decade. Done well this could also provide an opportunity to support project repowering.

There are some design issues that need to be considered including the shift of liquidity into day ahead markets and the potential new risks and unpredictable market behaviour during periods of oversupply and negative pricing.

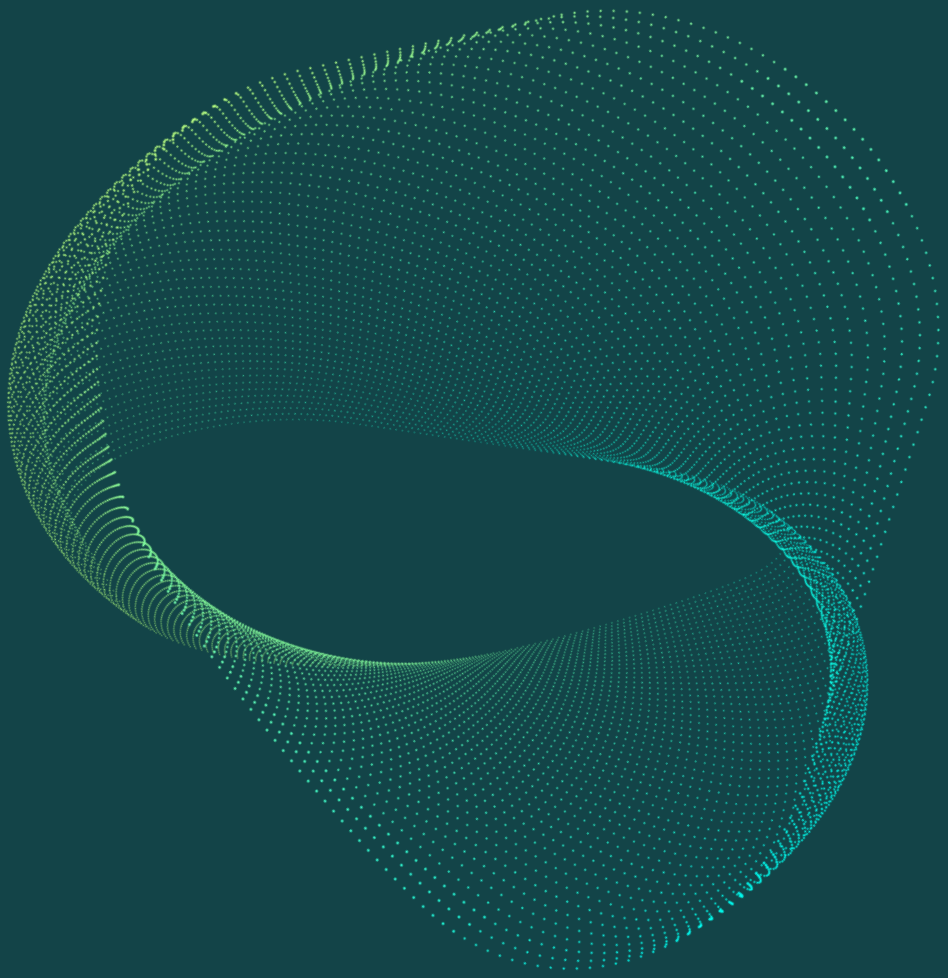
We support the goal to introduce the WCfD quickly but there is also a need to get the design right and perhaps an opportunity to look at different design options especially around the contract term and setting of the reference price.

Conclusion

Overall, it is positive the government and its officials are pursuing practical solutions that could be implemented in the near term. The devil of course is in the detail, and we look forward to working with DESNZ to bring these policies to fruition.

Meanwhile there are other areas of wholesale market design which we think deserve more attention. These include:

- Increase market transparency and maintain price competition to prevent price gouging
- Encouraging the development of the corporate and utility Power Purchase Agreement (PPA) Market
- Potentially looking at how Government could directly procure, or underwrite the procurement, of electricity on long term contracts to fund a social tariff or targeted bill relief.



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