

## The Review of Electricity Market Arrangements (REMA) End User Forum

Session 1 pre-read:

Ensuring fair outcomes for end users from REMA

February 16 2023

*This is a background note from Citizens Advice and Sustainability First. The overall aim of the first session: to explore what fair outcomes for end users could look like in the context of REMA*

The Review of Electricity Market Arrangements (REMA) is the largest programme of reforms to the electricity market in a generation. It aims to ensure that the UK can successfully deliver a decarbonised power system by 2035 at least cost. This will require investment in additional capacity and supporting technologies, and efficient operation of the system to best match supply and demand.

As part of this, Government is considering reforms to the price signals that market participants (suppliers, generators, flexibility providers and very large consumers) receive, to ensure that these prices accurately reflect the costs of delivering a secure decarbonised power system. The Department for Business, Energy and Industrial Strategy (BEIS) has set out that this will be done whilst ensuring fair outcomes for consumers.<sup>1</sup> This session will seek to explore what fair outcomes for consumers could look like, and the tradeoffs that may need considering.

The interests of different electricity end users today by no means fully coincide - whether among domestic, industrial, commercial consumers or communities - and we do not start with a blank slate. The ways in which wholesale market costs, together with network and policy costs, flow through into retail prices and tariffs today already give rise to a range of distributional impacts. However, in today's market most households and also many businesses have retail tariffs at a 'flat' p/kWh rate, regardless of when or where they consume their power.

Except for the largest customers, underlying costs are largely averaged and shared among all end users on a common basis (e.g costs of wholesale electricity, security of supply, and whether for usage at peak- or at high-cost times, or by location). Reforms such as half-hourly settlement will start to change the tariff picture for end-users but REMA introduces additional questions about the nature of wholesale price signals needed to deliver an efficient net zero power system.

Potential reforms to strengthen price signals in the wholesale market could lead to end users facing greater variations in the cost of their electricity, whether by generation fuel type, time period, scarcity/plenty or potentially by location. The extent to which this could impact end user groups differently raises questions about what fair outcomes would look like - including what major trade-offs need to be considered.

---

<sup>1</sup> BEIS (2022), [Review of Electricity Market Arrangements Consultation](#), 'At the same time, our market arrangements will need to ensure fair outcomes for consumers. Consumers will not be unfairly exposed to price signals that they cannot respond to, will retain choice over how they engage with the energy system, and remain protected as the system evolves. Most importantly, they will have a reliable and affordable electricity supply so that they can go about their daily lives.'

**This session will focus specifically on REMA reform.** We do not address how the fixed costs of the power system (including network and policy costs) are allocated between gas and electricity bills, or the specifics of any future energy retail strategy. At this stage the forum will not look to explore whether potential costs are recovered through taxation or bills.

## What are the main issues around fairness in REMA?

- Allocation of costs and benefits

Reforms are designed to spur the development of a far larger electricity system, which will be vital to support decarbonisation and electrification of heat, transport, and industrial processes at least cost. Doing this will likely entail a rejig of current policy and market mechanisms. Existing mechanisms may be reformed (with arrangements made to preserve existing contracts), and other new ones designed in order to deliver an optimal power mix for a decarbonised system. The way in which this will be implemented is still to be decided. Eventually, these decisions will shape the extent to which specific end users stand to benefit from a future energy system.

- Exposure to price signals for flexibility

A major goal of REMA is to ensure the power system of the future operates as efficiently as possible, in order to reduce overall costs. From the perspective of end users, this could mean wholesale costs vary more strongly according to output, time period and location in order to encourage flexibility. The way that these signals are passed through to different end users will have significant distributional impacts. In particular, the level to which individual consumers are rewarded for the value their flexibility provides, or whether this benefit is distributed across all consumers. Ensuring affordability of supply will also mean that there will need to be consideration of who should be shielded from certain price signals altogether.

- Implementation of reforms

Changing market arrangements will require decisions to be made on the timing and pace of reforms, and the extent to which existing market participants and specific consumer groups are shielded from any changes. This will affect how costs and benefits are balanced over time, and how quickly a net zero power system can be delivered.

## Where are there trade-offs?

In considering how best to ensure fair outcomes, it is important to understand some of the likely trade-offs that are part of decision-making.

- ‘Least cost’ vs. least distributional impacts

Exposing consumers to more granular price signals can incentivise flexibility in energy consumption. By matching demand more closely with available supply, the need for investment in additional energy resources and network capacity is reduced, and consumers can benefit from lower cost,

greener supplies. This in principle would reduce the overall cost of the energy system for all consumers. However, whilst this may deliver a decarbonised power system at 'least cost' it could also create new and potentially significant variations in cost for different end users. These could vary across a number of dimensions, including:

#### **Between levels of ability to engage**

Some consumers will be more readily able to shift demand more easily than others. Domestic consumers with heat pumps and EVs may be able to benefit most from flexibility, but there are high upfront costs associated with these new technologies that would act as a barrier to engagement for many. Non-financial factors also affect engagement, including health, digital exclusion, and literacy. While 'average' consumers may stand to benefit from some reforms, benefits or costs may differ between individuals. This could also be a challenge for I&C customers, for example certain industrial processes may require consistent high electricity use which would make it difficult to shift demand.

#### **Between different regions**

More granular pricing could impact each part of the UK differently. Depending on how reforms are implemented on the demand side, it may be that whilst most parts of the UK will see lower bills, some may see their bills increase even though the average bill goes down.

- **The needs of current vs. future consumers**

Decarbonising our power system by 2035 will require significant investment in new generation and storage technologies, and doing so will deliver benefits across multiple generations. This raises questions over how and over what timeframe new arrangements are put in place, the benefits are spread, and the costs of new infrastructure are recovered. Additionally, approaches to cost recovery must ensure that bills remain affordable now and in the future.

- **The needs of domestic vs non-domestic consumers**

Households and I&C consumers differ in their level of energy use and patterns of consumption, and as a result can rightly be expected to face differing market conditions. If households are shielded from certain costs to ensure affordability, this could result in I&C consumers bearing a greater share of the policy costs associated with REMA. The reverse could be true as well if I&C consumers are exempt from certain costs (and possibly also true if some but not other I&C customers are exempt). Balancing the needs of different consumer groups and considering how potential costs and benefits fall will be key to ensuring fair outcomes. Whilst the scope of this extends beyond REMA itself, it is important to note as a major trade off in energy policy nonetheless.

## **Fairness in energy policy**

There is no single 'off-the-shelf' definition of fairness in energy policy. There are several conceptual approaches that are often taken to set out fairness:

- Equality – all offered access to essential services on the same terms (does not differentiate for income, location, capability - so leads to differential outcomes etc)
- Equity – all get same outcome (i.e. if needed, support given to achieve a specific outcome - takes account of affordability)
- A ‘rights-based’ approach – essential services are an essential human right
- A risk-based approach – minimise harm (people, planet)
- A benefit maximisation approach – the way benefit maximisation is framed matters i.e. benefits to individuals / communities / society?

As well as decisions around how costs are allocated and who is exposed to price signals, another element of fairness is that the process by which decisions are reached is seen to be fair.

Citizens Advice and Sustainability First set out a strawman below that highlights principles for fair outcomes relating to wholesale market reforms. Next to each principle is a set of possible implications for what this could mean for wider policy decisions. It builds on previous work by both organisations and is intended as a prompt for discussion.<sup>2</sup>

Principle	What could this look like in terms of fair outcomes for electricity end users?
Equitable treatment	<ul style="list-style-type: none"> <li>● Some end users receive targeted financial support to overcome barriers to participation in e.g., flexibility</li> <li>● Work done to overcome non-financial barriers to participation</li> <li>● Cost recovery is progressive</li> </ul>
Inclusive	<ul style="list-style-type: none"> <li>● End users, especially those in vulnerable circumstances, are able to engage with the future energy system in a way that meets their own needs</li> </ul>
Justifiable	<ul style="list-style-type: none"> <li>● End users are only exposed to price signals to which they are able to respond</li> <li>● REMA policy costs are not overly borne by those least able to pay them</li> </ul>
Transparent	<ul style="list-style-type: none"> <li>● End users have been made aware and had opportunity to be involved in how policy decisions have been reached and why</li> <li>● REMA policy options have been evaluated based on their ability to facilitate fair outcomes for end users</li> <li>● Clarity of roles between BEIS, Ofgem and ESO in delivering fair outcomes for end users</li> <li>● End users informed of composition of energy bills and factors that drive change</li> </ul>

## Conclusion

The forum is asked to consider:

<sup>2</sup> Sustainability First (2019), [What is fair?](#) and (2022) [Sustainability Principles](#)  
Citizens Advice (2021), [Rough trade - balancing the winners and losers in energy policy](#)

- Whether the principles outlined above reflect participants' own views of how to ensure fair outcomes for end users from REMA - including any omissions or deletions.
- The possible outcomes noted against each principle for end user fairness in REMA (noting that some of them reach beyond REMA to wider affordability and retail programmes) - including any omissions or deletions.
- Are these additional issues useful to better indicate how the costs and benefits of change may lie, now and into the future, from REMA proposals?

**Future forum sessions** will allow in-depth discussion of main REMA reform options [although these may be subject to change]. This includes the role of marginal pricing in electricity wholesale markets, bridging between wholesale and retail reform and the role of demand-side flexibility, and, locational signals. Each forum session will also discuss the likely main trade-offs and distributional impacts for each topic in more detail.