

The Energy Prices Act 2022: A barrier to net zero?

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Environmental Law Review
2023, Vol. 25(1) 51–58
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DOI: 10.1177/14614529221146633
journals.sagepub.com/home/elj



Abstract

This legislative note evaluates the recently introduced Energy Prices Act 2022, particularly with respect to the impact that it might have on the renewables industry and the UK's ability to meet its climate change targets through the installation of renewable energy technology. The Act comes at a time where the UK and many other countries are gripped by both a global energy crisis and a cost of living crisis which has resulted in significant struggles, with some households in the UK being forced to choose whether to heat and power their homes or pay for food. The Energy Prices Act 2022 was introduced to reduce the financial burden of energy bills, and also to limit the profits made by low carbon generators. Since the enactment of the Act, further developments have been made in both of these fields. This legislative note will evaluate the contents of the Act itself, along with the further developments which have taken place and will analyse the potential impact that these changes could have on the renewables industry.

Keywords

Energy, renewable energy, contract for difference, climate change

Introduction

This legislative note evaluates the recently introduced Energy Prices Act 2022, particularly with respect to the impact that it might have on the renewables industry and the UK's ability to meet its climate change targets through the installation of renewable energy technology. The Energy Prices Act received Royal Assent on the 25th October 2022 – a speedy thirteen days after its first reading on the 12th October 2022. The Act is one of the only pieces of legislation that was produced during Liz Truss's short stint as Prime Minister, however many of the main outcomes of the legislation have already been challenged by the successive Government. The lightning speed at which the Bill became law can be largely attributed to the fact that it pertains to cost-saving energy measures for the general public, and was introduced during a cost of living crisis where 91% of adults surveyed in Great Britain reported that their cost of living had increased compared to a year ago, with 6 out

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of 10 reporting that they were very or somewhat worried about keeping warm in their home this winter.¹

This note will provide an overview of the main features of the Act, along with the further changes that have been made by the Chancellor's budget in November 2022. This includes the way in which the Act provides powers to the Secretary of State to introduce a number of cost-saving initiatives for UK households with respect to their energy bills, namely the Energy Price Guarantee and the Energy Bill Relief Scheme. This is followed by an explanation of one of the most controversial elements of the legislation which is the power to introduce a cost-plus revenue limit and voluntary contract for difference process. These new powers relate to capping the revenues made by low carbon energy generators and encouraging energy generators which are not currently subject to a contract for difference (a long-term agreement designed to provide the low carbon energy generator with price certainty over the lifetime of the contract) to enter into one. Despite their infancy, these powers have already been subjected to change by the current Government with the Chancellor's budget on the 17th November 2022 announcing an alternative 45% levy on electricity generators. The legislative note will then move on to analyse the potential impacts of the Act in more detail, paying specific attention to the implications of the revenue limiting measures that have been taken against renewable energy generation. As this is the most contentious element of the Act, it will be analysed with respect to the potential impact that it could have in undermining investor confidence in the UK and thus hindering the UK's ability to meet its 2050 net zero targets.²

Background

The Energy Prices Act 2022 was introduced during a time of political turmoil. The Prime Minister who introduced the Bill resigned five days before it received Royal Assent after spending only 45 days in the job.³ The Act has come at a time where the UK and many other countries are gripped by both a global energy crisis and a cost of living crisis.⁴ The aftermath of Covid-19 resulted in a surge of manufacturing in an attempted economic recovery – this followed a long cold winter of 2020–21 which had already depleted gas supplies.⁵ This was then followed by the Russian invasion of Ukraine in February 2022 causing a significant increase in gas prices, with gas prices having increased by 141% since the winter of 2021/22.⁶ This has resulted in significant struggles in the UK with many lower income households being forced to choose whether to heat and power their homes or pay for food.⁷

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1. 'Public opinions and social trends, Great Britain: 26 October to 6 November 2022' (*Office for National Statistics*, 11 November 2022) <https://www.ons.gov.uk/peoplepopulationandcommunity/wellbeing/bulletins/publicopinionsandsocialtrendsgreatbritain/latest> (accessed 16 November 2022).
 2. The Climate Change Act 2008 (2050 Target Amendment) Order 2019, SI 2019/1056.
 3. Joshua Nevett, Kate Whannel, 'Liz Truss resigns: PM's exit kicks off another Tory leadership race' (*BBC*, 20 October 2022) <https://www.bbc.co.uk/news/uk-politics-63332037> (accessed 16 November 2022).
 4. Brigid Francis-Devine et al. 'Rising cost of living in the UK' 'Why are energy bills going up?' (*House of Commons Library*, 20th October 2022) <https://commonslibrary.parliament.uk/research-briefings/cbp-9428/> (accessed 16 November 2022); 'Why are energy bills going up?' (*Energy savings trust*, 26 August 2022) <https://energysavingtrust.org.uk/why-are-energy-bills-going-up/> (accessed 16 November 2022).
 5. Jillian Ambrose, 'What cause the UK's energy crisis?' (*The Guardian*, 21 September 2021) <https://www.theguardian.com/business/2021/sep/21/what-caused-the-uks-energy-crisis> accessed 16 November 2022.
 6. Paul Bolton, Iona Stewart, 'Domestic energy prices' (*House of Commons Library*, 9 November 2022) <https://commonslibrary.parliament.uk/research-briefings/cbp-9491/> (accessed 16 November 2022).
 7. William Wallis, Delphine Strauss, 'Poor face choice to 'heat or eat' as British energy price surge looms' (*Financial Times*, 31 January 2022) <https://www.ft.com/content/cc960e4d-a1f2-48b7-b506-a7ffbc63fff> (accessed 16 November 2022).

In an attempt to alleviate this issue, the Energy Prices Act introduced a number of measures – including two schemes which would directly reduce both domestic and non-domestic energy bills. In addition to this, the Act shone a spotlight on profits made in the low carbon energy generation sector and sought to set a cap on the revenue received by specified generators who are not already subject to a contract for difference. Certain low carbon generators are making significant profits at the current time because the price of the electricity that they generate is coupled to the price of gas. This means that even if the low carbon generator's costs have not increased during the energy crisis, their profits will have significantly increased as the price of gas increases.⁸ The fact that gas dominates energy prices in the UK might seem surprising, given that gas generates less than half of electricity (under 40%) in the UK and only around 20% in the EU, however, as Grubb explains, 'in wholesale electricity markets, the most expensive generator sets the price.'⁹ In an attempt to rectify this disparity, the Energy Prices Act introduced powers to limit the revenue gained by low carbon energy generators and to encourage them to enter into a voluntary contract for difference. This is explained in the following section in more detail.

The key features of the Energy Prices Act 2022

The energy price guarantee and energy bill relief scheme

Two of the most well-known outcomes of the legislation are the energy price guarantee and the energy bill relief scheme. These two schemes have received significant media coverage and have impacted the majority of the public through a direct reduction in their energy bills.¹⁰ The Energy Price Guarantee applies from the 1st October 2022 and uses Government funding to cap the unit prices of gas and electricity for domestic use. It is claimed that this will keep the average annual energy bill to around £2,500.¹¹ However, despite the original plan to keep the Price Guarantee in place until 2024, the new administration led by Rishi Sunak have confirmed that this will change in April 2023 with the average energy bill expected to rise to around £3,000 per year.¹² In order to implement this, sections 1(1) and 5(1) of the Energy Prices Act allow for the Secretary of State to establish a domestic electricity price reduction scheme for Great Britain and Northern Ireland and sections 1(3) and 5(3) allow for the Secretary of State to establish a domestic gas price reduction scheme for Great Britain and Northern Ireland.

In addition to the Price Guarantee, the Energy Prices Act also allows for the introduction of the Energy Bill Relief Scheme. This applies to eligible non-domestic gas and electricity customers, and to heat network customers. The scheme will benefit businesses, voluntary sector organisations, such as charities, and public sector organisations such as schools, hospitals and care homes. The unit prices for these non-domestic customers will be reduced by the government to £211 per megawatt hour (MWh) for electricity and £75 per

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8. Note this only applies to low carbon generators who are not subject to a Contract for Difference. The Contract for difference process and the way it affects low carbon generation profits is explained below in the section entitled 'The cost-plus revenue limit'.
 9. Professor Michael Grubb, 'Opinion: Renewable are cheaper than ever – so why are household energy bills only going up?' (*UCL*, 18 January 2022) <https://www.ucl.ac.uk/news/2022/jan/opinion-renewables-are-cheaper-ever-so-why-are-household-energy-bills-only-going> (accessed 16 November 2022).
 10. The Energy Crisis and the Government's plans to provide support have received significant media coverage. See for example: Martin Lewis, '14 'energy price guarantee' need-to-knows' (*Moneysavingexpert*, 8 November 2022) <https://www.moneysavingexpert.com/utilities/energy-price-guarantee/> (accessed 16 November 2022); Jess Clark, 'Energy bills support scheme: who is eligible and when will it be paid?' (*The Guardian*, 29 July 2022) <https://www.theguardian.com/money/2022/jul/29/energy-bills-support-scheme-who-is-eligible-and-when-will-it-be-paid> (accessed 16 November 2022).
 11. Explanatory Notes to the Energy Prices Act 2022, para 7.
 12. Kalpana Fitzpatrick, 'Autumn Statement: Energy Price Guarantee extended – but will not be as generous' (*Moneyweek*, 17 November 2022) <https://moneyweek.com/personal-finance/605439/energy-price-guarantee-u-turn> (accessed 19 November 2022).

MWh for gas.¹³ This scheme also applies to heat network providers who run their systems on gas as explained further in the following section.

Support for heat network customers

The Energy Prices Act also provides a degree of protection for customers on heat networks. Heat networks (also known as district heating systems, communal heating systems and teleheating¹⁴) provide hot water to residential and commercial buildings and remove the need for gas boilers to be installed in individual buildings. Comparatively, the level of heat networks in UK homes is currently very low with only 2–3% of buildings¹⁵ being served by a heat network (approximately 500,000 customers¹⁶). Whilst heat networks have been around in the UK since the 1960s, the concept has been slow to emerge due to a lack of early government support.¹⁷ As a result, heat networks are currently unregulated in the same way that the gas and electricity industries are. This has led to a number of heat network customers being stuck in monopoly contracts where their heat providers have increased their prices by as much as 700% since 1st April 2022.¹⁸ This is due to the fact that heat networks are not subject to the same kind of price caps or regulation over their price setting as the electricity and gas industries are. In an attempt to rectify the long-overdue problem of a lack of regulation in this sector, the Energy Bill was introduced on the 6th July 2022 to appoint Ofgem as the regulator over heat networks with powers to monitor pricing and introduce a cap if necessary.¹⁹ However, due to other measures also being introduced by the Energy Bill, the recent changes in government have resulted in the progress of the Bill being paused whilst the new administration agrees on its approach to regulating the energy sector.²⁰ This means that heat network customers remain in an unregulated system.

As heat networks are not currently regulated by Ofgem and their customers are not subject to the same energy price caps that apply to gas and electricity customers, the Government has introduced the Energy Bill Relief Scheme. This ensures that the price of the gas that is purchased by heat networks that run off of gas is capped to £75 per MWh.²¹ The owner of the heat network is then required to pass on any savings that result through to their customers.²² This feed-through requirement does not apply to heat suppliers who already

13. 'Energy Bill Relief Scheme: help for businesses and other non-domestic customers' (*Department for Business, Energy & Industrial Strategy*, 21 September 2022) <https://www.gov.uk/guidance/energy-bill-relief-scheme-help-for-businesses-and-other-non-domestic-customers> (accessed 16 November 2022).

14. 'Teleheating' (*European Environment Agency*) <https://www.eea.europa.eu/help/glossary/gemet-environmental-thesaurus/teleheating> (accessed 18 August 2022).

15. Jack Miller, 'Heat Networks' (*UK Parliament*, 29 September 2020) <https://post.parliament.uk/research-briefings/post-pn-0632/> (accessed 18 August 2022).

16. Becky Mawhood, 'House of Commons Library Research Briefing: Heat networks and energy prices' (*House of Commons Library*, 19 April 2022) <https://researchbriefings.files.parliament.uk/documents/CBP-9528/CBP-9528.pdf> 7.

17. P Woods, J Overgaard, 'Historical development of district heating and characteristics of a modern district heating system' in Robin Wiltshire (ed), *Advanced District Heating and Cooling (DHC) Systems* (Woodhead Publishing, 2016, p. 8).

18. 'Heat Trust welcomes extension of energy bill support scheme to residents on communal electricity systems; (*Heat Trust*) <https://www.heattrust.org/latest-news> (accessed 18 August 2022).

19. Energy Bill HL Bill (2022-23) 39.

20. Paul Waugh, Hugo Gye, 'Liz Truss to ditch Boris Johnson's energy overhaul plans to focus on driving down cost of household bills' (*Associated newspapers limited*, 14 September 2022) <https://inews.co.uk/news/politics/liz-truss-to-ditch-boris-johnsons-energy-overhaul-plans-focus-driving-down-cost-household-bills-1856951> (accessed 16 November 2022).

21. 'Energy Bill Relief Scheme: help for businesses and other non-domestic customers' (n 13).

22. 'Guidance on the Energy Bill Relief Scheme pass-through requirements for heat networks in the UK' (*Department for Business, Energy & Industrial Strategy*, 4 November 2022) <https://www.gov.uk/government/publications/pass-through-requirements-for-energy-price-support-provided-to-intermediaries/guidance-on-the-energy-bill-relief-scheme-pass-through-requirements-for-heat-networks> (accessed 16 November 2022).

offer a form of ‘price promise’ to their customers which implements a system where heat network consumers are linked to domestic gas and electricity prices, in which case the consumer would already be paying similar prices to gas customers who are benefitting from the Energy Price Guarantee.²³ For those customers who are not already benefitting from a price promise from their heat supplier, the supplier must ensure that they pass on the benefit to the consumer within thirty days of the Regulations coming into force.

The cost-plus revenue limit (as replaced by the electricity generators levy)

One of the most controversial features of the Energy Prices Act is the introduction of the Cost-plus revenue limit. The intention of the cost-plus revenue limit was to provide the Secretary of State with the power to set a cap on the revenue which has been raised by specified low carbon generators who are not already bound by a contract for difference. A contract for difference is a government mechanism for supporting low-carbon electricity generation and has been introduced to cater for the fact that low carbon generation can come with very high upfront costs.²⁴ To date, contracts for difference have been offered through a competitive bidding process. Therefore, whilst it is common for a low carbon development to be subject to a contract for difference, there will also be a number of developments which are not subject to these agreements if they either did not submit a bid or were unsuccessful in obtaining one. Under a contract for difference, low carbon generators are paid a flat (indexed) rate for a 15 year period – this figure is calculated as the difference between the ‘strike price’ which is the price for electricity reflecting the cost of investing in a particular low carbon technology, and the ‘reference price’ which is the average market price for electricity in the market.²⁵ The biggest benefit of a contract for difference is that it provides certainty for low carbon generators as they will receive a set rate for the electricity that they produce for 15 years. However, as the energy crisis has hit, this has sent the reference price much higher than it usually is. Therefore, low carbon generators who are not subject to a contract for difference have the potential to be making significant profits at this time.

The Energy Prices Act had provided the Secretary of State with the power to introduce such a cap to address situations where low carbon generators are making these significant profits, however on the 17th November 2022, the Chancellor announced that the Government are instead introducing a 45% levy on electricity generators. This replaces the cost-plus revenue limit. This 45% levy applies to those who generate electricity from nuclear, renewable and biomass sources²⁶ and is argued by the Government to be ‘a more proportionate measure that is not only administrable through the corporate tax system, which generators are familiar with, but will leave generators with a greater proportion of their returns to invest in growing the UK’s renewable energy capacity.’²⁷ The levy applies to what the government term to be ‘extraordinary’ profits, which is defined as electricity sold above 75MWh, and is a temporary levy due to end in 2028. In the same way as the cost-plus revenue limit, the levy will not apply to electricity generators who are currently bound by a contract for difference.

23. *ibid.*

24. ‘Contracts for Difference’ (*Department for Business, Energy & Industrial Strategy*, 13 May 2022) <https://www.gov.uk/government/publications/contracts-for-difference/contract-for-difference> (accessed 16 November 2022).

25. *ibid.*

26. ‘Electricity Generator Levy Technical Note’ (*HM Treasury*, November 2022) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1118358/Electricity_generator_levy_technical_note_final.pdf (accessed 19 November 2022), 9.

27. ‘Energy Taxes Factsheet’ (*HM Treasury*, 17 November 2022) <https://www.gov.uk/government/publications/autumn-statement-2022-energy-taxes-factsheet/energy-taxes-factsheet> (accessed 19 November 2022).

Voluntary contracts for difference

Related to the abovementioned cost-plus revenue limit is the fact that the government have also used the Energy Prices Act to provide the Secretary of State with the power to create a voluntary contract for difference process which would apply to low carbon generators who are not currently bound by a contract for difference. Until now, contracts for difference have been awarded in specific allocation rounds so renewable generators have had to time their developments accordingly in order to obtain development consent in time to then apply for a contract for difference.²⁸ This new voluntary contract for difference offering will allow renewable generators who did not manage to obtain a contract for difference initially to sign up to one from 2023. However, the success of the scheme will largely depend upon the strike price that the government is willing to offer on the new voluntary contracts.

The impact of the legislation

Some of the provisions introduced by the Energy Prices Act 2022, such as the Energy Price Guarantee and the Energy Bill Relief Scheme, would have been welcomed by many households and businesses around the UK as it provided some much-needed breathing room from the crushing energy prices that are gripping the finances of many in this cost-of-living crisis. However, as the phrase goes, good things don't last forever. For the Energy Price Guarantee, it will provide customers in the UK with six months of relief from high bills before the scheme is scaled back and the average household bills will increase further to £3,000 per year. However, it is not the Energy Price Guarantee or the Energy Bill Relief Scheme which has caused the most controversy from the Energy Prices Act. The proposed cost-plus revenue limit, now replaced by the 45% levy on extraordinary electricity generation has caused a significant degree of upset within the electricity generation industry.

When it was announced, the cost-plus revenue limit was met with scepticism from industry leaders, however there was a degree of hope that the consultation phase, which was due to tease out the finer details, would result in a scheme that was agreeable to both generators and the Government.²⁹ However, this scepticism has turned to anger and disappointment from industry leaders after the Chancellor announced that the cost-plus revenue limit would be replaced with a 45% levy.³⁰ Whilst the profits made by energy companies at this time have become a regular feature in the news, with many calling for windfall taxes to be implemented to prevent excessive profiteering at a time when many are suffering financial hardship, there has also been an understanding that the government must take care to tread a fine line with low carbon technologies so as to not deter low carbon generators from choosing to construct in the UK. In order to meet its climate target of reducing its greenhouse gas emissions to zero by 2050, low carbon technologies need continued support from the government. In order to meet this target, it is forecast that the UK needs to increase its renewable energy output from 40GW in 2019, to 88GW in 2030 and

28. 'Contracts for Difference' (n 24).

29. 'SSE comments on UK government's Cost-Plus-Revenue Limit' (*SSE*, 11 October 2022) <https://www.sse.com/news-and-views/2022/10/sse-comments-on-uk-government-s-cost-plus-revenue-limit/> (accessed 19 November 2022); 'RWE responds to proposed UK Government 'Cost-Plus Revenue Limit' (*RWE*, 11 October 2022) <https://www.rwe.com/en/press/rwe-ag/2022-10-11-rwe-responds-to-proposed-uk-government-cost-plus-revenue-limit-> (accessed 19 November 2022).

30. Ian Griggs, 'Industry dismay at UK government plan for 45% windfall tax on renewables' (*Windpower Monthly*, 17 November 2022) <https://www.windpowermonthly.com/article/1805603/industry-dismay-uk-government-plan-45-windfall-tax-renewables> (accessed 19 November 2022); Alban Thurston, 'Energy Industry slates Chancellor' (*The Energyist*, 18 November 2022) <https://theenergyist.com/energy-industry-slates-chancellor/> (accessed 19 November 2022); 'Autumn Statement 2022: electricity generator levy a risk to renewables investment' (*Pinsent Masons*, 17 November 2022) <https://www.pinsentmasons.com/out-law/news/electricity-generator-levy-a-risk-to-renewables-investment> (accessed 19 November 2022).

186GW in 2050.³¹ In addition to this, the current energy crisis has shown that relying on other countries for energy can lead to volatile situations where conflict and economic problems can cause significant problems for energy security.

There is now a real fear that the introduction of the 45% levy could undermine investor confidence and could potentially lower the number of low carbon generators who choose to develop in the UK, thus potentially hindering the UK's ability to meet its 2050 emission targets. Whilst the government have been very keen to stress that the levy is temporary and proportionate and therefore 'is not expected to harm long term investment due to it applying to only a portion of excess profits',³² it will inevitably cause a change in existing contracts for low carbon generators who are not currently subject to a contract for difference.

Another argument from the Government in favour of introducing the levy is the comparison to other countries, such as France, Italy and Spain, who have also taken steps to reduce extraordinary returns being made by low-carbon generators.³³ This also follows a similar scheme which has recently been introduced in the European Union, where a temporary regulation has been introduced to cap the revenue on electricity produced at EUR 180 per MWh.³⁴ Whilst the introduction of similar levies in other European countries may signal an indication that the UK's renewable prospects will not be significantly hampered, the risk that industrial leaders will choose to boycott development in countries which impose such levies remains a real concern for climate mitigation efforts.

It is interesting to note how the Government have deliberately chosen to exclude gas generators from the levy.³⁵ Oil and gas companies were already subject to a 25% windfall tax which has now been increased to 35%, however the Government justified excluding them from the extraordinary profits levy by arguing that they are in a different position to electricity generators in the sense that, unlike electricity generators, the costs of gas inputs have increased meaning that whilst gas companies are making significant profits at this current time, their outgoings have increased more than electricity generators. The Government also expressed a concern whereby if they were to apply this levy to gas companies then this could further increase the price of gas, along with all other forms of energy in the market.³⁶ Thus it seems, for now at least, that fossil fuels remain to be the driving force when it comes to energy prices, and the Government's hands are tied when it comes to imposing harsher forms of levy and taxation than those already in place.

Conclusion

The Energy Prices Act 2022 seems unlikely to stand the test of time due to the volatile and continually-changing nature of the problem that it aims to tackle, however it has already earned its place in the history books as one of the key pieces of legislation introduced from the shortest standing Government in British history. It is hoped that the current Government have made the right call with respect to the Electricity Generators Levy and that this does not end up as an unfortunate footnote in the history books detailing the reason as to why renewable energy generation was stunted in the UK due to a lack of investor confidence. There is no doubt that the Chancellor and the current Government have an incredibly tough job

31. 'Make way for renewable energy generation' (*Crown Commercial Service*, 27 October 2021) <https://www.crowncommercial.gov.uk/news/make-way-for-renewable-energy-generation> (accessed 20 November 2022).

32. 'Energy Taxes Factsheet' (n 27).

33. *ibid.*

34. Council Regulation (EU) 2022/1854 of 6 October 2022 on an emergency intervention to address high energy prices [2022] OJ L1 261/1.

35. 'Electricity Generator Levy Technical Note' (n 26) 11-12.

36. *ibid.*

on their hands – one which has highlighted that, despite the extensive development of low carbon technologies on a global scale, fossil fuels remain the dominant force in the industry when it comes to pricing. Whilst all of the measures outlined in this legislative note are temporary in nature to solve today’s problem, it is clear that in the longer term more work is needed to reform electricity markets to sever the price link to gas and produce a market which is simultaneously fair for customers whilst attractive for investors.³⁷

Declaration of conflicting interests

The author(s) declared no potential conflicts of interest with respect to the research, authorship, and/or publication of this article.

Funding

The author(s) received no financial support for the research, authorship, and/or publication of this article

37. Michael Grubb, Paul Drummond, Serguey Maximov Gajardo, ‘Reforming electricity markets for low-cost and low carbon power’ (*UCL*, 6 September 2022) <https://www.ucl.ac.uk/bartlett/sustainable/research-projects/2022/nov/reforming-electricity-markets-low-cost-and-low-carbon-power> (accessed 20 November 2022).