

Fairer energy

The case for energy
market reform

What's in an energy bill?

It's not as simple as the cost of energy.

Energy bills are made up of **multiple components** covering the costs of the whole energy system – not just for generation, distribution and supply, but also the costs of government policy.

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Where does £10 go?

Energy costs

This is the wholesale cost of the electricity and gas that suppliers buy to serve their customers.

Network costs

The charges paid to gas and electricity networks for building, maintaining and operating the infrastructure that transports energy around the grid.

Operating costs

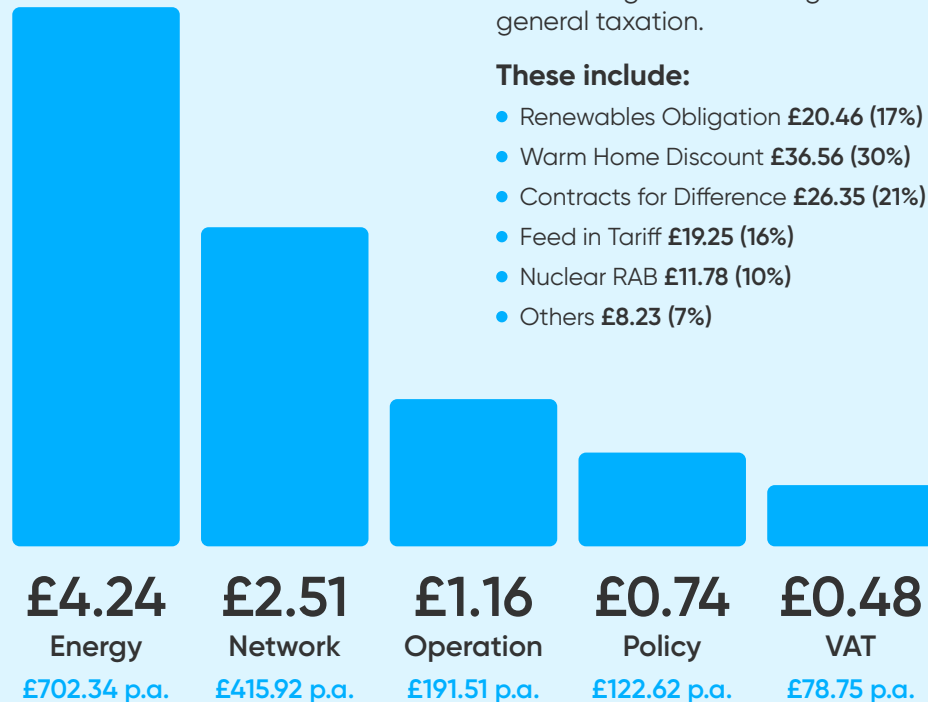
The costs of running an energy supplier, including delivering government policy and schemes, billing and payments, sales and marketing, customer services and metering.

Policy costs

The cost of government schemes that energy suppliers are required to collect funding for through customer bills, rather than these being funded through general taxation.

These include:

- Renewables Obligation **£20.46 (17%)**
- Warm Home Discount **£36.56 (30%)**
- Contracts for Difference **£26.35 (21%)**
- Feed in Tariff **£19.25 (16%)**
- Nuclear RAB **£11.78 (10%)**
- Others **£8.23 (7%)**



There is no single cause of high bills. There are a number of drivers, most of which are outside suppliers' control.

Government and the regulator can take action across different areas to support GB households with affordability.

VAT

A 5% tax applied to the total energy bill which goes to Treasury.

Debt

Domestic energy debt now stands around £5 billion. The costs of bad debt is socialised across bills, driving up costs for other customers. Costs cover writing off debt, recovering the debt, and working capital costs.

Supplier margin

Ofgem's price cap includes an allowance for suppliers to make 2.4% EBIT - a measure of profitability. By contrast, network price controls assume 5-7% returns. In reality, suppliers don't achieve 2.4%. Persistent cost underestimation and restrictions on debt recovery mean suppliers have achieved only 13% of that target over the past five years (0.312% EBIT).

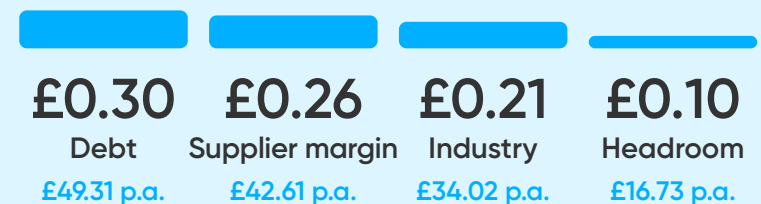
Industry costs

The costs of running industry bodies, including the DCC which manages smart meter communications (the majority of costs), SEGB which runs campaigns on smart meter adoption, and other data services.

Headroom

An allowance of 1.5% added to other costs to account for uncertainty in Ofgem's modelling and for changes within each cap period.

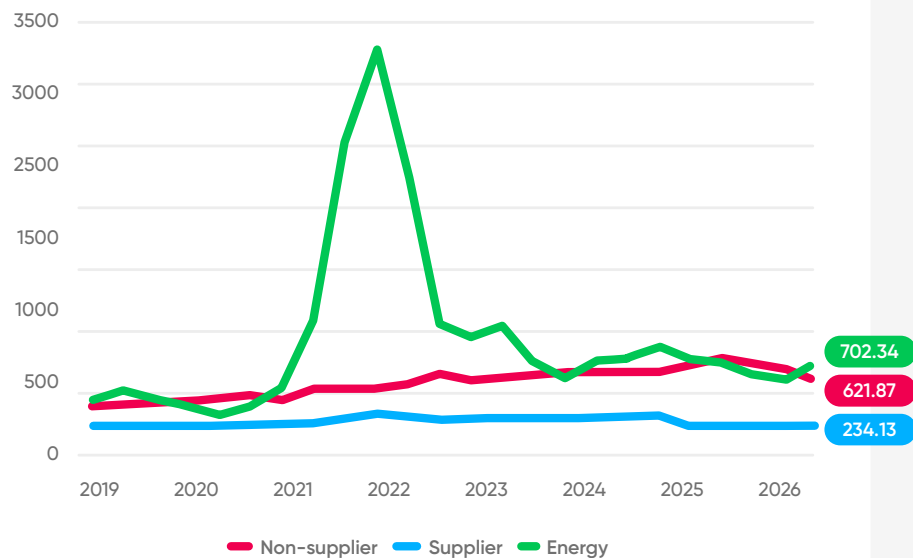
This breakdown uses the July 2026 – September 2026 price cap for direct debit customers, given most customers pay by direct debit. The prepayment price cap is £50 cheaper at £1,812. Paying by standard credit (on receipt of bill) is the most expensive at £2,005 (£184 more than prepayment). We have included Contracts for Difference (CfD) costs as a policy cost given they are a regulated, government-backed adjustment to the wholesale market price.



Even when wholesale prices are stable, structural costs are rising

Wholesale costs have stabilised

Energy costs spiked during the energy crisis sparked by Russia's invasion of Ukraine. Following this peak, prices stabilised. While geopolitical volatility can have significant impacts on wholesale energy costs, UK Government has limited control over this - at least in the medium-term.

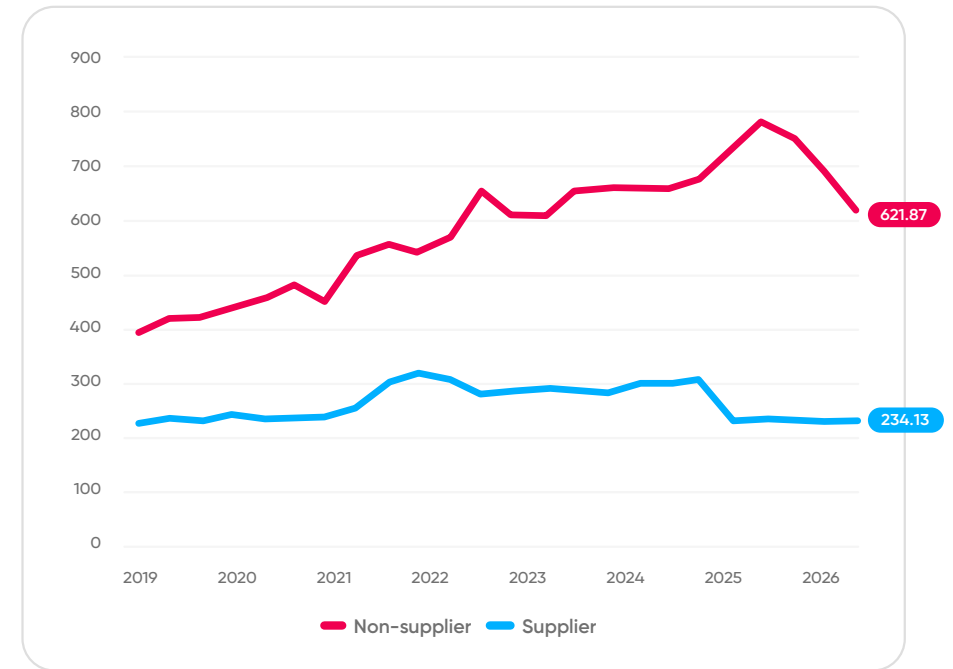


Due to the way the price cap is calculated, supplier costs include actual supplier costs (operating costs and EBIT) in addition to industry costs. Non-supplier costs cover policy, network, industry and debt costs. Energy is the wholesale energy costs. Headroom and VAT are not included.

Structural costs are rising

Non-supplier costs (including network, policy and bad debt costs) contribute almost as much to a bill as the cost of energy. These costs are projected to continue to increase as we build out energy infrastructure needed to deliver a secure, resilient and low-carbon energy system for the long term. Ofgem estimates network build out will add £108 to bills by 2031.

Meanwhile, supplier costs have remained relatively stable.

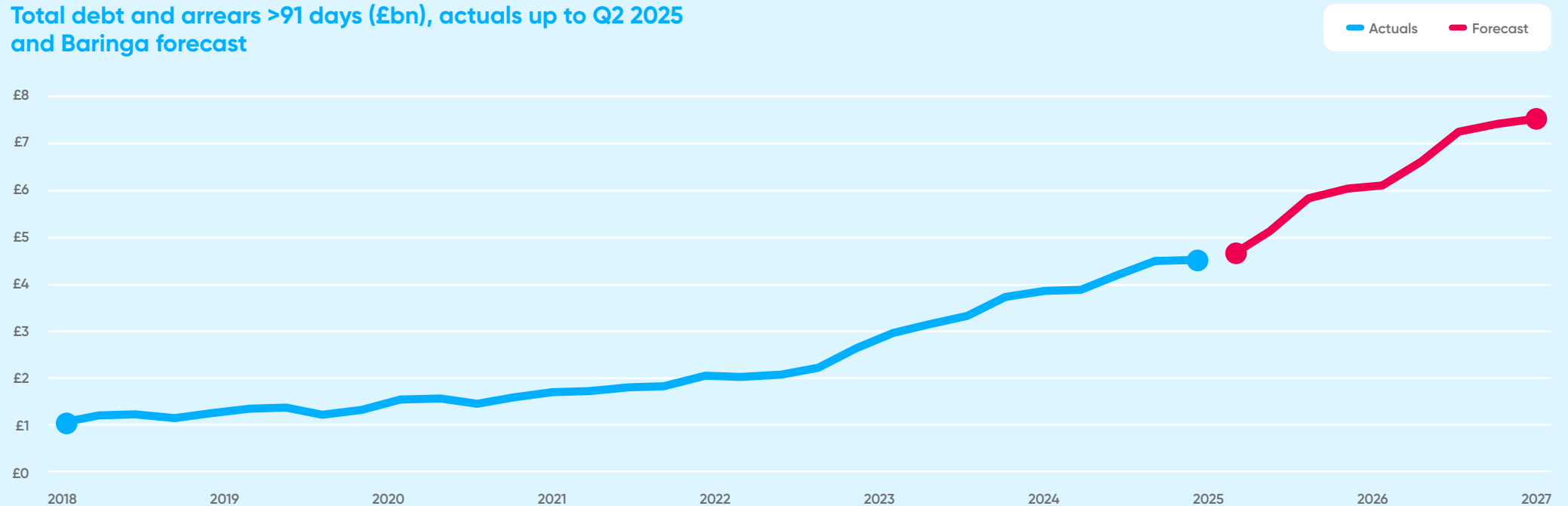


The drop in non-supplier costs we saw in the last quarter was due to removal of the Energy Company Obligation and 75% of the Renewables Obligation from bills and into general taxation, which at the time lowered bills by £149.51. From July onwards, Ofgem has also revised its 'typical domestic consumption values' down to reflect improved energy efficiency. Structural costs may therefore look to have decreased by a larger proportion in the last quarter.

Supplier costs include operating costs, industry costs and EBIT. Non-supplier costs cover policy, network, industry and debt costs. Energy costs are wholesale energy costs. Headroom and VAT are not included.

Meanwhile, debt is spiralling

Total debt and arrears >91 days (£bn), actuals up to Q2 2025 and Baringa forecast



There is a misconception that the energy crisis is to blame for the enormous debt burden. However, debt has continued to rise after prices stabilised. Debt is a result of the broader affordability crisis and policy decisions which have limited the ability of suppliers to collect payments.

As suppliers effectively collect money on behalf of other organisations, they take on all the debt risk in the energy sector. Suppliers are expected to manage this risk on behalf of industry but lack recourse to recover costs.

This undermines the financial resilience and investability of the retail market while driving up costs for paying customers.

While Ofgem's debt relief scheme is targeting debt accrued during the energy crisis, we must urgently put the brakes on debt

accumulation and then turn to addressing post-crisis debt. Otherwise, the cost of debt to all customers will continue to rise.

Baringa analysis showing total debt and arrears (>91 days). Actuals shown up to Q2 2025. Onwards is Baringa's forecast.

What needs to change

We need a fairer way to fund the transition and protect households, while promoting investment and innovation.

1 Lowering costs

We need to have an honest conversation about rising energy costs, where they should sit and how they should be managed. Bills will continue to increase. If Government wants to prevent this, these costs must be moved elsewhere. If people cannot afford an essential service like energy, this is a social and economic policy problem that Government must address.

Currently, vulnerable and low-income customers carry a disproportionate share of costs while accessing few of the benefits. A fairer balance and the right support are essential to maintaining public consent for the transition.



Reform Warm Home Discount into a meaningful social discount scheme

The Warm Home Discount has only risen by £10 in a decade and does little to address fuel poverty.

A more impactful, targeted support mechanism is needed, delivered as lump-sum winter payments when need is highest and the risks of cold, damp homes are greatest.

Ringfence VAT revenue to pay for reformed Warm Home Discount

Removing VAT would be regressive, benefiting high-consumption households most. Instead, ringfencing VAT revenue could fund a larger social discount and remove WHD costs from bills.

With £2.5 billion of VAT revenue and WHD costs removed, 6 million WHD recipients could save £450, with all other customers saving around £40.

Review policy costs and move into general taxation

Removing ECO and RO from bills is welcome, as is the commitment to stronger scrutiny of any new costs.

This framework must be delivered quickly and assess all remaining policy costs, including whether they should move into general taxation – a fairer approach than placing a greater burden on those already struggling.

Put the brakes on debt accumulation and provide relief for those in need

Energy debt is rising, with costs ultimately shared across all customers.

Tackling this must be a priority through a debt-relief scheme, improved affordability support, and ensuring fair debt collection.

Fund network upgrades through Government bonds

The energy transition is a once-in-a-century economic transformation, comparable to post-war reconstruction or wartime mobilisation.

Government could adopt a similar model to fund this, issuing energy transition bonds to raise long-term capital to fund infrastructure upgrades. Transition bonds would attract institutional and public investors, spreading costs more evenly across society and time, while ensuring the benefits of the transition are shared more fairly and accelerating investment into the UK.



Solar can
save up
to £600
on average
per home

2 Supporting solar

Behind-the-meter solar and batteries are among the most effective ways to cut energy bills. Adding a 5 kWh battery can raise solar self-consumption to 54%, and Utilita believes this can reach up to 70%.

Expanding on-site generation and storage eases pressure on the grid, reduces the costs of network build-out, and makes electric heating and EVs more affordable. It also shields households from volatile international energy markets. Yet many cannot afford these technologies, meaning they shoulder the costs of the transition without accessing the savings.

Unleash private investment in social housing

Credit risks and tenancy issues hinder private finance for solar in social housing, where the impact can be greatest. Grants alone

won't build a sustainable market. Government should instead use GB Energy and Warm Homes Plan funding from GB Energy to support new business models that unlock private capital.

Move quickly to offer low and zero interest loans

The Warm Homes Plan's commitment to expanding green finance is welcome, but speed is critical. Delays risk stasis in the market as consumers wait for affordable loans.

Direct community benefit funds to solar for low-income households

As Government considers how to share the benefits of new infrastructure with host communities, it should channel community benefit funds into rooftop solar for low-income households – ensuring the transition delivers tangible benefits for everyone.

3 Unlocking investment and innovation

Suppliers collect costs for parts of the energy system outside their control, with the only give in the system being suppliers' own costs and margins.

In the last 5 years, underestimated costs and tight price-cap calculations have caused almost £5bn of under-recovery, leading to underinvestment and stalled innovation. This has weakened balance sheets, reduced service quality, slowed progress on net zero and smart-system goals, and ultimately left customers facing weaker competition, less innovation, and higher systemic risk.

Government and Ofgem recognise the need for a retail market that can attract investment, but action is now required.

Return the price cap to its original purpose

Designed to protect disengaged and vulnerable customers from excessive pricing, the cap has evolved into a mechanism that forces suppliers to converge, limiting choice and innovation. Ofgem should restore a single cap set at the point of exploitative pricing, allowing suppliers to compete

below it and develop offers tailored to different customer groups, helping to reduce bills.

Streamline retail regulation

Ofgem's supply licence and guidance exceeds 10,000 pages. Much of it is outdated, conflicting or overly prescriptive – it drives up costs, forces convergence, and isn't fit for a future energy system.

An outcomes-based approach, underpinned by guaranteed performance standards and automatic compensation, would set clear minimum expectations while giving suppliers flexibility to innovate. This should be backed by a full review to remove unnecessary rules, with ongoing updates to ensure regulation remains fit for purpose.



Save over £500 for those who need it most



An action plan:

- ✓ Reform Warm Home Discount into a meaningful social discount scheme
- ✓ Ringfence VAT revenue to pay for a reformed Warm Home Discount

Saves £42 for all and £450 for those most in need

- ✓ Move quickly to get low and zero interest loans for clean tech on the market

- ✓ Unleash private investment for solar and batteries in social housing

- ✓ Direct community benefit funds from renewable projects and infrastructure developers to solar for low-income households

- ✓ Review policy costs and move into general taxation

Saves up to £40

- ✓ Fund network upgrades through government bonds

Saves £108 by 2031

- ✓ Put the brakes on debt accumulation and provide relief for those in need

- ✓ Streamline regulation of the retail market to support innovation

- ✓ Return to using the price cap as a protection from excessive charging practices

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