**TWO-WAY CONTRACT-FOR-DIFFERENCE TO REDUCE WHOLESALE ELECTRICITY PRICES**

**EIUG POSITION PAPER**

**Introduction**

This position paper sets out the remaining issue of the wholesale electricity price differential between Great Britain and European countries that puts GB energy intensive industries (EIIs) at a competitive disadvantage and proposes a Two-Way Contract-for-Difference (CfD) to resolve this issue. The Two-Way CfD reduces EIIs exposure to wholesale electricity prices by providing them with an agreed wholesale price achieving parity with the lowest wholesale electricity prices in relevant European countries. The Government already has a governance structure in place to implement the proposal in less than a year. The EIUG advocates for the Government to adopt the Two-Way CfD.

**Issue**

The removal of the indirect cost of levies and obligations on suppliers and compensation for up to 90% of network charges have reduced the industrial retail electricity price differential between Great Britain and European countries. However, the differential has not reduced to zero and a significant disparity remains, mainly due to wholesale electricity prices – see figure on the right from UK Steel’s industrial electricity prices report 2025.



The Baringa report for UK Steel states that “*the GB [wholesale electricity] market’s higher reliance on gas generation has driven higher power prices in recent years due to exposure to high wholesale gas prices. Despite significant growth in renewable generation, gas plant still sets the price most of the time with power prices therefore trending in line with wholesale gas prices*”.

The first consultation on the review of electricity market arrangements (REMA) explored reforms that move away from marginal pricing – splitting the market and green power pool – but the second consultation on REMA ruled out making any changes suggesting that renewables will be more and more on the margin.

However, academic research[[1]](#footnote-1) points out that, “*although in 2021 gas-fired power stations accounted for 43% of electricity generation in the UK, this form of generation set the system price 97% of the time*” which is unlikely to change significantly, let alone how an increase in renewables on the margin might be reflected in industrial retail electricity prices. The wholesale electricity price differential is therefore likely to persist.

**Two-Way EII Contract-for-Difference (CfD)**

The EIUG therefore proposes a two-way EII CfD. The objective of this CfD is to reduce EIIs exposure to wholesale electricity prices by providing them with an agreed wholesale price achieving parity with the lowest wholesale electricity prices in relevant European countries.

When the wholesale market price is above a strike price, EIIs receive a payment from Government for the difference between the strike and wholesale prices. When the market price is below the strike price, EIIs pay the Government the difference.

*Administration*

The Government could set the strike price based on whichever electricity price is lowest of a selection of European countries, for example, and review it on a quarterly basis to reflect any changes. The calculation of the difference between the CfD strike price and market reference price could include an ex-post reconciliation at the end of each quarter. The market reference prices can be calculated in the same way as for the renewable CfD.



The Government already has a governance structure in place with the Low Carbon Contracts Company that administers renewable CfDs. Using the LCCC will likely reduce the time for implementation to less than a year. Furthermore, there are no upfront capital requirements nor any technical and operational barriers to implement a two-way EII CfD.

The EIUG proposes that all energy intensive companies in eligible sectors for the EII renewable exemptions schemes are in scope of a two-way CfD.

*Economics*

A two-way EII CfD would transfer the cost of short-term wholesale price volatility and medium-term higher GB wholesale prices to Government. Depending on how the Government may wish to finance this CfD – with the EUIG having strong preference for it be funded by the Exchequer – the Baringa report for UK Steel also estimates what the impact might be if the CfD were to be funded via a levy on other consumers. Indexing the strike price to the French wholesale electricity price could increase the electricity price for non-EIIs by an average of £0.17/MWh between 2026-2030 and reduce it by £0.04/MWh on average between 2031-2035, as the steel industry electrifies and wholesale prices in GB come down relative to France’s.

Using projected EII electricity demand of 9.7 TWh in 2025 increasing to 12.2 TWh by 2035, the net cost to consumers is estimated at £51m annually between 2026–2030 and an average net benefit of £13m to the consumer annually between 2031–2035. As businesses could choose whether or not to enter a CfD, the likely cost could be lower.

These costs could be lower if the two-way CfD contained a DSR/consumer flexibility element to incentivise EIIs to reduce their consumption at peak times. One option could be to disapply the CfD at peak hours or link it to a Triad-style network charge reduction.

**Conclusion**

The Two-Way CfD is an option to reduce the wholesale electricity price differential with other European countries. It is basically a hedge with the risk of a negative differential transferred to Government in the short to medium term, but this will bring UK wholesale prices for EIIs more in line with that faced by European competitors and allow EIIs to compete on a more level playing field. The governance is already in place and administrative processes only need little change to implement it. The EIUG therefore proposes the Government to implement the Two-Way CfD for energy intensive industries.

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1. Zakeri et al. (2023), “The role of natural gas in setting electricity prices in Europe”, *Energy Reports*, volume 10: pp 2778-2792. [↑](#footnote-ref-1)