
PERSPECTIVE

The big issues for electricity market reform

There has been plenty of opportunity to discuss the UK Government's electricity market reform (EMR) proposals over recent months. The pros and cons, details and alternatives, have all been extensively debated in a range of conferences, seminars, workshops, breakfast meetings and dinners. Much of the discussion has focused on the details of the proposals: how to design a contract-for-difference feed-in-tariff or whether a targeted capacity mechanism is the best way to deliver security of supply. However, occasionally, says Simon Skillings*, contributors have injected a degree of excitement into proceedings by claiming that the whole basis of EMR is flawed and it will only be a matter of time before reality will strike home and common sense will prevail. In the following article he sets the scene for the publication next month of the EMR conclusions.

Electricity Market Reform (EMR) is based on the presumption that the power sector needs to be transformed to an extent, and at a rate, that cannot be funded under the current market arrangements. Sufficient numbers of investors are simply not prepared to take the risks involved and it is, therefore, necessary for the government to intervene to directly transfer risk from investors to customers by signing long-term contracts that stabilise future earnings. The objection raised is that this approach simply won't work.

Firstly, it is argued that investors do not believe that government aspirations to transform the sector are credible, and affordability considerations will drive future administrations to renege on targets and even on contracts. Earnings risk is, therefore, merely being swapped for policy risk, and investment propositions are no more attractive to investors under EMR than they would be without it.

The other main argument is that the EMR hypothesis does not reflect the current reality of financial markets. Institutions may claim that they are not investing because the risks are too high but they are actually constrained by the liquidity of their resources as they try to strengthen balance sheets following the financial crisis. In other words, the money simply is not there to invest, regardless of the risks involved.

We shouldn't be trying

Interestingly, proponents of these arguments do not follow up these points with alternative suggestions as to how the investment necessary to transform the power sector could be brought forward. Instead, they argue that it is, in any case, not sensible to have an energy policy which involves spending money transforming the power sector in our country when other countries aren't doing the same. Sometimes this argument is even extended to calls to renegotiate the

EU Renewables Directives and associated targets.

Positioning the UK and the EU as international leaders or follows in decarbonisation and low carbon technology has been a long running debate and people in both camps hold strong views. However, what is clear is that among those who believe that the UK and Europe need to show leadership in order to deliver security and prosperity for citizens, and that this involves a transformation of the power sector over timescales similar to those proposed by the Committee for Climate Change, there is no other game in town.

The basic premise of the EMR remains unchallenged: the only plausible way to attract the level of investment required involves the government signing long term contracts that stabilise future earnings for investors. There is very likely to be a degree of truth in the objections described above. However, it is unlikely that these are black and white issues and the extent to which they represent insurmountable obstacles remains to be tested.

Difficult quest

However, the implementation of a system of long-term contracts gives rise to a number of issues that Government needs to address. In particular, which contracts need to be signed and whose job is it to negotiate or allocate them. This, in turn, demands clarity over those tricky policy issues involving overall carbon ambition and the extent to which government promotes particular technologies.

In addition, delivery institutions, and how they are governed, will need to be defined. These are difficult questions that were barely mentioned in the EMR consultation and there may be those in government who would still rather avoid having to tackle them.

It will, therefore, be extremely interesting to observe how government grapples with these issues over the coming weeks and what finally emerges in the White Paper.

Will government hold firm to the EMR logic for long-term contracts and set out how it intends to define contract volume and delivery institutions? Or will it effectively de-scope the proposals, perhaps by adopting a price-lead premium feed-in-tariff approach? And, if the package is de-scoped in this way, does this signal a more fundamental shift in government policy away from a position of international leadership in decarbonisation and low carbon technology? If this is the case, the ramifications would be significant, both across the entire energy sector and beyond.

We wait with interest.....

**Simon Skillings is director of Trilemma UK and a senior associate at E3G se of 'either/or'. Rather it should be a case of the regulators and the operators working out how best to gain the maximum advantage for this country, for Scottish jobs and our wider economy."*