PERSPECTIVE

Waiting for Godot

Market reform has been talked about for years and the Energy Bill should provide much-need clarity for the energy sector. In the following article *Simon Skillings** fears that such optimism is misplaced.

The Energy Bill is due to be published at some point in November. I suspect that there are many people in the industry who are waiting with baited breath to finally get some clarity about the policy landscape. After all, we haveve all been talking about electricity market reform for long enough. Surely we can now put these issues to bed and get on with tackling the substantive challenges ahead. Alas, I fear that such optimism is misplaced.

At the time of writing this article, it is far from clear that the key political decisions will be made in time for the Bill to be laid before Parliament. However, even if the planned timescales for publication are met, it is likely that significant gaps in the policy framework will remain.

Various updates will be published setting out progress in the design of capacity mechanisms, contracts-for-differences, payment mechanisms, etc. However, the extent of the progress might be limited and more unanswered questions will probably have emerged since the last set of technical updates was published in the summer.

It is easy for companies to become immersed in these technical details and use the current policy uncertainty as an excuse for strategic inaction. There are, of course, some major investment decisions that can only proceed once key elements of the new market arrangements have been implemented and the relevant contracts signed.

However, many decisions related to business organisation, resource allocation, supply chain investment and project development can only be assessed on the basis of the market arrangements that might exist in five or ten years. Over these timescales, there are some rather more fundamental market design questions that need to be considered.

While the UK Government has been considering how best to design the GB market arrangements, the European Commission and associated agencies have been driving forward the internal energy market agenda. Here we have a fundamental dichotomy. Are policy objectives best delivered through the implementation of national measures or through pan-European markets? It is difficult to argue from a theoretical basis that security of supply and decarbonisation goals cannot be achieved more cost-effectively through an integrated European market. Indeed, many industrial players believe that the real benefit of an EU-level market is that the policy framework is more stable and at less risk of knee-jerk political interventions by national governments.

However, it is far from clear that this is where we are heading.

EC communication

At the same time that the UK Government is planning to table the Energy Bill, the European Commission has published a Communication on the Internal Energy Market. This powerfully advocates the benefits of a fully integrated and competitive pan-European market. Although much of the document focuses on the need for recalcitrant member states to urgently implement the so-called ‘Third Package’, some aspects of the Communication highlight concerns directly relevant to UK electricity market reform.

Firstly, the subsidies associated with the new contract for difference feed-in-tariffs must comply with State Aid regulations. Hitherto, generous exemptions have been applied to support the deployment of renewables but the Commission is now undertaking a review of the guidelines on state aid for environmental protection. Apart from the obvious and direct implications for nuclear subsidy, there are also indications that the Commission would favour requiring renewables support to meet certain, as yet undefined, best practise criteria with the aim of ensuring greater consistency in national approaches.

Secondly, the Commission believes that the capacity mechanisms currently being discussed across Europe are ‘public service obligations’ which are subject to EU control. A capacity mechanism can only deliver a bespoke national security standard if there is some constraint, either physical or administered, on the free trade of electricity with neighbouring countries. The Commission, therefore, recognises the emergence of such schemes as a potential threat to the single market and is warning that it might propose further measures following a more detailed review of the issue.

The complex legislative framework surrounding European energy policy makes it difficult to predict who will prevail on individual issues when there is disagreement between member states and EU institutions. Certainly, national governments want to retain control of their energy markets. In part, this is to meet the clear expectation of the national electorate that it is up to their government to keep the lights on.

More often, however, it is to allow delivery of a national industrial policy, such as coal in Poland or solar in Germany. On the other hand, increasing physical interconnection between countries, which most member states seem to support, will make it increasingly difficult and expensive to run national agendas that are not in keeping with the internal energy market.

Strategic message

The key strategic message for players in the electricity industry is that the Energy Bill will not herald a substantial period of stability in the market arrangements.

Instead, there remain competing visions of the future structure of the market and how this is best delivered. The EU is not going to ignore what is happening in the UK and the next few years are likely to see on-going discussions over the compliance of the Energy Bill with European rules and the extent to which revisions may be required. In the longer term, there remains no consensus as to whether subsidies will be phased out and investments made purely on the basis of future market earnings forecasts or whether a centrally administered long term contract system will become the norm. The latter appears more consistent with the current realities of the financial markets but no clear narrative exists explaining how it might be delivered through a single European energy market.

Any company waiting for clarity in the electricity market arrangements before progressing business strategy will, like the characters in the Beckett play 'Waiting for Godot', be left marking time as the rest of the world moves forward. Smart organisations will treat uncertainty in market arrangements as an inevitable and on-going fact of life that needs to be evaluated and managed as a critical part of business operations.

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IN BRIEF

On the move

• Energy Minister John Hayes has announced the appointment of Stephen Dingle as the new Chair of the Coal Authority. Dingle has had a career as an investment banker and financial advisor. He spent the majority of his career at NM Rothschild & Sons Limited and latterly he specialised in advising on the financing of commercial property for clients in both the public and private sectors as a partner with Ernst & Young LLP.
•Dr Norman MacLeod has been appointed as Technical Director, HVDC at Parsons Brinckerhoff. Previously he worked for Alstom Grid, where he was Technical Marketing Director.
• Chelsea FC Director, Paul Heagren, will be joining Waste2Tricity's board as a result of Russianb Roman Abramovich, acquiring a 10% stake in its share capital.
• Theo Simon has been appointed as the new Spokesperson for the Stop Hinkley Campaign.

Onshore wind O&M costs down

The operation and maintenance (O&M) costs associated with onshore wind farms have dropped by 38% in the last four years, according to a new study.

Bloomberg New Energy Finance's global 'Wind operations and maintenance price index' revealed that the average price for full-service O&M fell to €19,200 (£15,400) per MW annually in 2012, down from €30,900 in 2008.

However, eastern Europe and the UK were found to have the highest pricing for full-service offerings, which Bloomberg put down to higher labour costs and/or a limited local supply chain.

Commenting on the findings, Michael Liebreich, chief executive of Bloomberg, said: "Wind power has done much to improve its competitiveness against gas-fired and coal-fired generation in recent years, via lower-cost, more technically advanced turbines, and more sophisticated siting and management of wind farms."

The news will come as a boost to wind farm developers and investors who have been coming under increasing pressure from members of government keen to reduce subsidies.