companies, does heighten concern about the widening gap between UK base-load capacity supply and demand – and how it can be bridged.

Not only are several coal-fired plants due to be closed under the Large Plant Combustion Directive (LPCD) but also the UK nuclear new-build programme is subject to many risks – financial, operational, planning, construction and regulatory inter alia.

The renewables agenda, too, is now looking increasingly frayed. During the boom years, a shift to 'greener' generation plant, financed by heavy subsidies, was undoubtedly appealing. During more straitened economic times, this arrangement looks far less sustainable.

Renewables development is also very beholden to National Grid's investment programme, with many coastal and off-shore wind plants due to be linked into the grid – at very considerable cost.

For the incoming coalition government, UK energy issues demand urgent attention – they are probably the second most important priority after cutting back the UK's £150 billion plus annual public sector net deficit.

Instead of churning out White Papers - so beloved by the previous government - the challenge now is to focus on ensuring that the UK's massive generation investment requirements are actually delivered.

Such a task also has to focus on the current financial state of the six integrated energy companies, whilst recognising that four of these six companies have a raft of competing generation projects – some no doubt offering far better rates of return - in other countries.

If that investment is not forthcoming, the UK could be left – literally – in the dark.

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Power market reform - what are the issues?

The debate over power market reform already seems to have been going on for a long time and latest indications are that firm government proposals will not appear in draft legislation until 2011. However, during this inexorable, and at some time frustrating, process there are likely to be significant moments where the future direction is set. Simon Skillings* examines the issues at stake.

The next few months appears to be one of these critical periods since this is the time during which the new coalition government will need to decide on the extent of its ambition with regard to market reform.

It is true that the coalition agreement spells out a series of, apparently quite clear, reform measures and the newly imposed fiscal straightjacket does constrain the room for manoeuvre. Nevertheless, there is a rather stark choice facing ministers and one that needs to be addressed before the autumn.

The choice concerns the durability of a newly reformed power market. Are we creating a market framework that can endure for several decades and form the bedrock upon which a decarbonised power system can emerge? Or are we merely adding a few bells and whistles to the current system that may underpin the next wave of investment but will mean, in all likelihood, we will be back considering market design again within, say, five years?

This decision will not be easy. Incremental change to the current market arrangements would follow the pattern set by the previous Government with the market defined by an ever more complex tapestry of instruments.

Indeed, it is likely that ministers are already being heavily lobbied as to how to implement a variety of measures including carbon price floors, emissions performance standards, feed-in-tariffs and capacity payments, and it may be possible to construct a set of changes which satisfies the short term needs of the majority of stakeholders.

However, it is difficult to see how such a reform package will create enduring incentives for the efficient investment in low carbon generation and

investors are unlikely to commit significant amounts of capital in the situation where major ongoing reform of the market seems inevitable.

For example, it seems fanciful that a new fleet of nuclear power stations (or even one nuclear power station) will be financed on the basis of a series of policy levers, such as a carbon price floor, being set at a particular level in the early 2010s when the business case is based on earnings over decades.

It may not, therefore, be easy to drive forward the investment agenda with incremental additions to the current market framework without incorporating rather hefty subsidies arising from an effective negotiation with key corporate investors.

On the other hand, re-designing the market arrangements in a way which ensures robust and efficient investment incentives in the short, medium and long term is no easy task.

Firstly, it requires rather more political energy than a few piecemeal changes and it will be necessary to win the argument that this should be an issue of political priority that demands action beyond the narrow confines of the coalition agreement[1].

However, perhaps the most significant obstacle is that no ready-made solution exists which has achieved anything like broad stakeholder support. Indeed, the models which seems most robust to future scenarios involve a move towards a single buyer approach and this, albeit in a rather extreme form, was excluded as a possibility in the recent Treasury Energy Market Assessment.

All big political decisions require a broad coalition of supporters and it is currently difficult to see how such a coalition can emerge when potential long term solutions are, as yet, so poorly defined. So, the next few months will be critical. Can one or two changes be bolted on to the existing market arrangements which will bring forward a wave of new investment but avoid the need to pay a high price to insure investors against the risk of future market reform?

Or will a compelling new market design emerge which will drive efficient investment, thereby helping the low carbon transformation to proceed? Neither option is currently politically attractive, although this situation will be strongly affected by the positions that stakeholders adopt in the reform discussions.

The choice for business

Size has become the winning formula for success in power markets. The market and regulatory risks are such that they are most effectively managed through scope and scale in business operations.

However, it has become increasingly apparent that the extent of the investment required in the power sector over the next few decades, and the nature of the risks involved, mean that sufficient finance cannot be delivered through the traditional route of leveraging the balance sheets of the large utility companies.

New sources of investment will be required and if sufficient funds are to be attracted to the power sector then it will be necessary to reduce the investment risks and costs of capital. Indeed, one of the key challenges for power sector reform involves transferring a proportion of investment risk to customers or society as a whole and, if we are really going to drive the levels of investment required, this transfer of risk might need to be quite substantial.

The reform agenda therefore represents a key strategic challenge for businesses operating in the power market. The nature of the risks will drive the optimum business models and create the foundation upon which a competitive strategy can be built. Continually seeking new ways to 'win' in chosen markets is the bread and butter of competitive strategy and is something that keeps corporate strategy teams fully occupied.

However, reviewing which markets to compete in and, by implication, the underlying business model, is an exercise that happens far less frequently and requires the close involvement and sponsorship of the most senior officers in the company.

This creates a major dilemma for businesses currently operating in the energy markets. On the one hand, there is the desire to minimise the potential for ongoing regulatory and policy change by ensuring that a new market framework is introduced that can credibly survive the transformation to decarbonisation.

However, there is a chance that this will involve a major change to the market risk landscape and render current business models obsolete. On the other hand, it is tempting to focus on short term business targets and try to negotiate piecemeal changes to the market that make it easier to

justify current investment plans to the capital markets, albeit in the knowledge that significant ongoing policy risks remain.

This decision can only be taken in the board rooms of the affected companies. In the absence of strong top-down direction to consider the opportunities of alternative business models in line with changes to the market framework, it seems inevitable that those individuals responsible for representing their corporate interests in market reform discussions will be constrained by the presumption that existing business models must prevail and be forced down the path of negotiating incremental changes to the existing framework.

Politicians and leaders of energy companies both face a major choice regarding market reform over the coming months. On the one hand there is the potential to 'muddle through' with incremental changes.

However, there is also the possibility to seriously explore how the market might be designed to genuinely underpin the transformation through to decarbonisation and the new business opportunities that will arise.

Neither way forward can or should be viewed as the 'easy' choice.

End notes

1. Although the promise in the coalition agreement to 'reform energy markets to deliver security of supply and investment in low carbon energy, and ensure fair competition including a review of the role of Ofgem' does not exclude the possibility of fundamental reform.

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Could planning reforms backfire?

In Great Britain, climate change and sustainable development have been firmly placed at the heart of the planning system. The UK has agreed to a binding target that 20% of the EU's energy consumption must come from renewable sources by 2020, with a proposed UK contribution of 15% by 2020. In terms of electricity use, the government has stated that more than 30% of electricity generated will come from renewable sources by 2020, with wind energy providing about two thirds of this total. A significant element of these targets is expected to be delivered locally, through the planning system. In the following feature, Philip Lewis* outlines how the coalition government's reform of the English planning system could have a negative impact on UK onshore wind energy targets.

The planning system in England had been developed in recent years in ways which are arguably beneficial to wind energy development.

The previous government had introduced Regional Spatial Strategies (RSS), which set out a long-term strategic, spatial and integrated framework for the English regions. These provided regional and sub regional targets for renewable energy development which have become important considerations in the planning process, particularly in the North East of England.

However, RSS are set to be abolished without a suitable replacement as proposed in the Decentralisation and Localism Bill. Decision-making powers on housing and planning policy are to be returned back to local councils.

Past experience of local councils determining the number of new houses to be built in local areas arguably led to significant under-provision in certain areas and poor spatial distribution of development, leading to one question – will councils actually make provision for wind energy development in England, as it is hardly likely to be popular?

The loss of regional renewable energy targets will have a significant effect on future development of wind energy in England, if councils do not make appropriate provision. Climate change and energy policy are very much national considerations, and strategic level decisions are still necessary.

The RSS system's targets for renewable development have been key considerations in many wind energy appeal decisions in England that otherwise may not have been granted.

Its abolition could give rise to a 'planning by appeal' approach, especially if a policy vacuum occurs as a result of the abolition.