



The draft Energy Bill 2012

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On the 9 May 2012 the [Queen's Speech](#) announced that:

“My Government will propose reform of the electricity market to deliver secure, clean and affordable electricity and ensure prices are fair”.

This will be done through the latest in a line of energy bills. This note outlines the bill's likely main provisions and the background to these.

On 22 May 2012 the Department for Energy and Climate Change (DECC) published a [draft energy bill](#), for pre-legislative scrutiny alongside a series of [technical updates](#), [aide-memoires and impact assessments](#). The Energy and Climate Change Select Committee will examine the bill with a view to reporting before summer recess (17 July 2012).

Initial press coverage has focussed on support for nuclear generation, which the bill proposes through 'contracts for difference', along with other low-carbon generation. As with other such support mechanisms, these costs will be passed onto consumers via their bills. Some commentators have speculated that wider 'electricity market reform' is unlikely to engage the public. But get this, and related issues, right, one [commentator](#) argues, and electricity market reform could lay the groundwork for a low carbon economy.

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1 Introduction

1.1 The draft Energy Bill 2012

On 22 May 2012 the Department for Energy and Climate Change (DECC) published a [draft energy bill](#),¹ for pre-legislative scrutiny.

Alongside this, DECC published a series of new [technical updates](#), and also [aide-memoires and impact assessments](#) (IAs) on its website.²

The Energy and Climate Change (ECC) Select Committee will examine the bill with a view to reporting before summer recess (17 July 2012).

1.2 The Bill's structure

Part 1 of the Bill deals with electricity market reform (EMR), specifically:

- Chapter 1 – Contracts for Difference
- Chapter 2 – Investment Instruments

¹ Draft Energy Bill, May 2012 CM 8362 at <http://www.official-documents.gov.uk/document/cm83/8362/8362.asp>

² Links to all these from <http://www.decc.gov.uk/en/content/cms/legislation/energybill2012/energybill2012.aspx>

- Chapter 3 – Capacity Mechanism
- Chapter 4 – Conflicts of Interest
- Chapter 5 – Contingency Arrangements
- Chapter 6 – Renewables Obligation: Transitional Arrangements
- Chapter 7 – Emissions Performance Standard
- Chapter 8 – Strategy and Policy Statement

The rest of the bill is likely to attract less interest and covers:

- Part 2 Nuclear regulation; establishing the Office for Nuclear Regulation, largely putting existing arrangements on an independent, statutory footing
- Part 3 Government Pipeline and Storage System (GPSS)
- Part 4 Offshore transmission and general/miscellaneous
- Schedules

This note will outline in more detail the measures in the draft bill, and the background to and proposals under EMR.

Extent

Energy is generally a reserved matter, apart from the promotion of renewable energy. All of the Bill applies to England, Scotland and Wales, although there are no GPSS assets in Wales. Parts of the Bill only apply to Northern Ireland although the Command Paper suggests that further measures may be adopted by the Assembly.

1.3 Recent Energy Acts

There were Energy Acts in 2008, 2010 and 2011. In short (the list is not exhaustive and the links are to other Library standard notes):

- The Energy Act 2008 included provision for [carbon capture and storage](#), [smart metering](#), [feed-in-tariffs](#), the [Renewable Heat Incentive](#) and several offshore issues
- The Energy Act 2010 introduced mandatory social price support (the scheme now operating as [Warm Home Discount](#) in place of voluntary social tariffs). It gave Ofgem new powers to regulate the energy markets along with its primary objective to take into account the needs of current *and future* energy consumers
- The Energy Act 2011 introduced the [green deal](#) (the government's 'flagship' energy new efficiency scheme), minimum energy efficiency requirements for the private rented sector, measures making information on energy performance certificates more widely available, and an ability to require clearer energy company tariffs

The 2011 Act was intended at one time to be even larger (announced as an 'Energy Security and Green Economy Bill' in the Queen's Speech), and to include:³

- Electricity market reform (EMR)

³ See [Library research paper 11/36](#) 4 May 2011, Energy Bill <http://www.parliament.uk/briefing-papers/RP11-36>

- A limit on carbon emissions from power stations
- The creation of a Green Investment Bank (GIB)

The first two measures will now be taken forward in the forthcoming energy bill. The Green Investment Bank has been separated out and will now be implemented instead through an Enterprise and Regulatory Reform Bill.⁴ See the [Library standard note on the GIB](#).⁵

2 The UK electricity market

2.1 The 'big 6'

The UK's electricity market is dominated by the 'big 6' energy companies. Through acquisitions and mergers, many are now multinationals and only two remain UK registered:

- Npower is part of the German RWE Group
- Scottish Power is now owned by the Spanish utility Iberdrola
- EDF Energy is part of Électricité de France
- Centrica owns British/Scottish Gas (UK registered)
- E.ON Energy is a subsidiary of the German E.ON Group
- Scottish and Southern (registered in Scotland)

There are four main parts of the electricity business;

- generation
- transmission ('transport'; the high voltage electricity network)
- distribution (shorter distance 'transport' – the local low voltage networks)
- supply (to domestic or business customers)

All of the big 6 are 'vertically integrated' which means that they are involved in aspects of the industry from generation through to supply. There are moves at an EU level (through the so-called 'Third Package') to 'unbundle' companies. This would mean separating the ownership or accounts of the different parts of the business. However, the measures agreed at EU level apply only to companies that transport electricity or gas, i.e. National Grid and similar companies. So the concerns remain about transparency of the big 6 and the market. This is mainly because under the current arrangements these large companies and/or their subsidiaries generate, supply and trade electricity on the current wholesale market (see below) which may hinder new entrants to the market, reducing competition.

2.2 Ofgem

Ofgem, as the energy regulator, has a remit to protect the interests of (current and future) consumers and it does this primarily through promoting competition in the energy markets, along with regulation. It operates through the Electricity Act 1989 and the Gas Act 1986 as

⁴ The Queen's Speech 2012- Briefing Notes Cabinet Office 10 May 2012
<http://www.cabinetoffice.gov.uk/sites/default/files/resources/Queens-Speech-2012-briefing-notes.pdf>

⁵ <http://www.parliament.uk/briefing-papers/SN05977> *Green Investment Bank* 9 May 2012

amended, and under later Acts. Under these, it sets 'licence conditions' that energy companies have to meet. It can also levy fines of up to 10% of turnover.

The [2011 Ofgem Review](#)⁶ said there was a need for greater clarity between Ofgem and Government, and that the government guidance that accompanied Ofgem's statutory duties lacked impact. Ofgem's decision making could also be more transparent.

Ofgem imposes price controls on the monopoly parts of the energy business (transmission and distribution) but overall supply price controls were discontinued in 2002 (because there was thought to be sufficient competition in the supply business). Ofgem balances (as Ofwat does for the water industry for example) what companies need to invest in infrastructure against the effect on consumers' bills.

2.3 Consumers' bills

It is almost inevitable that consumer bills will continue to rise, and a large current driver of increasing bills is rising wholesale [energy prices](#),⁷ which have largely swamped the effect of various [fuel poverty](#)⁸ schemes. As well as this however, Government social and environmental policies also feed through to consumer bills.

The Department for Energy and Climate Change (DECC) publishes an assessment of the effect of such policies⁹ which shows that:

Government policies are estimated to represent around £89 (7%) of an average household energy bill (before any rebates) in the UK in 2011. However, accounting for improvements in energy efficiency as a result of policies and the receipt by eligible households of a Warm Home Discount rebate, energy and climate change policies are estimated to be adding just 2% on average to household energy bills in the UK in 2011 (compared to bills in the absence of these policies)

But in the longer term, measures such as energy efficiency and EMR are expected to feed through. The same DECC report says that by 2020 households will, on average, save £94 (7%) on their energy bills compared to what they would have paid in the absence of policies. This does not mean that bills will not rise overall; only that the rise may be lower than it might have been otherwise.

DECC's November 2011 assessment includes the effects of EMR and of changes to the renewables obligation (RO). But the [Summary Impact Assessment](#) (IA) published alongside the draft energy bill pulls these out to look at the effects of the EMR policy package alone.

This will affect electricity bills in three main ways; though CfD low carbon payments and capacity payments (which will be funded through energy bills), lower RO support costs, and effects on wholesale prices resulting from a change in the generation mix.

While the net effect on domestic bills will be a 2.4% increase from 2016-2020, from then on the effect is expected to be negative, with a much greater decrease up to 2030, giving an

⁶ DECC May 2011 *Ofgem review Summary of Conclusions* <http://www.decc.gov.uk/assets/decc/what%20we%20do/uk%20energy%20supply/energy%20markets/regulation/1658-ofgem-review-summary-of-conclusions.pdf>

⁷ See Library standard note *Energy Prices* <http://www.parliament.uk/briefing-papers/SN04153>

⁸ See Library standard note *Fuel Poverty* <http://www.parliament.uk/briefing-papers/SN05115>

⁹ DECC [Estimated impacts of energy and climate change policies on energy prices and bills: November 2011](#) linked to from http://www.decc.gov.uk/en/content/cms/meeting_energy/aes/impacts/impacts.aspx

overall 4.3% decrease over the period 2016-2030 as a result of EMR.¹⁰ Again, bills will still rise overall; the IA shows increasing 'baseline' energy bills.

The Government, Ofgem and consumer bodies encourage consumers to consider switching energy suppliers; otherwise competition in the supply market cannot work effectively. The Government has supported the switching campaigns [Energy Best Deal](#) and [Check, Switch and Insulate to Save](#). But many people are 'sticky' customers, who never switch.

Ofgem has been doing work for some time now on tariff simplification, mainly to help people switch supplier more easily. Following its energy probe, for instance, it introduced annual energy statements on bills (showing a household's annual usage), and on 1 December 2011, Ofgem published [Domestic Proposals](#) arising from its retail market review.¹¹ These include fixed standing charges to be set by Ofgem, making it easier to compare suppliers' unit prices.

Ofgem also publishes regular market reports that attempt to estimate energy companies' profit margins. However, this is difficult because companies hedge or buy their energy in advance, and because the wholesale energy market is rather 'opaque'.

The Queen's Speech included, notably, reform "to ensure prices are fair".

However, rather than referring to work such as Ofgem's directly affecting consumers' bills, this reference is most likely intended to be a wider reassurance¹² that lower carbon generation and EMR does not necessarily mean higher energy prices, at least in the long term.

2.4 Balancing and settlement; the wholesale market

National Grid, the system operator, has to balance the transmission system, since electricity cannot be stored. Generators and suppliers make contracts with each other or with the wholesale market (the power exchange), sometimes far in advance or sometimes on a close to real-time basis, based on what they think demand is going to be at any given time. They also make offers and bids of what their charges will be if they are asked by National Grid to come on- or off-stream to balance the system.

This is all done continuously, on a half-hourly basis, and all has to be reconciled afterwards according to actual demand and whether the system as a whole had a shortfall of generation or was surplus (an arrangement called 'balancing and settlement'). This reconciliation is done by an organisation called Elexon. The system of charges incentivises generators to match demand by making different payments according to whether the system as a whole was short or long (in surplus) at any given time. However, clearly, any given company and its subsidiaries may be generating, supplying and trading at any given time, i.e. selling and buying electricity, and this leads to some opacity in the market.

3 What is 'EMR' and why is it needed?

The vision for future energy generation is a shift away from larger fossil-fuel powered stations to encompass a 'balanced mix' including smaller, more localised renewable generation, including micro-generation. The transmission grid has not yet evolved for this. The future

¹⁰ See Table 6, page 16 of the summary IA available at <http://www.decc.gov.uk/en/content/cms/legislation/energybill2012/energybill2012.aspx>

¹¹ Ofgem 1 December 2011 *The Retail Market Review: Domestic Proposals* <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR%20Domestic%20Consultation%20December%202011.pdf>

¹² "The Energy Bill is Coming" *Business Green* 9 May 2012

also involves lower carbon emissions,¹³ and therefore investment in low carbon technologies. This will drive energy prices up in the short term, on top of changes in wholesale prices.

At the same time, customers attach high value to security of energy supply. The ‘capacity margin’ is the UK’s margin of spare generating capacity in excess of maximum electricity demand. This needs to be maintained at around 20%, basically, and is threatened as existing large plant closes, often as emission standards tighten under UK and EU rules. Over a fifth of generation is expected to come off line over the next decade.

Ofgem’s [Project Discovery](#)¹⁴ in February 2010 looked at the UK’s security of energy supply. It estimated that replacing aging infrastructure (power generation, transmission and distribution networks) and moving towards decarbonisation might require up to £200 billion of investment by 2020 alone and said that customer bills would rise under all scenarios.

DECC produced an [Electricity Market Reform](#) Consultation in December 2010.¹⁵ This outlined the challenges facing the UK and said that capacity margins would reduce from around 20% in 2010 to below 10% by the end of the decade, so “the right investment signals” were needed to attract new baseload gas plant and additional flexible plant to ensure system balancing from the late 2010s to the 2020s:

Without reform, the existing market will not deliver the scale of long-term investment, at the pace we need, in particular in renewables, new nuclear and CCS, nor will it give consumers the best deal. However, if we are to meet our long term carbon targets, we need to reform the market now, to make low-carbon investment more attractive.

The consultation led to the July 2011 [Energy White Paper *Planning Our Electric Future: a White Paper for secure, affordable and low carbon Electricity*](#).¹⁶ It concluded that the market would not deliver the investment in low-carbon generation required.

The Energy and Climate Change (ECC) Select Committee has looked both at [security of energy supply](#)¹⁷ and at [EMR](#).¹⁸ It has said that EMR presents a “once in a generation opportunity to shift our energy usage to a low-carbon, energy-secure and affordable future”.

3.1 The elements of EMR

The White Paper made four main proposals,¹⁹ which the EEC Committee has called the ‘four pillars of EMR’:

- **Feed-in-tariff with Contract for Difference (FIT CfD)** to provide long term contracts of price support to different generation types
- **A capacity mechanism** to encourage flexible reserve/cushion plants or demand reduction measures ‘to ensure the lights stay on’

¹³ A 15% renewable energy target by 2020 and 80% carbon reduction target by 2050

¹⁴ Ofgem 3 February 2010 *Project Discovery Options for delivering secure and sustainable energy supplies* <http://www.ofgem.gov.uk/Markets/WhlMkts/monitoring-energy-security/Discovery/Pages/ProjectDiscovery.aspx>

¹⁵ Department for Energy and Climate Change, Cm 7983

¹⁶ CM 8099 12 July 2011

¹⁷ ECC Committee, *Eighth Report UK Energy Supply: Security or Independence?* 10 October 2011 <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmenergy/1065/106502.htm>

¹⁸ ECC Committee, *Fourth Report Electricity Market Reform*, 27 April 2011

¹⁹ See summary timeline chart on page 14 of the White Paper, op. cit.

- **Carbon price floor** to ‘underpin’ carbon price support providing a minimum guaranteed level; this has already been provided for in legislation (see below)
- **An emissions performance standard (EPS)** to limit how much carbon coal power stations can emit; so that no new coal is built without demonstrating carbon capture and storage (CCS) technology or being ‘CCS-ready’ (not necessarily fitted)

Capacity mechanism

The White Paper talked about “uncomfortably low capacity margins towards the end of the decade”, perhaps to below 5%. It said DECC was consulting on the type of capacity mechanism to be introduced (including demand response as well as generation). The White Paper posed two options for a GB-wide system:

The first is a targeted mechanism in the form of a Strategic Reserve, a development of the lead option from the December 2010 Electricity Market Reform consultation document, designed to address stakeholder concerns. This comprises centrally-procured capacity which is removed from the energy market and only utilised in certain extreme circumstances.

The alternative would be a market-wide mechanism in which all providers willing to offer reliable capacity are provided incentives to do so. Under both options, we plan to ensure a fair and equivalent treatment of demand side resources such as storage and demand side response, alongside generation, with the aim of securing best value investment across the power system.

In its December 2011 [Technical Update to the White Paper](#) DECC said that the Government had decided to legislate for the second option, a capacity mechanism in the form of a Capacity Market. Some DECC [FAQs](#) explain how this would work: ²⁰

Providers of capacity – including existing and new plant, and potentially non-generation technologies such as demand side response and storage – enter into an auction to secure contracts for providing capacity.

If providers of capacity are successful in the auction, they receive, in the delivery year, a payment to provide reliable capacity when needed, and are penalised if they fail to deliver.

The first auction may be ready to run in 2015 if needed. The Technical Update proposed that National Grid, as the GB [grid] system operator, would operate both the capacity mechanism and contracts for difference. This, and any synergies and any potential conflicts of interest, is currently being consulted upon.²¹ DECC stresses that the Capacity Market will work alongside, and not replace, the wholesale market.

Contracts for Difference

The White Paper basically agreed with the consultation proposals on support for renewables, which were consistent with “*the agreed position that new nuclear stations should receive no public support unless similar support is available to other low-carbon technologies*”. ‘Feed-in Tariffs with Contracts for Difference’ (FiT CfD) will provide long-term contracts for all forms of low carbon generation, including renewables.

²⁰ <http://www.decc.gov.uk/assets/decc/11/meeting-energy-demand/energy-markets/3885-emr-technical-update-faqs.pdf>

²¹ Letter from Ofgem/DECC 8 March 2012 <http://www.decc.gov.uk/assets/decc/11/consultation/4562-joint-decc-ofgem-letter-seeking-views-on-potential.pdf>

The main alternative had been a Premium Feed-in-Tariff or PFiT, a static payment on top of that obtained from selling electricity in the wholesale market, which some renewable generators had favoured; this more closely resembled the current renewables obligation (RO). The FiT CfD is more complicated than the PFiT but the White Paper says it is:²²

a long-term contract set at a fixed level under which variable payments are made to top-up the level of payment to the generator to the agreed tariff. The FiT payment would be made in addition to the generator's revenues from selling electricity in the market. The FiT CfD is a two-way mechanism that has the potential to see generators return money to consumers if electricity prices are higher than the agreed tariff.

The White Paper outlined different ways of designing the reference price against which payments will be made to different forms of generation. It is proposed that the renewables obligation will close for new entrants in March 2017 with FiT CfD coming in from 2014.

Some observers feel that the proposed solution may favour nuclear above renewables,²³ but much will depend on the final design; the White Paper proposed different contract types for intermittent vs. baseload (constant, not highly variable) generation.²⁴

Final Investment Decisions

In the meantime, before the CfD regime comes in, this could lead to some investment decisions being delayed. For this reason the bill includes the provisions on 'investment decisions', and there is a 'Final Investment Decision (FID)' enabling project. DECC says that a number of developers including new nuclear and early stage carbon capture and storage developers have expressed interest in the FID enabling process. This might provide an early additional 'level of comfort' on terms and conditions that would likely operate under CfD.²⁵

Carbon price floor

Fluctuations in the price of carbon in the form of EU emissions trading scheme (ETS) allowances have resulted in uncertainty for investors in low carbon technologies, contributing to investment below that required to meet UK carbon reduction and renewable targets.

To address this, the Government committed to introduce a floor price for carbon and published a consultation on carbon price support in December 2010. Following this it announced in the March 2011 Budget that it would be introducing price support via the Climate Change Levy and fuel duty with a target price of £30 per tonne of carbon dioxide in 2020. The floor price will start at about £16 per tonne. At the time of the announcement the trading price was around £15 per tonne, but by December 2011 it had fallen to around £6.

Critics of the proposals say that as designed the floor price will unfairly subsidise existing renewables and nuclear; and offer support to any proposed new nuclear generation. The Library note on carbon price support is available [here](#). Because the carbon price floor was legislated for by the Finance Act in 2011, it is not in the Energy Bill 2012.

²² DECC [Energy White Paper](#) *Planning Our Electric Future: a White Paper for secure, affordable and low carbon Electricity* CM 8099 12 July 2011 pg 19

²³ e.g. *Financial Times*, 14 July 2011 "Energy reform will generate two-tier victors" p.19

²⁴ DECC [Energy White Paper](#) *Planning Our Electric Future: a White Paper for secure, affordable and low carbon Electricity* CM 8099 12 July 2011 Annex B

²⁵ CM 8362, page 37

Emissions performance standard (EPS)

An EPS will be set initially at a level equivalent to 450g CO₂/kWh (at baseload) for all new fossil fuel plant, with an exception for Carbon Capture and Storage (CCS) plants under the UK CCS Demonstration programme, or receiving EU funding for commercial scale CCS.

The Government intends this to help prevent unabated coal fired power stations being built. Typical coal-fired stations will have to limit emissions by 40%, while the level is intended not to restrict “*the new gas plant the UK needs to be built to maintain sufficient capacity*”.

However, the EPS will be subject to regular reviews as part of the process of three-yearly reports on decarbonisation under the Energy Act 2010.²⁶

Several coal-fired power stations are already set to close by 2015 after opting-out of the emissions controls set by the Large Combustion Plants Directive.²⁷

4 Other measures in the bill

4.1 Energy Strategy and Policy Statement

The *Ofgem Review Final Report*²⁸ published alongside the July 2011 *White Paper*²⁹ accepted that the Government needed to communicate more clearly its policy goals for the gas and electricity markets and the respective roles of Government and Ofgem in delivering these. Policy clarity and stability will help attract investment in the energy sector. The White Paper gave more background on what the Strategy and Policy Statement would need to do:

A new statutory ‘Strategy and Policy Statement’ will be established. This document will:

- set out the Government’s policy goals for the gas and electricity markets;
- describe the roles and responsibilities of Government, Ofgem, and other relevant bodies; and
- define policy outcomes that Government considers Ofgem to have a particularly important role in delivering.

The Statement will need to be approved by Parliament and it will be “*intended to remain stable over at least the length of a Parliament*”.

4.2 Office of Nuclear Regulation

A new independent statutory body, the Office for Nuclear Regulation (ONR) will regulate the nuclear power industry. Following a *review*³⁰ commissioned in 2008, since 1 April 2011 the ONR has been a non-statutory agency of the HSE. The office’s areas of responsibility will not change significantly; it will deal with transportation and nuclear installations inspections, and the Environment Agency will also continue to inspect such sites, for example. A Written Ministerial Statement on 8 February 2011³¹ announced that legislation would be brought forward.

²⁶ DECC *Energy White Paper Planning Our Electric Future: a White Paper for secure, affordable and low carbon Electricity* CM 8099 12 July 2011

²⁷ <http://www.environment-agency.gov.uk/business/sectors/32613.aspx>

²⁸ <http://www.decc.gov.uk/assets/decc/11/meeting-energy-demand/energy-markets/2151-ofgem-review-final-report.pdf> DECC July 2011

²⁹ http://www.decc.gov.uk/en/content/cms/legislation/white_papers/emr_wp_2011/emr_wp_2011.aspx

³⁰ See <http://www.hse.gov.uk/nuclear/ndchanges.htm>

³¹ HC Deb 8 February 2011 c7WS

4.3 Government pipeline and storage system

The GPSS is owned by the Ministry of Defence and it supplies 40% of aviation fuel in the UK to commercial airports such as Heathrow and Gatwick and to RAF/US airbases. Legislation is needed to create transferable rights of access to the land through which the pipeline runs, so that its future sale might be possible.

4.4 Offshore transmission

This is a technical measure. Companies developing offshore generating stations can also construct the transmission lines connecting these to the grid. Under EU rules however, companies are not supported to be both generators and transmission operators without fully 'unbundling' the parts of their business. But constructors need to be able to test the transmission lines they have built, so to allow this, a change to the Electricity Act 1989 will stop this being a criminal offence.

5 Will EMR work?

Attracting low carbon investment

In its report on EMR of April 2011 the ECC Committee recognised the potential of EMR, but felt that the consultation paper's proposals were "over-complex, potentially expensive and fail to recognise the urgency of the transformation that needs to take place". They would not attract the investment needed soon enough.

When it revisited the subject of EMR in its [Eighth Report UK Energy Supply: Security or Independence?](#)³² the committee remained concerned about urgency and attracting investment, given that it felt the proposed package of measures was too complex and might therefore seem too risky or unstable for investors.

Initial reactions to the Queen's Speech were largely positive, while stressing that the detail and implementation were vital.

The director-general of the CBI was reported as saying that "*Business investment in low-carbon will only happen when the detailed market framework is in place. Today's announcements are an important stepping stone.*" The chief executive of the Renewable Energy Association said that developers in renewables, who are currently developing projects that will operate under the new regimes, needed to know the details as soon as possible. The chief executive of The Climate Group said that "*This is a positive step after two years of lack of direction on the environment and the low carbon economy - but we need more details on the government's funding commitments.*"³³

However, according to the *Guardian* blog on initial reactions to the bill itself,³⁴

There seems to be a consensus, particularly among environmental groups, that the bill will largely favour the nuclear and gas industries, with the new long-term contracts known as "contracts for difference" disadvantaging the smaller renewables companies.

Trading arrangements

The ECC committee said in its April 2011 EMR report:³⁵

³² October 2011

³³ *Business Green* "Queen's Speech- the reaction" 9 May 2012
<http://www.businessgreen.com/bg/analysis/2173490/queens-speech-reaction> and *ENDS Report* "Draft energy bill may appear in a fortnight" 9 May 2012

³⁴ <http://www.guardian.co.uk/environment/blog/2012/may/22/energy-bill-gas-carbon-targets> 22 May 2012

The big omission from the Government's proposals is a plan for reform of the wholesale electricity market. The core of the electricity market—the wholesale market—would not be changed by the measures proposed. The consultation document proposes a number of "bolt on" measures that reform the subsidies and structures around the market, not the market itself.

The dominance of the vertically-integrated big 6 needed to be broken to allow new entrants, which was currently hampered by an "illiquid and opaque wholesale market". Reform of the wholesale and balancing markets would be "a real electricity market reform".

In the November 2011 [Westminster Hall debate on the ECC committee's EMR report](#),³⁶ Barry Gardener MP elaborated:

Vertical integration allows a utility company to generate the electricity under one arm of the company, which it sells through an intermediary—often offshore—which they also own, and then on-sells to another arm of the corporation, which supplies it to us as the consumer. The result is a total lack of transparency in the true cost of electricity. All the big six operate similar structures, which prevent real competition and stop new entrants coming into the market.

Much of what the large energy companies do is trading energy, to optimise the price they buy and sell at compared to the wholesale price. They trade much more than they generate purely to supply customers' needs. On addressing the liquidity of the wholesale markets, the White Paper was rather non-committal, while considering it to be one of the most important barriers to entry and growth. It also said that the government considered liquidity reform to be critical in enabling EMR to deliver efficiently and cost-effectively.

In its July 2011 [response to the Committee's report on EMR](#), the Government said that Ofgem had set out proposals aimed at improving overall liquidity and meeting the needs of independent generators and suppliers, and that the Government welcomed this "clear direction of travel". If continued barriers to entry were not addressed through Ofgem's actions, then the Government would work to identify appropriate solutions.

The Committee had felt that on the future evolution of the wholesale market, the Ofgem review was an opportunity for Ofgem to help deliver decarbonisation and security of supply alongside affordability. The Government said it had already undertaken to produce the new statutory Strategy and Policy Statement, setting out policy goals for the gas and electricity markets, and it would make clear Ofgem's role in delivering and reporting on this.

Tim Yeo summarised the ECC committee's view in the [Westminster Hall debate](#)³⁷ in November 2011. He asked again whether the Minister was:

Contemplating a more thorough plan for reform of the wholesale and balancing markets—in other words, real electricity market reform?

In that context, the Committee recommended that the Government incorporate a review of the present trading arrangements and of liquidity in their White Paper, but the Government largely delegated the responsibility to Ofgem, which has subsequently proposed that utilities must auction 20% of their electricity by 2013 in a range of products including near-term supply. It is not clear, however, that the 20% will make a sufficiently big difference. Scottish and Southern's pledge to sell 100% of its electricity

³⁵ ECC Committee [Fourth Report Electricity Market Reform](#) April 2011

³⁶ HC Deb 3 November 2011 c366WH onwards, comments at c374WH

³⁷ HC Deb 3 November 2011 c366WH onwards

in the spot market is welcome, but the details about how SSE will deal with its futures contracts still needs to be spelled out if we are to see what benefit will be achieved.

He also asked when Ministers would judge whether Ofgem had been successful in addressing the barriers to entry, and on what basis they would make that judgment.

Another dash for gas?

The ECC Committee revisited the subject of EMR in its [Eighth Report UK Energy Supply: Security or Independence?](#) (October 2011). On the White Paper, it said:

We are not convinced that the proposals set out in the White Paper on reforms to the electricity market strike the right balance between encouraging investment in new gas-fired plant in the short-term (to fill the gap that will be created by the closure of around 19GW of nuclear, oil-fired and coal-fired plant by 2020) and the need to decarbonise the power sector over the course of the 2020s, which will ultimately entail only a very limited role for unabated gas-fired capacity. In particular, the proposed form of the Emissions Performance Standard could risk locking the UK into a high-carbon electricity system in the future.

Another point the Committee raised was why the government felt it necessary to consult on an electricity capacity mechanism but not on gas storage. The committee remained concerned about the energy gap and the role of gas. It felt that the EPS proposal was weak, so this would result in a 'dash for gas' ahead of the 2015 review, again 'locking us into' a high-carbon electricity system and risking climate change targets.³⁸

Moreover, applying the EPS only to coal puts the government in the position of choosing technology winners, exactly the outcome that an EPS, by mandating an outcome not a particular technology solution, is supposed to avoid.

One commentator has said in summary:³⁹

The devil will inevitably be in the detail and as such the next few months will be characterised by an almighty row between those green businesses and NGOs who fear the reforms are not tilted far enough in favour of low carbon energy and will instead drive a new "dash for gas", and those (often climate sceptic) think tanks and MPs opposed to any green subsidy mechanisms, which they fear will drive up energy bills. Throw the pro- and anti-nuclear camps into the mix and it is going to be a bruising few months.

³⁸ See para 103 of the Committee's October 2011 report onwards

³⁹ ["The Energy Bill is Coming"](#) *Business Green* 9 May 2012