



01 Open issues: Where are we?

Electricity Market Reform Briefing Paper
September 2012

This is the first in a series of briefing papers which we will be issuing to summarise some of the current issues and progress around Electricity Market Reform (EMR).

Timeline to date

- The Department of Energy and Climate Change (DECC) published its EMR White Paper and a Technical Update in 2011. The draft Energy Bill was published in May of this year
- The Parliamentary Select Committee on Energy and Climate Change conducted pre-legislative scrutiny of the Bill and reported in July of this year

Open issues

The Select Committee made a number of recommendations as part of its scrutiny and these echoed a number of comments made by those who submitted evidence to the Committee. In summary, the main issues are:

A single counterparty for CfDs

The model for the Contracts for Difference (CfD) which had been most fully developed and which is provided for in the draft Bill is for a multiparty contract between, on one side, the generator and, on the other side, all licensed suppliers.

Each suppliers' share of the obligations under the CfD would be determined by their market share, defined by metered use. The cost of this mechanism would then be passed through to consumers.

The Government already recognise in publishing this model that there has been strong concerns raised by the industry. The Committee echoed these concerns and said that "the multiparty proposal is not workable".

DECC recently confirmed that an alternative model with one central counterparty is now under discussion. This would be a newly created central body that would sign bilateral contracts with generators. It could be Government or privately owned.

Recent comment would seem to suggest that a single counterparty will be the model adopted, however, there remain a number of issues including the nature of the ownership of the counter party and, critically, the underwriting of the payment obligations.

The “bankability” of PPAs under EMR

DECC published a call for evidence in early July on this issue which closed in August. DECC asked for information on the barriers to securing long term power purchase agreements (PPAs) for independent renewable generation.

Independent renewable companies place heavy reliance on creditworthy bankable PPAs for funding. There has been evidence in the market place that there is increasing difficulty in attracting PPA offers on bankable terms. It is contended that there is less of an appetite in submitting PPA tenders from power suppliers and the terms of these tenders are producing higher discounts in GB compared to other European markets. Government remains of the view that CfDs have a number of positive impacts on the PPA market, however, there may be immediate issues to deal with in terms of the attractiveness of PPAs whilst the EMR reforms are being initiated.

Who should be the EMR delivery body?

It has been highlighted that there are potential conflicts of interest between the system operator, National Grid, administering both the strike prices under CfDs and the

capacity market. National Grid's EMR delivery role may potentially conflict with its existing roles for example, as system operator, transmission network owner, interconnector owner and its involvement in connection of offshore windfarms.

The Select Committee's recommendation was that National Grid should be removed from this role and replaced by a new independent, not-for-profit, company. National Grid have given assurances that they can manage any potential conflicts between being the EMR delivery body and its other system operation roles.

Transparency in strike price allocation for CfDs and nuclear

Concerns have been raised with the Select Committee about the transparency in setting nuclear strike prices in bilateral negotiation. The perception was that decisions are being made behind closed doors which could directly impact the low carbon agenda. The recommendation was that an independent panel of experts should be appointed to oversee the negotiations and that a nuclear strike price higher than that given to offshore wind does not represent good value for money to the consumer.

Conclusion

The above issues are not the only issues that have arisen as the draft Bill gains momentum to its final form which is expected to be presented to Parliament shortly. Implementation of the new legislation will be challenging. Given Charles Hendry's recent departure from his post as energy minister at the DECC and his replacement effectively “mid-stream” in the EMR process, his successor will have a demanding task to get to grips with the complex issues involved and to implement EMR effectively.

If you require advice on any of the matters raised in this paper, please get in touch with any of our lawyers listed below, who have been focusing on keeping updated on EMR developments, or your usual Shepherd and Wedderburn contact.



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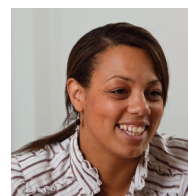
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