Electricity Market Reform

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Summary and Recommendation:

This report provides a summary of the Electricity Market Reform (EMR). On the 12 July 2011 the Government published 'Planning our electric future: a White Paper for secure, affordable and low-carbon electricity'. The White Paper sets out key measures to attract investment, reduce the impact on consumer bills, and create a secure mix of electricity sources including gas, new nuclear, renewables, and carbon capture and storage.

Recommendation:

That the contents of this report are noted.

1. Introduction

The EMR is designed to ensure a flexible, smart and responsive electricity system, powered by a diverse and secure range of low-carbon sources of electricity.

With a quarter of the UK's generating capacity shutting down over the next ten years as old coal and nuclear power stations close, more than £110bn in investment is needed to build the equivalent of 20 large power stations and upgrade the grid.

In the longer term, by 2050, electricity demand is set to double, as we shift more transport and heating onto the electricity grid. Business as usual is therefore not an option.

Key elements of the reform package include:

- A Carbon Price Floor (announced in Budget 2011) to reduce investor uncertainty, putting a fair price on carbon and providing a stronger incentive to invest in low-carbon generation now;
- The introduction of new long-term contracts (Feed-in Tariff with Contracts for Difference) to provide stable financial incentives to invest in all forms of low-carbon electricity generation. A contract for difference approach has been chosen over a less cost-effective premium feed-in tariff.

- An Emissions Performance Standard (EPS) set at 450g CO_2/kWh to reinforce the requirement that no new coal-fired power stations are built without Carbon Capture Storage (CCS), but also to ensure necessary short-term investment in gas can take place; and
- A Capacity Mechanism, including demand response as well as generation, which is needed to ensure future security of electricity supply. We are seeking further views on the type of mechanism required and will report on this around the turn of the year.

2. Contracts For Difference (CfD)

CfDs intend to provide long-term revenue certainty to investors in low carbon generation, including renewables, nuclear and carbon capture and storage.

Under CfDs, generators will receive the price they achieve in the electricity market plus a 'top up' to an agreed level – called the 'strike price'. When the market price exceeds the strike price, the generator will have to pay back the top up. The Government believes CfDs offer the best value for money and price stability for consumers.

However, some sections have been claiming the CfDs unfairly favour nuclear energy and are a roundabout manner of providing subsidies for nuclear energy. Under EU regulations it is illegal to offer subsidies for nuclear energy and subsidies should only be available for relatively new forms of electricity generations such as wind power and green energy.

Details about the CfDs, including what the price strike will be set at, have yet to be determined. This will be announced at the end of 2013 after consulting with industry.

The Government will put in place effective transitional arrangements to ensure there is no gap in investment while the new system is established.

The proposed CfDs were welcomed by the developers of potential new nuclear generators within the UK and seen to give some form of assurance or security over pricing for the future. CfDs will provide stable and predictable incentives for businesses to invest in low carbon electricity generation. However E.on stressed that more clarity was needed in order to offer more certainty in CfDs but it has the potential to provide workable mechanisms through which companies (such as E.on) could work.

3. Implications for Copeland

The energy market at the moment is quite volatile. Renewable energy is susceptible to changes in Feed in Tariffs (FiT) and nuclear energy is vulnerable to international and global anti-nuclear pressures. Within the UK we have already witnessed with parent companies of the Horizon proposal on Anglesey and at oldbury deciding to sell on their proposals due to pressure exerted by the German government. Therefore, it is crucial that potential developers are offered some form of revenue certainty prior to them committing to invest billions of pounds in what is a long term return in investment projects such as the nuclear energy field.

Copeland's future economic prosperity is intrinsically linked to the potential nuclear new build project at Moorside. The Energy Market Reform and CfDs in particular are vital to instil faith and viability in the nuclear sector.

Nuclear new build developers have indicated that the proposed reforms have come at the right time and could be highly influential in ensuring the success of future new builds.

4. Way Forward

Publication of the White Paper marks the first stage of the reform process. The Government intends to legislate for the key elements of this package in the second session of this Parliament and for legislation to reach the statute book by the end of the next session (by spring 2013) so the first low-carbon projects can be supported under its provisions around 2014.

The Government needs to make solid progress with the Energy Bill and the EMR to provide assurance to enable large scale investment in projects such as nuclear new build. Developer's final investment decisions will hinge on what the Energy Bill says, how it will implemented and administered. Therefore the EMR and the electricity bill are significantly linked to the economic regeneration of Copeland.

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Consultees

Appendix a – An indicative Timetable for Implementation and Transition