

Cohesive and clear measures needed for energy market reform

The energy industry is not an industry for the faint-hearted – it has been in constant flux since I joined it over twenty years ago. In that time I have worked in pretty much every facet the industry has to offer: generation, retail, finance, trading, even transmission, in many countries across Europe. One thing I know for sure: Britain is where radical reform tends to happen first.

Britain pioneered the move to free and open energy markets, and has reaped the benefits that this move brought for many years. Britain still ranks as one of the most competitive energy markets in the world with some of the lowest energy prices in Europe.

However, trust in Britain's energy companies and energy markets has, arguably, never been lower. Despite evidence to the contrary from numerous sources, the energy market is assumed by most to be uncompetitive and 'big six' energy company profits assumed to be unfair and unjustified.

The truth of the matter, according to Ofgem's own analysis, is that the profit margin for an average dual-fuel residential customer has only recently reached positive figures after years of being negative, and still only stands at around £15 on a £1000 bill. According to the Prime Minister's own energy advisor energy company profit margins average around half that of most FTSE 100 companies.

Ofgem has estimated that the UK needs £200bn of investment in new energy infrastructure by 2020. This is a huge leap compared to current, record investment levels: twice the recently agreed bail-out for Greece; like the UK hosting the Olympic Games twice each year for the next eight years.

And eight years is no time when it comes to planning and constructing major projects like new energy infrastructure. If policy yet to be enacted is supposed to change the behaviour of investors, then it's too late. For my board and me, 2020 is already in the rear-view mirror. That is why I will state, time and time again, intervention must be simple and coherent. It must be quickly and easily enacted. Unfortunately, the differing agendas and multitude of proposals for change coming from government – indeed, from different camps within government – and from our regulator, and from consumer-groups and many others all threaten this need for simplicity, clarity and cohesiveness.

Carbon price support

The carbon tax is a perfect example. Its proper name is the 'Carbon Price Support', but it is a carbon tax, and I will therefore call it that. In conception, its aims were clear and laudable, but in practice it has fallen



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short and in my view is actually now counter-productive.

Its original aim was to amplify the signal from the EU Emissions Trading Scheme. Putting a guaranteed floor price on carbon emissions, so that techniques to lower carbon emissions become less of a financial risk and could therefore be put into practice in the most cost-efficient way.

When announced in April, the reality was far less useful: a tax on fuel used, based on its carbon content. To my knowledge, taxes have never changed investment behaviour – they are simply too easy for politicians to change or abandon when it suits them. As the abandoning of the fuel duty escalator showed – ironically announced in the same budget as the Carbon Tax. In addition, the tax will be implemented before any change in behaviour can take place: penalising some whilst benefiting others before they even have a chance to act.

The government's own response to its consultation expected energy-intensive businesses to see a 6% increase in their energy bills by 2016 due to the tax, and much more by 2020. It is worth remembering that industrial competitors outside of the UK will not be subject to these additional costs, yet any additional carbon reductions made in the UK due to this tax will make it easier for the rest of Europe to achieve their own carbon reductions.

It's worth remembering, too, that the tax has been set much higher than anticipated – a further shock to investor confidence – but arguably at a level that will still make little difference to UK investment without further measures.

As a final nail in the coffin, it seems that those industries in the UK that are most energy intensive will be protected from the impact of the tax anyway. A vastly important point for the recovery of our economy and of the impact of carbon leakage, but it begs the questions: who is this tax aimed at? What is it supposed to achieve? How does it integrate with the overall plan for energy policy?

In the suite of measures providing

simple, coherent, and effective signals to the market, it is sadly out of place.

Technology jigsaw

The energy gap must be filled from both the supply side and the demand side. All too often I see people slipping into thinking in terms of megawatts when they should be thinking in terms of megawatt hours: energy not capacity. This is important as the different technology options available fit together like a jigsaw: they all bring different strengths and weaknesses to the table.

Offshore wind power is expensive and intermittent, but can and should make a significant contribution. Large-scale, sustainably-sourced biomass can offer a non-intermittent renewable option, whilst new nuclear offers low carbon, baseload energy on the very largest scale. The jury remains out on the value of carbon capture and storage, but we cannot afford to discard any option without understanding its true potential, so research and demonstration must continue. Gas brings a much-needed controllable, rapid response, maintaining the integrity of the overall energy system, whilst still being clean, efficient and cost-effective.

The government's flagship programme for energy policy change is the Electricity Market Reform (EMR). The government's proposals are laudable, their objectives sound. However, my concerns remain for the coherency of the overall package. The EMR currently looks overly complex, and I see competing tensions between the different parts of the package that can only act to muddy the clarity of signals to investors.

We need an economically rational and diverse low carbon energy mix to meet our chosen policy goals, and we need to move towards this mix at a rate that the economy can support and in a way which supports economic growth and strengthens the UK supply chain.

We need to continue to innovate and deliver demand side initiatives. Robust, cost-reflective price signals are again key, and I have real concerns that EMR proposals for a capacity mechanism will dilute the benefits of smart meters and other demand side measures. There is still time to ensure that the EMR takes a holistic view and that energy policy as a whole comes together to give clear, coherent messages to a market that is waiting to invest.

I know that, if government and regulator can introduce the right coordination, then industry can support its aims and is waiting to invest and deliver. The energy industry is not an industry for the faint-hearted, but I wouldn't have it any other way.

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