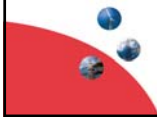


Are the current electricity market arrangements out of date?

Cornwall Energy summer event
IoD
2 June 2009



What we will cover...

- Set the context
- Highlight some recent comments and tensions between policy objectives
- Outline some of our thinking with regard to defects in current market settings
 - Neta design
 - retail markets
 - governance
- Focus on impacts for competition

Setting the scene (1)

- Neta has endured longer than Pool without comprehensive review
 - it was a very radical departure
 - limited first year review in 2002
 - profound changes in industry structure
 - price probe has belatedly raised some issues
- Given the claims made for it at the time this is perhaps surprising
- So is Neta delivering against design objectives, especially with regard to enhancing the competitive process? Have some elements performed better than others?

➤ Is it time for a calm assessment?

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Setting the scene (2)

- Over same period fundamental shift in policy
 - 2003 and 2007 white papers
 - changing relationship between key policy drivers
 - Ed Miliband's call for "more muscular policy"
- Policy now translating into increasing market interventions
 - supplier obligations
 - feed-in tariffs, smart metering, social tariffs

➤ Are current market settings appropriate given new challenges and obligations?

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Setting the scene (3)

- Some recent criticisms
 - Dieter Helm: *Credible energy policy, Meeting the challenges of security of supply and climate change, 2008*, [Policy Exchange](#)
 - Simon Skillings: *Time for a change*, [New Power UK](#)
 - Alastair Buchanan on 20 May
 - “The fundamental question at the moment is whether the market design is fit for purpose” [Hansard](#)
 - well-documented concerns about governance
 - but suggests regulator has open mind on merits (or otherwise) of current trading arrangements?
- **But only high-level diagnosis of problems**
- need to define remedies and specific measures

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Defining the issues - wholesale

- Neta market design based around liquid trading and cost-reflective uncontracted trades
 - In practice double jeopardy illiquid trading and penal cash-out
 - Question-marks over adaptability to new challenges
 - intermittency and inflexibility penalised
 - how will we deal with “surplus” must run plant?
 - new markets vs. old barriers
 - transmission erroneously seen as separate domain
- **Tacit acceptance (by some) of competitive distortions but what are we doing about them?**

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What are we doing - wholesale

- Despite received wisdom of fluid market rules, NETA design has been largely static
- Ofgem rightly extended price probe to address wholesale market interactions
 - market access deteriorating at time when number of participants increasing
 - APX and N2Ex encouraging but ...
 - further price probe thoughts eagerly awaited
- What would mandatory trading achieve?
 - granularity
 - credit issues

➤ We need to broaden agenda of debate

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What should we be doing - wholesale

- Don't need redesign but:
 - extend market opening
 - delay gate closure
 - recognise split market
 - swap imbalances
 - ex post trading
- ...and of course cash-out



➤ For whatever reason the industry is obsessed with the symptoms, not the causes

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Defining the issues – retail markets

- Retail competition now firmly back on the agenda
 - after the lord mayor's show...
 - acute political pressure to deliver
 - windfall issues, social problems have complicated a simpler matter of how is the market working
 - regulatory pendulum has swung back...
 - ... but markets have fallen
- Direct response to probe but will remedies constrain competition?

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What are we doing – retail markets

- Domestic measures:
 - remedies package
 - undue discrimination
 - direct debits
- Important not to lose sight of real problems in traded markets
- Tyranny of the timetable, with Ofgem committed to implementation for this winter
- But more general tendency to intervene first, then think later

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What should be done – retail markets

- Improve information
- Codes of practice
 - including in contracts market
- Do not reregulate SME markets
- Above all do not constrain ability to compete



Rubik's ice cube

- Yarrow, Waddams, etc think remedies go too far
 - “retrogression”

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Defining the issues - governance

- Governance
 - David Currie's “half a solution” comment on Neta market design
 - code governance review essential
 - it has identified many problems and issues
 - many examples of bad governance
 - but will the review deliver and go far enough?

- Good governance is a prerequisite for competition in markets with complex trading rules

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What is being done - governance

- Code governance review has five important work-strands
 - major policy reviews
 - governance of network charging
 - smaller participant issues
 - environmental objectives
 - code administrators' review
- But is the debate now characterised by a choice between low-level tinkering vs. major policy review?

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What should be done - governance

- Key features of code governance are appropriate
- Build on strengths of independent panels
 - code administrators to act as critical friend
 - code of practice etc
 - administrators owned by trading parties



“Of course, this is the worst-case scenario. Things will probably look much better in the morning.”

- Central design body needed urgently
 - major policy review but as a default

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Conclusions (1)

- Basic market concepts are as valid to day as back in the late 1990s/early 2000s
- But:
 - evident tension with Government policy objectives
 - alarming trend of competition being subordinated
 - major suppliers now instruments for delivering policy
- Diversity of supply and innovation needs diversity of participant
 - scale players can only go so far in responding to incentives and meeting objectives
 - important details and governance are inhibiting realisation of market objectives

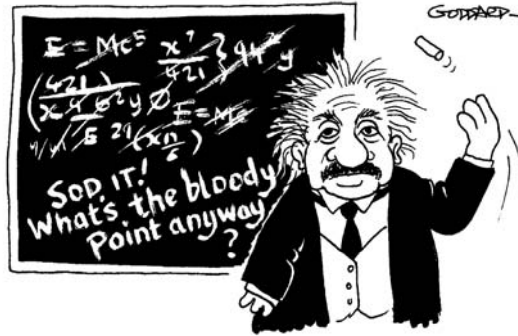
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Conclusions (2)

- More generally can competitive markets deliver new government policies?
 - yes, provided identified defects at both wholesale and retail levels are addressed
 - in particular wholesale market rules need a significant refresh
 - retail interventions need to be carefully targeted
 - better governance a critical element of ensuring adaptability
 - going forward we need a much greater emphasis on developmental issues that looks across governance structures

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Thank you for listening!



Einstein develops his theory of negativity.

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