

Date: 10 March 2011

Electricity Market Reform
DECC
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3 Whitehall Place
London
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Dear Sir/Madam

re: Consultation Electricity Market Reform

Since privatisation in 1989 there have been a number of reforms to the electricity market. We have seen: changes to the way that renewables have been subsidised (NFO, ROC and FiT); complete reform of balancing mechanisms; introduction of new wholesale markets and forms of contract; and of course the introduction of full retail competition. In addition to these major changes there has been a plethora of minor changes in rules and regulations each aimed at addressing a specific issue.

The reality is that the benefit of all of this change has not added significantly to the value being delivered to customers or the achievement of various policy objectives. Some of these changes have simply reversed previous changes. For example the way in which renewables are funded, when we had the non-fossil fuel obligation it was argued that it would be more efficient to have a common subsidy for all technologies, and ROCs were introduced. FiTs have just re-established differential subsidies.

Any further change is likely to simply transform or move the perceived problem that it is intended to address to another place. The much acclaimed NETA in reality did very little to improve or clarify the wholesale market. And indeed much of the current EMR is aimed at revising the NETA arrangements. It is interesting that the proposals contain the re-introduction of CfDs, the main contract form in the post-privatisation era.

What the industry certainly does not need is a raft of changes largely driven by the desire of a new administration to put its mark on it. The cost of constant change in the energy industry has been huge, both in terms of out of pocket costs to implement the change, and the opportunity cost of the delays and re-direction of resource while it is happening.

Any further changes should be preceded by doing some really simple stuff that will have a direct impact on achieving major policy objectives. Primary amongst these is the reduction in energy consumption to address climate change issues, reliance on imports and ageing and insufficient infrastructure. Remove the VAT subsidy. The price increase will further encourage energy efficiency and improve the economics of energy saving measures. The additional revenue could be directed towards addressing other policy initiatives such as (i) increasing benefits to alleviate Fuel Poverty; (ii) funding innovation in the energy/environment arena; or (iii) simply to reduce other forms of taxation to achieve budget neutrality.

The next step should be to effectively implement existing regulations that will encourage competition and diminish exploitation from the dominant players. In particular (i) controls on predatory and differential pricing; (ii) bad sales practices; and (iii) illegal winback activity.

Removal of the complex array of specific measures, such as FiTs, Warm Home Discount, Green Deal etc, would further simplify the industry and remove barriers to entry and growth. Higher prices (through VAT), higher benefits, better competition and more direct action on reducing energy consumption in buildings will mean that these measures will be largely redundant.

These changes will deliver value to customers largely through reduced prices, and thereby remove the excess profit potential for the Big 6 suppliers. This in turn will force them to trade more efficiently in the wholesale market. If there is a residual problem in the wholesale market it can be addressed.

Finally, there needs to be a change in the mindset at Ofgem. There is currently a high tendency to get too involved in detailed business processes. If regulators were good business people they should be out running good businesses. Otherwise stick to regulation. A simple reduction in the number of senior people at Ofgem is highly likely to achieve this objective. Where more resource is required is in the effective policing of existing licence conditions.

These changes could be implemented very quickly, and I would urge action immediately.

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