

Electricity Market Reform Contact Group meeting

10 November 2011

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1. Welcome and introductions
 2. Update on the EMR Programme
 3. The Institutional Framework
 4. Update on Contracts for Difference
 5. Closing remarks and actions

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Technical Update to the White Paper

- On course to publishing the Technical Update to the White Paper around the turn of the year
- The Update will respond to the consultation on the Capacity Mechanism and set out at a high-level the institutional arrangements for the CfD and Capacity Mechanism
- CM: TU will set out the chosen model; the rationale for the model and comparison with other options; consultees' views; outline of eligibility; and interactions with CfD & cash out reform, etc.
- IF: Outline of chosen model; overview of options and assessment against criteria and delivery of functions; rationale for design, etc.

Progress on other parts of the EMR package

- CfD: Mindful of the need to give the market as much visibility as possible on how key issues relating to the CfD will be resolved and plan to publish an update in the new year.
- EPS: informal consultation (on grandfathering; upgrades and life extensions; and exemptions for plant in the CCS demonstration programme) closed on 31 October. Will set out further detail on EPS in the new year.
- Enabling early investment decisions: Considering the form of comfort that might be given to support the taking of early investment decisions for low-carbon projects ahead of EMR implementation. Will publish some further information about the process around the turn of the year.

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Contents

- What we said in the White Paper
- Governance
 - Split of functions between Government and the delivery body
 - The principles for the hybrid model
- Payment structures: key considerations
- Questions for discussion

What we said in the White Paper:

Functions	Criteria
<ol style="list-style-type: none">1. Setting the overall policy approach and objectives2. Translating policy objectives into technical requirements3. Delivery of the contracts4. Data reconciliation and managing payments5. Monitoring compliance and enforcement	<ol style="list-style-type: none">1. Accountability2. Independence3. Credit worthiness4. Technical expertise5. Commercial and financial skills6. Value for money

Functions and accountability: What could the Delivery Organisation do?

Functions	Spectrum of Independence		
	Low (Government)	Medium (Hybrid)	High (Independent)
Set policy approach and objectives	Government	Government	Government
Translate the policy	Government	Government and Delivery Organisation	Delivery Organisation
Deliver the contracts	Delivery Organisation	Delivery Organisation	Delivery Organisation
Data reconciliation and managing payments	Delivery Organisation	Delivery Organisation	Delivery Organisation
Monitor compliance and enforce	Delivery Organisation (or Ofgem)	Delivery Organisation (or Ofgem)	Delivery Organisation (or Ofgem)

Hybrid model principles

- Accountability: Government would make decisions on policy framework and objectives, and on rules (e.g. eligibility) and parameters (e.g. strike) of the schemes.
- Independence: the delivery body would provide independent, expert advice to Government on how best to meet objectives, and on what rules and parameters will be needed.
- Value for Money: Government and the delivery body would both be required to take value for money considerations into account before making any decisions.

Payment models: key consideration

Criteria for payment models:

- Does it increase competition?
- Is it acceptable to generation?
- Is it acceptable to suppliers?
- Is it acceptable to investors?
- Does it create barriers to generation entry?
- Does it create barriers? to supplier entry?
- Is it too complex?

Discussion questions

- Does the hybrid model provide the right level of accountability to Government? Does it give the necessary degree of independence?
- How would you prioritise the criteria for the payment models? Are there any others we should be considering?

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Contracts for Difference were chosen in the White Paper, and key design choices were made

Rationale for adoption

White Paper made a firm decision to implement CfDs...

- More cost effective:
 - Lower cost of capital
 - More control over potential for excessive rents
- Practicable for all types of low carbon generation
- Public finance impact can be managed

Key design choices

... and set out the basic structure we are minded to adopt.

- Price discovery: initially administrative, leading to competitive
- Reference Price: appropriate for different technology characteristics
- Pay on output (energy) with an open question on base load to pay on output or firm volume.

Progress overview

Heads of terms for contracts

Developing process and rules for contract allocation and price setting. Working up commercial terms including contract volume, length and reference price.

Route to market/liquidity

We continue to discuss with stakeholders and work with Ofgem on addressing these issues. Ofgem is due to make a decision on its liquidity proposals towards the end of the year.

Coherence

We continue to work closely with other areas of the EMR package including the capacity mechanism and institutional design to ensure that we deliver a coherent package.

We are currently engaging on all of these areas with participants in the market, both bilaterally and via associations and group workshops.

Forward Timetable

- The technical update to be produced around the turn of the year will be focused on Institutions and the capacity mechanism.
- However, we are mindful of the need to give the market as much visibility as possible on how key issues relating to the CfD will be resolved and plan to publish an update in the new year.
- This will also inform the process of developing primary legislation for introduction in May 2012.

Next steps

Our short term objective is to publish an update on CfD design and price setting in the new year that;

- covers the key areas and is well aligned with the capacity mechanism and institutional design
- demonstrates how the CfD will enable an efficient allocation of risk between generators and consumers
- provides more clarity and helps to build confidence in the CfD mechanism

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