



# The rise and fall of electricity regulation

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# Overview

- Some heresies
- Review changing role of regulator through UK experience. The rise and fall of regulation
- In a carbon-constrained energy environment, what is the role of an independent regulator?

# Some heresies

- The world is more complicated than ever before
- Regulation/policy has recently become a difficult juggling act
- Consumer participation is an illusion
- Regulators must 100% autonomous & independent
- More competition and less planning is always the answer

# Changing regulatory roles in UK

- Up to 1990: Expected to be temporary role setting monopoly prices & overseeing transition to competition
- 1990-97: Dealing with failed RPI-X mechanism, failed wholesale markets & uncompetitive market structure
- 1997-2002: Redesigning wholesale market & introducing retail competition. Given prime duty of protecting consumers
- 2003 onwards: Presiding over failed markets & uncompetitive market structure. Drifting aimlessly as prices rise sharply
- 2011 onwards: Electricity Market Reform
- 2015: Competition & Markets Authority investigation

# Vision of privatisation/liberalisation: Up to 1990

- Up to 1990, prices set via negotiations between state-owned electricity industry and government. Balance of expertise strongly with industry
- 1989: Determination to have 'light' regulation. Aim is to 'hold the fort' until competition arrives (Littlechild)
- Job of regulator to temporarily set prices for remaining monopolies and facilitate transition to competition.

# Setting monopoly prices & competitive markets: 1990-97

- Littlechild: Level of  $X$  the outcome of bargaining between [the utility] & the Government; an exhaustive costing exercise is not called for. RPI-X 'not appropriate' if competition not expected
- 1993, RPI-X had failed. Replaced by *ex ante* form of RoR regulation with an exhaustive costing exercise
- Generation was duopoly exploiting its market power
- Large consumers got low prices at expense of small consumers

# Wholesale & retail market design: 1997-2002

- Gas regulator merged with electricity regulator
- Compulsory Pool market replaced by commodities market at huge expense, >£1bn (4x cost escalation)
- Did the Pool fail or was it sabotaged by bad design & poor software (Richard Green)?
- Retail competition cost consumers £1bn (4x cost escalation), is cumbersome and expensive to run

# Drifting aimlessly: 2003 onwards

- Up to 2003, real prices fell, but due to very low privatisation price and weak fossil fuel prices
- 2003-14, real electricity prices increased by 80%, gas by 135%
- Wholesale market failed: doesn't set wholesale price, high barriers to entry, doesn't give investment signals
- Disillusionment with retail competition. UK energy companies less trusted than UK banks
- 2003, UK electricity prices (pre-tax) for medium domestic consumers in 12 out of 22 EU MS cheaper. 2014, UK most expensive of 28 MS
- 2014 About 900 staff cf about 200 in 1990
- Competition & Markets Authority Investigation commissioned 2014

# Electricity market reform

- Buchanan Ofgem (2010) ‘Unprecedented combination of [events] has combined to cast reasonable doubt over whether the current energy arrangements will deliver secure and sustainable energy supplies. There is an increasing consensus that leaving the present system of market arrangements & other incentives unchanged is not an option.’
- Government agreed & Electricity Market Reform (EMR) process started

# Electricity Market Reform: 6 key measures

1. 'C' Price Floor provides stronger incentive to invest in low carbon generation now. Introduced at €16/tonne in 2013 but planned real price increases to €43 in 2020 (€85 by 2030 ) abandoned. DECC. No role for Ofgem
2. Feed-in Tariff with Contracts for Difference to provide stable financial incentives to invest in low-carbon electricity generation. Bilateral negotiations with EDF for nuclear, capacity auction for renewables. DECC. No role for Ofgem
3. Emissions Performance Standard: Prevents new coal-fired plant being built. DECC. No role for Ofgem
4. Capacity market. First auction carried out Dec 2014 for payments to be available at peak. Most existing plants (50GW) successful. Capacity payments subject to EU Commission Inquiry. DECC. No role for Ofgem

# Electricity Market Reform : 6 key measures

5. Limit on the number of energy tariffs offered to domestic consumers. No role for Ofgem
6. Measures to improve the liquidity of the electricity market. Introduced March 2014, implemented by Ofgem.

Ofgem (Dec 2014) Results show that there has been an improvement in liquidity in the wholesale market. But we recognise that there are other factors that could have contributed to this

Fuel poverty a major political issue

Threat of blackouts in 2015/16

Smart meters being rolled out at a cost to consumers of ca £12bn. Benefits to consumers £9bn. What if this is 4x over budget?

# Final thoughts

- Ofgem marginalised, ineffective but intrusive.
- Why? Poor track record? Competition & Markets Authority investigation illustrates failure of Ofgem
- Ofgem allowed re-integration of generation and retail, it oversaw wholesale & retail market design, it oversees operation of retail & wholesale markets
- Or does dominance of climate change mean policy decisions dominate and there are few 'objective' decisions to take?
- Is it unwillingness of government to let go of key decisions? Was Ofgem strong in 1990s because fossil fuel prices low and climate change not embodied in policy so no need for 'policy'? Earth Summit was 1992



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