The return of the CEGB?

Britain’s central buyer model

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June 26th 2014

1. Introduction

Though no part of any grand plan, and certainly not by intention, the British energy market has morphed from a liberalized quasi-competitive market into one that is driven by the state. It has happened largely by accident rather than design, but it also has a remorseless political economy logic behind it. It is the unintended consequence of a long series of well-intended interventions.

The result is closer to the old nationalized industry command-and-control structures, which had the Central Electricity Generating Board (CEGB) at its core, than to the competitive market model to which politicians aspired for the last quarter of a century. Though the industry is still in private hands and there is no statutory monopoly, a number of the features of the CEGB model have been creeping back. Now almost every significant investment in electricity generation is contracted for by the single buyer that this government has created, and retail prices are close to being regulated, de facto if not yet de jure. This is not yet the limit to the interventions. The Labour opposition proposes to go even further, fixing prices for an initial period of 20 months.

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How did it end up like this? It started at the end of the 1990s with the replacement of the electricity pool with the New Electricity Trading Arrangements (NETA), which in turn facilitated a process of vertical integration creating the “Big 6”, which in its turn limited competitive entry in both generation and supply. It received a major push with the coming of climate change policies, notably the EU’s 2020-20-20 package and the UK’s Climate Change Act both in 2008, and then with Energy Market Reform (EMR), Ed Miliband’s policy in 2009-2010. This has been subsequently fleshed out by Chris Huhne and then Ed Davey, resulting in the 2013 Energy Act, which took it one massive stage further, adding capacity contracts and Feed-in-Tariffs (FiTs), replacing the Renewable Obligation Certificates (ROCs). Added to this suite of interventions, nuclear is obviously a state project. Treasury financial guarantees are the latest intervention.

This list is by no means exhaustive, and alongside these developments, a large body of interventions has been built up covering network regulation, wholesale and supply market regulation, social policies, energy efficiency measures and smart meters. The resulting mass of interventions is probably beyond the scope of any official in DECC to fully comprehend.

This paper describes how this mass of interventions has been built up, why it follows a predictable path of ever-greater complexity, what the consequences are, and what options there are to stem the tide.

2. First steps—the massive mistake that was NETA

There were many things, with hindsight, that were wrong with the way privatisation was done. At the time, the conventional view was that the government had not gone far enough in the breaking up of the CEGB into four bits (National Grid, National Power, PowerGen and British Energy). The twelve Regional Electricity Companies (RECs) had not been fully split up between distribution and supply. It was argued in defense that this was the best that could be done at the time, and it was left to the Office of Electricity Regulation (OFFER), the new electricity regulatory body, to finish the job—alongside the Office of Gas Regulation (OFGAS), which had already got its teeth into the corporate structure of British Gas. Stephen Littlechild, the first Director General of OFFER, brought clarity of vision—regulation was necessary only as long as the competition that he actively promoted had yet to take up the strain of disciplining the companies and bringing new entrants into the market.

So strong was this new conventional wisdom that the future was assumed to lie in more and more competition, and electricity would become a “normal”
competitive industry in due course. It proved a model for others to follow—especially in Europe. The Internal Energy Market (IEM) was modeled on the British experiment. It was recognized that it would be a gradual process.

Liberalization in Britain came in two stages—in 1994 and finally in 1998. The long-term take-or-pay contracts were gradually broken down—between the generators and British Coal, and between the oil and gas companies and British Gas. In Europe, it took much longer, and is not yet completed, especially in respect of Gazprom and the major German energy utilities.

As with many experiments into largely unknown territories, the absence of evidence and experience let the ideology of the market dominate the process of implementation. If competition was everywhere a "good thing" and "the more the better", who could object to further measures on this path? The ideology confused competition with liberalization and in particular *laissez faire*. For some, the task was largely to get the government out of the way, and stamp out all residual traces of the old planned CEGB world. For others, markets require rules and structures, and for them, the role of regulation and markets is altogether subtler. Just as the Stock Exchange is highly regulated in order to make it competitive, so too with electricity markets. But rather than focus on the rules governing the market design at privatisation (the Pool and the badly designed capacity market), the *laissez faire* approach suggested that the market participants should be allowed to contract as they chose. Rather than compelling all power to be sold in the Pool, and giving rights to all suppliers to buy power in the Pool, a more liberalized model that became NETA was promoted, with the central idea that bi-lateral trades outside any pool should be allowed.

The obvious response from the companies was to contract bilaterally with *themselves*—in other words, the NETA market design had the unintended consequence of heralding in a dash-to-vertically-integrate. All the companies eventually did it, often going through several ownership iterations. Many of the Regional Electricity Companies (RECs) were first bought by American companies (with no generally discernable benefits and much financial engineering), and then the Europeans stepped in to buy the generators. Four of the big 6 ended up owned in whole or in parts by Europeans—Scottish Power (Iberdrola), PowerGen (EON), National Power (RWE) and International Power, broken out of National Power (GDF-Suez) and British Energy (part of EDF) combined with London Electricity (EDF). Only Centrica (itself broken off from British Gas) and Scottish and Southern Energy (Hydro Electric plus Southern Electric) are still independently owned and quoted on the Stock Exchange—along with National Grid (which incorporated Transco, once part of British Gas).

Vertical integration and an opaque wholesale market largely put paid to entry in generation and in supply, except for special and marginal players—and
eventually for renewables companies. It ushered in endless regulatory arguments, around 20 “inquiries” and “probes” by OFGEM (a merger of OFFER and OFGAS), the highly interventionist proposal by the Labour Party to fix prices for 20 months, and a full Competition and Markets Authority (CMA) inquiry. OFGEM has also come forward with Retail Market Reform (RMR) that limits the suppliers to a small number of tariffs and heavily curtails their freedom of maneuver. This is a very long way from *laissez faire* and allowing the companies to behave as if they were in a “normal” competitive market. It is about as un-Littlechild as you can get. Nobody could regard these multiple inquiries and interventions as reflecting a good competitive market outcome.

The trouble with inquiries is that they engender the expectation that “something will be done”. The current CMA inquiry falls into this category. Inquiries beget further interventions. Further interventions beget more unintended consequences. These beget more interventions. Eventually the results are so complicated and unsatisfactory that radical options start to gain traction. In both the wholesale and the retail markets, these polarize around the reintroduction of state control and regulation (particularly in supply) and structural break up to create a more competitive landscape.

### 3. The impact of climate change policies on competitive markets

It is one of those silly mantras that European Commission officials and national politicians trot out that climate change policies in general, and renewables in particular, are fully consistent with security of supply, competitive markets, and affordability. It is “win-win-win….” The trilemma of energy policy is not, it is claimed, a problem of three conflicting objectives requiring the painful political need to define the trade offs, but one great happy family of objectives. Messrs Miliband, Huhne and Davey trotted out this argument in respect of competitive markets and renewables. Mr. Davey was at it again at the beginning of May 2014, claiming that Britain’s climate change policies were the best way of dealing with the threat to security posed by the Russians—and that the rest of Europe should follow his lead. They “know” the answer—their particular technologies to address climate change. It is just the question that varies.

The reasons this trio have been so certain that climate change polices dove-tailed with competitive markets is because they “knew” that oil and gas prices were going to go ever upwards. They shared this certainty with the progenitors of the EU’s climate change package. “Knowing” that the upward path of oil and gas prices in the first half of the 2000s would keep going up gave them the certainty that current renewables, whilst temporarily expensive, would soon be in the market—around 2020 was the usual guess. So any subsidies could be
temporary—and any market interventions would be temporary too. There would need to be ROCs and FiTs to get the renewables going, but by around 2020 they would stand the market test against the (by then) assumed much more expensive fossil fuels.

This led to a serious mistake. They concluded that intervening in the market would be a short term, temporary affair. By 2020 there would again be open competitive markets for all the technologies, and renewables would have won. The US, led back then by George Bush, was not only being bad in not taking up Europe’s “lead” on climate change, but would suffer the consequences, with its reliance on what were assumed to be expensive fossil fuels. Europe would be the future for energy intensive industries, and it would have created its own Googles, Apples and Microsots of the renewables industry.

It has already turned out differently. Like their CEGB predecessors and the ministers who determined its path, they got fossil fuel prices wrong. The CEGB “knew” that oil and gas prices would go ever upwards after the 1970s (and especially after the Iranian revolution and the doubling of the oil price at the end of the 1970s), and so they set about planning for a new generation of nuclear power stations. 10 were proposed in Parliament in 1981. Like EDF in France, the future was a friendly place for the sorts of technologies they “knew” would be best for Britain.

Europe—and Britain—now face in some respects a rather nastier energy future. There are few good reasons for the certainty about oil and gas prices, and the US is in the energy ascendency, out-competing Europe’s energy intensive industries. Current renewables are not about to be competitive—they could be out of the market for a long time to come. The importance of this point is not so much one about climate change—current renewables do little if anything to mitigate global emissions, encouraging carbon consumption as they do—but rather it is about the role of markets and intervention. Renewables are a classic example of the temporary becoming permanent—the subsidies will not be able to wither away without the current renewables going with them, and all the political embarrassment and investor losses that would bring.

4. Snouts in the trough—the irresistible attraction of economic rents and subsidies

It is here that a second major unintended consequence of the climate change policies comes into play. In addition to the mistake about the fuel prices, politicians never thought about how the subsidies would provide powerful incentives for lobbies to pursue the associated economic rents. Profits from
subsides are not only a natural objective of companies but they become addictive. If the architects of the climate change policies had taken a look at the way the Common Agricultural Policy (CAP) has panned out, and how the farming and agrochemical lobbies have come to not only exploit it, but also become dependent on subsidies through their capitalization in land prices and share prices, they might have thought a bit harder about how to design their intervention.

Market-based mechanisms like carbon taxes are hard—but not impossible—to capture. Technology-based interventions, and policies with property rights attached, are much softer targets. The various lobbyists scored a bull’s eye—they got both the EUETS with grandfathered permits (rather than a carbon tax), and a technology-based subsidy scheme.

Capture is a well-known feature of relations between government and industry, and regulators and regulatees. The former was once dressed up as “corporatism” and the promotion of “national champions” to reflect the convenient marriage of interests between politicians and company boards. Yet it is curious that capture does not feature in the appraisal manuals for new policies, in the scrutiny of legislation and in the design of interventions.

The way it works is by closing the gap between the principals and agents. A principal-agent problem arises when objectives differ and there is asymmetric information. The government wants something done in the public interest, the private sector wants to make money, and the private sector has considerable informational advantages. Both sides play the game. The easiest way is to try to influence politicians by making it in their own interests to act in those of the companies. “Revolving doors” see politicians and regulators join company boards. Most energy ministers end up on energy company boards, or as their advisors.

Next comes the lobbying—donating to political parties and causes close to the interests of political parties, hosting dinners, being attentive to the constituencies of key politicians, and so on. None of this is new, surprising or generally illegal. Rather its aims are to influence the objectives of politicians (and regulators). It is a game played out in Westminster, Holyrood and constituencies across the country.

The second aspect of the principal-agent problem is the information asymmetry. Here companies go to great lengths to influence the information that flows across ministers’ desks. If it is offshore wind subsidies companies want increased, then it helps to get politicians to believe investment will stop without more money. If it is a nuclear FiT, then the costs and risks are spelt out in negotiations. Often “independent” third parties are drawn in to provide reports
and research to back up corporate claims. Economic consultancies play a significant role in producing reports to support particular corporate interests. Again none of this is new, surprising or generally illegal.

The key point is that this will all inevitably happen, and policy needs to be designed with “eyes wide open”. The more detailed the intervention, and the more technologically determined, the greater the chances of capture. British politicians have fallen right into this trap, and the result has been some very inefficient investments.

5. The slippery slope—ROCs, FiTs and technology-specific subsidies

Renewables policy started off with a single subsidy value. Renewables would get contracts that paid them one unit of Renewables Obligation Certificate (ROC) for their output and this would top up the money they received from the wholesale market. All renewables were on the same level playing field.

At this early stage, even this simplicity was compromised by the need to decide what constituted a renewable for the purposes of the ROC support. Interventions always require boundaries to be defined, and a great deal of economic rent hangs on where that boundary is set. To be inside gets the subsidy. To be just outside triggers great lobbying efforts to get over the boundary.

In the case of renewables, there is no single definition, and for the very good reason that there are no absolutely zero carbon technologies. There are no pure renewables. There are lots of ways of cutting carbon emissions—from wind farms, to nuclear, capturing leaking coal-bed methane and switching from coal to gas. Where to draw the line?

A political rule is that it is much more painful to strike out a technology that has been inside a subsidy boundary than to include a new one. It can be done, and indeed recently DRAX has had a setback with the Feed-in-Tariff (FiT) it had expected to get. But losers tend to be more vocal than gainers and this can result in lots of political pain, and possibly resort to legal action. In general, politicians get congratulated for extending subsidies and caned for withdrawing them.

The result is that the domain of subsidies grows and grows. This has happened in two ways in Britain—banding the subsidies; and including more technologies. The first step was in response to pressures from particular technologies that needed more than one ROC to get by. Offshore wind led the way. It is an order of magnitude more expensive than onshore wind, and early on its corporate interests lobbied for two ROCs. It was a masterly demonstration in lobbying techniques, combining direct advocacy, the threat to withdraw investment from
a large offshore wind farm, and a supporting media strategy with lead articles in the key newspapers. And it worked.

ROC$s became “banded”—a different subsidy for each technology. The scope for lobbying mushroomed as a result. Now everyone had to have their snout in the trough, in the battle to get a particular subsidy for their chosen technology. It is hard to imagine any policy design better suited to capture. And it worked again.

So profitable were some of the early renewables that politicians tried to row backwards, correctly anticipating a consumer backlash when the bills eventually turned up. In an attempt to trim back the returns, the plan was to remove the wholesale price contribution and put all the renewables on fixed-price contracts. These were dressed up as contracts-for-difference, introducing another layer of complexity, and yielding rents not only to the companies but also to advisers, risk managers and financial institutions.

This is where the pressures to include more technologies came in. The ROC$s did not include nuclear, which was not included under the EU Renewables Directive. A key political reason for inventing the FiTs—in addition to cutting out the wholesale revenue—was to get nuclear a subsidy too. The nuclear interest had a good case to make—it was much cheaper than offshore wind and, in any event, given the life of the plants and the capital intensity, it could not survive on the basis of spot markets. The result is FiTs banded for each of the ROC-based technologies and for nuclear too. Given that the government keeps changing these FiTs, there is everything to lobby for.

The consumer backlash has led to more interventions to try to square the circle of more subsidies and pressure for lower bills. There is a Levy Control Mechanism to try to cap the total pot of subsidies and there have been attempts to withdraw or reduce some of the subsidies as the scale of the costs are revealed. Onshore wind has come under sustained political attack—this time from those lobbying against the intrusions in the landscape. Some solar farm subsidies have been suddenly withdrawn, because there has been too much coming on stream—beyond DECC’s forecasts.

From a political economy perspective, this is all very predictable. Each policy intervention has unintended consequences which require new interventions to deal with them. The degree of intervention will get more and more complex until such time as the weight of interventions produces results sufficiently perverse and inefficient that there is major reform.

That moment is probably still some way off. Many customers might pay for the subsidies, but some customers are also in receipt of the subsidies, and companies hold contracts with government guarantees and with legal force. In Germany, the
middle class property owners have latched onto the bonanza that has been the subsidies for solar panels. These subsidies have been paid for by the poorer customers who could not get on the bandwagon. So entrenched are the middle class subsidies that the parallel with the Common Agricultural Policy (CAP) has been recognised. Germany is already committed to around Euros 20 billion per annum in subsidies already. There is no obvious way out.

The unintended consequences—and the costs—beget more fine-tuning. The Treasury dreamt up the Levy Control Mechanism to cap the total amount of subsidy. The result is that the subsidies have to be rationed. But what happens if nuclear gets the lion’s share? How will all the subsidies to the other players be dealt with? The government will literally have to keep making it up as it goes along.

To be fair, DECC has a “plan” to solve all this. It argues that the interventions—the banding in particular—are all temporary and it intends to move to a technology-neutral auction of the subsidies in due course—after 2000—gradually. But when it comes to how this transition will work, the detail is at best hazy. All the existing investments will have guaranteed subsidies stretching into the long distant future. Nuclear will need subsidies for a long time.

The really naïve bit about the “return to the market” is the assumption that the renewables will be largely competitive by then—that they will not need the subsidies. That depends on the wholesale price being much higher than now. Not surprisingly that is exactly what DECC forecasts show. Forecasting has become part of the capture game.

There is however no good reason for thinking wholesale prices will be anything like DECC assumes, and indeed they might be lower than now. If that turns out to be the case, the “return to the market” would end the prospects of much of the current renewables technologies. It would be amazing if the various lobbies did not major on arguments about the “jobs”, “technology investments” and “new national champions” to head this off. It would be rash to assume that the logic of the return to market would allow this to happen. Subsidies, once begun, are more likely to be permanent.

6. The capacity market adds a whole new complexity

The ROCs and the FiTs brought on lots of renewable capacity, much of which is intermittent. Intermittent renewables require intermittent fossil fuel power stations to back them up. Wind and solar have near zero marginal costs, and hence they dominate dispatch and push everything else (except nuclear, which also has near zero marginal costs) off the system.
CCGTs are typically built on a business model which sees them starting out as baseload to recover their fixed costs, and then gradually moving up the merit order. This model is no longer feasible with lots of intermittent renewables on the system. An investor in a new CCGT cannot know when the plant will run, and in turn cannot contract for a continuous gas supply. The gas supply contracts have to be interruptible too—and therefore more expensive.

The result is that investment in CCGTs requires a capacity contract to make the numbers add up. The ROCs and the FiTs have had the massive unintended consequence of requiring a capacity contract set up primarily for gas. The result is that now all new investment needs the intervention of fixed priced contracts, effectively guaranteed by government.

Once this was realised, attention turned to designing this new bit of policy. How should the capacity mechanism be designed? The obvious answer is an open auction of all the ways of delivering a fixed amount of capacity. But this might produce results that DECC—and many vested interests—might not like. Extension of existing coal stations’ lives is one possibility, as is storage and demand side measures—alongside gas. DECC decided it “knew” the answer not only to how much capacity would be needed but also which sort. The first capacity contract auction has been designed to bring on a new gas CCGT, and indeed after consultation the length of the contract was deliberately lengthened from 10 to 15 years with this purpose in mind. But to placate the other options, there would also be separate, shorter-period auctions as well.

Even this is not the limit of the detail of the intervention. A tricky question is what to do with mothballed newish gas stations that could also provide this capacity. Should they be included in the auctions? Then there is the one gas station going ahead under the existing regime, pre-capacity auctions—ESB’s Carrington. Would it be fair to exclude it? DECC decided in effect that the former should not be included, but the latter should. To add yet another complication, additional limited-period (one year and three year) auctions will be conducted as well, so as not to leave out old plant whose lives may be extended, or the demand side.

Any project or interest excluded will no doubt cry “foul” and start lobbying. However robust DECC tries to be, the temptation will be to mollify its critics by promising to run the second and subsequent auctions differently. Thus begins a game of nods and winks and extensive new lobbying. Next time the capacity contract length and intended winners will be even harder to define.

The difficulties are not confined to the longer-term capacity auctions. Two more interventions have been added to the bundle of interventions to deal with the capacity crunch forecast for the winter of 2015/16 when the margin might be as
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tight as 2%—or even less. The System Operator (SO), National Grid, is entering into demand-side contracts to shed load at peaks, and with existing marginal power stations to enter a strategic reserve. In both cases, extensive rules are needed and the SO will use the legal powers provided in earlier (pre EMR) legislation. Probably it will prove expert in doing this with a further unintended consequence—its success will beget an expectation that it will do it again and these two new “temporary” mechanisms will become permanent.

7. The myriad of other interventions

Energy and climate policy interventions are not just limited to renewables subsidies and capacity contracts. These are just two parts of a massive web of piecemeal interventions. These cover everything from energy efficiency and social policy interventions, to the bulk of market regulation of networks transmission and supply. This is not the place to review each and every one of the interventions. Rather two key points need to be established: the scope and scale of the interventions; and the fact that they continue to increase.

First, the sheer scale. Attached below is a list of just some of the current intervention measures:

Table: Some of the major interventions

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<tr>
<th>EMR + EU Packages</th>
<th>Legacy interventions</th>
<th>Investigations and developing interventions</th>
<th>Offices and Institutions</th>
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<tr>
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<td>• Retail Market review</td>
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<td>• Transitionary FITs for nuclear</td>
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<td>• Standardised prices</td>
<td>• Office for Nuclear Development</td>
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<tr>
<td>• Capacity market</td>
<td>• CESP</td>
<td>• Information requirements</td>
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<tr>
<td>• EPS</td>
<td>• ECO</td>
<td>• Continuing probes (17 so far)</td>
<td>• Ofgem</td>
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<td>• Green Deal</td>
<td>• RIIO</td>
<td>• Wholesale market review</td>
<td>• NG’s ring-fenced SO (for FITs and capacity markets)</td>
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<td>• Smart Meters</td>
<td>• Low carbon</td>
<td>• Liquidity requirements</td>
<td>• Environment Agency</td>
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<td>• Floor price of carbon</td>
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<td>• Continuing probes (many so far)</td>
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<tr>
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<td>• EU Commitment on Energy Security</td>
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Even though it is woefully incomplete, the table raises a number of questions. The first is to consider whether anyone could actually carry all of them in their head. Could any DECC official make even a rough stab at reciting this list? Asking this question is a very instructive exercise. It is like a “mastermind” special topic. The answer is almost certainly no. This begs a further question. How could a market function when the participants have only the haziest idea of all the interventions?

This list keeps on growing. There is no table listing those policies and interventions which have been dropped for the very good reason that it is not clear there are any.

To take the exercise one stage further, each main intervention could be analyzed for the number and form of the changes that have been made to it over time, and whether these have increased in frequency. This is sadly well beyond the scope of this paper. It would be a research project in its own right.

The focus here is the wholesale marker and the areas which were once controlled by the CEGB. Complexity has also been added to the rest of the industry, notably the networks. The regulation of energy networks started out as a simple affair and is not a matter of immense complexity. At the outset the idea was that RECs would be price takers, and that the job of the regulator was to fix the prices *ex ante* for a five-year period, and then leave the companies alone. Given the prices, the companies would profit-maximize by cost-minimising and in the process reveal their costs. For Littlechild, the first regulator, it was hopeless to try to accurately predict costs and even worse to try to control profits. The asymmetry of information was simply too great. Better to fix prices and reveal costs, than try to second-guess.

The network model lasted barely four years, before the politics caught up with the economics, and regulators started filling in the details. Each review was more detailed than the last, as each new regulator made their mark. Eventually the regime was replaced by one called RIIO—(Revenue=Incentives+Innovation+Outputs). Now there were incentive mechanisms for all sorts of things. The regulator even expropriated £500 million of customers’ money to run a “low carbon innovation” competition.

In the case of supply, there was a major step towards deregulation. Supply price regulation was abolished, except in Northern Ireland. Yet that did not mean the regulators left supply to the market. On the contrary, a host of interventions were added, including fines and penalties. Eventually the Prime Minister promised that everyone would be on the lowest tariff, and OFGEM proposed the Retail Market Reform (RMR) and four tariffs. Four more tariffs are allowed for smart meters. Even this was not enough and the CMA has eventually been called
in, together with *ad hoc* letters and recommendations from the regulator about price setting.

More complexity meant more people to deal with the consequences. When British Gas was privatized, OFGAS was set up to regulate the company with a staff of around 20 people. Today almost 600 people work for OFGEM. DECC has almost 1500. Every company in the sector has its own regulatory team, with the result that the total number of people across the companies is probably greater than that of OFGEM. Then there are all the specialist regulatory advisers, consultancies and lawyers covering regulation. Regulation and government intervention has created its own industry literally thousands of people. Regulators have their own websites, daily email alerts, press releases and so on.

8. **How does it differ from the CEGB?**

The CEGB was a state-owned statutory monopoly. It owned generation and the transmission grid, and sold its power to the state-owned area boards, which became the Regional Electricity Companies. They passed these costs onto customers through their supply monopoly. The CEGB priced its output through the Bulk Supply Tariff (BST), which comprised a capacity charge and an energy charge, set to recover sufficient revenue to meet the Treasury’s rate of return target. The Areas Boards passed the fixed element on through a standing charge, and the energy costs through a per unit charge, and used special tariffs to incentivise load shifting for night storage heating. Industry got lots of special deals.

The CEGB had a statutory duty to ensure security of supply, and it planned both the form and location of investments. Private contractors, on behalf of the CEGB, carried out the investments. Investment was financed by a mix of retained earnings and state provision, and the cost of capital was therefore that of the Treasury.

The similarity with the current situation is that DECC, through the SO, is determining all significant investment in electricity generation through the awarding of contracts, in part through competitive auctions. Lord Marshall, the last CEGB chairman, would have found the machinations of the SO very comprehensible and probably, like the SO, have raised his eyebrows at DECC’s analysis and political interventions.

The CEGB would not have had to pay a 10% real rate of return on new power stations like Hinkley. It would also have earned a normal return on its existing assets, rather than the system marginal costs under the current wholesale
market arrangements. The falling price of coal would have been passed through to customers, since it was the margin on costs that it needs to earn, not the price of the marginal fuel costs of marginal unit of capacity. The average price to customers would not even in theory have had to approximate the entry cost.

The CEBG could and did enter into long-term contracts—in particular with the state coal monopoly, itself under the considerable influence of the mining unions. Similarly British Gas had been able to underpin the development of North Sea gas through long-term contracts. Customers therefore had a degree of price stability rather different than under the current wholesale market arrangements.

The regulator OFGEM was unknown. The CEBG dealt with its political masters in government, and the state appointed non-executives on its board. But it would have been familiar with a number of the regulators’ activities. These include the fixing of network returns, and most recently with exhortations to change prices on the basis of an external view of costs. Now the Chief Executive of OFGEM writes opportunistic letters on prices and costs, whereas ministers would have whispered in the managers’ ears.

9. The fork in the road

Under EMR and the associated interventions, ministers have taken the electricity industry a long way from competitive markets. The state is back big time, and is largely in control of the key decisions concerning investment. Yet Mr Davey keeps telling all and sundry in the press, at conferences, and in Parliament that much of this interference is temporary, and that he is set on a course to a technology-neutral, pro-competitive future.

It is very hard to be reassured on this front. The subsidies for the various “winners” he has picked will be needed long into the future, unless there is a sharp rise in wholesale prices. DECC predicts this, but then Mr Davey, his predecessors and DECC have been predicting that fossil fuel process will go ever on upwards for a very long time. The rationale of their policies depends upon it. By 2020 oil and gas prices are supposed to be so high that the renewables will be competitive, as will new nuclear, and we can transition back to the market, save only for new technologies still in the R&D stage of development and deployment.

This high fossil fuel world was predicated on peak oil theories and for a world in which technological progress was largely confined to the “good” technologies, and was largely absent for the “bad” fossil fuels. Then along came fracking and the unconventional revolution in the US, and suddenly the bet made by Messers
Miliband, Huhne and Davey looked a dubious one. Not that this stopped them repeating it.

Thus if Mr Davey really intends to return to a technology-neutral policy, he will have to accept that the subsidies will go, and with them many of his pet technologies. It looks particularly bleak for offshore wind. He would be a brave politician to face down all the vested interests and lobbyists, but then he is unlikely to be around to face the consequences.

The more likely outcome is that the subsidies are a permanent feature of the landscape—in addition to all the legacy contracts Mr Davey will have left industry and consumers to pay. If this is the case, a good question to ask is whether, in the presence of so much picking of winners and state control, it would be better to face reality and go the whole way back to the CEGB with full state control and state finance. At least consumers would be spared paying 10% real for new investments. This is the route that the railways have begun to take with the full renationalisation of Network Rail in September 2014.

The return of some of the main features of the CEGB is already with us. Before yet more state control is imposed, it is worth remembering not only the strengths but also the weaknesses of the CEGB model. There is still a choice between a form of managed competition, and the picking of winners by the government. The choice of the competitive route would require an emphasis on carbon pricing, a willingness to have a renewables/low carbon-wide auction, and open capacity contract auctions. It would be good to believe that our political masters would confront this choice, but the evidence from the history of energy policy suggests that choices and changes come after energy crises, not before. As the capacity margin shrinks towards zero in the winter of 2015/2106, that point may be reached sooner than the minister and DECC appreciate.