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17th January 2011

Dear Sir,

RESPONSE TO UK ELECTRICITY MARKET REFORM PROPOSALS

I am writing in response to your consultation (the "Proposals") on UK Electricity Market Reform ("EMR"). I am a power sector professional, having held various senior roles in the UK power generation industry over the last 20 years.

I have set out below my comments on the Proposals:

1. Carbon Price Support

The Climate Change Act ("CCA") requires reductions of carbon emissions by 80% by 2050. The EMR consultation document cites DECC's 2050 analysis, and says that "it shows that the power sector emissions need to be largely decarbonised <u>during the 2030s</u>". This is not a conclusion of the DECCs 2050 analysis. The Proposals then proceed to suggest measures be implemented <u>prior to the 2030</u> (not "during the 2030s"). The DECC 2050 analysis did not show that power sector emissions need to be largely decarbonised <u>prior to 2030</u>. The DECC 2050 analysis considered a number of different (non-exhaustive) scenarios for faster or slower compliance by **2050**. The DECC 2050 analysis did **not** conclude that power sector emissions need to be largely decarbonised prior to 2030. As the statement about the DECC 2050 analysis is the only rationale contained within the EMR consultation in support the Proposals, correction of the claims made about the DECC 2050 analysis and its conclusions should be a priority.

Indeed there is no valid technical reason why carbon emissions reductions need to occur prior to 2030 to reach the 2050 target. There is more than sufficient time, 20 years, to implement the reductions post 2030 if that was considered desirable, for example on economic grounds. There would be substantial cost savings as compared with the Proposals from delaying compliance until after 2030, given the improvements in technology we can expect in the interim period. Further, there are already substantial carbon emission reductions 'baked-in' as a result of the impact of the existing EU scheme, and closures of 12000MW of UK coal and oil plant required under EU legislation by 2015. There is no a need for additional measures now, merely to comply with the 2050 target.

If there is a desire within government to reduce carbon emissions faster than the 2050 target to meet some political agenda, perhaps so the UK can be seen to 'lead' on this matter, this does not justify exaggerating the meaning or utility of the DECC 2050 analysis. We have only recently seen the resultant public backlash when less than robust science has been used to justify a climate science agenda.

In any event, no single European country can have a material impact on global carbon emissions. The only valid rationale for unilateral early compliance would be a belief that others would follow. The grounds for such a belief are at best tenuous; past experience and the parlous state of the global economy would indicate that other countries are unlikely to follow a UK lead. Most if not all other countries in Europe will not go beyond the emissions compliance obligations agreed in current or future Europe wide, or global, emissions reduction deals. The UK already suffers a substantially greater economic burden from carbon taxes than other European countries simply because the UK has a relatively high proportion of coal fired power generation. As such, if the UK adopts policies which force significant additional emissions reductions ahead of legal requirements, the damage to UK industry, and the expansion of UK fuel poverty, would be all the greater.

On the Proposals themselves, whilst some argue that the proposed carbon floor would encourage new build renewables and nuclear, in fact it would be ineffective as such an incentive:

- A mechanism that offers certainty of income after 2020, the earliest point at which new nuclear could feasibly be commissioned, would be required to incentivise new nuclear. The introducing of the proposed carbon floor mechanism prior to 2020 would not provide this incentive. EDF has publicly stated that the proposed carbon floor is insufficient to incentivise new build. The key impact of the proposed carbon floor on EDF, and the French government which owns some 80% of EDF, is a 'windfall' gain for **existing** nuclear (almost all owned by EdF) which would benefit from the consequent increases power prices from 2013 without any increase to their costs;

- To incentivise new renewables again a fairly certain income would be required. However, the impact of the proposed carbon price floor on the power prices that renewables generators would earn is uncertain. This impact on these prices would depend on amongst other things the level of gas and coal prices, and how much gas and thermal generation plant there will be in the market in future. These are both very difficult to predict.

Finally, there are some material problems with the implementation of the proposed carbon 'floor' mechanism (which that are not covered in the EMR consultation document):

i) If the reference carbon price for the 'floor' is taken as an **historic** average, for example of the previous year, the lag effect would create a situation where in any single year UK power generators could be exposed to a significantly greater or lower carbon price than other countries in Europe; and

ii) If instead the reference carbon price for the 'floor' is taken as some **future** market price or index, this will offer a significant trading opportunity. Under the proposed mechanism utilities will clear be incentivised to manipulate prices in what is a relatively thinly traded market.

To conclude on the Proposals covering carbon price support, the implementation of the proposed floor would damage the competitiveness of UK industry, exacerbate fuel poverty, and distort UK power prices. The CCA provides no mandate for such a tax, and neither does or can the DECC 2050 analysis. The proposed floor mechanism would be ineffective at incentivising new nuclear and renewables. The impact of the tax would be regressive, disproportionately effecting the poorest in society, whilst providing a windfall gain to EDF and the French government. This is an ill conceived tax and should be rejected.

2. Feed-in Tariffs

The existing renewables obligation system has been successful, and is generally accepted by developers and lenders. The pace of new renewables growth is constrained largely by available sites, permitting, transmission etc. The tariff has not been a constraining factor, other than some grandfathering issues around new build biomass which are easily solved. As such, introducing a new system is unlikely to deliver significantly faster renewables growth, and indeed could be counter-productive.

3. Capacity Payments

The stated government preference is for a targeted capacity mechanism – akin to the recently withdrawn Short Term Operating Reserve long term contract auctions by National Grid, but I assume to a greater extent.

These proposals if implemented do not appear likely to materially impact the market, albeit may provide some useful incentive for new build peaker plants.

4. Emissions Performance Standards ("EPS")

The government should be aware that carbon capture and storage ("CCS") is nascent technology, and for that reason alone it is imprudent for the government to base policy on assumptions that CCS will work. Governments are not well placed to make judgements about which technologies will be successful.

The impact of the introduction of the EPS, which makes CCS mandatory on new coal plant, effectively would prevent any new build coal plant in the UK until CCS is proven and can be operated without massive subsidy; this may well be never.

5. Concluding Comments

Overall there are significant issues with the Proposals, as highlighted above. The Proposals related to carbon price support would be the most damaging to UK industry and consumers, and additional measures prior to 2030 are not, and cannot, be justified by the 2050 targets in the CCA.

The UK wholesale power markets have operated very well over the last 15 years. In recent years the operation of the markets has successfully attracted massive investment including in the last three years some 8000MW of new CCGT plant. The renewables obligation scheme has attracted the fastest growth in wind power generation seen anywhere globally. The government proposals for market and renewables incentive reform may be well intentioned, but their necessity is questionable, and the consequent uncertainty a negative for investors.

I trust that you have found my responses helpful, and would be pleased to discuss any points further.

Yours faithfully,

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