



Electricity Market Reform Consultation response

Wednesday, 09 March 2011

DECC Consultation Co-ordinator
3 Whitehall Place
London SW1A 2AW

Dear Sir / Madam,

Thank you for giving the Institute of Directors (IoD) the opportunity to comment on your consultation document, published in December 2010. Issues surrounding energy and electricity policy are of considerable interest to the IoD and its membership.

About the IoD

Founded in 1903, and granted a Royal charter in 1906, the IoD is an independent, non-party political organisation of 40,000 individual members. Its aim is to serve, support, represent and set standards for directors to enable them to fulfil their leadership responsibilities in creating wealth for the benefit of business and society as a whole. The membership is drawn from right across the business spectrum. 92% of FTSE 100 companies have IoD members on their boards, but the majority of members, some 70%, comprise directors of small and medium-sized enterprises, ranging from long-established businesses to start-up companies.

General Comments

The Institute of Directors (IoD) supports the government's aim of securing supply, maintaining price stability and addressing climate change. However, the IoD believes that the government should allow the market to function effectively in order to enable market forces to achieve these goals.

Britain's electricity market is over regulated. UK governments have designed detailed programmes and schemes controlling the market to an extent that disables it. On the subsidies front; the government fragmented the renewables market by creating a technology based subsidy, for example the Renewable Obligations (RO) and the Feed in Tarrifs (FIT) are a prime example for this. On the regulations front, the market is also over regulated; there is an extensive

domestic regulations such as gas and nuclear generations, Emission Performance Standards (EPS), Climate Change Levy, on top of extensive European regulation in this area. All these different schemes and programmes lead to a high level of uncertainty and confusion within the market. This also undermines markets and impedes the investment decision. Instead investors and entrepreneurs wait for the government to make decisions on which technologies are favoured by them. The final outcome is that regulatory and political uncertainty not only increases costs in the market, but also encourages market investors to 'wait and see'. This undermines the innovation and investments that are critical for developing an effective electricity and energy market.

The consultation paper "Electricity Market Reform" does not fully address these problems. The IoD contends that this should be the core aim of any new policy. We consider this consultation paper to add a new layer to old and ineffective policies leading to greater complexity and greater inefficiency. The IoD encourages the government to use market tools such as the carbon price to develop the electricity market and enable Britain to achieve its energy goals.

Answers to specific questions

1. Do you agree with the Government's assessment of the ability of the current market to support the investment in low-carbon generation needed to meet environmental targets?

The Institute of Directors (IoD) agrees with the analysis presented in chapter one of the consultation paper. However, based on a recent survey¹ conducted by the IoD among our members there are additional points we wish to emphasise.

- a. High level of uncertainty hinder innovation and investment – organisations the IoD surveyed felt that the government does not have a long-term energy strategy and policy. Existing policies are too complex and tend to miss their targets. This leads to a lack of investments and generates great uncertainty within the electricity market. In order to encourage investment in low carbon generation, the government should adopt a long-term strategy and implement a suitable policy that will provide confidence to investors and entrepreneurs.
- b. The government is not communicating a clear policy– It appears that the government is either not communicating its policy well or that the policy is too complex. Many of the organisations we surveyed indicated that the government's energy related policies and schemes are unclear for them. We assume investors and entrepreneurs face challenges, which undermine investment in this field.
- c. The government's energy and electricity policy changes frequently, while it is constantly under a review and re-assessments. Markets find it difficult to cope with regulatory uncertainty and unpredictability. This leads to delayed investments and rising costs.

2. Do you agree with the Government's assessment of the future risks to the UK's security of electricity supplies?

The IoD strongly agrees with the Government assessment of the future risks to the UK security of electricity supplies. A recent survey conducted by the IoD reveals that the IoD members' primary concern is with security of supply.

¹ IoD Energy Survey, February 2011.

- It is not surprising that IoD members are concerned with energy security. This consultation paper offers a range of possibilities and suggestions but contains many uncertainties. The government should adopt a strategy that will provide confidence to businesses, and will offer an alternative proven path to ensure security of supply in addition to the numerous experimental programmes.
- The UK Climate Change Act (2008) sets out a requirement to reduce our greenhouse gas emissions by at least 80 per cent by 2050 relative to 1990 levels. In order to achieve this goal Britain needs to transform its electricity system. This requires very large scale investment (Ofgem estimates that £200bn of investment is needed by 2020 alone). It is unclear how the government proposes this investment to be financed. Businesses are very concerned with higher taxes or additional levies on energy, which can result in further erosion in competitiveness.
- The UK will need to achieve these emissions reductions while safeguarding energy security, by replacing operations that are already scheduled to close and by ensuring that the system is sufficiently flexible to balance supply and demand and avoid outages. However, it is not stated under any policy how this would be achieved. IoD members would like to see a clear strategy that uses proven technologies as a possible path of achieving these goals; for example combining natural gas and nuclear energy.

3. Do you agree with the Government's assessment of the pros and cons of each of the models of feed-in tariff (FIT)?

The IoD partly agrees with the Government's assessment of the pros and cons of the feed-in tariffs (FIT) model. The IoD believes that the general assessment framework is correct. However, we feel that there is room to elaborate on the disadvantages of FIT. The IoD believes that the current framework of subsidies hinders the market from delivering the results we aspire to see. It hinders the carbon price and reduces incentives for both the supply and the demand side. Long-term FIT discriminates between technologies when their core aim is to provide investors with certainty about the level of support. These schemes although well intentioned, have a combined effect that distorts the market.

4. Do you agree with the Government's preferred policy of introducing a contract for difference based feed-in tariff (FIT with CfD)?

The IoD thinks the Government did not fully take into consideration all possible negative spill over effects arising from this proposal. The IoD believes that this aspect of the proposals can greatly distort the market. It can hamper small and medium enterprises (SMEs) from integrating and operating successfully in the electricity market by benefiting large-scale generators.

8. What impact do you think the different models of FITs will have on the availability of finance for low-carbon electricity generation investments from both new investors and the existing investor base?

The IoD believes that the different models of FIT will distort the market and will undermine investment. It is our view that the market is being sliced and divided into too many sections. The IoD believes that market forces and market structure should be used in order to generate investment and ensure a functioning electricity market. It is the IoD position that a stable carbon price is the best, most effective framework for achieving this goal. FIT and other schemes

create distortion within the market (as mentioned earlier) and undermine the development of a stable electricity market.

26. Do you agree with the Government's preferred package of options (carbon price support, feed-in tariff (CfD or premium), emission performance standard, peak capacity tender)? Why?

The IoD is in favour of the Carbon price support, and believe that this along with a carbon tax would be an effective policy to encourage decarbonising the economy. Nevertheless, the IoD objects to FIT and other schemes that generate complexity and artificially discriminate between technologies. Based on a survey conducted by the IoD among its members, we believe there are some challenges to be highlighted that can possibly apply to this package:

- Firstly businesses feel that the energy and electricity policies are unclear and too complex.
- The policies are constructed as one scheme on top of the other, while from time to time an additional scheme is generated to address a certain aspect that was not considered when the initial scheme was implemented. This leads to an overly complex system in which companies and organisations find it hard to function effectively.
- The IoD believes that this package too, will lead to a complex market structure that simply lacks transparency and thus also lacks efficiency.

32. What changes do you think would be necessary to the institutional arrangements in the electricity sector to support these market reforms?

33. Do you have view on how market distortion and any other unintended consequences of a FIT or a targeted capacity mechanism can be minimised?

In order to function effectively, the electricity market needs long term policy and clear rules. It needs rules that will set a stable carbon price and consequently encourage development of low carbon technologies. Such policies include a long-term carbon price, a carbon tax or a carbon allowance. This will shift the market away from carbon-based energy into low carbon energy. The core issue policy makers should tackle is whether they aim to supplement markets or replace them. If the aim is to replace the market, as seen in recent years we should anticipate low results in terms of carbon reduction and improving the electricity market. On the other hand, if policy makers aim to supplement markets by designing policies that will provide incentives to achieve policy goals, elimination of many of the existing policies, regulations and schemes would pave the way for carbon reduction and improving the electricity market.

The variety of schemes and regulations, described in the consultation paper illustrate the complexity of the electricity market. The IoD believes that:

- Firstly, the level of government intervention in the market should be reduced. This will generate a greater simplicity in the system and will achieve greater transparency.
- Secondly, the IoD's view that a long-term carbon-pricing framework is the most efficient method to support low carbon electricity generation.
- Thirdly, the IoD believes that the Government should address the issue of security of supply by developing a nuclear and natural gas strategy that will ensure stable long-term supply, as an alternative path to reach its 2050 goals.

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