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Consultation on Electricity Market Reform

We welcome the opportunity to respond to this consultation on electricity market reform.

Tesco is a major UK and global business, with a stake in the effective operation of the electricity market, and in the UK achieving its climate change objectives. We are a significant consumer of electricity, an investor in renewable energy generation to meet our own climate change targets, and, as a leading retail business, sensitive to the impact on our customers of increased energy prices.

We strongly support the Government's objective of reducing emissions from UK electricity generation, and indeed the wider economy. As part of our climate change strategy, we have made a commitment that Tesco will be a zero carbon business by 2050, without purchasing offsets. We have also set interim targets to halve our direct emissions impact.

In our opinion a transparent and consistent carbon price is essential to effective decarbonisation across the economy. Tesco has already responded to the Treasury's consultation on a carbon price floor, but we would like to take this opportunity to reiterate that the introduction of a carbon floor price must be accompanied by the removal and reform of other existing carbon tax mechanisms, most notably the abolition of the Carbon Reduction Commitment. Following the Government's decision in the Spending Review to retain the revenue from the CRC, this is now an unnecessary and distortive downstream carbon tax.

Given the Government's strategic desire to promote specific types of renewable or low-carbon energy generation, we also support the case for maintaining some incentive mechanisms in addition to a carbon floor price, as set out in the EMR consultation. It is imperative that this be accomplished in a manner which minimises the costs for business like Tesco and for our customers of meeting climate targets. We therefore urge the Government to:

- focus strictly on cost-effectiveness criteria when setting the level of reward available under feed in tariffs. The Government must avoid repeating the experience of small-scale feed-in tariffs, where the initial generous levels for solar PV have had to be reviewed at short notice, creating uncertainty for investors; and
- consider fully the interaction between feed in tariffs and the proposed carbon price support mechanism. In the short term, the Government should set carbon price support at a low level - but with clear plans for increases over time - in order to avoid creating windfall profits for existing low-carbon generation. A high level for the carbon price floor in the short term would increase costs for consumers without delivering additional carbon savings.

As an investor in renewable energy generation, we also emphasise the need for clarity and certainty over the financial support available. It is particularly important that we have early certainty over the transitional period and the treatment of existing plant; ambiguity here risks a delay to the new investment that we are considering now. Moving forward into a new feed in tariff regime, we have concerns that the auctioning approach proposed in the consultation document could generate uncertainty and deter new entrants to the market. We would prefer a clear framework for determining the price based on an assessment of the market, with defined review points.

Finally, we urge the Government to give further consideration to how liquidity in the wholesale market can be improved more generally. The low levels of liquidity at present are a barrier to new suppliers entering the market, and to efficient price discovery. This benefits the major energy suppliers, at the expense of energy consumers like Tesco and our customers, who pay for it through higher prices. In addition, liquidity in the wholesale market is necessary for the effective operation of the feed-in tariff with contracts for difference model proposed by the Government.

The attached paper gives a more detailed view on some of the specific questions asked in the consultation document.

I should be delighted to discuss these issues in more detail with you.

Yours sincerely

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Annex: Tesco responses to selected questions

Current Market Arrangements

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?

Yes, we agree that current market arrangements will not be enough to encourage sufficient investment in low-carbon generation.

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

Tesco shares a general concern around the risk to security of energy supply in the UK and the potential impact of this on long-term energy prices.

Options for Decarbonisation

Feed-in Tariffs

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

Yes, we agree that the mechanism is preferable, if it can in practice deliver the greater level of overall efficiency suggested by the theoretical analysis. Much will depend on the actual levels of support and the detail of the mechanism.

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?

We are more likely to invest if the subsidy regime offers us good returns that we can price into business cases with certainty.

10. How important do you think greater liquidity in the wholesale market is to the effective operation of the FIT with CfD model? What reference price or index should be used?

Liquidity is very important, in order to ensure that generators are able to sell their power on the same basis as the CfD payment has been calculated. The CfD approach will only work if the subsidy is based upon a price for electricity that a generator is actually able to receive in the market. We therefore urge the Government to give further consideration to how liquidity in the wholesale market can be improved.

11. Should the FIT be paid on availability or output?

We think FITs should be paid on output, for two reasons. Firstly, for reasons of principle, a subsidy for renewable electricity should only be available for electricity that has actually been generated. Secondly, it is hard to envisage how a fair 'availability' payment could be made to uncontrollably intermittent forms of generation like wind.

29. How do you see the different elements of the preferred package interacting? Are these interactions different for other packages?

The Government must focus strictly on cost-effectiveness criteria when setting the level of reward available under feed in tariffs. The Government must avoid repeating the experience of small-scale feed-in tariffs, where the initial generous levels for solar PV have had to be reviewed at short notice, creating uncertainty for investors.

The Government needs to consider fully the interaction between feed-in tariffs and the proposed carbon price support mechanism. In the short term, the Government should set the level of carbon price support at a low level - but with clear plans for increases over time - in order to avoid creating windfall profits for existing low carbon generation. A high level for the carbon price floor in the short term would increase costs for consumers without delivering additional carbon savings.

Implementation Issues
30. What do you think are the main implementation risks for the Government's preferred package? Are these risks different for the other packages being considered?

The transition from RO to FITs will be very important; ambiguity about what will happen to prospective plant during and after the transition would risk a delay to new investment now.

31. Do you have views on the role that auctions or tenders can play in setting the price for a feed-in tariff, compared to administratively determined support levels?

We think that auctions would generate uncertainty, and that this could deter new entrants to the market. A clear framework for determining the 'right price' for technologies (based upon an assessment of the market), with defined review points, might be a better approach.

34. Do you agree with the Government's assessment of the risks of delays to planned investments while the preferred package is implemented?

The transition from FITS to ROCs is the main issue – provided there is certainty, new investment will take place. It is also important that there is an equitable transfer out of the RO for existing generation, in order to maintain confidence in the Government's approach.

36. We propose that accreditation under the RO would remain open until 31 March 2017. The Government's ambition to introduce the new feed-in tariff for low carbon in 2013/14 (subject to Parliamentary time). Which of these options do you favour:
• All new renewable electricity capacity accrediting before 1 April 2017 accredits under the RO;
• All new renewable electricity capacity accrediting after the introduction of the low-carbon support mechanism but before 1 April 2017 should have a choice between accrediting under the RO or the new mechanism.

So long as there is certainty relating to the transition and the support available, we would prefer to be able to choose between the RO and the new mechanism for our existing renewable generation.