



Contribution to the Energy Market Assessment

The UK Business Council for Sustainable Energy (UKBCSE) brings together the major players¹ in the energy sector to secure an effective and rapid transition to a low carbon economy that both tackles the challenge of climate change and maintains the UK's security of supply.

This document sets out initial high level points to feed into the HM Treasury / DECC Energy Market Assessment and 2050 pathways work.

Overview

- Scale of challenge – Analysis by Ofgem and others (e.g. Ernst and Young) suggest £200bn to deliver all of the low carbon investment we need by 2020 (impact on bills potentially ~25% increase). Imperative that infrastructure is delivered in a timely and co-ordinated manner to minimise the impact on consumer bills, especially through effective parallel investment in energy efficiency.
- Investors need to have clarity and certainty about investment. This is urgently needed if the energy sector is to deliver 2020 targets, set the UK on a path to the 80% green house gas reduction for 2050, take a strong lead in creating low carbon technology jobs *and* maintain security of supply.
- The industry has a strong track record on investment, but, looking ahead to 2020 and beyond, welcomes a necessary evolution of the market. All of the companies acknowledge that the incentive arrangements currently in place appear insufficient to deliver capital-intensive low-carbon plant and supporting infrastructure to successfully de-carbonise the power sector on a least-cost basis by 2030, and current arrangements need some enhancement.
- Delivering a secure and low carbon future will require a diversity of technologies *and* a long term and coherent market framework. This will make the UK an attractive place to invest and also feed through to the investment needed in the supply chain to stimulate new green jobs in key UK sectors.
- Government needs to be open and honest about the long term direction of energy prices and the support that is/will be available to help customers make the transition – especially through effective action on energy efficiency (it cannot all be left to CERT and CESP).

¹ Members of the Council include Centrica, EDF Energy, E.ON UK, National Grid, RWE npower, Scottish and Southern Energy and Scottish Power.

- Government needs to own the agenda and companies stand ready to actively participate in a well ordered and constructive discussion about delivering capital-intensive low-carbon investment.

Market Incentives

- **Industry commitment to invest** – the industry stands ready to invest in new capital-intensive low-carbon energy generation. Stable long-term market frameworks are necessary to make the UK an attractive investment environment by de-risking policy uncertainty. Long-term clarity in UK market frameworks will help to attract affordable long-term financing into the UK by lowering the cost-of-capital and enabling appropriate investment returns.
- **Power market evolution** – in order to deliver the capital-intensive low-carbon energy generation and supporting infrastructure necessary for substantial de-carbonisation of the power sector by the 2030s on a least-cost basis, some reform of the market is appropriate. The industry believes this should be evolutionary and build on the present market-based principles, rather than being a fundamental re-think reflecting less market-based approaches.
- **Gas market – stability** – in terms of achieving statutory targets for renewables and for carbon, the gas market does not face the same near-to-medium term challenges as the power market, The industry continues to take the view that non-market interventions, e.g. strategic storage, are unnecessary and, by distorting the market, could be counter-productive. The key to ensuring security of UK gas supplies into the 2020s remains continuing gas market liberalisation in continental Europe, further interconnection and continuing the move towards greater continental gas market transparency that is already being seen.
- **Security of supply - power sector** - the industry considers that a first focus needs to be on ensuring delivery of new low-carbon energy generation, with due regard for diversity and cost-effectiveness. Without such investment coming forward on a timely basis, security of supply (including fuel-security) is also unlikely to be assured.
- **Incentive mechanisms** - the industry agrees on the need for incentive mechanisms to encourage investment in low carbon energy generation which would give greater long-term confidence to investors. Any such incentives, which may be in the form of obligations, must take into account the carbon price and be consistent with delivering substantial power sector de-carbonisation by the 2030s and with meeting EU and UK statutory targets for 2020 and 2050.

In developing any incentive mechanisms, it will be important to strike the right balance; minimal change may be insufficient to bring forward capital-intensive low-carbon generation, whilst options such as tenders, or a central energy buyer would involve an undue degree of departure from market based approaches.

- **Criteria against which to judge incentives** - The industry believes that any incentive mechanisms would need to meet the following high-level criteria:
 - Consistent with EU ETS (by allowing EU ETS to continue to function as an important means of incentivising low carbon investment).
 - Effective in delivering a lower cost of capital by minimising unnecessary political and regulatory risk, over and above normal market risk.
 - Capable of practical implementation within a realistic time-scale.
 - Reasonable in terms of cost to customers (which an incentive obligation could help to ensure).
 - Durable.
 - Compatible with continuation of an open and competitive wholesale market.
 - Avoid undue complexity.
 - Safeguard recent investment.

- **Incentives - Lessons-to-date** - In looking to develop incentives in the future, it will be important to consider lessons learned so far from past and existing mechanisms. For example, looking at lessons to date from renewable incentives, there have been a succession of additional / incremental schemes (e.g. original RO, banding, headroom, re-banding offshore, FiTS) – each adding to overall scheme cost while also undermining the EU ETS. Going forward, in considering new or additional incentive schemes, these lessons need to be reflected upon in the round and in the context of the market as a whole – e.g. impact on financeability, timing, trigger signals for new investment, impact on carbon price and / or other unintended consequences. The pros and cons and likely costs and benefits of different incentive mechanisms will need to be well understood in the round – e.g. with respect to bankability, overall economics, costs for consumers, and market stability.

- **Timescales** - An adequate review of market mechanisms will take time - both to ensure full consideration of the many inter-related issues, and, thereafter to implement. Therefore, commitment now to legislate for a long-term framework is fundamental. This will be an essential step in establishing an appropriate long-term framework for an incentive mechanism or obligation consistent with power sector de-carbonisation by 2030, and in clarifying and de-risking the investment outlook for capital-intensive long-lived low-carbon energy generation. The legislation must

establish the framework at the earliest practicable date, but implementation may be deferred, activated at a future date specified in the legislation².

- **Short-term operational security** - in the near term, price can be expected to be a sufficient mechanism with regard to short-term operational security. Longer-term issues about security of supply need consideration in the round together with consideration of market incentive arrangements for low-carbon. Separately, as identified in the recent Call for Evidence, active steps are needed to further develop a potentially far more flexible demand-side, including a need to understand demand-side interactions with supply-side flexibility into the medium and longer-term.

Conclusion

The Council welcomes the opportunity to provide input to the Energy Market Assessment and 2050 pathways work and looks forward to continued engagement with Government and other stakeholders as this work progresses.

UKBCSE / 01 March 2010

The views expressed in this paper cannot be taken to represent the views of all parts of all companies in the UKBCSE. However, they do reflect a general consensus.

² For example, an incentive mechanism or obligation could be triggered (subject to criteria in the legislation), from say, 2015-16, linked to a requirement to deliver low-carbon power at a subsequent forward date, say, 2017-18.