

Press Release

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Wednesday 3 February 2010

ACTION NEEDED TO ENSURE BRITAIN'S ENERGY SUPPLIES REMAIN SECURE

- **Ofgem recommends far reaching energy market reforms to consumers, industry and government**
- **The unprecedented combination of the global financial crisis, tough environmental targets, increasing gas import dependency and the closure of ageing power stations has combined to cast reasonable doubt over whether the current energy arrangements will deliver secure and sustainable energy supplies**
- **Prompt action will reduce risk to energy supplies, help lower costs to consumers and help progress towards climate change targets**

Ofgem today published its Project Discovery conclusions after extensive consultation and analysis. They confirm the need to act to deliver both security of supply and environmental objectives at affordable prices beyond the middle of this decade. Prompt action will ensure that consumers do not pay more than is necessary and also allows time for a wider range of reforms to be considered.

Ofgem has put forward a wide range of options for further consultation, including improved market signals, obligations on suppliers and capacity tenders to give greater confidence to help meet our carbon targets. Other options also include more structural reform ranging from a centralised renewables market through to a central buyer of energy.

Ofgem's Chief Executive, Alistair Buchanan, said: "Our evidence shows that Britain has a window of opportunity to put in place far reaching reforms to meet the potential security of supply challenges we may face beyond the middle of this decade. We do not advocate change lightly, but all the facts point to the need for reforms now to provide resilient supply security. Acting earlier will also help keep costs as low as possible for consumers and business.

"The overwhelming majority of responses to Ofgem's October consultation show that there is an increasing consensus that leaving the present system of market arrangements and other incentives unchanged is not an option. Ofgem has therefore put forward a range of possible options to unlock the up to £200 billion of investment Britain may need. We are keen to work with Government to find the best way forward."

Reform is needed because a combination of factors have come together including: the global financial crisis, significant world-wide demand for investment in energy, tough EU emissions targets, the closure of ageing power stations and an increasing dependency on gas imports. The outcome of Copenhagen, in terms of lower carbon prices, reinforces the

climate of significant uncertainty just when an unprecedented level of investment is required.

Notes to editors

1. Key issues

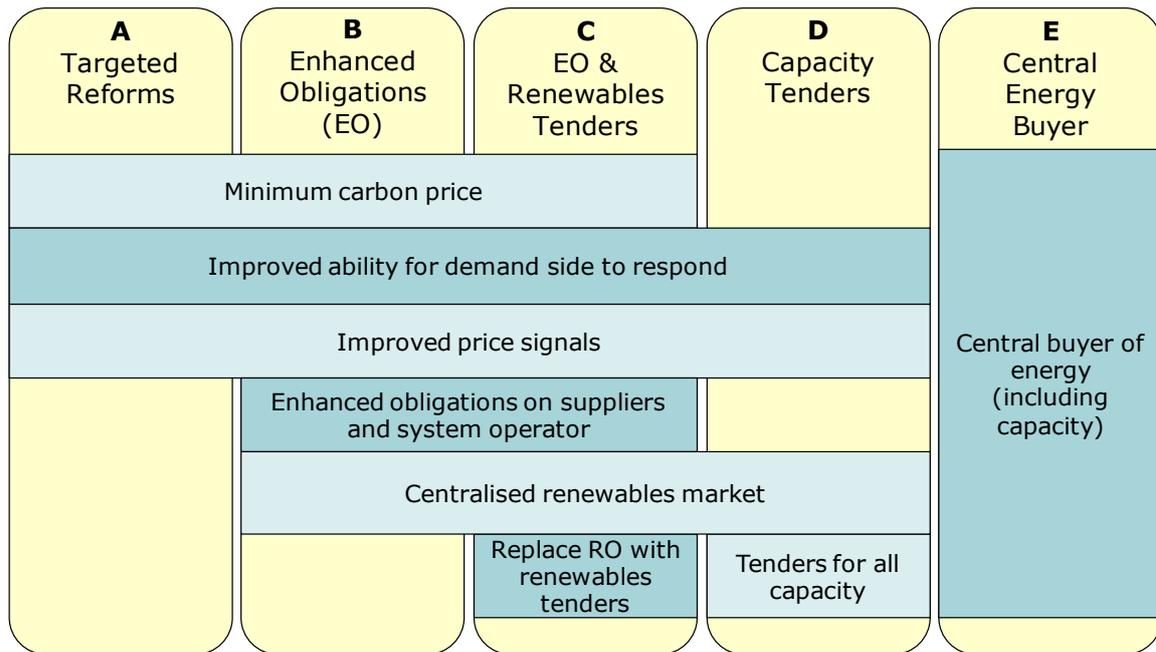
Following over a year's analysis and consultation Ofgem has identified five key issues which in combination represent an unprecedented challenge to our current energy arrangements. These are:

1. There is a need for unprecedented levels of investment to be sustained over many years in difficult financial conditions and against a background of increased risk and uncertainty.
2. The uncertainty in future carbon prices is likely to delay or deter investment in low carbon technology and lead to greater decarbonisation costs in the future.
3. Short-term price signals at times of system stress do not fully reflect the value that customers place on supply security which may mean that the incentives to make additional peak energy supplies available and to invest in peaking capacity are not strong enough.
4. Interdependence with international markets exposes GB to a range of additional risks that may undermine GB security of supply.
5. The higher cost of gas and electricity may mean that increasing numbers of consumers are not able to afford adequate levels of energy to meet their requirements and that the competitiveness of industry and business is affected.

Consistent with the analysis in the recent Energy Markets Outlook (EMO) report, published jointly by the Department of Energy and Climate Change (DECC) and Ofgem, our scenarios show supply to be relatively secure until around 2015.

2. Ofgem's proposals

Ofgem particularly emphasises the importance of developing a coherent package rather than implementing reform in a piecemeal fashion. Whilst some of the measures could be taken forward individually by Ofgem and industry, many would require Government action. The packages are broadly differentiated by the level of reform involved and are outlined in the table below.



Targeted Reforms

This policy package seeks to promote low carbon investment by reducing carbon price uncertainty through a minimum carbon price while improving market signals and encouraging more demand-side response. Although a minimum carbon price would best work as part of a European wide scheme, if this did not happen it may be necessary to consider a minimum GB carbon price. By reducing uncertainty about the price of carbon it would encourage investment in low carbon technologies.

Sharper signals in the gas and electricity wholesale markets would encourage suppliers to ensure that they had more access to back-up supplies, especially at times of high demand for energy. Better price signals would also encourage more demand-side response from energy users.

Enhanced Obligations

If Targeted Reforms did not provide sufficient confidence for security of supply the Enhanced Obligations package could be considered. This package would impose obligations on suppliers on top of the reforms outlined in the Targeted Reforms package. The obligations would seek to further improve security of supply by requiring suppliers to demonstrate they have sufficient plans in place to cope better with threats to security of supply and placing obligations on the system operator (National Grid) to take additional measures to help further improve security of supply.

Enhanced Obligations and Renewables Tenders

This option would include the reforms in the Enhanced Obligations package and in addition would replace the Renewables Obligation with tenders for renewable generation. The tenders would offer investors a guaranteed return, over say a 20 year period. This would again encourage investment in renewable energy by providing investors with increased certainty over the revenue they would earn.

Capacity Tenders

Capacity tenders for all forms of generation, including renewables, as well as gas storage and other gas infrastructure, would provide greater confidence for delivering security of supply. This is because it would provide clearer long-term investment signals.

Central Energy Buyer

If capacity tenders are deemed to be insufficient the most radical of the five packages would be a central energy buyer. This solution would involve co-ordinating all future investment through a single entity. While significant legal issues would need to be addressed it would see a central energy buyer determining the amount and type of new generation needed and enter into long-term energy contracts for power. It could also tender for new gas infrastructure.

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