



OFGEM'S THREE YEAR STRATEGY 2004-7

Introduction

1. The Environment Agency (the "Agency") signed in May 2001 a Memorandum of Understanding with the Gas and Electricity Markets Authority (the "Authority") with the purpose of ensuring effective co-ordination of the actions undertaken by the two organisations related to environmental issues.
2. Since then the Agency has worked increasingly closely with the Authority on a number of environmental issues. It has also commented on several key documents for the Authority and recently on the Department of Trade and Industry's draft Social and Environmental Guidance to the Authority regarding the requirements of the Energy White Paper (please also see remarks below in Part 1 of this Note).
3. The Agency is pleased that the Authority has recently given environmental issues greater prominence.
4. Even so, the Agency considers that more can be done and wishes to see environmental issues becoming a core part of the Authority's thinking and actions.

Response

Part 1

5. The Agency would wish the main points raised in its response to the Department of Trade and Industry's draft Social and Environmental Guidance to the Authority regarding the requirements of the Energy White Paper to be reflected in Ofgem's Three Year Strategy 2004-07 (for convenience an extract from this response dealing with "Environmental Issues" is attached to this Note).
6. In particular this concerns

- **Paragraph 9**

The Gas and Electricity sectors are major contributors to the total national emissions of greenhouse gases, and especially of carbon dioxide. As such they have a substantial effect on both the local and the global environment.

- **Paragraph 10**

The draft Guidance deals largely with Climate Change issues. It should be extended to consider changes in air quality which may arise from the actions of the Authority.

- **Paragraph 12**

...vital for the contribution needed by the Authority for the UK to meet the requirements of certain future environmental legislation...

- **Paragraph 13**

“...that in the longer term carbon trading should be the central plank of our future (carbon) emissions reduction policies...” and the “...Government expects the Authority to consider how to achieve the target whilst continuing to protect the interests of consumers...”

- **Paragraph 14**

The Agency supports the Government’s aim to increase the amount of electricity generated from renewables over the next 20 years. It has worked very closely with the Authority during the development of carbon trading in the UK and to promote possible SO₂ and NO_x trading under the Large Combustion Plants Directive.

- **Paragraph 15**

The Government expects the Authority to help secure improved energy efficiency including CHP to provide significant levels of carbon saving and to remove, where possible, barriers inhibiting progress.

- **Paragraph 16**

Government expects the Authority to provide a framework within which businesses and the economy generally are encouraged to work towards the Government’s overall objectives and targets.

- **Paragraph 17**

Essential that the Authority addresses the second goal of the Energy White Paper on “maintaining the reliability of energy supplies”.

- **Paragraph 18**

The Agency would wish the Authority should take into account the environmental impact of any actions it takes to maintain the reliability of energy supplies.

Part 2

7. The Agency notes the five key themes in the current Authority Corporate Strategy 2003-2006. The Agency’s comments are focussed largely on environmental issues, and in particular:

- **Theme 2 Regulating monopoly businesses effectively**

Enable network companies to invest efficiently and manage their networks effectively to meet future security of supply and environmental priorities.

- **Theme 3 Securing Britain’s gas and electricity supplies**

Work to ensure that competition and regulation continue to help deliver safe and secure supplies (involving the requirements of the Energy White Paper).

- **Theme 5 Working towards a low carbon economy**

Work to ensure that competition and regulation contribute to a sustainable energy, at least cost to consumers.

Each of the above topics are on-going issues and accordingly the Agency would like each of them to be reflected in the Strategy for 2004-7.

8. In answer to the specific questions posed in Sir John Mogg's letter the Agency wishes to make the following comments:

6.1 The key challenges you consider the industry faces in the in the short to medium term (for example, structural, social, environmental or technological).

The Energy White Paper has set out some ambitious targets and Ofgem must play a key role in ensuring these targets are delivered. Fundamental changes must take place in all parts of the electricity and gas markets over the next 20 years and it is important that Ofgem's policies reflect this. As well as delivering significant reductions in emissions, the industry also faces other environmental obligations and pressures. These include:

- The EU Emissions Trading Scheme, which will require reductions in emissions of carbon dioxide (from now);
- The Large Combustion Plant Directive (LCPD) which sets out controls on sulphur dioxide and nitrogen oxide emissions. Existing large combustion plant will need to decide by June 2004 whether to opt for closure. The Agency has supported the adoption of an emissions trading scheme to implement this Directive as this gives a certain environmental outcome at least cost to operators;
- Integrated Pollution Prevention and Control Directive (IPPC) from 2006;
- National Emissions Ceiling Directive (controls on sulphur dioxide and nitrogen oxides) by 2010;
- The Sulphur Content in Certain Liquid Fuels Directive (on going); and
- The Habitats Directive, Waste Incineration Directive and Local Air Quality Standards.

Many of these requirements will place extra pressure on coal-fired generation, which is likely to decline as a result. Therefore, it is important that Ofgem recognises this and includes this trend in its strategy for regulating the markets to allow a manageable transition to a fundamentally different energy supply system.

It would be helpful if a work item was added to the 2004-7 strategy to deal with each of these topics.

6.2 What actions do you consider the Authority should take to respond to these challenges?

The Authority has been very successful in its recent strategy of working closely with the DTI, Defra, the Agency and key stakeholders during the implementation phase of the above new Regulations. This practice should be continued and extended for the period 2004-7. The Agency particularly favours the use of market mechanisms (such as emissions trading) to support the delivery of the environmental improvements required by the above legislation and would be pleased to work with Ofgem in their development.

6.3 Are there new areas of work that, you believe, should be set in train and what degree of priority should they be given?

Several new areas of work have already been discussed by the Agency with the Authority, some of which are outlined in the Memorandum of Understanding between the Authority and the Agency. They should be added to the 2004-7 Strategy and be given high priority. In particular these cover:

- Use of Environmental Impact Assessments for each of the actions by the Authority (the Agency strongly supports this initiative);
- The development and implementation of environmental reporting requirements for the electricity and gas industries, including key environmental performance indicators.

6.4 Is there existing work that could be given greater or lesser priority or even stopped?

The Agency would wish for environmental issues to be more clearly defined as a key priority for the Authority and given higher priority.

The use of a trading scheme to deliver reductions in carbon dioxide will, in the medium term, result in a major shift away from coal to greater use of gas and renewables. The electricity and gas markets should be structured such that market penetration by these cleaner technologies is not disadvantaged. For example, these new technologies should be allowed to access the grid readily and the network will need major modifications to allow this. Ofgem can play a significant role in ensuring this and its strategy should recognise this and have firm plans in-place to assist this transition.

Further information

7. For further information or clarification about any of the comments made in this response, please contact either Dr Neil Davies or Dr Peter Newman, Head Office Process Industries' Regulation Policy, Environment Agency Block 1, Government Buildings, Burghill Road, Westbury-on-Trym BS10 6BF Tel. nos. 0117 914 2947/2939, or e-mail address: first name.second name@environment-agency.gov.uk.

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Extract on “Environmental Issues” taken from response from the Environment Agency to the Department of Trade and Industry Consultation on the draft Social and Environmental Guidance to the Gas and Electricity Markets Authority

Section on “Environmental Issues”

9. The Gas and Electricity sectors are major contributors to the total national emissions of greenhouse gases, and especially of carbon dioxide. As such they have a substantial effect on both the local and the global environment. This point is recognised in the Authority’s Environmental Action Plan.
10. The draft Guidance deals largely with Climate Change issues. It should be extended to consider changes in air quality which may arise from the actions of the Authority. One example of the need for this concerns the changes in the transition from the electricity pool to the new trading arrangements (NETA). This affected the balance of the fuel mix with an increase in coal burn at the expense of gas. As a consequence more sulphur dioxide will have been emitted and will have affected air quality.
11. The Agency strongly endorses the reminder to the Authority that the Utilities Act 2000 places duties on the Authority to *“promote the efficient use of gas and electricity, and to have regard to the effect of licensed activities on the environment”* (Paragraph 2.1).
12. This is vital for the contribution needed by the Authority for the UK to meet the requirements of certain future environmental legislation and in particular:
 - Emissions Trading (carbon dioxide from 2005 and possibly SO₂ and NO_x by 2008);
 - the need for the regulated industry (and especially the Electricity Supply Industry) to meet various Air Quality Standards at given dates between 2003 and 2010;
 - Integrated Pollution and Prevention Control (IPPC) under which many activities covered by the Authority are to be regulated by 2007;
 - Large Combustion Plants Directive (as used by the Electricity Supply Industry) by 2008; and
 - National Emissions Ceilings Directive by 2010.
13. The Agency agrees (Paragraph 2.3) *“...that in the longer term carbon trading should be the central plank of our future (carbon) emissions reduction policies...”* and the *“...Government expects the Authority to consider how to achieve the target whilst continuing to protect the interests of consumers...”*
14. It also supports the Government’s aim to increase the amount of electricity generated from renewables over the next 20 years. The Agency has worked very closely with the Authority during the development of carbon trading in the UK and to promote possible SO₂ and NO_x trading under the Large Combustion Plants Directive.
15. It welcomes the Government’s assertion (Paragraphs 2.4 and 2.5) that improved energy efficiency including CHP is needed to provide significant levels of carbon saving and that the Government expects the Authority to help secure these

objectives and to remove, where possible, barriers inhibiting progress.

16. The Agency also welcomes (Paragraph 2.6) that the Government expects the Authority to provide a framework within which businesses and the economy generally are encouraged to work towards the Government's overall objectives and targets. Such a structured approach is necessary if these are to be achieved.
17. There is essentially nothing in the draft Guidance on the second goal of the Energy White Paper on "maintaining the reliability of energy supplies". However such considerations are very important in view of the projected changes in energy production and in the structure of the National Grid.
18. Although the Agency has no responsibility for the reliability of energy supplies, it will have to regulate the environmental consequences of actions taken in this respect. Therefore the Agency would wish a section added to the draft Guidance requiring that the Authority "...should take into account the environmental impact of any actions it takes to maintain the reliability of energy supplies..."