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Date: 10 March 2008

Dear Ms Kulhavy,

SembCorp Response to Consultation Document "Distributed Energy – Initial Proposals for More Flexible Market and Licensing Arrangements"

Thank you for the opportunity to comment on the proposals set out in your December 2007 consultation document. This letter sets out the response of SembCorp Utilities (UK) Limited ("SembCorp").

Background

SembCorp provides utilities and services to industrial customers on the Wilton International manufacturing site on Teesside. SembCorp owns a private distribution network and a good-quality combined heat and power station on the site. We have also recently commissioned a new 30MWe stand alone biomass-fired power station ("Wilton 10").

The site electricity demand is close to 200MW, made up of around a dozen large non-domestic customers. Most of this demand is met by licence-exempt supplies of on-site generation. Where this is not the case (for example where top-up electricity is imported from the Grid) the supply is made by our wholly-owned subsidiary Wilton Energy Limited, which holds an Electricity Supply Licence. SembCorp is also exempt from the requirement for a generation licence and a distribution licence.

Our interest in this consultation stems from a specific issue we have in relation to "On-Site" supply licence exemptions. Hence our comments relate solely to Chapter 2 and specifically to Question 4, seeking views on the 2001 Class Exemption Order (the "Order"), including opportunities for clarification.

On-Site Supply Licence Exemption

Paragraph 2.5 states that one of the drivers for the last set of changes to the Order was a desire to encourage more use of CHP and renewable energy sources. This objective is even more relevant today. However Paragraph 2.6 correctly identifies that the evolution of the exemption rules over time has led to extremely complex regulations which are difficult to interpret. We believe some of the previous changes may have been made to accommodate complex sites such as our own (then under previous ownership), and we thank the government for this. Nevertheless, we suggest that there is a clear case for simplification of Class C of Schedule 4, both to provide clarity and to provide fair treatment for different categories of on-site generator. This would remove the perverse incentive described in Paragraph 2.8.

The issue here is that a different exemption limit applies to supply to a single on-site customer (or qualifying group of related customers) than to a group of unrelated customers. In the former case there is no limit on the amount of exempt supply, while in the latter case there is an aggregate limit of 100MW. We cannot see any justification for one customer (or group of related users) being treated more favourably than a group of unrelated customers and believe this disparity results almost "by accident" from the piecemeal evolution of the Order rather than by design.

This issue is directly relevant to the Wilton International site. In the early 1990s this was owned completely by ICI, but over the years different chemcial plants on the site have been sold to different chemical companies, while the utilities business itself was also sold as a stand alone business and is now owned by SembCorp. Hence Wilton International is now a manufacturing complex comprising several major chemical plants owned by leading chemical companies. Under the ICI regime all site demand could be supplied with licence exempt on-site generation, and this provided a continued incentive to develop and operate high efficiency CHP generation. Indeed SembCorp commissioned a new 40MW CHP unit in 2004 and is currently constructing another.

However, the various ownership changes on the site mean that we are now very close to the limit of exempt supply. Total site demand is around 200MW, of which around 100MW is a "qualifying group" and the other 100MW is "additional group consumers". This means we are not able to offer licence exempt electricity to potential new customers wishing to locate to Wilton, thus reducing our competitiveness in attracting further inward investment to the site and the surrounding area and significantly reducing the incentive to invest in further CHP plant. We are currently receiving a high level of interest from potential inward investors in developing further energy intensive process plants on our site but in many cases we are competing with sites in continental Europe. Electricity price is likely to be a key factor in their ultimate choice of location.

We have real investment projects which are affected by this issue. For example the Ecco paper mill (which has received planning permission) is an investment of around £450m which will create around 150 permanent direct jobs. There is another paper mill project of similar size with a Spanish company (which does not compete with Ecco), and a Japanese investment of around £150m and 220-250 jobs on which we have been working closely with UKTI with the support of Lord Jones. Together these plants would add a further 100 megawatts of demand (all of which would be above the existing supply limit). Wilton is the only UK candidate site in the UK for the Japanese investment. The Japanese have highlighted electricity prices as the key factor in the final location decision. Unfortunately, because of the 100MW limitation, the benefits of on-site CHP generation that we are able to offer these potential investors are significantly curtailed.

Proposed Solution

We would like to propose an amendment to the order which both clarifies Class C of Schedule 4 and addresses the disparity described above. We tabled some suggested for this in a meeting with Rita Wadey of BERR on 22 October 2007. In summary, the proposal is to remove the 100MW limit on supply to additional group consumers while maintaining the same protection for domestic customers.

The consultation document discusses the need to safeguard consumer choice and protection and suggests that the licensing framwork delivers this. However, we believe that the requirement for a supply licence represents unnecessary regulation in the case of supplies to very large customers over private networks. Our customers choose whether to locate to our site and have highly expert energy buying functions. Energy cost is one of the main factors in selecting a site, and competition between potential host sites can effectively come down to a competition in energy prices. Some of our customers have the option to switch to a different supplier but to date all have preferred to be supplied with licence exempt electricity.

We understand that BERR is awaiting the outcome of a European court case before deciding on the best way forward for the exemptions regime. Furthermore we agree that raising exemption limits generally is not a solution to the problem of encouraging more distributed generation on public networks. Nevertheless we believe exemptions will always have a role to play for some distributed energy schemes, particularly those where private networks already exist. In these cases the aim should be to minimise the regulatory burden unless there are very good reasons not to, and the most effective way to do this is to remove the need for any form of electricity licence.

<u>Summary</u>

SembCorp believes it has a real prospect of attracting further process industry customers to the Wilton International site. However the Order contains a limit beyond which acts as a disincentive to developing additional CHP capacity and prevents us offering electricity which is both competitively price and low-carbon.

This is an issue which-

- deters further investment by SembCorp in good quality combined heat and power and so is likely to result in greater CO_2 emissions than necessary;
- discourages inward investment by increasing costs; and
- results from a provision in the Order which we believe is out of date (dating from the mid-1990s), and which discriminates against multi-owner sites (such as Wilton) in favour of sites owned by a single company.

Please do not hesitate to contact me should you have any questions or comments concerning our response.

Yours sincerely,

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