



Mr Mark Feather  
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The Office of Gas and Electricity Markets  
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25 April 2008

Dear Mark

### **Proposed Guidance – Environmental Issues & the Code Objectives**

Wind Energy is pleased to submit this response to Ofgem's letter regarding proposed guidance on the interpretation of environmental issues and code objectives. We are writing on behalf of seven group companies with wind power projects under development across Scotland with a combined capacity of some 600MW. The principal shareholder in the Wind Energy companies is AES Corp, one of the world's leading independent power producers.

We welcome Ofgem's acknowledgement that it needs to take a central role in facilitating the achievement of ambitious carbon reduction targets and support attempts to ensure that the consideration of any proposal to amend industry codes is supported by a robust and comprehensive assessment of any environmental costs or benefits. The remainder of our response focuses on two elements of the guidance:

- The appropriate measure of the cost of carbon; and
- A number of procedural questions which the letter raises.

We discuss each of these issues in turn below.

### **The choice of the appropriate price of carbon**

We are pleased that Ofgem has acknowledged the need to quantify the environmental consequences of policy proposals. We recognize that DEFRA has recently revisited, updated and reissued guidance about how to factor the cost of carbon into public sector policy appraisal and note that proposals have been extensively reviewed by leading academics. We recognize the difficulties in deciding on the appropriate approach to determining the cost of carbon, particularly given the need to make assumptions about, amongst other things, technological development, wider global efforts in tackling climate change and uncertainties over the damage it may cause. Overall we consider that, given that suggested Shadow Price of Carbon (SPC) is based on the optimum stabilization goal (450-550ppm CO<sub>2</sub>e) assumed by the Stern Review of the Economics of Climate Change, it represents the most pragmatic estimate available at present. We further note the guidance proposes a sensitivity range of -10/+20% around the core value of £25/tCO<sub>2</sub>e in 2007 prices, makes provision for the cost to be increased to reflect inflation plus 2% annually and is subject to periodic adjustment and reassessment.



We note that Ofgem also suggests that the EU Emissions Trading Scheme (EU ETS) price may also be used to value costs and benefits. We are somewhat surprised that Ofgem is proposing two alternative approaches. While the EU ETS price might be an appropriate measure were there a liquid market covering all emissions, it is not clear that this is currently the case. As noted in Defra's guidance, the price is likely to reflect the value of traded carbon emissions given constraints on supply imposed by current policy. As such we are concerned that it could undervalue environmental benefits and confuse the assessment process.

We consider that it would be useful for Ofgem to clarify their rationale for suggesting that both the EU ETS price and the SPC should be used in policy appraisal, along with their reasons for rejecting alternative measures. We also feel it would be helpful for Ofgem to provide a view on the discount rate which should be used in undertaking analysis.

### Procedural issues

While being broadly supportive of including the SPC in the assessment of modification proposals, Ofgem's letter raises a number of questions.

Industry governance arrangements are predicated on the industry governing itself and assessing the impact of any proposal against given code objectives in order to develop a recommendation(s) which are submitted to Ofgem. Ofgem then assesses a proposal against these objectives and a series of additional, clearly defined, wider statutory duties. While this framework is not necessarily perfect (and we have responded separately with our thoughts on improvements which could be made through the code governance review), it provides a clear division of responsibility. Given that opinions over the relative merits of proposals inevitably vary, it seems likely that estimates of the quantum of carbon savings attributable to a proposal would also vary. In our view, it will be important for Ofgem to take a proactive role in steering working group discussions and ensuring that the additional analysis required of the industry does not increase the timeframes for developing and assessing modification proposals<sup>1</sup>. We also consider that working group analysis should not be a substitute for robust assessment of proposals by the Authority.

We have a number of additional questions arising from the Authority's proposed approach:

- *The rationale for providing informal guidance, rather than amending code objectives?* It is not immediately clear how the Authority's informal guidance interacts with licence obligations and existing code objectives. This could, in theory, lead to some confusion or differences in interpretation between stakeholders, which might be mitigated were a more formalised process adopted.
- *The reasons for providing guidance on environmental objectives, rather than any of the Authority's wider statutory duties?* The Authority clearly needs to have regard to all its wider statutory duties in considering its decision on any proposal. While we accept that the rationale for considering environmental impacts within an assessment of a proposal may be more

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<sup>1</sup> We consider that there may be a need to provide Working Groups with scope to draw on specific expertise or commission external analysis in order to achieve this.



compelling than for other statutory duties, we would be interested to understand the reasons for Ofgem only issuing guidance in respect of environmental issues.

We hope that these comments prove useful. Please do not hesitate to contact me should you wish to discuss any aspect of this response.

Yours Sincerely

Mike Davies  
Managing Director