

Consultation response

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TO: Kersti Berge

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RE: PROJECT DISCOVERY- ENERGY MARKET SCENARIOS

Which? consultation response.

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Introduction

- 1 Which? is an independent, not-for-profit consumer organisation with over 700,000 members and is the largest consumer organisation in Europe. Which? is independent of Government and industry, and is funded through the sale of Which? consumer magazines, online services and books.
- 2 In order to participate in society consumers need access to a safe, secure and affordable energy supply. To achieve this, there must be a clear and coherent policy that sets out actions (such as investments and regulatory reform), a timeframe for these actions and incentives, and subsidies, where required to ensure that implementation occurs as necessary. We believe this is the responsibility of Government.
- 3 With the extension of Ofgem's statutory duty to consider the interests of future consumers and to achieve sustainable development¹, a role has now also been set out for Ofgem in delivering security of energy supplies. It must be made clear how Government and Ofgem will work together to develop and implement a coherent strategy that may require powers that Ofgem does not hold and, importantly, who will ultimately take responsibility for securing consumers' energy supplies.

Energy Market Scenarios

- 4 Which? welcomes Ofgem's focus on security of supply through Project Discovery, and the publication of the conclusions of stage one- the Energy Market Scenarios². Comments on the assumptions, scenarios and stress tests are provided below. It would be helpful if some further key information was published to fully explain the basis of Ofgem's analysis:
 - > Basis for the assumption development and rationale for these;
 - > All the stress tests considered; and
 - > Rationale for taking forward the five stress tests in the consultation and discounting other stress tests.
- 5 We recognise that these scenarios are not predictions but rather tools to identify and examine the risks and weaknesses in future energy supply. However, there can be no room for complacency when assessing risks and weaknesses in the UK situation.

¹ 2008 Energy Act

² *Project Discovery- Energy Market Scenarios*, Ofgem, 9th October 2009

A need for action

- 6 Project Discovery - Energy Market Analysis complements the numerous publications that have already described our energy security and options for future development³. Many publications argue that the UK is vulnerable to a potential energy crisis with its associated risks of interrupted energy supplies and escalating costs to consumers. The urgent need for the implementation of a Government lead energy security strategy can therefore not be understated.
- 7 With stages two and three of Project Discovery⁴, Ofgem has a real opportunity to clarify its role in line with its extended duties leadership in the development and rapid implementation of a strategy which will protect consumers from insecure energy supplies over the next decade.
- 8 Which? would like to see an implementation timetable outlining next steps in this project to be published by the end of 2009.

Comments

The adequate level of energy security

- 9 While it has not been undertaken for the purpose of this document⁵, it is vital to determine and define an adequate level of security for energy supplies as a first step in securing future energy supply. The development of the Project Discovery scenarios and the use of stress tests are important tools in assessing adequate levels of supply capacity. However, two other points must also be considered:
 - > The need to balance a comfortable capacity margin with the increasing cost associated with too great a margin; and

³ *Energy policy: future challenges*, House of Commons Business and Enterprise Committee, First Report of the Session 2008-09, HC 32; *Energy Security: A national challenge in a changing world*, Malcolm Wicks MP, August 2009; *Dark days ahead*, Economist, August 2009.

⁴ Paragraph 1.5, *Project Discovery- Energy Market Scenarios*, Ofgem, 9th October 2009

⁵ Paragraph 2.10, *Project Discovery- Energy Market Scenarios*, Ofgem, 9th October 2009

- > The evolving UK energy mix, which may be driven by public policy reflecting environment considerations rather than market response.

Assumptions used in energy market scenario development

Assessment of assumptions

- 10 To enable stakeholders to make a full assessment of the assumptions used to develop the marker scenarios, more information on the basis of the assumptions is required. The information provided in the consultation document and in Appendix 2 is limited. No further information was made available from the Project Discovery Team upon request.
- 11 For example ‘energy efficiency measures’ are referred to as impacting the level of demand⁶, and the level of energy demand is clearly key to the strength of the scenarios as tools for risk assessment. Unfortunately the limited information available makes it impossible to assess the strength of the energy efficiency assumptions and the impact on demand. When the Project Discovery Team were contacted for more information the minimal information provided in Appendix 2 was simply repeated. Consequently we was unable to determine the robustness of the demand reduction assumptions. Ofgem should make the basis for the assumption development and rationale publicly available.

Willingness to pay versus ability to pay

- 12 In the document there is no scenario in which energy supplies stop flowing into and around GB. Key to this is that consumers will be willing, and able, to meet increased energy prices. While there is recognition that increases on price may impact on vulnerable consumers⁷, there has been no, or little, regard given to the impact on all consumers and the number who could be forced into financial difficulty and or fuel poverty⁸. If energy prices reach a point at which the ability of consumers to pay comes into question, then our energy supplies can no longer be classed as secure. This is a serious issue,

⁶ Table 2.2 Assumptions used for the scenario drivers and scenario variables and paragraph 3.65, *Project Discovery- Energy Market Scenarios*, Ofgem, 9th October 2009

⁷ Paragraph 2.3, *Project Discovery- Energy Market Scenarios*, Ofgem, 9th October 2009

⁸ BERR estimate that for every 1% increase in fuel prices an additional 40,000 households are pushed into fuel poverty.

especially ,given the current economic climate, and must be given due consideration.

Fuel Prices

The gas - oil link

- 13 Paragraph 2.48 states that gas prices are assumed to be linked to the price of oil, as is primarily the case. The formation of the Gas Exporting Countries Forum (GECF) has the potential to impact upon the price of gas. We recommend that there is clarification of the impact of GECF to the security of UK supply in the next stage of Project Discovery.

The price of coal

- 14 Paragraph 2.50 states that it is assumed that, under the Green Stimulus, coal will become less competitive than gas for a generation. In the next steps there should be clarification on how this assumption sits in relation to investment in carbon capture and storage⁹ (CCS) which would support coal as a competitive fuel source.

Energy market scenarios

The four energy market scenarios

- 15 As we have stated above, we welcome Ofgem's work in developing the four energy market scenarios for Project Discovery.

Additional scenarios

- 16 The four energy market scenarios presented in this consultation are divided into either rapid or slow environmental action, with rapid classified as global agreement on tackling climate change and slow classified as no global agreement and environmental concerns discounted for period.
- 17 However, there is a possibility that instead of a global agreement on climate change, there will be a national strategy, which may or may not exist

⁹ Paragraph 2.49, *Project Discovery- Energy Market Scenarios*, Ofgem, 9th October 2009

alongside a European strategy. The impact of this could be greater policy drive for investment to tackle climate change but with a low global carbon price, which will pose differing risks for our energy security and the cost of a secure energy supply. Consideration must be given to such potential conditions when assessing the role of the current market arrangements in delivery a safe, secure and affordable energy supply to consumers.

Consumers' bills

- 18 The four energy market scenarios all result in increased bills for consumers. In the next steps regard must be given to the ability of consumers to pay and to cope with substantial fluctuations in energy prices, which may occur as a result of intermittent supply associated with wind generation such as has been seen in Denmark¹⁰.

Stress tests

- 19 Which? agrees that the stress tests¹¹ applied to the scenarios are representative of real stresses to the GB energy security.
- 20 Below we have provided a list of additional stress tests covering a range of global and local issues. These may have been considered but dismissed, although no information is available to determine if this was the case.

Global

- > Crisis in the Middle East or in South America, involving countries such as Iran, Iraq or Venezuela
- > Terrorist attack overseas
- > Depletion of global uranium reserves
- > Substantive new reserves of oil are found, which leads to a drastic reduction on the commodity price of carbon
- > Gas and oil reserves are significantly less than predicted
- > Developments new technologies, such as CCS, that would make them cost effective are not realised
- > Extra claims on world power generation resources e.g. world water shortage requires huge expansion in desalination or crop irrigation.

¹⁰ *Wind power and spot prices: German and Danish Experience 2006-2008*, Renewable Energy Foundation, March 2009

¹¹ Chapter 4 Stress Tests, *Project Discovery- Energy Market Scenarios*, Ofgem, 9th October 2009

European

- > A major gas supplier (e.g. Russia) faces a domestic gas supply crisis and stops exporting gas to Europe on a long-term basis
- > Changes to European policy make it financially unattractive to supply energy to GB

GB

- > Flooding of gas and coal power stations resulting in their closure
- > Climate change results in flooding of coasts affecting the nuclear power stations located there
- > Terrorist attack

Next steps

- 21 This consultation sets out Ofgem's concerns around the existence of an uncertain policy environment in which energy supplies must be delivered¹². This clearly demonstrates the urgent need to develop and implement a coherent, and where necessary bold, energy strategy.
- 22 The energy market scenarios and stress tests detailed in this consultation have been developed with the assumption that market participants respond adequately to market signals¹³. It is questionable of whether energy market signals and incentives are aligned with the delivery of safe, secure and affordable energy for consumers, considering that the current market arrangements have failed to deliver basic security needs such as gas storage¹⁴. The domestic-gas rich circumstances in which the current market arrangements came about are quite different to the factors that the UK is now facing going forward. Consequently it may be that the current arrangements are not adequate. It is necessary to develop a policy framework that drives a secure energy supply from the centre and is not biased by the status quo of the current market arrangements and is clear on what it expects market arrangements are expected to deliver.

¹² Paragraph 1.12, *Project Discovery- Energy Market Scenarios*, Ofgem, 9th October 2009

¹³ Paragraph 1.12, *Project Discovery- Energy Market Scenarios*, Ofgem, 9th October 2009

¹⁴ *Energy policy: future challenges*, House of Commons Business and Enterprise Committee, First Report of the Session 2008-09, HC 32

- 23 The possible role of consumers in reducing demand, engaging in demand side management and in generating heat and power in contributing to security of supply and how it relates to energy efficiency measures should also be further explored in the next stages of Project Discovery.
- 24 We await the publication of stages two and three, which we hope will be robust assessment of the necessary steps to ensure secure GB energy supplies.