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Ofgem Project Discovery consultation – Alstom response

Summary

Overall, we are supportive of Ofgem's analysis of the challenges facing the UK energy industry and so our comments are brief.

Substantial investment is urgently needed and we believe that a portfolio of low carbon technologies will be required, including CCS, nuclear and renewables.

In principle, we are in favour of policy measures that help the market to work more effectively and efficiently. That is why we are interested in the targeted reforms and enhanced obligations/renewables tender packages in the analysis; and are not in favour of the Central Energy Buyer option.

Question 1: Do you agree with our assessment of the current arrangements?

We agree that there has to be significant doubt as to whether the current arrangements will deliver security of supply and decarbonisation objectives at an affordable price for consumers. We also agree that leaving the current arrangements unaltered is not an option.

Question 2: Are there other aspects of the current arrangements which could have a negative impact on secure and sustainable energy supplies, or costs to customers?

We think that the fragmentary nature of the current framework – with many overlapping policies – is a serious issue, in addition to the five problems identified below.

Question 3: Do you agree that the five issues we have highlighted are the most important?

We agree that the five main issues are:

1. Unprecedented levels of required investment (circa £200bn).

2. Uncertainty in future carbon prices.

3. Short term price signals at times of system stress not fully reflecting the value that customers place on supply security.

4. Interdependence with international markets exposing UK to a range of additional risks that may undermine security of supply.

5. Consumers having to face higher costs for gas & electricity.

On the financial point, we think the problem of liquidity could be emphasised more.

We agree that in isolation these five issues are not insurmountable, but, combined, they represent a significant challenge.

Question 4: **Do you have any comments on our description of what might happen if no changes are made to the current arrangements?**

We agree that there is a risk of greater dependence on gas if investment in renewables does not increase in pace (or if policies discriminate against coal e.g all CCS requirements need to apply equally to different fossil fuels). That also risks higher future costs of decarbonisation if these plants have to be written off before the end of their natural lifespan. We think this is a more likely outcome than CCGT investors being discouraged by the risk of future government intervention to deliver low carbon targets.

Question 5: **Do you believe that our policy packages cover a sufficient range of possible policy measures?**

We believe they represent a reasonable theoretical range – from continued reliance on a managed market to a highly centralised approach.

Question 6: **Do you have suggestions for variants to these policy packages?**

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Question 7: **What other policy measures do you believe should be considered, and why?**

The table of policies at figure 7 (page 51) appears to be a reasonable selection of alternative measures. Those under the investment heading - regulated returns/prices; Government loans; customer funded investments (e.g levy); and action to promote liquidity – may be worth further analysis.

Question 8: **Do you agree with the assessment criteria that we have used to**

evaluate the policy packages?

We think that the seven assessment criteria for action up to 2020 are reasonable:

1. Confidence in achieving supply security
2. Confidence of achieving 2020 carbon targets through domestic reductions
3. Confidence of achieving 2020 renewables targets
4. Risk of prices being greater than necessary
5. Risk of dampening of innovation
6. Implementation issues
7. Legal issues

Though an eighth – risk of deterring investment – would also be useful. In addition, it would be helpful to see a full cost/benefit analysis of the options.

Question 9: **Do you have any comments on our initial assessment of each of the packages?**

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Question 10: **Do you agree with our summary of the key benefits and key risks of each policy package?**

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Question 11: **Do you have a view on which package is preferable, or alternative policy measures or packages that you would advocate? We are particularly interested any analysis you may have to support your views.**

In principle, we are in favour of policy measures which help the market to function effectively and efficiently.

That means we are obviously attracted to targeted reforms (option A), such as a minimum carbon price. In our view, a higher minimum price for carbon is essential and needs to be EU-wide. Of the five challenges identified by Project Discovery (listed at Q3), proper carbon pricing would help with four of them: delivering investment; reducing carbon price uncertainty; addressing some of the international political risks; and keeping energy prices down.

In addition, there should be targeted incentives for key technologies (e.g CCS).

We are interested in options B (enhanced obligations) and C (enhanced obligations and renewable tenders), but would need to see more detail on those options before offering comments.

Capacity tenders (option D) do not appear to be an attractive option for the reasons outlined in the report: customers exposed to risk of poor decisions surrounding the type and scale of capacity required. Small-scale options and supply side may be overlooked.

We are not in favour of the Central Energy Buyer model (option E), as it would destroy the competitive electricity and gas market in the UK. It would return the industry to – effectively - a nationalised model which would not allocate investment efficiently and at lowest cost to the consumer. As the consultation document notes, it would probably be illegal under EU Electricity and Gas Directives.

As the report notes, the policy packages are 'specified….only at a high level at this stage'. We are likely to have more comments if any of the options are presented in greater detail in subsequent consultations.

Question 12: Do you agree with our assessment of the timing for important investment decisions?

We broadly agree that there is a window of opportunity between now and 2012/13 to make decisions key to the longer-term critical path.

At paragraph 6.6, it is suggested that 'it is uncertain whether CCS will be technically and commercially proven' by 2020. Our view is that CCS will be technically proven well in advance of 2020. Alstom is planning on having a CCS offer by 2015 and already has 10 demonstration projects globally, including the US Mountaineer plant (West Virginia) which began capturing and storing CO2 from a 20MW slipstream last October.

The key test is the commercial one, which is why we have consistently argued for targeted incentives for demonstration plants.

Question 13: Do you believe that early actions should be considered?

We believe that a comprehensive package should be introduced as soon as possible. Consideration could be given to introducing some elements earlier than others, but only if there are sound reasons for doing so within a clear, overall plan and a guarantee that it would not increase investor uncertainty.

Question 14: Do you think that the issues are such that policy measures should be considered as a package or should they be considered on a case-by-case basis?

As mentioned in the previous answer, we would like to see the introduction of a single, comprehensive framework, rather than piecemeal reform. The former is more likely to give investors the necessary confidence to invest.