

## **Minutes of the second Ofgem Environmental Advisory Group Meeting**

**Date:** 2 May 2003

**Time:** 10.30 – 12.30

**Place:** 9 Millbank, London

### **Present**

Robin Bidwell, Gas and Electricity  
Markets Authority  
John Costyn, Ofgem  
Brian Count, Innogy  
Henry Derwent, Defra  
Claire Durkin, DTI  
Paul Ekins, Policy Studies Institute  
Virginia Graham, Ofgem  
Paul Jefferiss, RSPB  
Eoin Lees, Eoin Lees Energy

Paul Leinster, Environment Agency  
Callum McCarthy, Chief Executive,  
Ofgem  
John Neilson, Ofgem  
Jeremy Nicholson, Energy Intensive  
Users Group  
John Roberts, United Utilities  
Alex Thorne, Ofgem  
Bryony Worthington, Friends of the  
Earth  
Philip Wright, Scottish Executive

### **Apologies**

Richard Farrant, Gas and Electricity Markets Authority  
Rupert Fraser, Fibrowatt  
Bill Stow, Defra  
Joan MacNaughton, DTI

### **1. Chairman's opening remarks and introductions**

Callum welcomed everyone to the second meeting of the Environmental Advisory Group, and particularly welcomed the two new members: Bill Stow, from Defra (who was represented by Henry Derwent) and Bryony Worthington from Friends of the Earth. Callum also welcomed Robin Bidwell who was recently appointed to the Gas and Electricity Markets Authority.

### **2. Impact of the Energy White Paper on Ofgem's work**

John Neilson outlined seven key points to come out of the White Paper as regards Ofgem's work on the environment:

- I. Central to the future market and policy framework will be the EU greenhouse gas Emissions Trading Scheme. Ofgem is involved with this and is assisting Defra with the preparation of the UK's National Allocation Plan.
- II. A joint working group on environmental issues comprising Ofgem, DTI and Defra will be set up. Ofgem is looking to the group to provide a common analytical framework for achieving environmental targets.
- III. Ofgem has committed to produce regulatory impact assessments for all significant new projects. These will include assessments of environmental impact and security of supply where appropriate.

- IV. Ofgem is working with Defra on the proposed extension of the Energy Efficiency Commitment from 2005.
- V. Ofgem is participating in a working group to examine barriers to the adoption of energy services.
- VI. Ofgem is involved in discussions with Government on the revision of the Secretary of State's social and environmental guidance to Ofgem.
- VII. Issues relating to distributed generation are being taken forward by the joint DTI/Ofgem Distributed Generation Co-ordinating Group (DGCG).

The key points from this discussion were:

#### *Emissions trading*

- It was recognised that emissions trading is a useful approach to reducing CO<sub>2</sub> emissions but implementing the EU scheme will have some challenges. Some specific issues were raised regarding the EU-ETS.
- Pricing is crucial for the success of the trading scheme. There is a need for monitoring of prices once the trading is introduced to check the way the market is responding.
- The scheme potentially transfers resources from consumers to generators which may not be equitable.
- The degree of transfer of assets depends to some extent on the cap. It is not yet clear whether the scheme will adopt the UK's Kyoto target or its more stringent domestic target as the cap.

#### *Government objectives*

- In the context of the White Paper it was suggested that Ofgem should work to assist the Government to meet its objectives at least cost to the consumer. Ofgem is in a good position to take an objective view and carry out analytical work.
- If the Government's environmental and other energy objectives conflict there will need to be tradeoffs.

Callum McCarthy agreed that widespread development of emissions trading was the best means of delivering environmental benefits at least cost. He also pointed out that Ofgem does monitor prices and watches what is happening in the wholesale markets, and will continue to do so after the introduction of the scheme.

Henry Derwent stressed that the EU trading scheme was not going to resolve all the UK's problems, as there are constraints imposed by the European legislation. However, Ofgem is fully involved in aspects of the design at the UK level including design of the National Allocation Plan in conjunction with Defra. He praised Ofgem's analytical contribution to the debate. He also pointed out that Ofgem has started to take an active role in the Sustainable Energy Policy Network which brings together a wide number of departmental policy units that will be involved in delivering the White Paper's commitments.

### **3. Environmental Impact Assessments**

John Costyn introduced this section by explaining that Ofgem is committed to introducing Environmental Impact Assessments (EIAs) a methodology for which it has been developing over the last year. He pointed out that there is increasing environmental input into Ofgem policy documents, and that the introduction of EIAs

will formalise this. John raised a number of questions that need to be resolved before the EIAs are adopted. These include:

- How to deal with the price effects? When energy prices go down so energy use tends to rise, as do emissions.
- Do we put a monetary value on carbon?
- If so, do we use the Treasury's illustrative carbon value of £70 per tonne, or do we use a range?

Callum added that Ofgem documents are regarded as too long already. He asked how Ofgem could combine intellectual rigour with not producing documents that were too long for serious readers.

#### *Environmental Impact Assessments*

- One member asked whether Ofgem would get an outside body to undertake the assessments or keep them in house.
- It was pointed out that if the EIAs were done by an external body then they would not form part of the internal decision making process.
- John Neilson replied that some work on this would be done by outside bodies through Ofgem's Environmental Economists' Panel, but otherwise the intention was to undertake most environmental assessments internally.
- Ofgem should go beyond carbon impacts in assessments and include amenity value, waste streams etc.
- The main reason for producing EIAs is to assist the decision making process and inform people as to why a decision has been taken. Taking a more systematic approach to looking at the options may identify the tradeoffs.

#### *Carbon valuation*

- The Treasury figure of £70 per tonne of carbon is illustrative and a number of other economists have taken issue with it, including Professor David Pearce in his recent paper.
- Any decision to settle on a specific value for carbon will be difficult as existing national and international targets are based on a scientific assessment of a desirable level of emissions – not a value of carbon. The 60% reduction figure in the White Paper therefore does not equate to the Treasury figure
- Carbon impact (measured in MtC) is feasible while monetisation is difficult and should be used for illustrative purposes. Monetisation may also obscure how tradeoffs have been made, so should be used with care.
- In the absence of greater coherence across Government Ofgem would be best not to use a monetary value of carbon in its assessment process other than for illustrative purposes.

Callum McCarthy said that Ofgem agreed the Government needed to clarify these issues. He pointed out that Ofgem's regulatory cycle was much shorter than the 50 year time horizon outlined in the White Paper.

- It was suggested that one way of addressing the long term target would be to have carbon reduction sub-targets for 2010 and 2020 etc.
- Ofgem should also encourage the most cost effective ways of meeting the targets irrespective of an externally determined value of carbon.

#### **4. Environmental Considerations in the Distribution Price Control Review (DPCR)**

John Costyn introduced this section. The DPCR is a major project within Ofgem's current work programme. From the start Ofgem has been working to ensure that environmental considerations are taken into account in the review. Some consumer work is being carried out to identify what the consumer perception of quality of supply and environmental impacts are and how much they would be prepared to pay to improve these. Ofgem will be looking at whether the incentives for the distribution companies are strong enough – especially in relation to reducing losses on the system and encouraging the connection and use of distributed generation. Ofgem is also looking at the structure of distribution charges.

Points made in discussion included:

- An important objective is to encourage distribution companies to pre-invest in the network.
- Policy assurances from Government will mean that distributed generation will be profitable, and this will lead to pre-investment.
- There needs to be regulatory assurance from Ofgem to ensure that there are no barriers to entry and that costs are transparent.
- The question was raised as to whether Ofgem sees its role as actively working towards achieving Government targets or merely responding to market development.

Callum McCarthy pointed out that no-one knows where the distributed generation will be. How do the distribution networks know where to pre-invest? Ofgem policy needs to be based on a realistic expectation of how much, where and what type of development will take place. The alternative is a risk of wasted investment in assets that are not used – which has financial and environmental impacts. However increased distributed generation is predicted to happen and Ofgem will ensure that companies can respond to this.

- One member pointed out that they had been working with councils in their distribution area to look at their planning decisions or guidelines for renewables (for example, not within 1km of an area of outstanding natural beauty). This can give indications as to where to undertake reinforcement work.
- One member suggested that developers who expressed a desire to make an investment that would require system reinforcement could be required to deliver an Assurance Bond, redeemable when the investment had been made (analogous to Pollution Assurance Bonds), to deter requests for reinforcement that subsequently turned out not to be necessary.

#### **5. Environmental Action Plan annual review**

Virginia Graham outlined the contents of the next Environmental Action Plan annual review. It will contain a report on progress throughout 2002 – 3. It will also set out Ofgem's forthcoming work, taking account of the White Paper. Copies will be sent to all EAG members.

#### **7. Date of next meeting: Tuesday 4 November 2003 14.30 – 16.30**

Callum McCarthy pointed out that he will not be chairing the next meeting as he will have left Ofgem by then. He was unsure as to whether it would be the Chairman or the Chief Executive who will chair the Group in future, but was sure that both will continue to attach high importance to the advice provided by the group.