

# Electricity Market Reform (EMR)

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**nationalgrid**

Investor Relations | National Grid

*“We welcome the announcement and look forward to playing our part in delivering government policy on EMR. There is still a lot of work to do, but we believe we are well placed to deliver these changes that will help provide secure and reliable energy supplies into the future.”*

Nick Winsor, UK Executive Director, National Grid



## EMR

The Electricity Market Reform (EMR) project was announced in the Coalition Government's first Annual Energy Statement in July 2010. The project aims to overhaul the current electricity market arrangements and assess the role that a package of incentives could play in supporting delivery of low carbon generation and security of supply for 2020 and beyond.

The EMR proposes a preferred package of four main mechanisms to encourage investment in low carbon generation: a Capacity Mechanism (CM) as well as changes to the current balancing arrangements, Feed-in Tariffs (FiTs) and a price floor for carbon, Emission Performance Standards (EPS).

- ◆ National Grid is fully supportive of the principles and aims of the EMR
- ◆ The detail and processes regarding how we deliver the new market mechanisms is yet to be ironed out, but we believe that we have the necessary expertise to deliver the mechanisms outlined in the technical paper, and deliver this stage of government policy to support the development of the energy market
- ◆ A CM should be designed to minimize any additional cost on customers by ideally only paying out to the extent that the existing market arrangements do not provide sufficient revenue to bring forward investment
- ◆ Market-based mechanisms offer the best way to deliver security of supply and while reducing the cost to consumers

## Announcement: Technical update

The Department of Energy and Climate Change (DECC) has proposed that National Grid implements and operates a Capacity Mechanism and implements, operates and is the contract counterparty for a Feed in Tariff (FiT) for low carbon generation as part of its Electricity Market Reform (EMR) package.

### Capacity Mechanism

The EMR Consultation in December 2010 was predicated on a targeted mechanism, where payments are only provided to resource what is needed to make up a shortfall in the market and ensure a secure electricity supply. However, a number of responses to the consultation were against that option.

In the EMR White Paper published in July 2011, the paper put forward two policy options; a targeted mechanism using a proposed strategic reserve and a market-wide mechanism, potentially in the form of a reliability market.

National Grid believes that any mechanism rewarding capacity should be designed to minimize any additional cost on consumers by ideally only paying out to the extent that the existing market arrangements do not provide sufficient revenue to bring forward investment.

Furthermore, additional market-based measures for example, sharper imbalance price signals or obligations on suppliers to procure sufficient capacity may offer more efficient mechanisms to secure sufficient capacity.

National Grid believes that the required level of security of supply that is provided by the capacity mechanism and the amount of low carbon generation should be facilitated by FiT, and these are policy decisions that should be taken by the Government.

### Feed-in Tariffs (FiTs) with contract for difference

FiTs are financial support mechanisms to provide revenue certainty for investors in low carbon generations plants. In the EMR White Paper the Contract for Difference (CfD) FiT was identified as the financial mechanism that would be adopted. The CfD FiT will top up the wholesale electricity price from the revenues received in the wholesale market up to a contracted strike price, set relative to the average market wholesale electricity price. In the event that the wholesale price exceeds the strike price, the purchasing generator will repay the difference, providing certainty for investors and consumers.

National Grid plans to run both schemes on an ‘open-book’ basis. The principle of the proposals is that we will take responsibility for implementing and managing the scheme but will not carry any financial risks of time lags of credit and debit payments of running the FIT, therefore our risk profile will be unchanged and there will be no impact on the wider financeability of the Group.

## Additional Incentives to help deliver a secure and low carbon future

National Grid does not have the responsibility for the management or the delivery of the following incentives but they are part of the Government's overall package in supporting delivery of low carbon generation and security of supply for 2020 and beyond.

### Changes to the balancing arrangements

Reform to the balancing arrangements are being proposed through changes to cash-out payments paid by parties out of balance, and this work is being led by Ofgem and is likely to be the subject of a Significant Code Review (SCR) during 2011.

In addition to cash-out, Ofgem are also looking to improve liquidity in the market which National Grid supports. Liquidity is necessary to safeguard the competitiveness of the electricity market, and the ability for new firms to enter and compete alongside incumbents – often known as the UK's ‘Big Six’ energy companies; Scottish Power, EDF Energy, SSE, British Gas, power and Centrica.

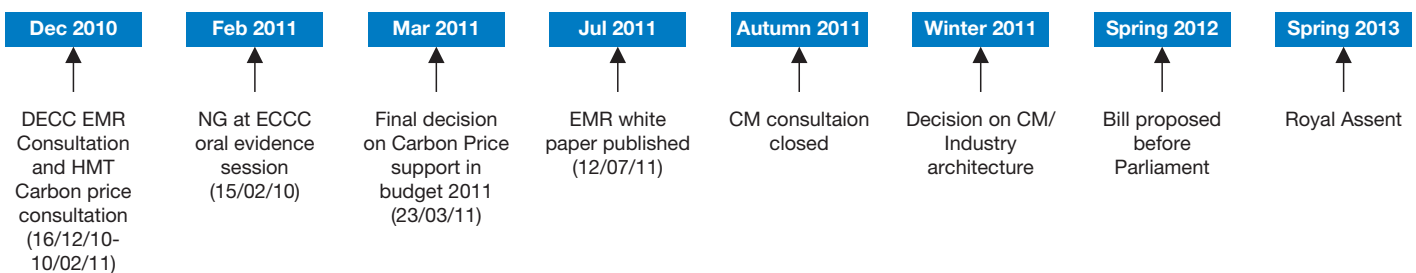
### Emissions Performance Standards (EPS)

An EPS is a restriction on the amount of carbon dioxide that can be emitted from power stations. EPS will apply to all fossil fuel plant that is larger than 50 MW from 2014, with the EMR White Paper proposing to set the level at 450g CO<sub>2</sub>/kWh. Projects in the UK CCS demonstration programme or benefiting from EU funding for commercial scale CCS will be exempt, however the decision remains open whether EPS will apply to Combined Heat and Power Plants (CHP).

### Carbon price floor support

In March 2011, the government announced that it would be introducing a floor price for carbon – starting at £16/tonne of carbon dioxide in April 2013, with a target price of £30/tonne in 2020 and increasing to £70/tonne in 2030. The aim is to provide greater long term certainty around the additional cost of running polluting plant and make lower-carbon investment more attractive. The Government also intends to introduce carbon price relief for carbon capture and storage (CSS) and combined heat and power (CHP), in order to ensure that these technologies are not penalized.

## Timeline



## Further information

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