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Dear Secretary of State,

DELIVERING ELECTRICITY MARKET REFORM

SSE has completed its analysis of the UK Government's White Paper: *Planning our electric future: a White Paper for secure, affordable and low-carbon electricity*. This letter sets out SSE's views on the proposed reforms and confirms its commitment to working with the UK Government and other stakeholders to deliver the best possible package.

Overall, there was much to be encouraged by in the White Paper:

- the continuing emphasis on protecting existing investments, which is vital to maintaining the confidence of investors;
- the recognition of the need for a capacity mechanism to ensure security of supply, particularly following the introduction of a high level of carbon price support in 2013;
- the consideration of a wider, market capacity mechanism and the recognition that this issue will need to be consulted upon further;
- the recognition that a 'one size fits all' approach to low carbon support is not appropriate;
- the acknowledgement that a great deal of additional work will be needed to make the proposed Contract for Difference Feed-in Tariff workable;
- the increased flexibility on access to the Renewables Obligation for projects started by 2017 and completed by 2020; and
- the recognition of 'grandfathering' permitted emissions levels under the new Emissions Performance Standard.

There are however several areas in the package which SSE believes can be improved, for example the grandfathering proposals within the EPS, and we will work with you and your team to ensure that the final package meets its objectives.

Two White Papers: our shared objectives

In advance of the UK Government's White Paper, SSE published its own White Paper: *A Package of Reforms to Encourage Investment in Electricity Generation*. This document brought together various organisations' responses to the initial consultation and suggested a package of measures aimed at:

- achieving the UK Government's decarbonisation, security of supply and affordability objectives;
- protecting existing investments;

- encouraging investment in low carbon technologies and firm capacity;
- maintaining the role, and benefits, of market forces;
- being robust and durable, providing long-term certainty for investors;
- avoiding complexity and prolonged periods of uncertainty;
- being introduced relatively simply and quickly; and
- sending appropriate signals to the supply chain to continue investing in the UK.

Having analysed your White Paper it is clear that while we may not be in 100% agreement over the suite of measures, there is no doubt that our objectives are aligned and that we are equally focussed on designing a market which delivers a secure and affordable low carbon electricity system.

Moving forward with a constructive dialogue

As you know, SSE is a UK based utility, with a core focus on the energy markets in Great Britain. In line with that, SSE expects to invest around £1.5billion to £1.7billion in each year to March 2015. As you know this programme is spread across our diverse energy portfolio with options for investments in wind (offshore and onshore), gas (including CCS at Peterhead), nuclear (through NuGen at Sellafield), gas storage, biomass, marine and the electricity and gas networks which SSE operates.

In line with its commitment to the GB markets, SSE is equally committed to working with the UK Government in its policy development process and will, therefore, look forward not backward with regards to reform of the electricity market. It recognises that a Feed-in Tariff with Contracts for Difference is the Government's chosen model for financial support mechanism and, as a result, is now focussed on working with the UK Government and other stakeholders to deliver a FiT with CfD which will secure the investment that is essential if the UK's energy objectives and obligations are to be met.

In all of the work that needs to be done in the coming months and years, SSE will be a constructive participant.

Views on the proposed EMR package

The fact the White Paper contained much to be encouraged by reflects the valuable policy work and discussions that took place in the first half of this year. Four things illustrate this.

First, tailored proposals for different technologies within the FiT with CfD model provide the opportunity to deal with the widely-held concern (reflected in SSE's joint letter with WWF and other stakeholders) that the FiT with CfD could be a "one size fits all" mechanism. SSE and other stakeholders are currently exploring how these specific mechanisms could work in practice, given the detailed design and implementation issues. These include choosing the appropriate markets for the reference price; ensuring that the setting of the 'Reference' and 'Strike' prices are at appropriate levels to stimulate the scale of investment required; avoiding support for technologies where it is not needed; and the development of the institution which will coordinate and run the process.

Second, the efforts to try and avoid an investment hiatus during the transition from the Renewables Obligation to the FiT with CfD are particularly important. Maintaining the RO in parallel until 2017, "vintaging" its support levels and including some form of grace period are all wise and positive steps. It is now vital to establish in detail how grace periods and phasing can work in a way which gives renewable energy and other projects the necessary comfort to proceed.

Third, on capacity, it is encouraging that the UK Government continues to take a broad view on the type of measure needed. The clear recognition that a targeted approach to capacity would lead to a "slippery slope" situation and that a market-wide mechanism is being seriously considered reflects well on the substantive nature of the consultations that have taken place in

the past few months. Given the economic issues that now apply to thermal plant investment, a market-wide mechanism would appear to SSE to be, in practice, unavoidable and SSE believes work now needs to focus on the right market-wide model.

Fourth, the UK Government's decision to choose an annual limit for an Emissions Performance Standard to allow the necessary investment in flexible plant to progress is both correct and important.

On this point, however, there has been some surprise about the grandfathering proposals within the White Paper, particularly the proposals for a three year review and the grandfathering for only a limited time. While the Government will want some flexibility to prevent 'carbon lock-in', the limited time proposal will particularly concern investors who do not want to be faced with unnecessary uncertainties during the development stages or left with stranded assets after construction.

Limiting the impact of EMR on the vulnerable

SSE is particularly conscious of the effect of electricity market reform on customers. Correspondingly, it is vital to design a system that is as efficient as possible for customers, utilising the benefits of market principles, such as economic dispatch, where possible. The final proposals must also be aligned with other parts of DECC policy so as to minimise costs.

While the decarbonisation of electricity production will reduce customers' exposure to the long-term increases in fossil fuels that are likely over the next two decades, there will, however, be costs to bear from any resultant delivery package. Not only must we ensure that the UK Government and other stakeholders communicate clearly and openly with customers, it is also vital that policy on fuel poverty is optimised.

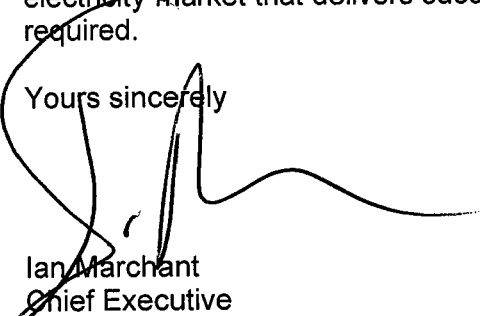
As part of its response to the Hills Review, SSE has suggested that a Fuel Poverty Agency (as part of Government or the voluntary sector) should be created to be the first port of call for vulnerable customers and to perform data matching exercises in order to comprehensively find the fuel poor for the first time. The Agency would then deliver tailor-made arrangements for each customer, which in some cases may be a benefits entitlement check, or in other cases a referral to a supplier for support through, for example, the Warm Home Discount.

Next Steps

As this letter has highlighted, much positive work has been undertaken, but there is still a lot more to do. In particular, the risk of unnecessary and potentially harmful complexity remains very high and a close focus on all aspects of the package is essential to ensure the resulting market framework is coherent, practical and durable and consistent with the objectives that have been set out for energy policy over the next decades. The opportunity is there; but so are the risks.

This letter confirms SSE's commitment to help translate the content of the White Paper into an electricity market that delivers successfully the secure and affordable low carbon economy that is required.

Yours sincerely



Ian Marchant
Chief Executive

cc: Charles Hendry, Minister of State, DECC,
Jonathan Brearley, Director of Energy Strategy & Futures, DECC,
Simon Virley, Director General for Energy Markets and Infrastructure Group, DECC

