

Vicki Bakhshi
Team Leader
Stern Review
2nd Floor, Room 35/36
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Your ref
Our ref DM/ef
Name David Mannering
Phone 01793 892172
Fax 01793 892981
E-Mail david.mannering@rwenpower.com

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Dear Ms Bakhshi

The Stern Review discussion paper (31 January 2006) brings into sharp focus a number of issues:

- The climate change problem is global in its causes and consequences and requires an international response.
- Developed countries such as the UK should show leadership.
- On the other hand, countries such as the UK are nervous about committing to early full scale action in case their efforts and competitiveness are undermined by a failure of others to follow suit.

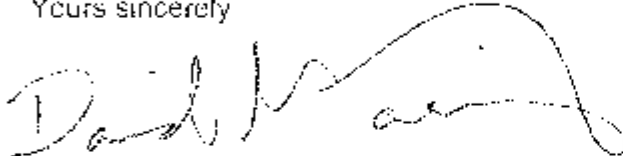
The challenge of how to find a way through these conflicting pressures is exacerbated in the UK by the required timing of investment decisions. Due to environmental regulations and natural lifetime limitations, a large volume of plant is likely to need replacing from around 2010 in order to maintain plant margins. This means investment decisions need to be made immediately. However, the international environmental framework applying beyond 2012 is unlikely to be confirmed before 2010 at the earliest. This combination of circumstances and pressures places particular importance on a measured response by the UK government.

As noted in your paper the private sector can deliver the changes needed to achieve a stable climate provided clear, long term and credible signals are provided. It would be understandable if the UK was unwilling to unilaterally apply EU ETS phase 3 type measures in full for fear of damaging UK competitiveness. On the other hand, if we do nothing, the resulting uncertainty may stymie the opportunity to adopt low carbon technologies which would have been viable should post Kyoto mechanisms eventually be agreed.

Our conclusion is that the government needs to fill the gap by signalling a commitment to a low carbon regime consistent with what the country can unilaterally afford. This should reduce the risk of too much higher carbon replacement generation. It would also demonstrate the UK's continued leadership in tackling climate change. In our view, what is required is for the government to work for the earliest phase 3 clarity regarding long term reduction targets and the allocation mechanism for existing and new plant. A fifteen year duration is also required to bring the system more closely into line with generation investment cycles. In addition, the Government must take upfront actions that adequately mitigate the risk of stranded development costs in the event that phase 3 fails to proceed. We have identified several possible solutions for this, the most practical of which being amendments to the current tax regime.

We would welcome the opportunity to discuss these issues more fully.

Yours sincerely

A handwritten signature in black ink, appearing to read 'David Mannering', with a large, sweeping flourish extending to the right.

David Mannering
Director of Economic Regulation