

VINCENT DE RIVAZ

Chief Executive

Our Ref
Your Ref

Stern Review Team
2/35
HM Treasury
1 Horse Guards Road
London
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Date 20 March 2006

Dear Sir Nicholas

EDF Energy welcomes the opportunity to respond to the Stern Review discussion paper on the economics of climate change. EDF Energy supports the approach set out in the discussion paper and believes the questions outlined cover the issues that need to be addressed in the review.

EDF Energy is fully committed to tackling climate change and we share this commitment with our parent company EDF. We are actively engaging in the government's Energy Review and we believe that early conclusions from the Stern review will represent an important contribution to that review.

EDF Energy supports the UK government's ambition to move progressively to a low carbon economy and to play a leading role in the global effort to address climate change. In our view, the scientific evidence presented to date justifies action to mitigate climate change by reducing greenhouse gas emissions.

The Science and Adaptation

EDF Energy welcomes the Stern Review's focus on gaining greater certainty around the nature and the scale of impacts in the longer term at a regional, UK and global level. We believe that further work is required on reducing the uncertainty surrounding the environmental, social and economic impacts of climate change, which is hindering effective assessments of the associated benefits of protecting against these impacts. This is potentially delaying the response to climate change and adaptation at a local, regional and global level. EDF Energy is working with the Met Office and other energy organisations to improve our understanding of the physical impacts of climate change and to develop appropriate responses in managing them.

EDF Energy also believes that greater emphasis is needed on identifying the risks associated with climate change at a regional basis within individual sectors, for example the electricity sector. This should form the basis for actions going forward in managing and adapting to climate change. Climate change adaptation will clearly require significant expenditure from both public and private sectors, but it is difficult to

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be precise. Government should ensure that public funding is available to support the initial detailed risk assessments and also the implementation of adaptation actions.

Long term policy framework

EDF Energy supports the UK government's leadership and commitment to the further development of international policies and its engagement with other countries in the negotiations to determine international emissions framework. EDF Energy concurs with the issues and questions raised in the Stern Review's discussion paper on international long term policy frameworks that incorporate developing and emerging countries, between which the details of the relevant framework may need to be different. It is important that the UK government separates the need for international targets and its own responsibility to respond to the challenge of climate change and moving to a low carbon economy.

We believe that to achieve the UK's emissions reduction ambition, a stable long term policy framework and the removal of barriers to the development of particular low carbon technologies is required. The European Union Emissions Trading Scheme (EU ETS) currently excludes carbon free technologies such as carbon sequestration, large hydro and nuclear from the scheme. Although these technologies can benefit from higher electricity prices driven by carbon prices in the EU ETS, the timescales of the EU ETS and the visibility and certainty of future prices does not match the investment life cycles of these assets. The potential risks faced by investors investing in low carbon or carbon free technologies include:

- EU or individual member state governments implementing policy in a manner that leads to a low or non significant price for CO₂; and
- Governments providing assistance to carbon emitting technologies by allocating free carbon allowances to new entrants under the EU ETS.

EDF Energy believes that commercial or financial instruments in the form of carbon reduction contracts have the capability of hedging the risk for investors in "low carbon technology" that is related to uncertain carbon prices and that they can be designed to be consistent with existing policy mechanisms. Contracts have the further advantage of allowing government "to bite off as much as it wants to chew"; since it can limit its liabilities under these contracts by controlling the volume of abatement it is willing to underwrite using this mechanism. Government can further limit its liabilities by influencing wider policy development and keeping the carbon price within a reasonable range that minimises its financial exposure. Contracts are also attractive because:

- They can be designed to allocate the regulatory risk associated with carbon markets more evenly and fairly between industry and government; and
- Can provide certainty on delivering known CO₂ reductions.

These contracts can be designed to be directly or indirectly linked to the EU ETS. EDF Energy believes that there are benefits for both developers and Government in keeping these contract mechanisms independent of the EU ETS. These include:

- Simplicity of contract form and execution (the purpose of the contract is to securitize the value of carbon reduction and promote long term investments – not to create tradable certificates);
- Reduced regulatory risk (value is not affected by changes to the EU ETS);
- Provides government with greater flexibility on how to underwrite any of its own liabilities under these contracts; and
- Contracts are not directly affected by subjective assessments of business as usual projections and targets set for the traded sector under the EU ETS.

Separating these contracts from the EU ETS does not in EDF Energy's view prejudice the use of the EU ETS to determine a reference price for the settlement of contracts.

EDF Energy is developing a detailed proposition on a suitable carbon price mechanism and this will be outlined in EDF Energy's Energy Policy review response. We believe further work is required in developing a framework for this mechanism that examines the commercial and regulatory features of the contracts. In addition the following detailed issues would need to be resolved:

- Commercial structure of contracts;
- Terms of delivery; and
- Interaction with support mechanisms for CO2 emitting plant such as allocation of free allowances to new entrants in the EU ETS.

I hope you will find our response helpful. If you have any queries or would like us to provide further help to your review, please do not hesitate to contact me.

Yours sincerely



Vincent de Rivaz