



House of Commons
Energy and Climate Change
Committee

Implementation of Electricity Market Reform

Eighth Report of Session 2014–15



House of Commons
Energy and Climate Change
Committee

Implementation of Electricity Market Reform

Eighth Report of Session 2014–15

*Report, together with formal minutes relating
to the report*

*Ordered by the House of Commons
to be printed 24 February 2015*

HC 664
Published on 4 March 2015
by authority of the House of Commons
London: The Stationery Office Limited
£0.00

The Energy and Climate Change Committee

The Energy and Climate Change Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department of Energy and Climate Change and associated public bodies.

Current membership

[Mr Tim Yeo MP](#) (*Conservative, South Suffolk*) (Chair)
[Dan Byles MP](#) (*Conservative, North Warwickshire*)
[Ian Lavery MP](#) (*Labour, Wansbeck*)
[Dr Phillip Lee MP](#) (*Conservative, Bracknell*)
[Rt Hon Mr Peter Lilley MP](#) (*Conservative, Hitchin and Harpenden*)
[Albert Owen MP](#) (*Labour, Ynys Môn*)
[Christopher Pincher MP](#) (*Conservative, Tamworth*)
[John Robertson MP](#) (*Labour, Glasgow North West*)
[Sir Robert Smith MP](#) (*Liberal Democrat, West Aberdeenshire and Kincardine*)
[Graham Stringer MP](#) (*Labour, Blackley and Broughton*)
[Dr Alan Whitehead MP](#) (*Labour, Southampton Test*)

Powers

The committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the internet via www.parliament.uk.

Publication

Committee reports are published on the Committee's website at www.parliament.uk/ecc and by The Stationery Office by Order of the House.

Evidence relating to this report is published on the [inquiry page](#) of the Committee's website.

Committee staff

The current staff of the Committee are Farrah Bhatti (Clerk), Vinay Talwar (Second Clerk), Tom Leveridge (Committee Specialist), Marion Ferrat (Committee Specialist), Shane Pathmanathan (Senior Committee Assistant), Amy Vistuer (Committee Support Assistant), and Nick Davies (Media Officer).

Contacts

All correspondence should be addressed to the Clerk of the Energy and Climate Change Committee, House of Commons, 14 Tothill Street, London SW1H 9NB. The telephone number for general enquiries is 020 7219 2569; the Committee's email address is ecc@parliament.uk

Contents

Report	<i>Page</i>
Summary	3
1 Introduction	5
2 From legislation to implementation	8
Setting a framework for Contracts-for-Difference	8
Preparing for the first Capacity Market auction	9
Meeting the timetable	10
Industry preparedness	11
Difficulties for small players	12
Reviewing the first year of EMR	14
3 Providing value-for-money for consumers	16
The role of National Grid	16
Demand-side response	18
4 Providing a clear, coherent and forward-looking policy	21
EMR: A cohesive package?	21
Greater visibility for investors	23
The Levy Control Framework up to 2021	23
On the road to 2030	25
5 Conclusions	27
Conclusions and recommendations	28
Formal Minutes	31
Witnesses	32
Published written evidence	33
List of Reports from the Committee during the current Parliament	34

Summary

The Government's flagship Electricity Market Reform was designed to drive investment in our energy infrastructure and manage the transition towards generating low-carbon, secure and cost-effective electricity. After years of planning, the Government has successfully put in place the necessary framework for the first Capacity Market and Contract-for-Difference (CfD) auctions under EMR, and DECC, National Grid and the Low Carbon Contracts Company have been helpful in preparing industry in the run-up to the auctions.

However, the speed at which participants have had to assimilate the complex policies have made it a challenging environment for smaller companies, and DECC is still failing to ensure that demand-side response (DSR) providers are given a level playing field in the Capacity Market. In order to avoid paying for more expensive generation capacity that may not be needed in the future, the Government should consider means to further support DSR in the Capacity market, for instance by increasing the contract length of DSR capacity agreements.

There also remain strong concerns around National Grid's potential conflicts of interest as EMR Delivery Body, and it is important that clear steps are taken to ensure that it does not have an unfair commercial advantage in future Capacity Market auctions.

With over 80% of the successful capacity agreements going to existing generating capacity, including coal-fired power stations, the CfD and Capacity Market mechanisms seem to be pulling in opposite directions, with the Capacity Market risking locking us into a higher carbon and more expensive trajectory than needed. A diversity of sources is clearly desirable, but CfDs and the Capacity Market are in danger of pursuing competing aims rather than complementing each other.

The proportion of the Levy Control Framework (LCF) already allocated to the early contracts for renewables may have pre-empted better value-for-money in the latter years of the LCF. Uncertainty in future wholesale prices, corresponding uncertainty in the buying power of the LCF, and uncertainty around the Government's intentions in the event that the LCF total is exceeded, all raise doubts in the minds of investors.

When conducting its first review of EMR in the summer, the Government will need to promptly detail lessons learned and assess the extent to which the 2014 rounds have contributed to the objectives of EMR. In conducting the review, DECC should particularly focus on:

- How engagement with small players can be improved
- How potential conflicts of interest with National Grid will be avoided or addressed
- How DECC will further develop the demand-side sector within the enduring EMR regime
- The future of coal-fired power generation in the capacity market

- How the cost of the Capacity Market will be controlled in future auctions
- Clarity and visibility of the LCF beyond 2020

The Government has succeeded in rolling out its reform relatively smoothly, but if EMR is to create a long-term secure, affordable and low carbon energy system, it must provide a stable policy framework to give investors the confidence they need.

1 Introduction

1. Over 14 GW¹ of Britain's existing generating capacity is expected to close by 2020,² as European air pollution standards cause coal and oil power plants to be retired and old nuclear plant reaches the end of its working life. The Government's Electricity Market Reform (EMR) was initiated in 2010 to drive investment in the UK's energy infrastructure in order to replace this existing capacity with new, low carbon sources of energy. EMR was designed to: (1) decarbonise electricity generation; (2) keep the lights on; and (3) minimise the cost of electricity to consumers.³

2. The Electricity Market Reform is enshrined in legislation in the Energy Act 2013.⁴ In order to bring forward the investment needed to meet the goals of EMR, the Act introduced two key mechanisms:

- Contracts-for-Difference (CfDs) provide long-term price stabilisation to low-carbon plant. The budget for these contracts falls within the Government's Levy Control Framework,⁵ and generators can compete for contracts in an annual auction;
- A Capacity Market provides a regular retainer payment to reliable forms of capacity (both demand and supply side), in return for the capacity being available when the system is tight. Generation and demand-side providers can compete for capacity payments in an auction held four years ahead of the year in which capacity is expected to be delivered, followed by a second auction one year ahead, if more capacity is needed. The first delivery year is the winter of 2018-19.⁶ The Capacity Market is expected to be paid for through the Levy Control Framework, but Capacity Market spend will be in addition to the existing £7.6 billion cap for low carbon electricity.⁷ The Government plans to set a separate budget for the Capacity Market when there is greater certainty on the size of the costs involved.⁸

In addition to these, the Government also introduced the Carbon Price Floor (CPF), a tax on CO₂ emissions, and Emissions Performance Standards (EPS), which require new coal-fired power stations to be equipped with Carbon capture and storage (CCS). Together, these four elements make the pillars of the Government's flagship reform of the electricity market.

1 GW = Gigawatt

2 Department of Energy and Climate Change, [Statutory Security of Supply Report](#) (October 2014), p 20-21

3 Department of Energy and Climate Change, '[Maintaining UK energy security](#),' accessed 12 February 2015

4 Energy Act 2013, [Part 2](#)

5 The LCF allows Government to control the cost to consumers from pursuing energy policy objectives. It caps the cost of levy-funded schemes.

6 Department of Energy and Climate Change, [Implementing Electricity Market Reform \(EMR\)](#) (June 2014), p 14

7 Department of Energy and Climate Change, [Annual Energy Statement 2014](#) (October 2014), p 75

8 National Audit Office, [The Performance of the Department of Energy and Climate Change 2013-2014](#) (December 2014), p 34

3. We have closely scrutinised EMR since its inception, and assessed and commented on the policy as it has developed from initial proposal to final legislation. In our 2011 report, *Electricity Market Reform*, we recommended a series of improvements to the Government's overly complex initial proposals. In particular, we recommended that the White Paper should include a demand reduction objective. We also called for the Government to publish a target implementation timetable as soon as possible, as uncertainties were already deterring investment. In its response, the Government confirmed its intention to publish a detailed implementation plan alongside draft legislation.

4. We then conducted pre-legislative scrutiny of the Draft Energy Bill⁹ after it was published in May 2012. We influenced the final shape of the bill by outlining flaws in the proposed CfD payment model. We also re-iterated our concerns that the Government continued to neglect the contribution that demand-side activities could make to energy security and climate change objectives. As a direct result of our scrutiny, a new Government-owned institution, the Low Carbon Contracts Company Ltd, was created to act as a counterparty to CfD contracts.

5. After years of planning and preparation, EMR is now in the first phase of its execution. Its successful implementation would play a critical role in the UK meeting its decarbonisation and energy security targets. As important milestones are met, continuing scrutiny and review will be central to the successful development of the reformed electricity market over the years, and decades, to come.

6. We launched this inquiry on 16 September 2014 to evaluate the Government's progress towards implementing the different strands of the EMR reforms, and assess whether the policy provides the best value-for-money for consumers. We heard from key stakeholders as the first Capacity Market and CfD programmes unfolded, to determine the extent to which the first year of EMR was in line with the policy's overall goals. We received 40 pieces of written evidence and held three evidence sessions between November 2014 and January 2015. A full list of witnesses can be found at the back of this report. We are very grateful to all those who took the time to contribute to this inquiry.

7. In addition to ensuring a smooth transition to a new market structure, EMR must guarantee that consumers paying for the policy will gain secure and low-carbon energy at the lowest cost. We recognise that we are in the early stages of EMR implementation. Rather than a technical review of the policy details, this report aims to provide a preliminary overview of the implementation of the Capacity Market and CfDs. It is part of the ongoing scrutiny of EMR that we have been involved in, and which we hope our successor committee will continue after the 2015 General Election. Chapter 2 provides an overview of the development of the policy since the passing of the Energy Act 2013, and assesses the ways in which preparations were made ahead of the first round of CfD and Capacity Market auctions. Chapter 3 outlines some key concerns about the value-for-money of EMR and suggests issues to be considered when the policy is reviewed after the General Election. Finally, Chapter 4 highlights the need for more clarity and policy stability

9 Draft Energy Bill, [Cm 8362](#), May 2012

if EMR is to attract the £110 billion of investment¹⁰ that is needed to replace Britain's generating capacity and cope with increasing stresses on electricity demand.

10 Department of Energy and Climate Change, [Electricity Market Reform: Delivering UK Investment](#) (June 2013) p 6

2 From legislation to implementation

8. The Energy Act 2013 received Royal Assent on 18 December 2013, and the first EMR delivery plan¹¹ was published the following day. DECC published its finalised policy positions for the timetable of EMR implementation in June 2014, maintaining that “the first CfDs are expected to be allocated during 2014” and “the first Capacity Market capacity auction will be run in December 2014”.¹² Many of the key missing details on the CfD and Capacity Market were provided in June and July 2014.¹³ The secondary legislation, needed to implement the package, passed into law during the summer of 2014.¹⁴

9. National Grid took on responsibility as the main delivery body for EMR on 1 August 2014. Its role includes:

- Carrying out analyses to inform Ministers’ decisions, including the level of support for CfDs and how much capacity to procure in the Capacity Market auctions.
- Administering both CfDs and the Capacity Market, establishing whether projects meet eligibility criteria to receive CfDs and running auctions for both mechanisms.

Two Government-owned companies have key roles in managing EMR mechanisms: the Low Carbon Contracts Company (LCCC) acts as counterparty to CfDs, manages the contracts and is responsible for payments under them; the Electricity Settlements Company is responsible for payment flows under the Capacity Market.¹⁵

Setting a framework for Contracts-for-Difference

10. The Contracts-for-Difference are long-term contracts between Government and a low-carbon generator that give a guaranteed tariff or price for electricity over a defined period of time. Their purpose is to reduce price volatility by providing a top-up payment between a market-based reference price and a pre-defined “strike price”.¹⁶ EDF Energy explained that “we expect Contracts-for-Difference to support investment in low carbon generation projects and to reduce risk for investors and reduce costs for customers by removing exposure to energy price risk”.¹⁷

11 Department of Energy and Climate Change, [Electricity Market Reform Delivery Plan](#) (December 2013)

12 Department of Energy and Climate Change, [Implementing Electricity Market Reform \(EMR\)](#) (June 2014), p 27

13 Department of Energy and Climate Change, [Implementing Electricity Market Reform \(EMR\)](#) (June 2014), Department of Energy and Climate Change, [Final Capacity Market Design Presentation](#) (July 2014)

14 The Contracts for Difference (Allocation) Regulations 2014 ([SI 2014/2011](#))

15 Department of Energy and Climate Change, [Implementing Electricity Market Reform \(EMR\)](#) (June 2014), p 22

16 Tempus Energy Ltd ([IEM 015](#)) para 11

17 EDF Energy ([IEM 021](#)) para 8

11. In September 2014, DECC published the final framework for the first CfD allocation round, which opened for applications in October 2014.¹⁸ In this round, technologies were grouped into three “pots”:

- Established technologies (Pot 1), which includes onshore wind (>5MW), Solar Photovoltaic (PV) (>5MW), Energy from Waste with CHP, Hydro (>5MW and <50MW), Landfill Gas, and Sewage Gas;
- Less established technologies (Pot 2), comprising offshore wind, wave, tidal stream, Advanced Conversion Technologies, Anaerobic Digestion, Dedicated biomass with CHP, and Geothermal; and
- Biomass conversion (Pot 3).¹⁹

Payments made to generators will be recovered from electricity suppliers, who are expected to pass on the costs to consumers. CfD expenditure is to be governed by the Levy Control Framework (LCF). The LCF places limits on the aggregate amount levied from consumers by energy suppliers to implement Government policy, so that DECC can achieve its fuel poverty, energy and climate change goals in a way that is consistent with economic recovery and minimises the impact on consumers. In its current form the LCF will support electricity policies to 2020–21. The level of the cap on spending under the LCF in 2011–12 was £2 billion, and will rise to £7.6bn in 2020–21 (in 2011–12 prices).²⁰ We note that the NAO report suggests there is a 20% headroom on top of the LCF cap,²¹ subject to subsequent clawback.

Preparing for the first Capacity Market auction

12. The aim of a capacity mechanism is to ensure a reliable electricity supply to consumers and reduce the likelihood of future power outages. RWE explained that the Capacity Market:

has been designed to deliver an economic and efficient outcome based on a competitive market-based approach. It has the potential to significantly enhance GB security of supply at the lowest cost for customers.²²

In June 2013, DECC issued detailed Capacity Market design proposals, confirming that an auction would be held four years ahead of the proposed delivery year where capacity may be needed (the so-called “T-4” auction), followed by a second auction one year ahead (so-called “T-1”).²³ The first delivery year is 2018–19. The “T-4” auction took place in

18 Department of Energy and Climate Change, [Contracts for Difference: Final Allocation Framework for the October 2014 Allocation Round](#) (September 2014)

19 Department of Energy and Climate Change, [Budget Notice for CFD Allocation Round 1](#) (October 2014)

20 Department of Energy and Climate Change, [Annex D: Levy Control Framework Update: Extending the framework to 2020/21](#) (July 2013), p 2

21 National Audit Office, [The Levy Control Framework](#) (November 2013), p 9

22 RWE ([IEM 010](#))

23 Department of Energy and Climate Change, [Electricity Market Reform: Capacity Market – Detailed Design Proposals](#) (June 2013), p 7

December 2014 and the “T-1” auction is planned for 2017. This framework will apply for different delivery years, with a second “T-4” auction planned for December 2015, for delivery in 2019–20.²⁴

13. The amount of capacity auctioned is based on an annual security of supply analysis carried out by National Grid.²⁵ In October 2014, the Rt Hon Edward Davey MP, Secretary of State for Energy and Climate Change, confirmed that the final target capacity for the 2014 four-year-ahead auction would be 48.6 GW.²⁶ A further 2.5 GW of capacity is expected to be contracted in the year-ahead auction in 2017.²⁷ Following a pre-qualification stage that saw 62 GW of capacity qualify,²⁸ the first Capacity Market auction successfully took place in December 2014.

Meeting the timetable

14. Many contributors acknowledged DECC’s efforts in meeting the “challenging”²⁹ timetable of EMR implementation and minimising delays,³⁰ describing this as “a significant achievement”³¹ that should be “congratulated”.³² Mark Ripley, Director of Regulation at National Grid, acknowledged that “the last 12 months have been very busy”, adding that it had been “quite a big push to get the secondary legislation through” but that “industry, DECC and ourselves, worked very well together”.³³ The Rt Hon Matthew Hancock, Minister of State for Energy, told us:

Over the last year, the implementation of EMR has involved two absolutely mission-critical moments, both of which have been successful. [...] The first is that, in the summer, we successfully gained State Aid approval for the structures and the processes, and that was very important for implementing it. The second was the execution of the capacity market auction over Christmas and in the run-up to Christmas.³⁴

15. However, concerns were raised that the successful pace of implementation may have been at the detriment of its quality.³⁵ While E.ON argued that DECC had “struck the right

24 Department of Energy and Climate Change, *Electricity Market Reform Annual Update 2014* (November 2014), p 20

25 Department of Energy and Climate Change, *Implementing Electricity Market Reform (EMR)* (June 2014), p 91

26 Department of Energy and Climate Change, ‘[Update to the target capacity for the Capacity Market auction](#),’ accessed 5 February 2015

27 Department of Energy and Climate Change, ‘[First Capacity Market auction begins today](#),’ accessed 6 February 2015

28 National Grid, ‘[Results of Capacity Market prequalification announced](#),’ accessed 5 February 2015

29 Scottish Renewables ([IEM 016](#)) para 2.1, VPI Immingham ([IEM028](#)) para 8, Vattenfall ([IEM 032](#)), Q173 [Mark Ripley and Neil McDermott]

30 Scottish Renewables ([IEM 016](#)) para 2.1, E.ON ([IEM 017](#)) para 2, InterGen ([IEM 018](#)) para 7.1, EnergyUK ([IEM 020](#)) para 1.3, EDF Energy ([IEM 021](#)) para 6, Renewable Energy Association ([IEM 024](#)), Institution of Civil Engineers ([IEM 034](#)), ScottishPower ([IEM 038](#)) para 5, RenewableUK ([IEM 040](#)) para 1, Q1 [Leonie Greene and Paul Spence], Q108 [Chris Elder]

31 Statkraft ([IEM 045](#)) para 2.1

32 Q108 [Sara Vaughan]

33 Q173 [Mark Ripley]

34 Q242 (Matthew Hancock)

35 Q1 (Leonie Greene)

balance between ensuring the various rules and regulations work sufficiently and avoiding delays to implementation”,³⁶ the Renewable Energy Association (REA) warned that there was “a danger of valid policy concerns being overlooked in the rush to meet the relevant deadlines and the bigger picture being missed”.³⁷ The REA added that the numerous decisions rolled-out through secondary legislation may not have been subject to sufficient scrutiny.³⁸ Leonie Greene, from the Solar Trade Association, called it “a tale of two halves”,³⁹ with very little being done for years and a sudden rush in the months leading to the first auctions. The Independent Renewable Energy Generators Group (IREGG) explained that:

The timeline for the policy development of CfD auctioning has been rushed. This put significant pressure on DECC, whose consultation documents were increasingly showing signs of strain as they included multiple mistakes; on industry, who had to dedicate substantial resources to assessing hastily drafted proposals and replying to DECC consultations at extremely short notice; and on investors, whose confidence has been shaken by a mechanism developed in this manner and confirmed only weeks before the first auction is due to take place.⁴⁰

The Minister rejected these criticisms as unfair, explaining that:

Of course, it has been implemented at pace. There has been an awful lot of work, and I want to pay tribute to the work of the officials in DECC. This has been one of the best teams that I have worked with in Government. It has moved fast and the electricity market is a complicated market, but I don’t think it has been rushed, no.⁴¹

16. We commend DECC for maintaining the ambitious timetable of EMR implementation and ensuring that the necessary framework was put in place in the lead up to the first Capacity Market auction and CfD allocation round.

Industry preparedness

17. The speed at which final legislation and policy positions were laid out has meant that industries wishing to participate in the Capacity Market auction or apply for a CfD have had to rapidly assimilate intricate documents and complicated eligibility criteria. Dr Nina Skorupska, from the REA, described the CfD policy as “highly complex”,⁴² and many stakeholders similarly commented on the intricacy of EMR.⁴³ Engagement with DECC and

36 E.ON ([IEM 017](#)) para 2

37 Renewable Energy Association ([IEM 024](#))

38 Q1 (Dr Nina Skorupska)

39 Q1 (Leonie Greene)

40 IREGG ([IEM 036](#))

41 Q243 [Rt Hon Matthew Hancock]

42 Q28 [Dr Nina Skorupska]

43 Solar Trade Association ([IEM 008](#)), E.ON ([IEM 017](#)) para 1, Statkraft ([IEM 045](#)), Q8 [Paul Spence], Q84 [Andrew Buglass]

relevant EMR bodies has therefore been crucial in helping the industry gear up towards the first round of auctions. The Renewable Energy Association explained that DECC had been “very open in offering to meet with stakeholders”⁴⁴ and others similarly felt that they had been adequately engaged throughout the process.⁴⁵ However, Leonie Greene warned that the process had at times felt “quite erratic”⁴⁶ and Sara Vaughan, Director of Strategy and Regulation at E.ON, added that some in the industry considered they had “not had as much time to be consulted on as [they] might have liked”.⁴⁷

18. Within such a new and complex policy landscape, DECC, National Grid and the Low Carbon Contracts Company (LCCC) have a crucial role in communicating with industry stakeholders and potential participants. We heard that the roles of National Grid and the LCCC were well defined,⁴⁸ and several stakeholders commented positively on their interactions with both of these bodies.⁴⁹ We heard that they had made worthwhile efforts to establish and run a series of workshops, which had been “very useful in this transition”.⁵⁰ However, the REA warned that the number of different bodies involved in EMR “may lead to some confusion among generators” and that these bodies should beware of “mixed messages being communicated to stakeholders”.⁵¹ Mark Ripley, Director of Regulation at National Grid, explained that:

We spent a lot of time engaging with people in the industry to ensure that they understood what they needed to do, and understood the various bits of paper and the various commitments they needed to make.⁵²

Neil McDermott, Chief Executive Officer of the LCCC, said that they had been “leading the implementation of the industry readiness to take part in the allocation rounds for CfDs”,⁵³ adding that the LCCC was doing its best to “ensure that generators, large and small, are aware of the process, understand the contract, and can take part”.⁵⁴

Difficulties for small players

19. SMEs and independent generators, who may have more limited resources than their larger counterparts, have faced difficulties in adapting and fully engaging with the complex EMR process.⁵⁵ RenewableUK said that their “sense is that smaller players and supporting

44 Renewable Energy Association ([IEM 024](#))

45 Q1 [Paul Spence and Danielle Lane], Q67 [Andrew Buglass]

46 Q3 [Leonie Greene]

47 Q108 [Sara Vaughan]

48 Solar Trade Association ([IEM 008](#)), Renewable Energy Association ([IEM 024](#)), RenewableUK ([IEM 040](#)) para 14

49 Vattenfall ([IEM032](#)), Q4 [Danielle Lane], Q5 [Paul Spence], Q109 [Rupert Steele]

50 RenewableUK ([IEM 040](#)) para 5

51 Renewable Energy Association ([IEM 024](#))

52 Q179 [Mark Ripley]

53 Q188 [Neil McDermott]

54 Q189 [Neil McDermott]

55 Renewable Energy Association ([IEM 024](#)), Qq1,3,25 [Dr Nina Skorpuska], Qq3,25,33,34 [Leonie Greene]

sectors, such as finance, have not had time to fully come to terms with the CfD framework”.⁵⁶ The Solar Trade Association explained that:

The eligibility requirements for the [CfD] scheme require considerable upfront expenditure, with no guarantee of return, therefore benefitting larger companies better able to spread and absorb risks over a portfolio of several possible development sites. The sheer complexity of CfDs will also favour large companies with the resources to pursue complex bidding strategies over many years.⁵⁷

20. Neil McDermott, Chief Executive of the LCCC, and Mark Ripley, Director of Regulation at National Grid, explained that they had put particular emphasis on running workshops on both CfDs⁵⁸ and the Capacity Market,⁵⁹ respectively, and engaged with trade associations “to ensure that generators, large and small, are aware of the process, understand the contract, and can take part”.⁶⁰ Neil McDermott reassured us that he was “particularly interested in the small end of the generators and suppliers,” and that one-on-one meetings had been “offered [...] to all generators”.⁶¹ He added:

You mentioned the Solar Trade Association. We have worked with them. We have worked with Energy UK, RenewableUK and the Renewable Energy Association to be able to try to maximise the reach that we tried to achieve.⁶²

Some organisations claimed that the framework was still geared towards people who really understood the market very well rather than people who wanted to enter the market.⁶³ However, Mark Ripley considered that “some familiarity with the electricity sector is in fact necessary if you are going to choose to be generating”.⁶⁴

21. In addition to being potentially disadvantaged by the complexity of the process, SMEs also face financial barriers in attempting to secure CfDs. In particular, the frequency of CfD allocation rounds—currently once a year—means that, after having invested large sums of money to meet prequalification criteria, unsuccessful applicants have to remain afloat for an entire year before being able to bid in the next auction for a chance to secure revenues for their projects.⁶⁵ Lark Energy, a UK-based developer of large-scale solar projects, explained that:

As a minimum, we strongly believe that there should be more than one auction a year to enable SMEs to participate properly in the auction market.

56 RenewableUK ([IEM 040](#)) para 4

57 Solar Trade Association ([IEM 008](#))

58 Q197 [Neil McDermott]

59 Q208 [Mark Ripley]

60 Q189 [Neil McDermott]

61 Q188 [Neil McDermott]

62 Q188 [Neil McDermott]

63 Q11 [Dr Nina Skorupska]

64 Q208 [Mark Ripley]

65 Lark Energy ([IEM 011](#)), Renewable Energy Association ([IEM 024](#)), Q25 [Leonie Greene]

The alternative is to allow the CfD market to be totally dominated by large companies and utilities.⁶⁶

The REA questioned “the feasibility of meeting Ministers’ stated aims for moving ‘from the Big 6 to the Big 60,000’, as the reality is likely to be the opposite”.⁶⁷

22. The Minister explained that the desire to open the market to new entrants and small businesses had to be balanced with “a reasonable certainty that the businesses on the other side are going to be able to deliver on their piece”,⁶⁸ explaining that other routes were available for small generators:

Of course, there will be very small suppliers who say they would love to be part of the capacity market or the CfDs, but they do not have the money to get going and they do not have a track record, and that presents us with a challenge. The answer is that this is only one part of the suite of solutions. The other part of the suite of solutions includes the feed-in tariffs and other measures to be able to encourage small generation.⁶⁹

Reviewing the first year of EMR

23. Following the first Capacity Market auction and first allocation of CfDs, DECC expects to conduct a comprehensive review of the first round of EMR delivery, ahead of the rounds opening later in 2015. The second “T-4” auction will take place in December 2015, and the volume to be procured will be published before the prequalification window opens.⁷⁰ A second CfD allocation round is intended to open in October 2015,⁷¹ with the budgets to be confirmed later this year.⁷² The Minister explained that DECC “will go through this [review] process over this summer to make any decisions on whether there needs to be changes”⁷³ and “do things in time to make changes”.⁷⁴ He added that he “fully expect[s] this to be an annual process”.⁷⁵ While the review has been welcomed by industry, Dr Skorupska told us that:

We believed we needed more auctions, more frequency in the year, and the argument we got back was that they needed to do an in-depth review first before they know how to run the next one. That is very good—big tick.

66 Lark Energy ([IEM 011](#))

67 Renewable Energy Association ([IEM 024](#))

68 Q263 [Rt Hon Matthew Hancock]

69 Q268 [Rt Hon Matthew Hancock]

70 Department of Energy and Climate Change, [Electricity Market Reform Annual Update 2014](#) (November 2014), p 20

71 Department of Energy and Climate Change, [Electricity Market Reform Annual Update 2014](#) (November 2014), p 16

72 Department of Energy and Climate Change, [Electricity Market Reform Annual Update 2014](#) (November 2014), p 10

73 Q250 [Rt Hon Matthew Hancock]

74 Q294 [Rt Hon Matthew Hancock]

75 Q294 [Rt Hon Matthew Hancock]

However, it is not very good for businesses that have to wait and see if they have the chance to have a go again.⁷⁶

24. We welcome the efforts by DECC, National Grid and the Low Carbon Contracts Company to help prepare industry in the run-up to the first Capacity Market and CfD auctions. However, the complexity of the policies and the speed at which participants have had to assimilate information have made it a challenging environment for smaller companies. A robust review of the auctions is clearly needed and lessons learned must be acted upon ahead of the next round of EMR delivery. We are worried that the timing of the review means that it risks taking place too close to the opening of the second CfD allocation round and Capacity Market auction. This may mean that industry concerns—particularly the concerns of small companies—are not addressed.

25. We recommend that DECC ensure its review of the first round of CfD allocation and first Capacity Market auction is concluded by the end of August 2015. The review should detail lessons learned from each step of the CfD allocation and Capacity Market auction outlined by DECC, and assess the extent to which the 2014 rounds contribute to the objectives of EMR. In conducting the review, DECC should particularly look at how engagement with small players can be improved. The review should also include an assessment of the pros and cons of running more frequent CfD auctions.

76 Q33 [Dr Nina Skorupska]

3 Providing value-for-money for consumers

The role of National Grid

27. We have previously raised concerns about potential conflicts of interest between National Grid's existing role (as the System Operator and owner of the transmission network) and its newer role as EMR delivery body. Following our pre-legislative scrutiny, we called for National Grid to be removed from its EMR role and replaced by a new independent, not-for-profit company,⁷⁷ a recommendation which was not taken up by Government.

28. As National Grid recommends the amount of capacity to procure in the Capacity Market to the Secretary of State, there is a risk that it has an incentive to over-procure capacity.⁷⁸ Some stakeholders were satisfied that DECC had dealt with this potential conflict of interest effectively.⁷⁹ However, new conflict of interest issues have arisen following the Government's recent confirmation⁸⁰ that interconnectors would participate in the second four-year-ahead Capacity Market auction in 2015. While this was necessary in order to meet State Aid approval conditions that generation from other countries should be included, the inclusion of interconnectors raises additional issues.⁸¹ Stakeholders have voiced their concern that this may prevent a level playing field because interconnectors represent transmission capacity rather than generation capacity and are exempt from certain charges faced by other Capacity Market entrants (such as a number of grid charges and the carbon price floor, which have to be paid by UK-based generators).⁸² Additionally, National Grid is itself a shareholder in a number of interconnectors, and E.ON expressed concerns about "National Grid running the Capacity Market as the Delivery Body, advising the Secretary of State on security of supply assessments and the capacity demand curve, whilst also benefitting as a participant".⁸³

29. A Panel of Technical Experts (PTE) was set up by DECC to impartially scrutinise and quality assure the analysis underpinning National Grid's recommendations for how much capacity to procure in the 2014 Capacity Market auction. Simon Moore, Infrastructure Policy Manager at Citizens Advice, told us:

The Panel of Technical Experts raised some questions about how National Grid had come to certain conclusions when it was preparing its report on

77 Energy and Climate Change Committee, First Report of Session 2012-2013, [Draft Energy Bill: Pre-legislative Scrutiny](#), HC 271-I, para 198

78 Citizens Advice ([IEM 005](#)) para 3, 5

79 Q69 [Andrew Buglass], Q138 [Sara Vaughan]

80 Department of Energy and Climate Change, ['Interconnectors to participate in the Capacity Market from 2015'](#), accessed 3 February 2015

81 Q109 [Sara Vaughan, Rupert Steele]

82 Q137 [Sara Vaughan], Q153 [Rupert Steele]

83 E.ON ([IEM 017](#)) para 23

how much capacity DECC should procure. My concern is that the issues that were raised were not well responded to, either by DECC or by National Grid, in a particularly public or clear fashion.⁸⁴

Professor David Newbery, Emeritus Professor at the University of Cambridge and member of the Panel of Technical Experts, expressed his view that the decision on how much capacity to procure had been “overhasty” and may have been better informed by waiting “to see how we get through this winter, what was the demand-side response and how we are going to deal with the interconnectors”.⁸⁵

30. Mark Ripley accepted that load connection to the network adds to National Grid’s asset base⁸⁶ but he defended the analysis underpinning the capacity procurement recommendation, stating that the company was not “incentivised on that”.⁸⁷ He added that there had been a “regular dialogue” with the PTE.⁸⁸ The Minister explained the difference between National Grid’s execution role, and the policy decisions that remain in the hands of the Government.⁸⁹ He emphasised this difference in relation to the role of interconnectors within the Capacity Market:

We will decide the policy framework within which interconnectors operate, along with Ofgem, who have a very important role. Grid have their statutory responsibilities in terms of connection, but the policy decisions will be taken by us and Ofgem.⁹⁰

31. Ofgem, as regulator of the electricity market, is responsible for overseeing the performance of National Grid in its EMR delivery functions.⁹¹ It will publish an annual report showing how well National Grid has performed, and where appropriate provide assessments in relation to key performance indicators.

32. Despite National Grid’s delivery functions being set out in secondary legislation and enforceable by Ofgem,⁹² we have heard that there is confusion and concern about how it will be held accountable in practice.⁹³ Mark Ripley explained that Ofgem had put in place “some operational incentives” and that National Grid was “subject to the same level of scrutiny from Ofgem in our EMR duties as we have for all of our other licensed duties, which is a well-known and established framework”.⁹⁴ He added that National Grid had “a long history” of managing the potential conflict of interest between their core regulated businesses and their non-regulated businesses, and that risks were “well mitigated by both

84 Q69 [Simon Moore]

85 Q68 [Professor David Newbery]

86 Q228 [Mark Ripley]

87 Q216 [Mark Ripley]

88 Q219 [Mark Ripley]

89 Qq246,248 [Rt Hon Matthew Hancock]

90 Q291 [Rt Hon Matthew Hancock]

91 Ofgem ([IEM 006](#))

92 Department of Energy and Climate Change ([IEM 023](#)) para 52

93 RenewableUK ([IEM 040](#)) para 15, Q109 [Chris Elder]

94 Q175 [Mark Ripley]

the arrangements [they] have in place as an organisation and the design of the qualification and auction process”.⁹⁵ Dermot Nolan, CEO of Ofgem, told us that he would like Ofgem to be “very centrally involved” in DECC’s review of EMR in the summer.⁹⁶

33. We remain concerned about potential conflicts of interest between National Grid’s executive and advisory role within EMR, and its commercial incentives—particularly given the move to include interconnectors in future Capacity Market auctions. The Panel of Technical Experts (PTE) and Ofgem have important roles in holding National Grid to account.

34. The questions raised by the PTE in its scrutiny of National Grid must be responded to publicly so that there is a clear line of sight between National Grid’s original analysis, scrutiny by the PTE, and subsequent policy decisions by DECC and Ofgem. We recommend that DECC’s upcoming review of EMR should include a point-by-point response to the issues raised by the PTE. The review should look again at how conflicts of interest are dealt with. We also expect DECC to set out what steps will be taken to ensure that National Grid does not have an unfair commercial advantage when interconnectors participate in future Capacity Market auctions.

Demand-side response

35. Demand-side response (DSR) could provide an important contribution to managing security of supply and cutting energy consumption. It offers a cheaper and greener alternative to building new generating capacity and could make a meaningful contribution towards security of supply.

36. There remains some lack of clarity as to the exact definition of what technologies are considered by DECC to be included within demand-side response measures. For example, back-up diesel generation is in our view not genuine demand reduction but localised generation. While Mark Ripley, from National Grid, categorically stated that diesel farms were not included in the definition,⁹⁷ the Minister acknowledged that “demand-side response is defined in the system as reduction in demand from behind the point of the consumer’s connection. It is hard for the Grid to be able to differentiate between different types”.⁹⁸ Baroness Verma also wrote to us that:

Demand-side response (DSR) is the active voluntary reduction in the amount of electricity a user is taking from the grid at a given moment in time. This can be achieved through the use of on-site (back-up) generators; shifting a business operation to another time of day; or reducing demand by switching off or turning down electricity use. [...]

95 Q217 [Mark Ripley]

96 Oral evidence taken on [27 January 2015](#), Q14 [Dermot Nolan]

97 Q226 [Mark Ripley]

98 Q295 [Rt Hon Matthew Hancock]

These providers—whether generation or load reduction services—can be referred to as “demand side” providers.⁹⁹

37. We recommend that the definition of demand-side response should exclude consumers turning on their own generation assets such as diesel generators. This agreed definition should be consistently and immediately applied by DECC, Ofgem and National Grid.

38. We have regularly outlined our concerns about the unfair treatment of DSR in the Capacity Market,¹⁰⁰ and contributors to this inquiry outlined similar concerns that demand-side response had not received sufficient attention and was disadvantaged compared to generation capacity.¹⁰¹ In particular, DSR providers can only bid for one-year contracts, whereas new generation can receive capacity agreements of up to 15 years.¹⁰² Tilting the playing field against a nascent technology like DSR is exactly the opposite of the approach usually followed by DECC.

39. The restriction of DSR contracts to one-year was described as a clear barrier to the development of the industry, as the timeframe is simply not long enough to incentivise businesses to change their practices.¹⁰³ Citizens Advice explained that the current approach ran the risk of locking Britain into long-term contracts with new-build power stations that may not be needed and that “some DSR may be blocked from coming forward, even if it turns out cheaper on a year-by-year basis”.¹⁰⁴ Evidence from markets in other countries, where equal contract lengths are awarded to both generation and demand capacity, suggests that DSR can make significant contributions, without being at the expense of new generation.¹⁰⁵ Sara Bell, CEO of Tempus Energy, explained that:

To ask different resources to compete on uneven grounds does not make a level playing field. The reason why the contract length is the same in other markets is to create that level playing field. Demand-side customers, when they become flexible, need technology. They need to make that investment but, much more importantly, they need to, as a company, buy into the value of being flexible.¹⁰⁶

40. Less than 0.4% of the capacity procured in the 2014 auction was awarded to DSR.¹⁰⁷ DECC expects DSR to primarily bid into the first one-year-ahead Capacity Market auction

99 [Letter from Baroness Verma to the Energy and Climate Change Select Committee](#) (January 2015)

100 [Letter from the Energy and Climate Change Committee to the Rt Hon Matthew Hancock MP](#) (September 2014), Energy and Climate Change Committee, First Report of Session 2012-2013, [Draft Energy Bill: Pre-legislative Scrutiny](#), HC 271-I, para 50, Energy and Climate Change Committee, Fourth Report of Session 2010-2012, HC 742, [Electricity Market Reform](#), para 59

101 Citizens Advice ([IEM 005](#)) para 18, Tempus Energy ([IEM 015](#)) para 22, Q122 [Sara Vaughan], Q146 [Sara Bell]

102 Department of Energy and Climate Change, [Implementing Electricity Market Reform \(EMR\)](#) (June 2014), p 103, Citizens Advice ([IEM 005](#)) para 18, Tempus Energy ([IEM 015](#)) para 22

103 Q122 [Jeremy Nicholson], Q146 [Sara Bell]

104 Citizens Advice ([IEM 005](#)) para 18

105 Q90 [Professor David Newbery], Q141 [Sara Bell]

106 Q146 [Sara Bell]

107 National Grid, [Final Auction Results](#) (January 2015) p 7

in 2017, for which a small amount of capacity has provisionally been set aside.¹⁰⁸ However, concerns were raised that the capacity procured during the 2017 auction runs the risk of being reduced in the event that it transpires that too much capacity was procured in December 2014.¹⁰⁹ Professor Newbery warned that:

We might then find that because we have procured so much, there is not much space left and the price at which we could have got [capacity] will be substantially lower. Then we will say, “What a pity. It would have been a good idea to wait until we got these cheaper options on the table”.¹¹⁰

Jonathan Mills, Director of EMR at DECC, acknowledged that the amount of capacity to be procured in the 2017 auction could be reduced:

I think the main way in which we are managing the risks of procuring too much or too little are the T-1 auction. We have not bought everything that National Grid say they think we will need in the delivery year at this stage. We left some open to be bought in T-1. Should we find that demand forecasts have lowered or there is more other plant on the system outside the capacity market, then we have the option of reducing the amount that we procure at that stage.¹¹¹

41. While acknowledging the cost-reduction potential of demand-side reduction and being “pleased to see that there was some demand-side reduction successful in the auction,” the Minister warned that “we have to be very careful what we mean by demand-side reduction, because often it is localised generation that is not in major plant”.¹¹² He added that DECC “had extensive discussions with the DSR fraternity” and that “some of the concerns that they had will be part of the review over the summer”.¹¹³

42. DECC is still failing to ensure that demand-side response (DSR) measures are on a level playing field in the Capacity Market. If we do not invest in DSR today, we may be forced to pay for more expensive generation capacity that we do not need in the future, thereby locking ourselves into a pattern of higher costs and, potentially, higher emissions.

43. We recommend that DECC’s review of EMR makes it easier for DSR to have a much bigger role in future Capacity Market auctions. DECC should consider increasing the contract length of DSR capacity agreements in the next Capacity Market auction. We also recommend that DECC set out a more detailed strategy on how to help the DSR market grow to reach its full potential, in line with its proclaimed approach of supporting early stage technologies.

108 Department of Energy and Climate Change ([IEM 023](#)) para 48

109 Citizens Advice ([IEM 005](#))

110 Q87 [David Newbery]

111 Q301 [Jonathan Mills]

112 Q289 [Rt Hon Matthew Hancock]

113 Q289 [Rt Hon Matthew Hancock]

4 Providing a clear, coherent and forward-looking policy

EMR: A cohesive package?

44. The Government stated that its vision for EMR was “to transform the electricity system to ensure it provided secure, affordable and low carbon energy”,¹¹⁴ with retired capacity to be replaced “with a cleaner mix of generation to help us meet our climate change and renewables targets and lay the pathway to a greener, more sustainable future”.¹¹⁵ One of EMR’s key objectives is to promote “investment in secure and low carbon electricity generation”.¹¹⁶

45. There is a risk that EMR as it is currently developing will see its different strands pursuing competing aims rather than complementing each other. The Capacity Market, which “supports fossil fuel generation regardless of carbon emissions or plant efficiency”,¹¹⁷ risks locking us into a higher carbon and more expensive trajectory than needed, and failing to address the low-carbon objective of the overall EMR framework.¹¹⁸ Simon Moore, from Citizens Advice, explained that:

We have seen it with the treatment of demand-side response and interconnection in the capacity market. I would also say we have seen it with things like the way CCS [Carbon capture and storage] has broadly been left outside the entire EMR package. These examples are things that were not seen as being inherently the focus of EMR so have been left behind. That potentially leads to a concern for the bill payer if these are things that could offer a more cost-effective solution to some of the problems that EMR is attempting to tackle but are not being incorporated into it.¹¹⁹

Sara Bell, CEO of Tempus Energy, warned that “the two parts of EMR have not been looked at holistically”.¹²⁰ Similarly, Dr Skorupska’s concern was that:

Most Capacity Market participation of the plants will be at part-load or at lowest capacity, at the lowest efficiency of that plant. Therefore, in a way, we are driving a market through CfDs to introduce renewable energy and then securing the Capacity Market mechanism, which locks in a high carbon future.¹²¹

114 Department of Energy and Climate Change, [Implementing Electricity Market Reform \(EMR\)](#) (June 2014), p 7

115 Department of Energy and Climate Change, [Implementing Electricity Market Reform \(EMR\)](#) (June 2014), p 7

116 Department of Energy and Climate Change, [Implementing Electricity Market Reform \(EMR\)](#) (June 2014), p 9

117 Renewable Energy Association ([IEM 024](#))

118 Q41 [Dr Nina Skorupska and Leonie Greene]

119 Q67 [Simon Moore]

120 Q108 [Sara Bell]

121 Q41 [Dr Nina Skorupska]

46. A number of participants maintained that a diverse mix of technologies was needed¹²² to achieve reliable and affordable electricity while meeting our decarbonisation targets. However, over 80% of the 49.3 GW of successful capacity in the 2014 Capacity Market auction was existing generating capacity, with coal plants making up nearly a fifth of the total.¹²³ While EMR was designed to replace the ageing generation plants and bring forward investment, only one new-build gas power station was successful in the auction. Mark Ripley, from National Grid, acknowledged that:

We haven't seen a huge amount of new build in the [2014] auction. I think that reflects the fleet we have. I would imagine as you get into the 2020s, when some of the coal plant that is on an [Industrial Emissions Directive]¹²⁴ exemption closes, you would see more capacity being built.¹²⁵

The Minister stated that he was “very happy with the outcome”,¹²⁶ of the first Capacity Market auction, which he considered had “been fair across technologies”¹²⁷ and produced “a good balance between supporting existing generation, supporting refurbishment and supporting new build”.¹²⁸ The clearing price of £19.40 per kW per year, he said, was “cheaper than we anticipated” and provided “good value for bill payers”.¹²⁹ National Grid estimated the total forecast cost of Capacity Agreements awarded to be nearly £1 billion.¹³⁰

47. However, with only 5% of capacity being new-build and less than 0.4% going to DSR, the “good balance” is questionable. Similarly, while the clearing price was cheaper than could have been expected had more new gas-fired power stations been successful, much of the successful existing capacity bid at much lower prices than this,¹³¹ but will receive the higher clearing price for their capacity—leading to the question: Are we just paying existing generators to do what they would normally have done anyway?

48. One reason for introducing the Capacity Mechanism is that as renewables - particularly wind - grow to provide a significant share of capacity it will be essential to provide back-up capacity which can be speedily ramped up when there are lulls in the wind. Evidence submitted to the Committee suggests that using generators not designed for this purpose will be costly in fuel and maintenance, have high carbon emissions and will shorten plant life considerably.¹³² It is therefore surprising that the auction mechanism did not seek to elicit capacity specifically designed for speedy, efficient and sustainable back up.

122 Q43 [Paul Spence]. Q45 [Dr Nina Skorupska], Q124 [Sara Vaughan]

123 National Grid, [Final Auction Results](#) (January 2015) p 7

124 The Industrial Emissions Directive (IED) commits EU member states to reduce the impact of industrial emissions on the environment.

125 Q235 [Mark Ripley]

126 Q242 [Rt Hon Matthew Hancock]

127 Q287 [Rt Hon Matthew Hancock]

128 Q242 [Rt Hon Matthew Hancock]

129 Q242 [Rt Hon Matthew Hancock]

130 National Grid, [Final Auction Results](#) (January 2015) p 3

131 National Grid, [Final Auction Results](#) (January 2015) p 4

132 Stag Energy ([IEM 003](#)), Q158 [Jeremy Nicholson]

49. While EMR was designed to bring forward investment in the electricity infrastructure and replace the UK's existing generation plants with lower carbon alternatives, there is a risk that the current design of the Capacity Market could result in a failure to meet these policy objectives. A diversity of sources is clearly needed, but Contracts-for-Difference and the recent Capacity Market results are in danger of pulling it in opposite directions.

50. *We recommend that the Government clarifies its ambitions for the future of coal-fired power stations in the Capacity Market and its expectations for both new plant and DSR in the second four-year-ahead Capacity Market auction in 2015. The Government's review of EMR should include a cost-benefit analysis of the 2014 Capacity Market auction in terms of balancing low clearing prices with long-term objectives to provide secure, affordable low-carbon energy.*

Greater visibility for investors

51. EMR is an important transformation of the current energy market framework, and short consultation periods and fast decisions have created a degree of investor uncertainty. The Independent Renewable Energy Generators Group (IREGG) explained that “frequent policy reversals make it almost impossible for the needed infrastructure investments to be sensibly deployed”.¹³³

The Levy Control Framework up to 2021

52. The Levy Control Framework (LCF) is the means by which the Government controls the expenditure paid for by households through higher energy bills or industry passing on its higher energy costs. The Government estimates that “the Levy Control Framework (LCF) is likely to support enough renewable capacity to achieve at least 30% of electricity generation from renewable sources” by 2020-21.¹³⁴

53. CfDs are to be paid for through the Levy Control Framework. As the price of CfDs will depend on the difference between the agreed strike price and the market electricity wholesale price, an important factor in determining the low-carbon buying power of the LCF will be future wholesale electricity prices. If wholesale prices fall, the cost for each CfD will rise, therefore increasing the burden on the LCF. This interaction between CfDs and the LCF creates allocation risks for investors. Additionally, the LCF is also used to fund the Renewable Obligation (RO) and small-scale Feed-in Tariffs (FiTs), so the budget available for CfDs will vary depending on the extent of other LCF expenditure.¹³⁵ WWF expressed their concern that “the vast bulk of the Levy Control Framework budget will be taken up by existing schemes [...] with only a comparatively small amount available under the enduring EMR regime”.¹³⁶ Statkraft, a Norwegian state-owned electricity company and

133 IREGG ([IEM 036](#))

134 Department of Energy and Climate Change ([IEM 023](#)) para 13

135 Scottish Renewables ([IEM 016](#)) para 7.1, Vattenfall ([IEM 032](#)), Independent Renewable Energy Generators Group ([IEM 036](#)), RenewableUK ([IEM 040](#)) para 30, 32, Statkraft ([IEM 045](#)) para 1.9

136 WWF ([IEM 031](#)) para 20

generator of renewable energy, called for more frequent updates on the resources available under the LCF, and suggested that the Government should:

set out the remaining budget available for future CfD allocation and [...] include revised commodity price assumptions underpinning the existing and projected costs of CfDs. Developers could then determine their competitive position and engagement strategy for future CfD allocation rounds and diminish the risk of poor transparency, resulting in attrition of the development pipeline.¹³⁷

Infinis, an independent renewable energy developer and generator, told us in October 2014 that:

The lack of a firm timetable for future [CfD] auctions is preventing us from planning our investment effectively. Currently there is very little commitment to any auctions beyond the first auction in October 2014 and as a result it is placing unnecessary pressure on companies to either drop projects or attempt to expedite them into the current allocation round.¹³⁸

54. Some stakeholders were also worried that a vast proportion of the LCF had been committed to the “Final Investment Decision enabling for Renewables” (FIDeR) projects.¹³⁹ FIDeR was designed to enable developers of low carbon electricity projects to take final investment decisions ahead of the Contract for Difference regime being put in place as part of Electricity Market Reform, with eight projects signed in May 2014. According to the National Audit Office, the FIDeR contracts have committed up to £16.6 billion (58%) of the funds available for renewable CfDs to 2020–21.¹⁴⁰ While Danielle Lane, from DONG Energy, explained that these projects had successfully allowed investors and developers to manage the transition to the new market,¹⁴¹ others judged that the decision of which projects would be awarded these funds was conducted in an opaque manner.¹⁴²

55. Mark Ripley, Director of Regulation at National Grid, told us that:

One of the things DECC has done in setting the Levy Control Framework is it can be reviewed. There is the scope for additional moneys. What I would say is that we need to see how things play out. We have not paid out any CfDs yet. We are trying to think what prices will be at some point in the future. But some of the sensitivities we modelled when we were providing evidence to DECC about strike prices were high and low wholesale price, to see whether, scenario-wise, you got to 2020 within the 7.6 billion. That has

137 Statkraft ([IEM 045](#)) para 1.10

138 Infinis plc ([IEM 035](#))

139 WWF ([IEM 031](#)) para 21, Q11 [Dr Nina Skorupska]

140 National Audit Office, [Early contracts for renewable electricity](#) (June 2014) p 7

141 Q6 [Danielle Lane]

142 Q11 [Dr Nina Skorupska]

formed part of the analysis. On an annual basis, that analysis will be reviewed to provide information that Government is able to make decisions upon.¹⁴³

56. The Levy Control Framework (LCF) finances existing (RO and FiTs), transitional (FIDeR) and new low carbon projects (CfDs). The scope for support of new renewable generation under the CfDs is therefore dependent on the cost of a number of existing commitments. There is a risk that such a large proportion of the LCF is already allocated to the early contracts for renewables, including an excessive proportion of very expensive offshore wind capacity, that it has pre-empted better value-for-money in the latter years of the LCF, when other technologies may have developed and their costs reduced. The uncertainty in future wholesale prices and corresponding uncertainty in the buying power of the LCF create a difficult landscape for investors. More clarity and visibility of the funds available for CfD projects is crucial to bring forward investment.

57. We recommend that DECC sets out what its intentions are across a range of potential future wholesale prices. DECC should commit to publishing more frequent updates of the funds left in the current LCF envelope and clarify rapidly what the timetable and budget of future CfD allocation rounds will be.

On the road to 2030

58. With investment decisions having to be made years in advance of delivery, industry and the supply chain need visibility beyond 2020. DONG Energy told us that offshore wind projects have a lead time of up to ten years, and “projects [...] being considered today would plan to be delivered after the end of the decade”.¹⁴⁴ Dr Nina Skorupska, from the REA, told us that with the current Levy Control Framework expiring in 2020-21, “we do not know what is going to happen post-2020 at this moment in time”.¹⁴⁵ Urgent consideration therefore needs to be given to the future of the LCF in the next decade.¹⁴⁶ Paul Spence, Director of Strategy and Corporate Affairs at EDF Energy, explained that:

The two things that are desirable under EMR are that it provides a clear framework and it provides some predictability that allows investment to happen. The questions that face all of us, whatever technologies we are developing at the moment, are all about what happens as we go into the 2020s and towards 2030. Having a sense of how the categories are going to be defined and a sense of how much is available in each of those categories will help us as we look at the potential projects that we need to develop. So having that sense of where this goes beyond 2020 and out beyond 2030 will only be helpful.¹⁴⁷

143 Q240 [Mark Ripley]

144 DONG Energy ([IEM 022](#)) para 5.3

145 Q53 [Dr Nina Skorupska]

146 Horizon Nuclear Power ([IEM 009](#)), Scottish Renewables ([IEM 016](#)) para 7.2, Vattenfall ([IEM 032](#)), Statkraft ([IEM 045](#)) para 1.10

147 Q13 [Paul Spence]

Andrew Buglass, former Head of Energy, Royal Bank of Scotland, and Co-Chair of Low Carbon Finance Group, added that visibility to 2020 “is not enough”¹⁴⁸ for investors:

I had one offshore developer say to me a little while ago that 2020 is almost tomorrow already because of the lead times. [...] As we look to industrialise the build-out of the various technologies, it is increasingly challenging for companies trying to bring forward projects that need to have visibility beyond that 2020 to know where they will end up. It was very interesting to hear a couple of the comments in the previous session about the sheer volume of developments costs involved before one can even know that one has a CfD. That is certainly consistent with comments that I have had from clients and fellow members of the Low Carbon Finance Group.¹⁴⁹

59. The Secretary of State suggested that it “would not be wise”¹⁵⁰ to provide information on the future of the LCF before the general election. He added that “investors in the UK have greater long-term visibility on this issue than they do in any other country in the world”,¹⁵¹ and could “take quite a lot of confidence that this Government and this country sets long-term frameworks and has long-term targets, probably more so than almost any other country”.¹⁵² He added that “the next government is going to have to have another Levy Control Framework to support those legally binding targets on us both from the Climate Change Act and from European agreements”.¹⁵³

60. If EMR is to become a successful and enduring policy that brings forward the investment in the electricity infrastructure that is needed to ensure a secure, affordable and low carbon energy to Britain, more clarity is needed beyond the life of the current Levy Control Framework.

61. We recommend that the Government clarifies the future of the LCF beyond 2020-21 as soon as possible after the General Election. Rolling forward projections of LCF funds should be published annually thereafter, so that investors are always able to look at least seven years ahead to make their investment decisions. The Government should also clarify its intentions in the event that the Levy Control Framework total is exceeded because gas prices remain much lower than previously anticipated.

148 Q79 [Andrew Buglass]

149 Q79 [Andrew Buglass]

150 Oral evidence taken on [21 January 2015](#), Q16 [Rt Hon Edward Davey]

151 Oral evidence taken on [21 January 2015](#), Q17 [Rt Hon Edward Davey]

152 Oral evidence taken on [21 January 2015](#), Q17 [Rt Hon Edward Davey]

153 Oral evidence taken on [21 January 2015](#), Q17 [Rt Hon Edward Davey]

5 Conclusions

62. Despite a challenging timetable, the Government has succeeded in putting in place a robust framework for the reform of the electricity market. The implementation of EMR through its first year has been relatively smooth. It is perhaps inevitable that some hurdles would arise when introducing a new and complex set of policies, and DECC, National Grid and the LCCC have done a good job in working to anticipate industry's concerns and helping participants prepare for the new regime.

63. Despite this smooth start, some key concerns remain. In particular, the Capacity Mechanism has committed taxpayers to annual payments of nearly £1 billion, only 5% of which will provide new capacity and just 0.4% going on Demand-side reduction—the rest going to existing, largely coal fired power stations, possibly paying them to do what they would normally have done anyway. Potential conflicts of interest, notably around the role of National Grid with the inclusion of interconnectors, must be addressed. It is also imperative, as we have previously called for, that EMR provides a level playing field for demand-side response. Addressing these concerns will help to ensure that future stages of EMR provides value-for-money for consumers.

64. If the EMR regime is to achieve its aim of creating a lasting secure, affordable and low-carbon energy landscape, it must provide a clear landscape for investors and participants. Long-term policy stability and clarity around funds available under the Levy Control Framework will be crucial in achieving its targets.

Conclusions and recommendations

Meeting the timetable

1. We commend DECC for maintaining the ambitious timetable of EMR implementation and ensuring that the necessary framework was put in place in the lead up to the first Capacity Market auction and CfD allocation round. (Paragraph 16)

Reviewing the first year of EMR

2. We welcome the efforts by DECC, National Grid and the Low Carbon Contracts Company to help prepare industry in the run-up to the first Capacity Market and CfD auctions. However, the complexity of the policies and the speed at which participants have had to assimilate information have made it a challenging environment for smaller companies. A robust review of the auctions is clearly needed and lessons learned must be acted upon ahead of the next round of EMR delivery. We are worried that the timing of the review means that it risks taking place too close to the opening of the second CfD allocation round and Capacity Market auction. This may mean that industry concerns—particularly the concerns of small companies—are not addressed. (Paragraph 24)
3. We recommend that DECC ensure its review of the first round of CfD allocation and first Capacity Market auction is concluded by the end of August 2015. The review should detail lessons learned from each step of the CfD allocation and Capacity Market auction outlined by DECC, and assess the extent to which the 2014 rounds contribute to the objectives of EMR. In conducting the review, DECC should particularly look at how engagement with small players can be improved. The review should also include an assessment of the pros and cons of running more frequent CfD auctions. (Paragraph 25)

The role of National Grid

4. We remain concerned about potential conflicts of interest between National Grid's executive and advisory role within EMR, and its commercial incentives—particularly given the move to include interconnectors in future Capacity Market auctions. The Panel of Technical Experts (PTE) and Ofgem have important roles in holding National Grid to account. (Paragraph 33)
5. The questions raised by the PTE in its scrutiny of National Grid must be responded to publicly so that there is a clear line of sight between National Grid's original analysis, scrutiny by the PTE, and subsequent policy decisions by DECC and Ofgem. We recommend that DECC's upcoming review of EMR should include a point-by-point response to the issues raised by the PTE. The review should look again at how conflicts of interest are dealt with. We also expect DECC to set out what steps will be taken to ensure that National Grid does not have an unfair commercial advantage when interconnectors participate in future Capacity Market auctions. (Paragraph 34)

Demand-side response

6. We recommend that the definition of demand-side response should exclude consumers turning on their own generation assets such as diesel generators. This agreed definition should be consistently and immediately applied by DECC, Ofgem and National Grid. (Paragraph 37)
7. DECC is still failing to ensure that demand-side response (DSR) measures are on a level playing field in the Capacity Market. If we do not invest in DSR today, we may be forced to pay for more expensive generation capacity that we do not need in the future, thereby locking ourselves into a pattern of higher costs and, potentially, higher emissions. (Paragraph 42)
8. We recommend that DECC's review of EMR makes it easier for DSR to have a much bigger role in future Capacity Market auctions. DECC should consider increasing the contract length of DSR capacity agreements in the next Capacity Market auction. We also recommend that DECC set out a more detailed strategy on how to help the DSR market grow to reach its full potential, in line with its proclaimed approach of supporting early stage technologies. (Paragraph 43)

EMR: A cohesive package?

9. While EMR was designed to bring forward investment in the electricity infrastructure and replace the UK's existing generation plants with lower carbon alternatives, there is a risk that the current design of the Capacity Market could result in a failure to meet these policy objectives. A diversity of sources is clearly needed, but Contracts-for-Difference and the recent Capacity Market results are in danger of pulling it in opposite directions. (Paragraph 49)
10. We recommend that the Government clarifies its ambitions for the future of coal-fired power stations in the Capacity Market and its expectations for both new plant and DSR in the second four-year-ahead Capacity Market auction in 2015. The Government's review of EMR should include a cost-benefit analysis of the 2014 Capacity Market auction in terms of balancing low clearing prices with long-term objectives to provide secure, affordable low-carbon energy. (Paragraph 50)

Greater visibility for investors

11. The Levy Control Framework (LCF) finances existing (RO and FiTs), transitional (FIDeR) and new low carbon projects (CfDs). The scope for support of new renewable generation under the CfDs is therefore dependent on the cost of a number of existing commitments. There is a risk that such a large proportion of the LCF is already allocated to the early contracts for renewables, including an excessive proportion of very expensive offshore wind capacity, that it has pre-empted better value-for-money in the latter years of the LCF, when other technologies may have developed and their costs reduced. The uncertainty in future wholesale prices and corresponding uncertainty in the buying power of the LCF create a difficult landscape for investors. More clarity and visibility of the funds available for CfD projects is crucial to bring forward investment. (Paragraph 56)

12. We recommend that DECC sets out what its intentions are across a range of potential future wholesale prices. DECC should commit to publishing more frequent updates of the funds left in the current LCF envelope and clarify rapidly what the timetable and budget of future CfD allocation rounds will be. (Paragraph 57)
13. If EMR is to become a successful and enduring policy that brings forward the investment in the electricity infrastructure that is needed to ensure a secure, affordable and low carbon energy to Britain, more clarity is needed beyond the life of the current Levy Control Framework. (Paragraph 60)
14. We recommend that the Government clarifies the future of the LCF beyond 2020-21 as soon as possible after the General Election. Rolling forward projections of LCF funds should be published annually thereafter, so that investors are always able to look at least seven years ahead to make their investment decisions. The Government should also clarify its intentions in the event that the Levy Control Framework total is exceeded because gas prices remain much lower than previously anticipated. (Paragraph 61)

Conclusions

15. Despite a challenging timetable, the Government has succeeded in putting in place a robust framework for the reform of the electricity market. The implementation of EMR through its first year has been relatively smooth. It is perhaps inevitable that some hurdles would arise when introducing a new and complex set of policies, and DECC, National Grid and the LCCC have done a good job in working to anticipate industry's concerns and helping participants prepare for the new regime. (Paragraph 62)
16. Despite this smooth start, some key concerns remain. In particular, the Capacity Mechanism has committed taxpayers to annual payments of nearly £1 billion, only 5% of which will provide new capacity and just 0.4% going on Demand-side reduction—the rest going to existing, largely coal fired power stations, possibly paying them to do what they would normally have done anyway. Potential conflicts of interest, notably around the role of National Grid with the inclusion of interconnectors, must be addressed. It is also imperative, as we have previously called for, that EMR provides a level playing field for demand-side response. Addressing these concerns will help to ensure that future stages of EMR provides value-for-money for consumers. (Paragraph 63)
17. If the EMR regime is to achieve its aim of creating a lasting secure, affordable and low-carbon energy landscape, it must provide a clear landscape for investors and participants. Long-term policy stability and clarity around funds available under the Levy Control Framework will be crucial in achieving its targets. (Paragraph 64)

Formal Minutes

Tuesday 24 February 2015

Members present:

Mr Tim Yeo, in the Chair

Dan Byles
Ian Lavery
Mr Peter Lilley
Christopher Pincher

John Robertson
Sir Robert Smith
Graham Stringer
Dr Alan Whitehead

The following declarations of interest relating to the inquiry were made:

18 November 2014, 9 December 2014, 13 January 2015 and 24 February 2015

Sir Robert Smith declared interests, as listed in the Register of Members' Interests, in the oil and gas industry, in particular a shareholding in Shell Transport and Trading (oil integrated).

Mr Tim Yeo declared interests, as listed in the Register of Members' Interests, in particular as unpaid president of the Renewable Energy Association, interests in the nuclear industry, and interests in Eurotunnel as a non-executive director and shareholder.

Draft Report (*Implementation of Electricity Market Reform*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 64 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Eighth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Tuesday 3 March at 9.15 am

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the Committee's inquiry page at www.parliament.uk/ecc.

Tuesday 18 November 2014

Question number

Danielle Lane, Head of UK Regulatory Affairs, DONG Energy, **Dr Nina Skorupska**, Chief Executive, Renewable Energy Association, **Leonie Greene**, External Relations, Solar Trade Association, and **Paul Spence**, Director of Strategy and Corporate Affairs, EDF Energy

[Q1-66](#)

Simon Moore, Infrastructure Policy Manager, Citizens Advice, **Professor David Newbery**, University of Cambridge, and **Andrew Buglass**, Managing Director, Head of Energy, Royal Bank of Scotland and co-Chair of Low Carbon Finance Group

[Q67-107](#)

Tuesday 9 December 2014

Chris Elder, Director, Energy Markets Group, InterGen, **Sara Vaughan**, Director of Strategy and Regulation, E.ON, **Rupert Steele**, Director of Regulation, ScottishPower, **Sara Bell**, Chief Executive, Tempus Energy, and **Jeremy Nicholson**, Director, Energy Intensive Users Group

[Q108-171](#)

Tuesday 13 January 2015

Mark Ripley, Director of Regulation, National Grid, and **Neil McDermott**, CEO, Low Carbon Contracts Company

[Q172-241](#)

Rt Hon Matthew Hancock MP, Minister of State and **Jonathan Mills**, Director of Electricity Market Reform, Department of Energy and Climate Change

[Q242-310](#)

Published written evidence

The following written evidence was received and can be viewed on the Committee's inquiry web page at www.parliament.uk/ecc. IEM numbers are generated by the evidence processing system and so may not be complete.

- 1 Alex Henney ([IEM0004](#))
- 2 Barrie Skelcher ([IEM0001](#))
- 3 Bellenden (sent on behalf of IREGG) ([IEM0036](#))
- 4 CHPA ([IEM0039](#))
- 5 Citizens Advice ([IEM0005](#))
- 6 Department of Energy and Climate Change ([IEM0023](#))
- 7 DONG Energy ([IEM0022](#))
- 8 E.ON ([IEM0017](#))
- 9 EDF Energy ([IEM0021](#))
- 10 Electricity Settlements Company ([IEM0044](#))
- 11 Elexon Limited ([IEM0013](#))
- 12 Energy UK ([IEM0020](#))
- 13 Greenpeace UK ([IEM0043](#))
- 14 Horizon Nuclear Power ([IEM0009](#))
- 15 Infinis plc ([IEM0035](#))
- 16 Institution Of Civil Engineers ([IEM0034](#))
- 17 InterGen ([IEM0018](#))
- 18 Lark Energy ([IEM0011](#))
- 19 Low Carbon Contracts Company ([IEM0037](#))
- 20 Low Carbon Ltd ([IEM0014](#))
- 21 Mineral Products Association ([IEM0012](#))
- 22 National Grid ([IEM0041](#))
- 23 Ofgem ([IEM0006](#))
- 24 REA ([IEM0024](#)); ([IEM0026](#))
- 25 RenewableUK ([IEM0040](#))
- 26 RWE ([IEM0010](#))
- 27 Scottish Renewables ([IEM0016](#))
- 28 ScottishPower ([IEM0038](#))
- 29 Solar Trade Association ([IEM0008](#))
- 30 Stag Energy ([IEM0003](#))
- 31 Statkraft UK Ltd. ([IEM0045](#))
- 32 Tempus Energy Limited ([IEM0015](#))
- 33 TGC Renewables ([IEM0007](#))
- 34 The Carbon Capture & Storage Association ([IEM0042](#))
- 35 UK Demand Response Association ([IEM0025](#))
- 36 Vattenfall ([IEM0032](#))
- 37 VPI Immingham ([IEM0028](#))
- 38 Which? ([IEM0030](#))
- 39 WWF-UK ([IEM0031](#))

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the Committee's website at www.parliament.uk/ecc.

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2010-12

First Report	Emissions Performance Standards	HC 523 (807)
Second Report	UK Deepwater Drilling—Implications of the Gulf of Mexico Oil Spill	HC 450 (882)
Third Report	The revised draft National Policy Statements on energy	HC 648
Fourth Report	Electricity Market Reform	HC 742 (HC 1448)
Fifth Report	Shale Gas	HC 795 (HC 1449)
Sixth Report	Ofgem's Retail Market Review	HC 1046 (HC 1544)
Seventh Report	A European Supergrid	HC 1040 (HC 1684)
Eighth Report	The UK's Energy Supply: Security or Independence?	HC 1065 (HC 1813)
Ninth Report	Solar Power Feed-In Tariffs	HC 1605 (HC 1815)
Tenth Report	The EU Emissions Trading System	HC 1476
Eleventh Report	The Future of Marine Renewables in the UK	HC 1624
Twelfth Report	Consumption-Based Emissions Reporting	HC 1646
First Special Report	Low carbon technologies in a green economy: Government Response to the Committee's Fourth Report of Session 2009–10	HC 455
Second Special Report	Fuel Poverty: Government Response to the Committee's Fifth Report of Session 2009–10	HC 541
Third Special Report	The future of Britain's electricity networks: Government Response to the Committee's Second Report of Session 2009–10	HC 629

Session 2012–13

First Special Report	The Future of Marine Renewables in the UK: Government Response to the Committee's Eleventh Report of Session 2010–12	HC 93
First Report	Draft Energy Bill: Pre-legislative Scrutiny	HC 275
Second Report	The road to UNFCCC COP 18 and beyond	HC 88 (HC 633)
Second Special Report	Consumption-Based Emissions Reporting: Government Response to the Committee's Twelfth Report of Session 2010–12	HC 488

Third Report	Low-Carbon Growth Links with China	HC 529 (HC 748)
Fourth Report	Pre-appointment hearing with the Government's preferred candidate for Chair of the Committee on Climate Change	HC 555
Fifth Report	Consumer Engagement with Energy Markets	HC 554 (HC 1036)
Sixth Report	Building New Nuclear: the challenges ahead	HC 117
Seventh Report	The Impact of Shale Gas on Energy Markets	HC 785

Session 2013–14

First Report	The Green Deal: watching brief	HC 142 (HC 607)
First Special Report	Building New Nuclear—the challenges ahead: Government Response to the Committee's Sixth Report of Session 2012–13	HC 106
Second Report	A Severn Barrage?	HC 194 (HC 622)
Third Special Report	The Impact of Shale Gas on Energy Markets: Government Response to the Committee's Seventh Report of Session 2012–13	HC 609
Third Report	UK oil refining	HC 340 (HC 718)
Fourth Report	Smart meter roll-out	HC 161 (HC 719)
Fifth Report	Energy Prices, Profits and Poverty	HC 108 (HC 717)
Sixth Report	Local Energy	HC 180 (HC 749)
Seventh Report	Pre-appointment hearing with the Government's preferred candidate for Chair of Ofgem	HC 645
Eighth Report	Levy Control Framework	HC 872
Ninth Report	Carbon capture and storage	HC 742

Session 2014–15

First Special Report	Levy Control Framework: Parliamentary oversight of Government levies on energy bills: Government Response to the Committee's Eighth Report of Session 2013–14	HC 590
First Report	Intergovernmental Panel on Climate Change Fifth Assessment Report Review of Working Group I contribution	HC 587 (HC 732)
Second Report	Innovate to accumulate: the Government's approach to low carbon innovation	HC 747 (HC 733)
Second Special Report	Carbon capture and storage: Government Response to the Committee's Ninth Report of Session 2013–14	HC 638
Third Report	The Green Deal: watching brief (part 2)	HC 348 (HC 882)
Fourth Report	Small nuclear power	HC 347
Fifth Report	Linking emissions trading systems	HC 739
Sixth Report	Energy Network Costs: transparent and fair?	HC 386
Seventh Report	Protecting consumers: Making energy price comparison websites transparent	HC 899