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Dear Daniel,

I wanted to follow-up on recent discussions between officials. Your team asked if we could provide a written response to the CMA offering more detail on particular proposed remedies which might improve their effectiveness.

Please find our response below.

We remain very happy to discuss this further with you and your team in more detail.

Yours sincerely,

John Fiennes

## **ENERGY MARKET INVESTIGATION: DECC VIEWS**

1. The Government fully supports the work of the CMA on energy markets. As set out in the Secretary of State's letter of 13 April, the measures set out in the Provisional Decision on Remedies should provide the foundation for a market that is more competitive, engages consumers and protects those who are losing out the most. The Government intends to act quickly on the final CMA recommendations.
2. Following that letter, the Department has been studying the proposed recommendations in more detail. Whilst we fully support the proposals we have some minor comments on three areas that we wish to raise now to ensure that these remedies work effectively and are implemented in the best way for consumers.
3. You have explained it would be helpful if we provided additional written detail to supplement the discussions we have already had at official level. In response to this request, we have summarised our comments below.

### **Allocation of CfDs outside the generic system**

4. We fully support the overall objectives of ensuring decision making for the allocation of CfDs outside the generic process is as transparent and robust as possible. Our aim is to use competitive methods of allocation even in these bespoke allocation processes and only use bilateral CfDs when there are no viable alternatives. However the proposed remedy implies additional processes when allocating CfDs outside the generic process. In particular, it proposes producing and consulting twice on an impact assessment, firstly before entering into a process with prospective generators (in order to identify costs and benefits); and secondly after the agreement of the strike price but before the deal is signed with prospective generators. As we understand it, the intention is to avoid over-compensation of generators and improve decision-making and transparency around bilateral CfDs.
5. In developing its processes for non-generic CfDs, Government has had to strike the right balance between transparency and the need to have a practical approach that allows effective commercial processes to take place.
6. In achieving this balance, Government processes in this area are already extremely open. The case for issuing nuclear CfDs outside the generic allocation process for low-carbon generation was first set out in the Energy White Paper in 2011, and has been examined in detail (including through a public process) by the European Commission. There has been extensive public debate on the terms. In the case of Swansea Bay, the Department has commissioned a review on the feasibility and practicality of energy from tidal lagoons.
7. We agree that transparency is important, but the specific proposed approach could affect the Government's ability to negotiate successful commercial arrangements with prospective developers. Because such projects are likely to be novel and/or highly capital intensive they are more likely to be significantly affected by any delay or uncertainty caused by consultative processes outside of the existing processes. Developers may seek to price the additional risks of delay and uncertainty in the projects from the outset. This carries a risk of leading to a worse commercial outcome.

### **Competitively allocated CfDs**

8. Government firmly believes that competition should be at the heart of the market and welcomes recommendations from the CMA on how this could be better delivered when it comes to allocating support for low carbon technologies.
9. The Government is also aware of the importance of providing developers with an understanding of its objectives and sufficient information about the size of the market to allow them to make informed decisions about whether and how to progress their projects, and is working to ensure that this happens. The Government has already acted to provide the market with foresight by providing information about three further auctions, the approximate budget available for the next auction, the broad capacity we are hoping to deploy over the 2020s, the budget currently available over the period and the strike prices. We are challenging the offshore wind sector to deliver against. The upcoming draft budget notice will provide all other pot 2 technologies with strike prices, months ahead of the next auction.
10. The proposed remedy as it is currently drafted may not provide that medium term foresight and would affect the allocation process and auction efficiency.
  - Fixing the budget at least 12 months before an auction would result in DECC assessing Levy Control Framework (LCF) spending, wholesale price assumptions and other fluctuating factors 18 months or more in advance of an allocation round and potentially even before the previous allocation round had completed. This could result in conservative budget setting which in turn would likely drive poor auction outcomes and under-delivery against decarbonisation objectives. By way of contrast, the 2014/15 CFD allocation round saw us set a high level budget significantly in advance of the round but then refine it twice in the period before the auction commenced as we sought to reflect our latest understanding of the state of the LCF, wholesale prices, load factors and other variables in the final budget.
  - As we have discussed, we have some reservations about how appropriate it would be to conduct the analysis proposed in the report namely comparing modelled outcomes of multiple pots against the outcome of a single pot approach. Those reservations apply particularly in circumstances where long term value for money requires Government to offer support to technologies that are still coming down the cost curve and where that cost reduction may be dependent on continued UK deployment, amongst others.

### **Ofgem's statutory duties**

11. As set out in the Secretary of State's letter, Government supports revisions to Ofgem's duties to give a clearer focus on competition. However, we think there are risks in an approach in which Ofgem is obliged to comment in public on all draft legislation and policy proposals that could affect markets. The Government places considerable value on Ofgem's independence and Ofgem is already able to make public comments where it considers this furthers the interests of consumers. In Government's view, this strikes the right balance. Putting in place a further legal obligation to require Ofgem to comment on Government policy could divert resources away from the central tasks of making the market work for consumers, including implementing many elements of the CMA's recommendations relating to the retail market.

12. The CMA also suggests that Ofgem publish an annual state of the market report, the content of which would extend to areas outside of its direct remit. There is already significant amounts of published material available from DECC, National Grid and the Climate Change Committee on these broader areas.

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