DEPARTMENT OF ENERGY & CLIMATE CHANGE

The Rt Hon Edward Davey MP
Secretary of State

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Dear Phil Mulligan,

Thank you for your letter dated 31 July, about clean energy generation. I apologise for the delay in replying.

Decc's Electricity Market Reform (EMR) measures seek to enable large-scale investment in low-carbon generation capacity in the UK and will help create financial certainty for investors.

The regulatory environment is critical to investor confidence. A coherent and stable regulatory environment minimises costs, creates jobs (Cogent, the Sector Skills Council, estimate that for each power plant there will be 5,000 jobs in construction and 1,000 longer term operating jobs), and helps keep consumer energy bills low.

I agree it is crucial that the power sector is largely decarbonised by the 2030s. The department is currently undertaking further work on the decarbonisation of the power sector, including on whether, how and when further targets might be necessary. Any such approach would need to take account of the need for flexibility in how we meet our carbon budgets in order to minimise costs to the economy.

We have noted the Committee on Climate Change's (CCC) recommendation that Government should set "a clear carbon objective for the Electricity Market Reform (EMR) (i.e. to achieve a carbon intensity of the order of 50 gCO2/kWh by 2030)". We are having regular discussions with the CCC on this issue to make use of their expertise in this area.

In the EMR White Paper, we recognised that reducing demand for electricity is likely to be more cost-effective than building additional generation capacity. It was right to do a thorough assessment before proposing further policy options – not least because a wide range of policies already affect electricity demand, and it was necessary to consider these in detail before proposing that additional action was required. Now that we have established that there is significant additional potential for electricity demand reduction, we are committed to consulting on policy approaches that can unlock this later this year. Not all the options under consideration would require primary legislation, but if this is the most appropriate route, we do not consider this timeframe rules out making changes through the Energy Bill.

Earlier this year, the Department ran a Local Energy Assessment Fund (LEAF) scheme that distributed £9.2 million to 236 community groups to help them understand the potential for improvements in energy efficiency and local deployment of renewable energy. Details of successful schemes can be found on the website at http://www.greencommunitiescc.org.uk. DECC and Defra are working together to deliver the Rural Community Renewable Energy Fund to help rural communities meet the upfront cost of developing renewable projects. This is due to start issuing loans in 2013. It is expected that rural communities will be able to apply for loans towards the cost of undertaking the feasibility and planning stages of renewable energy projects. Those successful in obtaining planning permission will repay the loans out of the income generated by their renewable energy project, so that the Fund can be recycled to support further community renewable energy projects. This fund will be available to rural communities in England only.

Industry want to see reliable contracts where they can be confident they will receive the returns promised. Contracts for Difference (CfDs) should benefit independent generators by enabling them to achieve highly stable and predictable returns. This should help them to attract capital from a wider range of investors. However, we recognise that before independent generators can raise debt to build their project, they require long-term contracts that guarantee that someone will purchase the power they generate.

We are aware that some independent generators have expressed concerns about a decline in the terms they are being offered for these Power Purchase Agreements (PPAs), which could potentially lead to less investment in renewables. We have published a call for evidence to assess and address barriers to market access that independent renewable generators may be experiencing.

Our EMR proposals are designed to incentivise all low-carbon generation, including community and co-operative projects. Those projects using eligible technologies of the requisite size, and which are not already eligible to receive the small scale FIT, will be able to access the CfD. As part of our development of the CfD we are seeking to ensure that the mechanism is accessible to all types of generation with the minimum of administrative complexity.

Electricity prices are expected to increase with or without EMR policies. However, a key aim of EMR is to meet the challenge of attracting the investment needed in the electricity system at lowest cost. While bills with EMR policies could be higher in some years compared to the baseline bill with current policies, on average bills with EMR are expected to be lower for the period to 2030 as a whole (with the largest savings expected towards the end of the next decade when the new low carbon plant is on the system).

I am extremely grateful to you for taking the time to share your views and concerns with me, and I have ensured that they have been shared with my officials. I hope that we can continue to engage on these matters throughout the passage of the Bill.

Yours,

Edward.

EDWARD DAVEY