

Energy and Climate Change Committee

Committee Office House of Commons 14 Tothill Street London SW1H 9NB

Tel: 020 7219 4610 Fax 020 7219 5998 Email: ecc@parliament.uk Website: www.parliament.uk/ecc

To: Maroš Šefčovič

Commission Vice-President for Energy Union
European Commission

15 September 2015

Dear Vice-President Šefčovič,

European Commission consultation on a new Energy Market Design

Thank you for meeting with the newly appointed Energy and Climate Change Committee in July, the Members present found it a very useful meeting. We agree that a more collaborative approach to the European energy system can address all sides of the energy trilemma and were pleased to hear that the Commission is looking to the UK's Electricity Market Reform in informing its new market design. I hope that your visit to the UK and wider European tour were fruitful, and that we will have further opportunity to discuss the Energy Union with you during our upcoming visit to Brussels in November 2015.

The Committee is indeed keen to follow developments in European energy policy and build on past interactions with the Commission. To facilitate this interaction the Committee has recently appointed Dr Alan Whitehead as its EU Reporter. Dr Whitehead will work more closely with the European Scrutiny Committee in the House of Commons to ensure that EU scrutiny issues make their way more quickly onto the Committee's agenda.

The Energy and Climate Change Committee is supportive of the European Commission's strategic objective to build a resilient Energy Union with a forward-looking climate policy. Building a stronger energy framework for Member States – while maintaining each country's right to its own energy mix – will help improve energy affordability, sustainability and security across Europe.

We are paying close attention to the Commission's implementation of the Energy Union package and to the current consultation on the issues that may need to be addressed in such a redesign of the European electricity market. The UK's Electricity Market Reform (EMR) has pioneered the transition to a new market structure. It was designed to drive investment in the UK energy infrastructure and manage the transition towards generating low-carbon, secure and cost-effective electricity.

The Energy and Climate Change Committee played a key role in the 2010-15 Parliament in scrutinising EMR, and conducted both pre- and post-legislative scrutiny of Government's policies. Implementing a new market framework does not come without its challenges, and the Committee sought to help Government address these challenges by gathering evidence from stakeholders and reporting the results of its inquiries. We hope that some of the results of this scrutiny may be useful and provide some lessons learnt to inform decisions. As the new Chair of the Committee in the 2015-20 Parliament I hope to continue this work by keeping a close eye on how EMR implementation unfolds in the UK and scrutinising the development of further policies in this area. For now, and I hope for the benefit of your

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current consultation, I outline some of the main conclusions from the previous Committee's work below.

The Committee examined the Government's proposals during the initial development of EMR. Its 2011 [Electricity Market Reform](#) report concluded that Government should:

- Simplify the overly complex initial proposals
- Include specific a demand reduction objective – so as to not focus change only on generation
- Publish an early target implementation timetable to reduce uncertainties that were already deterring investment.

In 2012, it then carried out [pre-legislative scrutiny](#) of the draft Energy Bill setting out the details of EMR. It shed light on a number of issues, including:

- Significant concerns surrounding the Contracts for Difference (CfD) model initially proposed, which was based on a “synthetic” counterparty. This was problematic because of genuine uncertainty about whether any contracts would be legally enforceable.
- The continued neglect of the contribution that demand-side activities could make to energy security and climate change objectives.

As a direct result of the Committee's scrutiny, a new Government-owned institution, the Low Carbon Contracts Company Ltd, was created to act as a counterparty to CfD contracts.

The Committee returned to its scrutiny of EMR last year, as the first CfD and Capacity Market unfolded. Its 2015 report [Implementation of Electricity Market Reform](#) outlined concerns that the speed at which participants have had to assimilate the complex policies have made it a challenging environment for smaller companies. It pointed out that DECC was still failing to ensure that demand-side response (DSR) providers were given a level playing field in the Capacity Market.

It also highlighted a more fundamental policy challenge. With over 80% of the successful Capacity Market agreements going to existing generating capacity, including coal-fired power stations, it noted that the CfD and Capacity Market mechanisms seemed to be pulling in opposite directions, with the Capacity Market risking locking us into a higher carbon and more expensive trajectory than needed.

It recommended that DECC should particularly focus on:

- Improving engagement with small players.
- Addressing potential conflicts of interest with National Grid, who is both a stakeholder and the delivery body of EMR.
- Further developing the demand-side sector within the enduring EMR regime.
- The design of the Capacity Market, in particular value-for-money: the Capacity Mechanism committed taxpayers to a payment of nearly £1 billion, only 5% of which will provide new capacity and just 0.4% going on Demand-side Response.

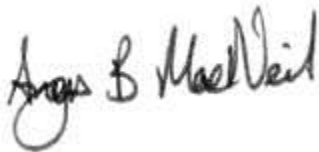
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- The need to provide clarity and visibility of the funds available for low carbon CfDs beyond 2020.

I hope that this summary and the links to previous more detailed reports of the Committee might provide a useful basis for developing the new European market design, building on lessons learnt in the UK.

A handwritten signature in black ink, reading "Angus B MacNeil". The signature is written in a cursive style with a large initial 'A'.

Angus Brendan MacNeil
Chair, Energy and Climate Change Committee