



# Energy and Climate Change Committee

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From Tim Yeo MP, Chairman

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I am writing to follow up the helpful session which the Committee had with you and other witnesses on the subject of demand-side response on 2 September.

Demand-side response (DSR) offers a cheaper and greener alternative to building new generating capacity. We believe it should play a crucial and growing role in keeping the lights on as capacity margins tighten in the coming years.

I am pleased that DECC, Ofgem and National Grid have been progressing policy initiatives and schemes designed specifically to encourage the development of this still nascent industry. But while these initiatives are welcome, it is important that they support DSR development and do not inadvertently construct obstacles that limit its potential. As you know, many DSR industry representatives have expressed serious and legitimate concerns about the design of the Capacity Market and its treatment of DSR. I outline some of these below.

### **Restrictions on auction participation**

The Government's transitional arrangements (TAs) designed to transition DSR into the Capacity Market are welcome because they will help DSR providers to participate in the enduring regime. However, DSR providers are currently being forced to choose between participating in the enduring Capacity Market auctions or in the TAs. This enforced choice could severely limit the development and future potential of DSR.

### **Limit on contract lengths**

DSR providers are currently only able to bid for a one-year contract in any auction, unlike power generation, which may be offered longer contracts, in some cases up to 15 years. DSR providers argue that they need longer term contracts to enable them to make competitive bids in these auctions. The impact of limited contract lengths may discourage some DSR providers from participating at all.

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### **Ministerial cancellation of DSR capacity**

The power to significantly cut the amount of capacity auctioned for DSR in the TAs currently rests at ministerial level. This introduces an unnecessary and damaging element of uncertainty into the bidding process. DSR companies are very concerned that once sufficient capacity has been secured in the main auctions the decision might be taken to reduce further the amount of capacity left to be procured in the TAs.

If these design faults are not rectified, the system could encourage the construction of expensive new power stations which are not actually required. The result of this will be to lock-in unnecessary high-carbon generation capacity instead of innovative demand-side solutions, leading to higher bills for electricity consumers and increased greenhouse gas emissions. It would be far more cost-effective to facilitate the use of DSR, where rapidly evolving technology is opening up new opportunities, as the experience in the United States already demonstrates, to smooth out peaks in demand. A report soon to be published by NERA Economic Consulting on the potential impact of DSR on customer bills estimated that changing the rules around DSR participation in the Capacity Market could reduce bills by up to £359 million in the first year alone.

As I made clear during the meeting of the Committee, I also believe that it is impossible for National Grid to give objective advice to Government on this issue since the profitability of their regulated United Kingdom business is directly linked to the construction of new transmission capacity, the demand for which will be cut if DSR provision grows in the way it has done in the United States.

Given the Government's goals for the electricity sector: ensuring low-carbon reliable energy supply at least cost to the consumer, any action which can be taken to further improve the prospects of DSR are surely welcome. With the right policy framework, this disruptive technology could catapult the UK's energy sector into the 21<sup>st</sup> century. I therefore urge you and your officials to address the concerns outlined above and consider the full details behind these concerns as raised during the Committee's recent oral evidence session on demand-side measures, the transcript of which can be found online:

<http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/energy-and-climate-change-committee/electricity-demandside-measures/oral/12185.html>

I also encourage you to meet with demand-side response providers, as several members of the Committee have done recently, to fully understand their concerns.

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