Dear Ms Waley,

HINKLEY POINT C

Thank you for your letter of 4 February. I understand your interest in hearing our view on the potential risks in the proposed Hinkley deal. As you know, we have been monitoring the government’s proposals for a Contract for Difference for the Hinkley investment. But, as we explained, it is not our role to question the merits of the government’s policy objectives or to be part of the government’s executive decision-making with regard to the proposed contract. The Comptroller and Auditor General still intends to report to Parliament once the deal is signed. I should mention that we may need some time between conclusion of the deal and publication of the report, so that we can audit and represent the handling of the deal through to its finalisation.

You asked about what our report will cover, including consideration by the European Commission, the constraint imposed by the Levy Control Framework and consideration of current and possible future scenarios. It is our intention to report on the deal as signed, covering the government’s commercial approach to securing the deal, the contract terms, its value for money and the resulting risks the government must manage, and the lessons learned. We would therefore principally focus on the outcomes of the negotiations, including those resulting from the European Commission’s review of the deal. We are looking at the Department’s economic modelling and business case for the deal and would expect to address the long-term implications of the Hinkley deal for future investment in renewables or new nuclear. You will see that in our previous electricity related work we have reported against the Department’s objectives for achieving energy security, decarbonisation and affordability for consumers; and in particular we have regularly reported on whether the Department is on track to meet its carbon reduction commitments within the Levy Control Framework caps.

In particular, we reported in November 2013 on the operation of the Levy Control Framework and in that report drew attention to the fact that Contracts for Difference would introduce a new risk of levy costs escalating if energy market prices fall below expected levels. This would apply in relation to Hinkley Contracts for Difference as well as Renewables. We reported then that the Department expected to achieve its ambition of 30 per cent renewable electricity by 2020 within the cost caps it had set for the Framework, but it had not given an indication of the probability that it would achieve it.
In our more recent, June 2014, report on the Department’s award of eight early Contracts for Difference for renewable electricity we again looked at the Department’s modelling and its forecast of the commitments these contracts made against the Levy Control Framework caps. There we reported that the early renewables contracts left relatively little uncommitted consumer funding for further renewable electricity contracts (Figure 8). You will see from that chart that this analysis took account of the extent to which the cap was already committed for other uses, including the Renewables Obligation, small scale Feed-in Tariffs, Contracts for Difference for non-renewable technologies and a provision for contingency.

You asked specifically about risks from potential foreign equity and the lessons for Hinkley from similar plants under construction elsewhere. As we set out when we met with you, we are closely looking at the risks in the deal and the due diligence work undertaken by the Government and the terms of the deal.

Thank you for pointing us to the Vienna Ombuds-Office report. It is interesting to consider alternative ways of assessing the case for investment in energy technology. The authors have used an approach which in some ways is similar to the Department of Energy and Climate Change’s general approach. They have used both analysis of standardised costs for nuclear and other technologies (their so-called “static” approach) and modelling of costs over time (their “dynamic” approach). DECC has historically used levelised costs to give a static view of the costs of alternative technologies. It has used cost information for this provided by various energy consultancies, and their reports are all available through the Department’s website. The Department also uses its Dynamic Dispatch Model to assess how its market based interventions, including the Emissions Performance Standard, Contracts for Difference and Capacity Market, affect generators’ investment decisions. Its modelling is based on its understanding of the UK market. We are not fully familiar with the model that the Austrians have used, but note that there appear to be some differences in approach. The Austrians’ modelling appears to be based on the renewables obligation and small scale feed-in-tariffs to support renewables, rather than the new contracts for difference regime. They have also assumed unlimited scope for cheaper renewables (onshore wind, in particular). We cannot tell from the report whether it addresses the potential difficulties for the electricity system from the intermittency of renewable energy.

Yours sincerely

John Thorpe

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