



Department for  
Business, Energy  
& Industrial Strategy

The Rt Hon Greg Clark MP  
Secretary of State

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Lord Hollick  
Chairman, Economic Affairs Committee  
House of Lords

11 January 2017

Dear Lord Hollick

### **Inquiry into the economics of UK Energy Policy**

Thank you very much for giving me and my colleague Mr Pocklington the opportunity to address the Committee on 10 January on what I believe is an interesting and timely inquiry. I am writing in relation to those matters on which I promised to follow up in writing, or on which the Committee sought additional material.

#### **(1) Strike Price for Hinkley and inflation**

- **Is the strike price in the Hinkley Point C deal linked to RPI or CPI?**

I can confirm that the strike price is linked to CPI.

- **Is there provision for the price to go down as well as up?**

Yes – the strike price is indexed to CPI, so if CPI is negative, the strike price will reduce accordingly.

- **Is there provision to change from CPI to another measure?**

For as long as CPI is published and there has been no material change to the basis of that index, CPI will be used whatever the government's preferred measure of inflation. However, there is a mechanism for the substitution of an appropriate alternative index in the case where CPI ceased to be published, or has itself been amended in a material way.

#### **(2) Discount rate: can you set out the reasons for the difference in the Government (£11bn - £21 bn) and NAO (£30bn) estimates of the cost of Hinkley Point?**

In our assessment of support payments we used the Social Discount Rate as provided in The Green Book guidance on appraisal and evaluation. This is standard practice adopted across all Government departments when appraising consumer and society-wide impacts. The rate is 3.5% for 30 years, falling to 3.0% for a further 35 years, then to 2.5%.

The NAO use a discount rate appropriate for the accounting treatment of financial assets. This fluctuates to reflect the economic conditions of the present day and is intended to represent Government long-term borrowing costs rather than societal or consumer time preference. In 2016 this rate was 0.7%, while in 2015 it was higher at 2.2%. It will fluctuate again in future.

In addition, we have chosen to present a range of support costs to reflect the inherent uncertainty in projecting them. The NAO figure focussed on our low wholesale price projections. This figure is comparable to the top end of our stated range. All else equal, a lower wholesale price will increase the cost of support payments, but the overall cost of electricity is the same (the strike price of £92.50/MWh).

**(3) Hinkley Point Government 'Guarantee': could you set out the terms of the £2bn guarantee to EDF. In particular: in what, if any, circumstances would it be called upon?**

In September 2016 EDF agreed and confirmed to the government in writing that it does not intend to avail itself of the £2bn guarantee negotiated at an early stage in the negotiations. That remains the case. Furthermore, to draw down on the guarantee, there are wide-ranging conditions which would need to be met, and complete satisfaction of these conditions is at the discretion of HMT ministers.

**(4) Demand side reserve: what has been the cost of the DSR in each year since it was established?**

There have been three four-year ahead (T-4) Capacity Market auctions to date – auctions were held in 2014, 2015 and 2016 for delivery of capacity in 2018/19, 2019/20 and 2020/21 respectively. Capacity providers winning agreements in these auctions will only be paid in the relevant delivery year subject to successfully completing various tests relating to the performance of their capacity. Penalties are applied in the event of non-delivery of capacity. Based on the volume of Demand Side Response (DSR) winning agreements in these auctions, we anticipate making payments of approximately £3.4m in 2018/19, £8.2m in 2019/2020 and £31.7m in 2020/21.

A separate Transitional Arrangements auction was held in early 2016 for delivery of capacity in 2016/17. Approximately £9m is due to be paid during this delivery year to providers of DSR capacity.

Please do not hesitate to call upon me if you have any further questions. I look forward to reading your final report and recommendations in due course.

Yours sincerely,



**THE RT HON GREG CLARK MP**

Secretary of State for Business, Energy & Industrial Strategy