



The Rt Hon Chris Huhne MP  
Secretary of State

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Dear Mr Qureshi,

Thank you for your letter dated 12 December, enclosing a report compiled by the London Assembly's Environment Committee members - *Plugging the Energy Gap – London's Energy Generation Strategy and National Energy Policy* - and setting out the recommendations from the report. I apologise for the delay in replying.

Your report's findings on district heating are consistent with the findings of DECC's Heat Strategy Project, which indicate that district heating can be one of the most effective ways of decarbonising buildings in built up areas with high heat demand, such as London. With this in mind, it is true that some level of support might be beneficial, particularly to help developers overcome the initial capital costs, which represent a significant barrier to deployment.

Your report proposes the inclusion of district heating in the Renewable Heat Incentive (RHI) as part of a review later this year (report recommendation 3). Currently, RHI tariffs apply to renewable heat generation for district heating networks, however, the tariffs do not extend to the cost of pipes. Because of the wide variation between networks, we have found that an appropriate uplift for district heating to include pipes is hard to calculate and apply in a consistent manner. This variation means uplift calculations could be based on the size of the network in terms of customers, the size in terms of infrastructure, the amount of heat generated, the extent to which it addresses hard-to-reach properties, or the extent to which it provides better carbon efficiency than alternative measures. For example, two networks of the same physical size might need very different sized boilers, which may also operate at different levels of efficiency. Therefore a standard uplift for all heat networks would not reflect the potential variation in networks or costs. Similarly, a distance-related uplift could inadvertently incentivise developers to extend networks to distant customers beyond what is reasonable.

I am currently working with key stakeholders through the Distributed Energy Contact Group to identify ways in which DECC can support district heating and distributed energy suppliers and we need to consider whether the RHI is the most suitable mechanism to support district heating or whether an alternative mechanism would be more appropriate.

Moving on to recommendations 5 and 6, the experience of the GLA's RE:NEW programme in highlighting the benefits of a street by street approach echo those that have been demonstrated by the Community Energy Saving Programme (CESP) e.g. economies of scales and community wide buy in. We have carried out an evaluation of CESP which has informed our proposals for the Green Deal and ECO. The evaluation report is available at: [www.decc.gov.uk/assets/decc/11/funding-support/3342-evaluation-of-the-community-energy-saving-programm.pdf](http://www.decc.gov.uk/assets/decc/11/funding-support/3342-evaluation-of-the-community-energy-saving-programm.pdf).

We fully expect the Green Deal, particularly where there is proactive local authority involvement, to be delivered across whole communities. We are currently consulting on proposals for the future Energy Company Obligation, focusing on how this might help to subsidise energy efficiency measures across all housing tenures, including social housing.

We acknowledge your point about London's share of CERT activity being disproportionately lower than other parts of the country. However, there could be scope for London to attract a greater level of CERT activity during the final year of the scheme, particularly in relation to lower-income vulnerable households. Suppliers have indicated that finding these sorts of household, which are the focus of their super priority group targets, is posing significant delivery challenges. Local authorities should be in a good position to use their local knowledge to help suppliers identify these consumers and unlock the delivery potential in their areas. We would strongly encourage all London authorities to so.

A number of Microgeneration measures will be eligible for Green Deal finance up to the level of the savings they can generate. Such measures may become a more attractive proposition in time as installation costs continue to fall. The RHI and the Feed-in Tariff scheme will continue to incentivise the installation of the measures.

We have been sent information about the RE:NEW case study as an example of how to roll out an area-based approach and we will look to use this in materials being published to support the delivery of the Green Deal.

As the ECO would focus more on hard to treat measures, London is likely to be more attractive to energy companies in future given that measures eligible in the ECO can be applied to London's large number of hard to treat properties. As set out in our consultation document, we do not see a case for introducing further constraints to delivery in geographical terms, but we would welcome your views on this issue as part of your consultation response. There might be a case in the future for reconsidering this position at a review point, when there would be evidence on the patterns of geographical distribution of measures from the new obligations.

Regarding recommendation 7, the Technical Update to the Electricity Market Reform White Paper, published on 15 December 2011, set out that Government's choice of capacity mechanism is a Capacity Market. At a high level, the Capacity Market we will introduce involves:

- estimating the total volume of reliable capacity required a number of years ahead;
- contracting for the required volume of reliable capacity from providers through a central auction process; and
- placing incentives on providers of capacity to ensure they are available when needed.

A Capacity Market will ensure sufficient flexible capacity is available by providing incentives to invest in new capacity or for existing capacity to remain open and offers the surest way to ensure security of supply against a range of credible scenarios.

The Government recognises that demand side response (DSR) has significant potential to help deliver secure energy supplies at least cost and, in many cases, reduce carbon emissions – by reducing the amount of network and generating capacity needed and by shifting demand to ensure we use low carbon sources of electricity more efficiently. We are keen that verifiable DSR can play a fair and equivalent role to generation in a capacity mechanism and will determine how to achieve this while undertaking detailed design of the mechanism.

In the Technical Update we identified three ways that DSR providers may be able to participate in the Capacity Market:

- **primary auctions** – DSR providers may be able to offer their capacity into a primary auction for capacity. The payment received from the auction may provide the funding to enable DSR, for example investment in automated equipment to reduce load when required.
- **secondary market** – DSR providers may be able to offer their capacity into a secondary market for capacity (i.e. between the capacity auction and delivery year). By allowing trading of capacity for shorter durations than might be possible to offer into a primary auction, this could provide opportunities for DSR measures that cannot guarantee delivery over long periods and/or are unable to commit over a long lead time.
- **peak price avoidance** – the cost of capacity purchased in a central auction will be allocated to suppliers in the delivery year. Depending on how these costs are allocated, suppliers may have an opportunity to reduce their share of these costs by incentivising consumers to avoid peak prices, for example by offering time of use tariffs.

In addition, the Government recognises other opportunities for DSR. We have committed to publishing an electricity system policy in 2012. This electricity system policy will look at whether the Government needs to take any action to ensure the electricity system can connect and balance supply and demand in a way that minimises cost and makes efficient use of assets. It will include consideration of the extent to which different non-generation solutions such as demand side response, storage and interconnection might contribute to balancing the future electricity system.



CHRIS HUHNE