



Department
of Energy &
Climate Change

Swansea Bay Tidal Lagoon: potential support for the project through the CFD mechanism

Stakeholder Engagement Document: Government Response

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Introduction

1. The Government is committed to achieving its low carbon energy goals through the deployment of a diverse range of technologies. Tidal range power, alongside the other low carbon technologies currently considered within the Contract for Difference (CFD) allocation framework, has the potential to contribute to the low carbon energy mix. Recent analysis¹ found that tidal lagoon technology could theoretically contribute up to 25TWh/year – the equivalent of 8% of the UK's electricity consumption in 2013² – of indigenous, predictable and low carbon electricity.
2. This document sets out the Government response to the Stakeholder Engagement Document on potential support for the proposed Swansea Bay Tidal Lagoon project through the CFD mechanism ('the CFD engagement document'), published on 23 January 2015³. In line with the Electricity Market Reform (EMR) Delivery Plan⁴ and the Government response to the consultation on directions to offer CFDs⁵, the CFD engagement document set out the proposed process that we would intend to follow, should we enter into a bilateral negotiation for a CFD with Tidal Lagoon (Swansea Bay) Ltd (TLSB).
3. A total of 53 responses to the CFD engagement document were received from a wide range of different organisations. This included representations from the renewable and low carbon power sectors, the supply chain, regional energy bodies, public sector organisations, community organisations, environmental groups, trade associations and financiers. A number of responses were also received from interested individuals.
4. The Government is fully committed to engaging with interested stakeholders and providing greater transparency when developing new arrangements for applying for a CFD outside of the generic process. In line with this commitment this document sets out the Government's position in response to the views offered by stakeholders in response to the CFD engagement document.
5. We would like to thank those who provided views on the process set out in the CFD engagement document. All the points raised as part of the engagement have been considered, and this document discusses what we consider to be the most significant issues raised.
6. **As set out in the CFD engagement document, considerations relating to a possible CFD are separate from and without prejudice to the determination of the consent application for the proposed project. Any decision to offer a CFD would also be subject to strict value for money considerations, the funds available within the Levy Control Framework (LCF) at the time of a decision and be subject to State aid approval.**

¹ <http://www.thecrownestate.co.uk/media/5476/uk-wave-and-tidal-key-resource-areas-project.pdf>

² Final Electricity Consumption taken from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/337649/chapter_5.pdf

³ <https://www.gov.uk/government/publications/swansea-bay-tidal-lagoon-potential-support-for-the-project-through-the-cfd-mechanism>

⁴ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/268221/18213_2013_EMR_Delivery_Plan_FINAL.pdf

⁵ <https://www.gov.uk/government/consultations/electricity-market-reform-emr-contracts-for-difference-regulations>

Responses to the CFD Engagement Document

7. This section looks at the four questions raised in the CFD engagement document and discusses the key points made in relation to each question.

Transparency

Question 1

Do you agree that this document provides transparency on the process for applying for and negotiating a CFD outside the generic CFD allocation process for a tidal lagoon at Swansea Bay?

8. The majority of respondents (82%) stated that the CFD engagement document offered adequate transparency. However, a small number (8%) of respondents raised issues about the lack of public scrutiny when entering into bilateral negotiations. The remainder either did not answer the question or their response was unclear (10%).
9. Those respondents that had concerns about the process of bilateral negotiations were of the view that more information needed to be shared with regard to how value for money and affordability would be assessed, should we enter into a bilateral negotiation for a CFD with TLSB. A few respondents were of the view that the process could be strengthened by DECC providing more information on the timescales for any negotiation process.
10. Government aims to be as transparent as possible; however certain details must be kept confidential in order to allow the Government to secure the best possible deal for consumers. Having considered the points raised it is our view that in publishing the CFD engagement document we have broadly achieved the appropriate balance between the need for transparency and retaining the flexibility to secure the best deal possible. We will keep in mind the general advantage of transparency through a negotiation process and consider whether at any point it is appropriate to provide more information.
11. During a negotiation, the developer would be required to share commercially sensitive information with Government and the European Commission in order to be able to determine whether a project represents good value for money and is affordable. A commercial negotiation would enable both parties to move to a common understanding of what strike price and length of contract would be needed to realise the project, in a cost effective, value-for-money manner. Any CFD signed following a Secretary of State direction would be published once completed, including the strike price and the reference price, having redacted commercially sensitive information. It is our view that this would provide significant transparency.
12. At present there is no timeframe for how long a negotiation may take. The timeframe would depend on a number of factors, many of which would be outside the control of the

Department. An example of this would be the time needed to obtain State aid approval from Directorate-General for Competition in the European Commission. A few respondents raised questions about the length of the proposed contract. A negotiation would carefully consider all aspects of the contract, including scrutinising the proposed length of a contract and its impact on value for money and intergenerational equity.

13. Any potential future decisions as to whether to award a CFD to the project would be informed by a full value for money and affordability assessment and be subject to robust internal scrutiny, and approval by HM Treasury. This is likely to be based on whether the CFD would provide the developer appropriate returns in relation to the project, without over-compensating them; and whether the negotiation has shown that the project could be cost-competitive on a broadly comparable basis relative to other options for delivering low carbon power or otherwise contribute to the delivery of a more socially cost effective electricity generation mix. Any decision to offer a CFD would also be subject to the funds that are available within the LCF at the time of a decision. In addition the project would also need to be affordable for electricity consumers, and would need to achieve State aid approval from the European Commission.
14. A few respondents questioned the use of CFD as a way to support a first of a kind (FOAK) technology. However, at the outset of its EMR Programme, the Government considered a variety of options for securing investment in low carbon electricity infrastructure. These included a range of revenue support options including premium payments, fixed payments and CFD, and also indirect revenue support through carbon pricing. The Department maintains that the CFD mechanism could be an appropriate way to support a Swansea Bay Tidal Lagoon project and any proposals for future lagoons. However, if any other form of support were available for the project outside the CFD, perhaps from non-UK Government sources, we would consider how this might be compatible with any CFD under negotiation and the wider delivery strategy of the Swansea Bay project.

Other tidal range projects

Question 2

Are there any similarly developed tidal range projects, of sufficient scale that could be in a position to compete with the Swansea Bay Tidal Lagoon as a FOAK project for this new industry, in the near future?

15. The majority of respondents either stated that they did not know of any comparable projects to the Swansea Bay Tidal Lagoon (70%) or did not address the question (23%). While three alternative tidal range projects were referenced by three separate organisations (7% of those that responded), none suggested or demonstrated that they were in a position to compete at this stage. One developer advised that their project may be in a position to be developed to a similar status as the proposed Swansea Bay Tidal Lagoon project within the next 3 years, once the necessary planning consents for the project had been obtained. No alternative project was mentioned by more than one respondent.
16. Following further assessment the Department does not consider that any of the other three tidal range projects mentioned by respondents have been sufficiently developed at this stage to provide alternatives which could viably compete with Swansea Bay Tidal Lagoon for a CFD now or realistically in the near future.

17. If a viable well-developed project does come to light at a stage where it could be used as a competitor, or benchmark, to a Swansea Bay Tidal Lagoon project negotiation then the Government would consider whether it could be included in the process, or what the other appropriate next steps might be. As set out in the CFD engagement document our preference, where feasible, would be to seek to introduce a competitive process for allocation of CFDs to any subsequent tidal range projects.

Appropriateness of a bilateral negotiation

Question 3

Do you agree with our view that, in the case of a FOAK project, consideration of the Swansea Bay lagoon project through a bilateral negotiation process is appropriate?

19. A large majority of respondents (85%) accepted the Government's position that the most appropriate process to establish whether this technology has the capability to be deployed at scale at an acceptable cost for consumers and to ascertain whether the potential benefits to the UK economy of a tidal lagoon industry in the UK can be realised is through a bilateral negotiation. Those in agreement stated that this approach for considering a FOAK project was acceptable as long as value for money for consumers was a key principle. We remain of the view that entering into a bilateral negotiation on the proposed Swansea Bay Tidal Lagoon project would offer Government a unique opportunity to scrutinise the potential of this technology to contribute to a diverse UK generation mix.
20. The majority of respondents were of the view that competition is not the only way to achieve value for money and that at present a competitive process in relation to the proposed Swansea Bay project was not feasible as other tidal range projects were not sufficiently well-developed.
21. A small proportion of respondents did not support the bilateral approach stating that it would not yield the best result for consumers. One respondent pointed out that the Competition and the Markets Authority in their recently published "*Energy market investigation - updated issues statement*" referenced the non-competitive approach to allocating CFDs, suggesting that there are risks that such contracts will unduly raise prices for consumers⁶.
22. The Government clearly recognises the value of competition. This was highlighted by the first CFD allocation round. This demonstrated the value of competition in driving down costs to consumers. The majority of larger scale projects awarded CFDs in the first allocation round achieved a saving on the administratively set strike price of approximately 17%⁷. As highlighted in the CFD engagement document, the Government continues to remain committed to using competition where possible to reduce the costs of decarbonisation and to move to technology neutral competitive allocation approaches across all low carbon technologies as soon as this is practical and effective. We do however remain of the view that, at present, it is not appropriate to subject the proposed Swansea Bay Tidal Lagoon

⁶ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/404867/Updated_Issues_Statement.pdf

⁷ <https://www.gov.uk/government/publications/annual-energy-statement-2014>

project to a competitive process given the FOAK nature of the project and the lack of well-developed alternative tidal lagoon projects. However as set out in the CFD engagement document our preference, where feasible, would be to seek to use a competitive process for allocation of CFDs to any subsequent tidal range projects. This could be against other low carbon technologies.

23. One respondent noted that the price being quoted by the developer exceeds every technology that has a strike price (except tidal stream and wave) and this would not in their view offer value for money. Entering into a bilateral negotiation to establish the required strike price for this project, would not necessarily mean that a CFD would be awarded to the developer. We would conduct a negotiation in such a way as to deliver an appropriate return to the developer while ensuring it remains affordable and value for money to the consumer. As set out in the CFD engagement document, if it is not possible to negotiate a contract (including a strike price for this development) that meets our value for money considerations and that is acceptable to both parties, discussions would be terminated. A bilateral negotiation would enable us to determine the true cost of the project to inform an assessment of the wider lagoon programme. It would enable a fuller assessment of the value for money and affordability cases and ensure that Government has the best information available on the costs and the benefits before any decision on whether to award a CFD is made.
24. A small number of respondents suggested their projects might be suitable for a bilaterally negotiated CFD either because they do not currently have a strike price or they consider their project to be larger or more unusual than other projects. It is important to note that whilst we think that the approach highlighted in the CFD engagement document is suitable for the Swansea Bay Tidal Lagoon project it is not intended to act as a precedent for any other projects seeking support where the strike price has not been administratively set. Government will consider such projects individually to determine what action might be appropriate although our preference is for direct competition between low carbon technologies. Two respondents were of the view that their larger or more unusual projects should qualify for a bilaterally negotiated CFD even though strike prices for such technologies were included in the EMR Delivery Plan. It is our firm view that the existing CFD allocation arrangements for established and less established technologies, for which administrative strike prices have been set, remain wholly appropriate.
25. A few respondents were concerned that other cheaper low carbon technologies with strike prices would not have access to the same level of support if Government entered into a bilateral process with TLSB. It is important to note that we support a broad range of different technologies to achieve the diverse mix needed to ensure the UK continues to enjoy safe and reliable access to electricity. Increased diversity of supply and strengthened competition will help to drive down costs in the low carbon power sector in the future. Any bilateral negotiation would offer an opportunity to explore how tidal lagoon technology compares with other low carbon technologies.
26. Some responses were concerned that the prospect of agreeing a CFD for the Swansea Bay project would impact on the funds available within the Levy Control Framework (LCF) for other projects. While this would be the case if a CFD were awarded, entering into a bilateral negotiation would not commit LCF funding for the project. Government is committed to providing all developers with the funding information required for their investment plans. This will be set out in CFD Budget Notices, which are published before

each allocation round⁸. To date, we have not released the entire potential budget for future CFDs. On our medium scenario there could be further funds available for allocation for CFDs for renewables and Carbon Capture and Storage rising to around £1 billion in 2020/21. The Department considers it appropriate to retain sufficient money in order to help drive competition and ensure later projects also have a potential route to funding.

27. One respondent commented that in their view, tidal lagoon technology is mature. At this stage, it is the Department's view that tidal lagoons present a novel application of existing technologies, which should mean that while the supply chain for this sector is immature it is well placed to diversify and respond to demand as necessary. While there are tidal barrages operating elsewhere in the world there are currently no tidal lagoons generating electricity. We anticipate that further in-depth consideration of this project alongside details on other emerging proposals for future lagoons could allow us to set an acceptable and appropriate strike price for tidal lagoons in the future. The Government remains committed to adopting competitive allocation approaches for any future tidal lagoon projects as soon as this can be achieved as well as moving to technology neutral competitive allocation approaches across all low carbon technologies as soon as this is practical and effective.

Assessing value for money; other considerations

Question 4

In respect of value for money, do you have any views on how we might assess the considerations set out? Are there any other considerations you think we should be taking into account in deciding whether to offer a CFD?

28. A majority of the respondents (82%) offered views as to how value for money should be assessed and what other considerations should be taken into account. Most respondents suggested that socio-economic factors, such as employment and local regeneration, should be included.
29. Development of the value for money case assessment will look to draw from existing guidance on undertaking policy appraisal (including The HM Treasury Green Book⁹), and consider the wide variety of potential impacts derived from this project (as well as potential future lagoons) where possible. If it is not possible to monetise particular impacts we will look to explore such issues on a qualitative basis.
30. One respondent suggested that the need for an EMR supply chain plan should be considered as part of any bilaterally negotiated CFD. Entering into a bilateral negotiation on the proposed Swansea Bay Tidal Lagoon project would offer Government the opportunity to explore the development of a supply chain with TLSB, and would form a key part of a negotiation. A supply chain plan would provide information about the impact of the project on competition, innovation and skills development in the industrial supply chain supporting the relevant low carbon electricity sector.

⁸ Information will also be made available in other publications as appropriate. For example, spending projections for all low carbon electricity schemes in the LCF were published in the Annual Energy Statement 2014: <https://www.gov.uk/government/publications/annual-energy-statement-2014>

⁹ <https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government>

31. Two respondents suggested including a Community Benefit Fund as part of any CFD negotiation for this project. Community Benefit Funds do however sit outside of the CFD process.
32. It is noted that a number of respondents were concerned about the potential re-opening of the Dean Quarry to provide raw materials to the project and the subsequent impact on the surrounding area of St Keverne. Several of those that responded in this regard made reference to considering the environmental impacts of re-opening the Quarry in the value for money case. Such broad considerations relating to environmental aspects of the supply chain are a matter for the relevant consenting processes applicable in this instance.

Next steps

33. The value for money and affordability cases will be updated as further information is made available on the proposed Swansea Bay Tidal Lagoon project and wider lagoon programme.
34. If a viable well-developed project does come to light at a stage where it could be used as a competitor, or benchmark, to a Swansea Bay Tidal Lagoon project negotiation then the Government would consider whether it could be included in the process, or what the other appropriate next steps might be. As set out in the CFD engagement document our preference, where feasible, would be to seek to introduce a competitive process for allocation of CFDs to any subsequent tidal range projects.
35. Considerations relating to a possible CFD are separate from and without prejudice to the planning decision on the project.
36. Any decision to offer a CFD would also be subject to strict value for money considerations, the funds available within the LCF at the time of a decision and be subject to State aid approval.

Annex A: List of Respondents

Afan Valley Angling Club
Allerdale Borough Council
Andrew George MP
Atkins
Balfour Beatty
Britain's Energy Coast
British Hydropower Association
Citizens Advice Bureau
Community Against Dean Super Quarry
EDF
EON
Federation of Small Businesses
Good Energy Ltd
Goodwin International Ltd
Harland & Wolff
Horizon Nuclear Power
Individuals (9)
InfraRed Capital Partners Limited
Landsvirkjun
Ledwood Mechanical Engineering Ltd
Marine Energy Pembroke
Mumbles Active Supporters Group
NSA Afan
Pembroke Port
Pontardawe and Swansea Angling Society
Port of Workington
Regen SW
Renewable UK
Rock Tidal Range Partners
RSPB
Samphire Amps
Scottish Power
Sheffield Forgemasters International
SSE
Statkraft
Swansea Active Supporters Group
Tidal Electric
Tidal Lagoon Industry Advisory Group
Tidal Lagoon, Neath Port Talbot Active Supporters group (ASG)
Tidal Lagoon Power
Tidal Lagoon Swansea Bay Plc
TLSB Active Supporters Group for Gower, Wales and UK

Wind Electric

