



Department  
of Energy &  
Climate Change

# Route to market for independent renewable generators

# Contents



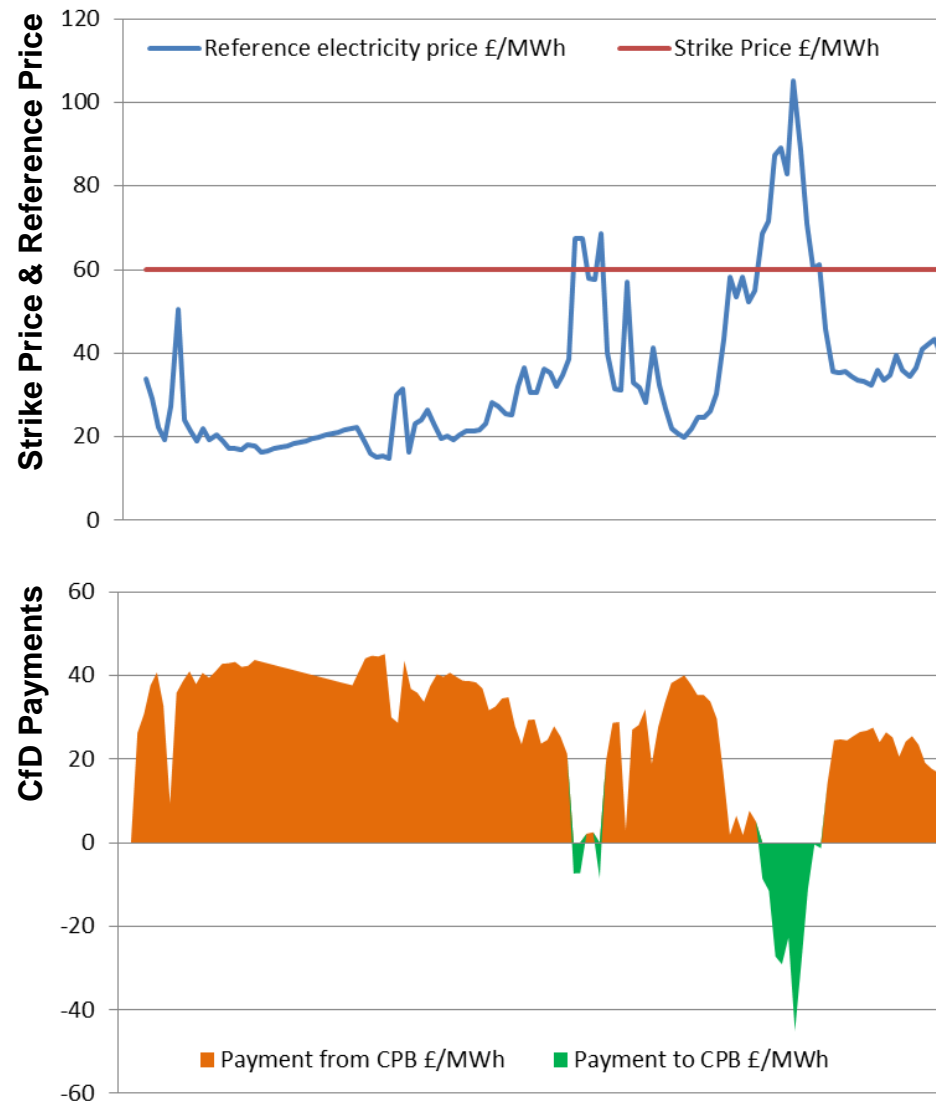
Department  
of Energy &  
Climate Change

- Overview – CfDs and the draft Delivery Plan
- Route to market for independent generators
- CfD Market Readiness project
- Offtaker of last resort
- Next steps / timetable



# Contracts for Difference overview

- CfD pays a variable 'top-up' to developers, based on:
  - Strike Price: Estimate of the cost of investing in each technology
  - Reference Price: Measure of the average price of electricity
- Benefits of the CfD include:
  - Removes **long-term wholesale price risk** – one of the largest commercial risks faced by developers
  - **Maintains normal incentives** to invest, innovate and operate at least cost
  - **Top-up payments are lower when prices are high**, keeping overall cost to consumers down





## CfDs – benefits to generators

1

**Removal of wholesale electricity price exposure** by providing a fixed strike price to developers, therefore stabilising project revenue

2

**Robust and reliable private law contractual arrangement** providing developers with a clear set of rights and obligations, and recourse to arbitration and expert determination processes to resolve disputes

3

**Robust single counterparty** owned by government and set up as a limited liability company

4

**Early certainty and security of support levels** in the project development process

5

Provision of an element of **protection against those risks that are outside the developers control** (e.g. change in law risk, force majeure risk, risk of grid connection delay)



# Route to market for independent generators

- Under CfDs generators have to sell their power in the market
- Lenders may still require independent generators to have long-term PPAs to cap imbalance / route to market risk
- Availability of long-term PPAs appears to have deteriorated recently
- CfDs remove need for price floors and to market ROCs in PPAs, but competition in long-term PPA provision may remain limited
- Ministers are committed to ensuring independent generators can play a full role under EMR
- Tackling this through **four strands** of work:
  - Working with Ofgem to improve wholesale market liquidity
  - Developing a sample PPA to work alongside CfDs
  - Developing best practice guidelines for use by industry
  - Exploring regulatory interventions to unlock alternative routes to market



# Sample PPAs and Code of Practice

## Sample PPAs

- **Sample PPA contracts which are compatible with the CfD and would provide the basis for commercial negotiations.**
- To enable market participants to understand the likely commercial arrangements for the sale of electricity through Power Purchase Agreements compatible with the CfD.
- To reduce barriers to participation at the outset of the scheme; reduce costs for the first movers; and improve investor confidence in the PPA market under CfD.

## Voluntary code of practice

- **Voluntary code of best practice setting out how market participants should engage in the process of negotiating and agreeing Power Purchase Agreements.**
- To provide market participants with a greater understanding of the approach that will be taken by different market participants in the PPA market under the CfD.
- To improve transparency and understanding of the drivers of commercial decisions, and to improve investor confidence in the PPA market.



# Design criteria for a regulatory intervention

## Objective

Increase the availability of bankable PPAs for independent generators

## Success criteria

- Improves availability and terms of bankable PPAs
- Works within existing market structures
- Maintains commercial incentives on operation and balancing
- Minimal distorting impact on PPA market
- Minimises cost to consumers
- Compatible with transition to competitive allocation
- Easy to exit when no longer required



# Offtaker of last resort – outline design

## Generators have a right to a 'Backstop PPA'

- ▶ Eligible generators have a **right to a 'backstop PPA'** enshrined in regulations and supply licence conditions
- ▶ Provides a **guaranteed route to market** at a **fixed discount to the market price**
- ▶ Fixed discount set to be larger than discounts expected to be available in the market, to ensure it is a genuine **'last resort'**
- ▶ Effectively **'caps'** generators' long term route to market costs (eg imbalance/basis risk)
- ▶ Gives **greater flexibility** to developers to choose the contracting structure and counterparty which best suits their appetite for risk

## Obligation on suppliers to offer backstop PPAs

- ▶ Certain suppliers obliged to offer to enter into (or bid to provide) a backstop PPA on specified terms
- ▶ Other suppliers may be eligible to opt to be 'voluntary' backstop offtakers
- ▶ Credit-worthiness ensured by credit rating, PCG, or letter of credit requirements

## Losses socialised across suppliers

- ▶ **Aggregate loss** (or theoretically profit) accruing to providers of Backstop PPAs **socialised across all suppliers** through a levelisation process.





# Offtaker of last resort – key design issues

<b>Eligibility</b>	▶ Which technologies / sizes of generator should be eligible for Backstop PPAs?
<b>Pricing</b>	▶ How should the fixed discount be set under the Backstop PPA to drive greater flexibility in bankable contracting strategies and counterparties?
<b>Risk Allocation</b>	▶ What is an appropriate risk allocation under the Backstop PPA, how is this grandfathered and how are distortions in the PPA market avoided?
<b>Timing</b>	▶ At what point should the backstop PPA be available – i.e. should it be available from day one or should it only be available a period of time after the start of the CfD?
<b>Access</b>	▶ Under what circumstances should the backstop PPA be available – i.e. any requirements on initial PPA term / contracting strategy, additional entry criteria?
<b>Offtakers</b>	▶ Which suppliers should be subject to the obligation to offer PPAs, and what criteria should determine eligibility to opt to provide Backstop PPAs?
<b>Allocation</b>	▶ How should a Backstop Offtaker be selected – e.g. generator choice, administrative allocation (e.g. by Ofgem), competitive tender?
<b>Levelisation</b>	▶ How should a levelisation payments be calculated and over whom should they be levied (i.e. all suppliers, or a sub-set of suppliers)?



# Potential benefits and risks for discussion

## Intended Benefits

- ▶ **Competition** – Improving competition in the PPA market by encouraging lenders to accept a wider range of counterparties and/or shorter term PPA positions, driving down PPA discounts
- ▶ **Diversity** – Spreading and dissipating energy risk by removing the requirement for all long term imbalance risk to be absorbed by PPA providers
- ▶ **Incentives** – Generators still exposed to imbalance risk thereby driving incentives in relation to design and operation of plant to minimise cost
- ▶ **Choice** – More effective CfD competition with greater offtake choices for bidders
- ▶ **Implementation** – Regulatory consistency within the existing EMR framework and market structures

## Risks / unintended consequences

- ▶ **Impact on suppliers** - Balance sheet impact of a contingent obligation to offer backstop on obligated suppliers
- ▶ **Impact on the PPA market:**
  - ❖ Distorting incentives on generators to continue to contract in the open market with backstop terms grandfathered from FID
  - ❖ Distorting incentives on suppliers to offer PPAs (hopefully addressed by levelisation)
- ▶ **Risk to the consumer** - Incentivising excessive risk taking by equity by insulating projects from downside
- ▶ **Moral hazard** – Implications of providing a backstop to poorly performing generators



## Offtaker of last resort – summary

- Potential to meet the design criteria, by enabling generators to use a greater variety of routes to market
- Amendments made to the Energy Bill to enable such a mechanism to be introduced
- More work needed on detailed design to understand risks, benefits, and practicality of the mechanism
- Number of key design issues to resolve



# Offtaker of last resort – next steps

- **Next few months**
  - Detailed policy design, including
    - commissioning consultants to advise on key issues
    - establishing ‘advisory group’ to feed in views
    - bilateral and wider stakeholder meetings
  - Stakeholder workshop to present emerging design
  - Consultation on policy
- **Early 2014**
  - Respond to consultation with final decisions
  - Publish draft secondary legislation for consultation
- **Summer 2014**
  - Revise and lay secondary legislation in Parliament