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Department of Energy & Climate Change

Capacity Adjustment

CfD Expert Group

11 October 2013

This is a discussion document and not a statement of government policy

Principles around capacity adjustment

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- Offshore wind Developers need flexibility to reflect the fact they struggle to be absolutely precise about the capacity which they will deliver at the point they apply for the CfD.
- Government needs to limit flex to:
  - deliver renewable and decarbonisation targets
  - Allow for reallocation of budget from non-performing projects
- Feedback on previous proposal suggested developers wanted more of the flex earlier in the development cycle. Strong message that post-FID, very little flex is needed.
- This is backed up by our research:
  - According to the Crown Estate c.40% of the offshore wind farms to date have been built out at below original consented/leased capacity .
  - These projects reduced their capacity post-consent, by anywhere from 15-40% (with the majority in the 20-30% range).
  - c.40%+ of projects reducing their capacity post-consent, by anywhere from 15-40% (with the majority in the 20-30% range). All these decisions were taken pre-FID, not during construction.
- The aim is that capacity adjustment provisions should:
  - Provide flexibility at the right point(s)
  - Provide the right amount of flexibility to take real account of the sort of changes which can occur (notwithstanding the fact that geological issues are covered separately, as are force majeure events).
  - Not offer flexibility for incompetent project management
  - Reduce bedblocking impact – by limiting free flexibility. [Note this does not remove risk of bedblocking entirely as projects can amend capacity by greater amounts, subject to a strike price adjustment which they may or may not decide is worth taking]
- Our proposals on capacity adjustment need to be seen alongside risk mitigation in the contract provided by FM, relevant geological issues.

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Current Scheme

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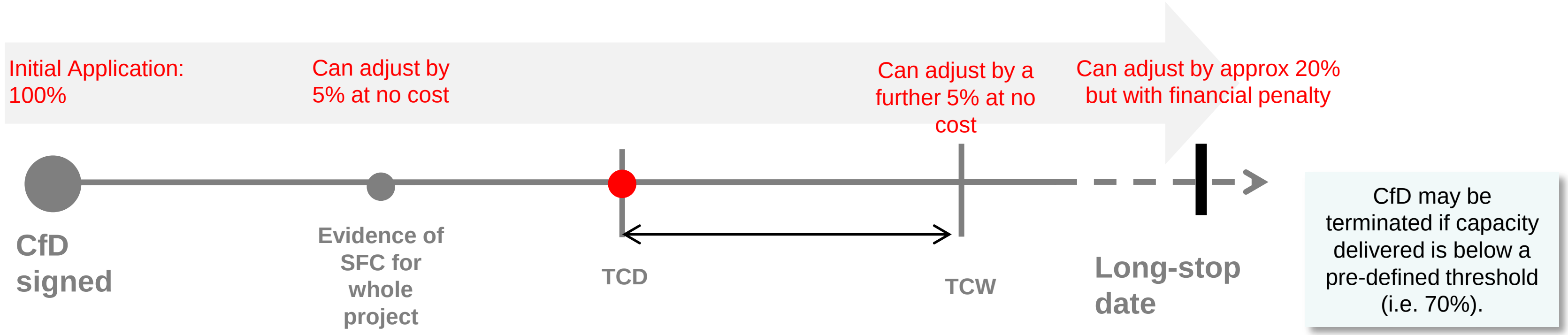

- **The allocation methodology proposed a more flexible, staged process** where developers can amend the capacity of the CfD at two different points:
  - At the Substantive financial commitment milestone, by a specified percentage (e.g. 5%); and
  - By Longstop Date, by a specified percentage (e.g. a further 5%)

- Delivering less than this adjusted level of capacity by the LSD:
  - Leads to a reduction in the Strike Price linked to the degree of under-delivery reducing the Strike Price by 0.5% for each 1% of unpermitted reduction in capacity;
  - Lead to a right to terminate the CfD only when the unpermitted reduction in capacity is greater than a specified threshold (e.g. failing to deliver 70% of initial project capacity).
- **Terminating at circa 70% significantly reduces developer risk compared to the 95% value previously proposed.**

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Alternative Option 1

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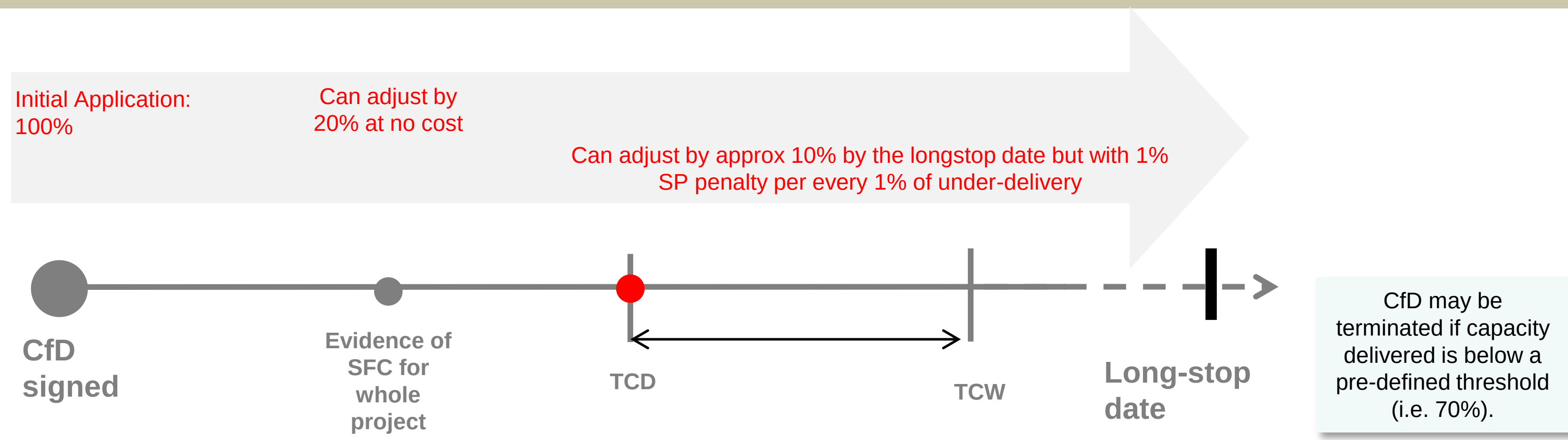

- Developers can still amend capacity at a couple of points:
  - At the Substantive financial commitment milestone, by a specified percentage (up to 20%); and
  - By Longstop Date, by a specified percentage (e.g. up to a further 10%)

- Delivering less than this adjusted level of capacity by the LSD:
  - Leads to a reduction in the Strike Price linked to the degree of under-delivery reducing the Strike Price by 1% for each 1% of unpermitted reduction in capacity;
  - Lead to a right to terminate the CfD only when the unpermitted reduction in capacity is greater than a specified threshold (e.g. failing to deliver 70% of initial project capacity).
- The no cost flexibility is only available up to SFC – so is effectively “use-it or lose it”.
- Once a developer notifies the CPB that it intends to make us of flexibility (either cost free or at a cost) the CfD is capped at that level.

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Alternative Option 2

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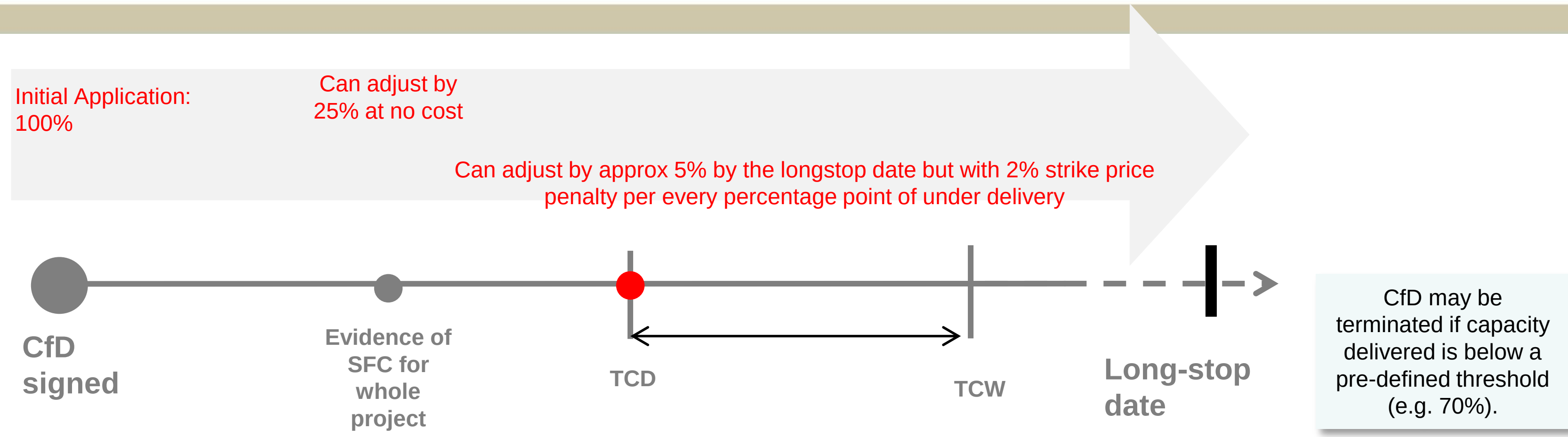

- Developers can amend capacity at a couple of points:
  - At the Substantive financial commitment milestone, by a specified percentage (up to 25%); and
  - By Longstop Date, by a specified percentage (e.g. up to a further 5%)

- Delivering less than this adjusted level of capacity by the LSD:
  - Leads to a reduction in the Strike Price linked to the degree of under-delivery reducing the Strike Price by 2% for each 1% of unpermitted reduction in capacity;
  - Lead to a right to terminate the CfD only when the unpermitted reduction in capacity is greater than a specified threshold (e.g. failing to deliver 70% of initial project capacity).
- Again, the no cost flexibility is only available up to SFC – so is effectively “use-it or lose it”.
- Once a developer notifies the CPB that it intends to make us of flexibility (either cost free or at a cost) the CfD is capped at that level.

Questions

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- Do you think the proposed alternative options offer the flexibility where it is needed?

- What do you think the proposed revisions will do to financeability of offshore wind projects?

- What impacts do you think either option will have on the wider system?

- Out of the two possible alternatives which option do you prefer?