Submission from the Low Carbon Finance Group

DECC Call for Evidence for barriers to securing long-term contracts for independent renewable generation investment.

The Low Carbon Finance Group ("LCFG") is a non-political group of senior practitioners in energy finance from across the finance spectrum, formed to provide policymakers with the factual basis for understanding the conditions required for attracting capital to low carbon energy, with significant investment focus and interest in renewable energy and energy efficiency.

Background

The ability to sell power into the market is a threshold issue for enabling financing of renewable energy (RE) projects. Greater clarity in this area, in the near term, will be central to sector investment as part of the broader EMR and infrastructure agenda.

Assisting with Further Market Evidence

1. PPA Conditions: in addition to the inputs above, DECC seeks actual market evidence of the PPA market (Questions 1. and 2. and Annex A). Although this is complicated by commercial confidentiality issues, LCFG - with feedback from DECC – is setting up a process to provide anonymised data on the PPA market and PPA terms, to the extent possible.

2. PPA terms and conditions, risk and weighting of different factors: we would be happy to go through this with DECC. PPA terms are the subject of the market evidence work above, we also outlined areas where changing terms are being observed in the presentation to DECC's workshop in June 2012.

3. Other European Markets: we are happy to provide specific input on the characteristics or details of other European markets such as Nordpool, Spain and Germany, and how these impact financing. This is likely to be most useful where DECC has specific questions. Noting that a characteristic of the latter is that there is institutionalised access for generators to sell power into those markets: a straightforward UK approach is required to avoid becoming comparatively less attractive.

Summary Points

Most independent generators (IGs) require access to third party, financial capital (in particular debt from banks) in order to provide the majority of the financing for their projects.

As a condition for providing that capital, financial institutions require that the developer has a guaranteed ability to sell their power, and that those sales are guaranteed to be at a well-understood and forecast-able index of power price for at least the term of the financing provided. This is central to revenue generation.

This assurance of access to market at a known reference price can either be provided institutionally through the market framework (for instance, as is the case in markets which offer feed-in tariffs with guarantee of despatch at the feed-in tariff price) or through the provision of a power purchase agreement from an entity which has both the skills to manage the risk associated with power trading and the credit worthiness to stand behind the commitment to provide such services over what is usually the majority of the lifetime of the asset.

In the absence of a move to institutionalised guaranteed access to the power market for all generators through, for example, an underlying reform of the electricity market, bankable PPAs will continue to be an absolute requirement of third party finance providers. This is a threshold issue.

Efforts to make the power market more liquid and accessible, while solving other issues in the market, are not a solution to guaranteed access to market per se, and hence will not negate the need for PPAs provided by creditworthy counterparties with the requisite skills in power trading.

If access to large amounts of third party, non-specialist capital from financial institutions is to remain available to RE projects by IGs then either

i. the market for creditworthy off-takers will need to be secured; or
ii. the institutional arrangements in the market will need to change to provide a guarantee of market access at a known, forecast-able and reliable reference price.

Existing LCFG input on route-to-market

LCFG has provided input over the last 18 months that remains relevant, and which we can discuss further.

1. LCFG original submission to EMR raised the route to market issue in the context of the shift away from the 'Obligation' under the RO for suppliers to source renewable energy (RE) generation (notwithstanding the buyout option) and concerns over the route for independent generators selling power into the market under the EMR proposals, when that obligation was no longer in place.

2. A working paper and further summary on Liquidity and EMR in the context of Ofgem's liquidity review, in mid-2011. These outlined a set of risks associated with selling power (including index risk, balancing risk and broader market risk).

3. Presentations to DECC workshops, summer 2012, providing an overview of the PPA market and recent trends, as well as factors in assessing the aggregator market.

Response

Over the last 18 months, LCFG has raised options or starting points for responding to risks in this area. We can add these to DECC's list, however as all of the options have complexities, are inter-related to other parts of EMR, or indeed suggest a more fundamental review of the electricity market than that implied in the Call for Evidence, it may be better to address in discussion.

Given the range of options likely to be put before DECC, it may be more useful to suggest an approach based on

1. Establishing the objective (as per summary above) to:
   - ensure the market for creditworthy off-takers is secured; or
   - ensure that institutional arrangements in the market guarantee market access at a known, forecast-able and reliable reference price.

2. Examining the impact on the risk profile of projects and the ability to secure finance, including factors such as:
   - increasing the transparency of pricing to access market;
   - timing: the need to respond to actual risks in the market in a timely fashion;
   - integration with other regulatory processes, including Ofgem's Liquidity Review and the Significant Code Review into Electricity Balancing, such that the intended outcome of each is clear.

3. Clarify an objective set of criteria to monitor the market: this may require some work given commercial confidentiality issues, but will be important.