

## **REAA Response to the Competition and Market Authority – Provisional Remedies**

The Renewable Energy Association (REA) is pleased to submit this response to the CMA's provisional remedies following their energy market investigation. The REA represents a wide variety of organisations, including generators, project developers, fuel and power suppliers, investors, equipment producers and service providers. Members range in size from major multinationals to sole traders. There are around 750 corporate members of the REA, making it the largest renewable energy trade association in the UK and the only body to cover all forms of energy.

As our membership is predominantly made up of renewable developers, generators and investors, it is appropriate that our response focuses on the remedies outlined in chapter two of the CMA's provisional decision, concerning wholesale energy costs. Within this response we therefore primarily comment on the suggested remedies to reform CfD budget allocations and the suggested locational adjustments for transmission losses.

On the whole, the REA welcomes the CMA's findings, especially with the focus on reforming the CfD allocation process. However, we do raise concerns as to the effectiveness of locational transmission pricing and its potential to negatively impact renewable generation.

### **1) Allocation of the Contracts for Difference within competitive auctions**

The REA welcomes the importance the CMA has placed on reforming how the budget for Contracts for Difference (CfD's) is both set and divided between technology pots. The proposed remedy for the introduction of compulsory impact assessments and consultations, prior to the allocation of a CfD auction will provide a greater level of transparency for developers and investors. This in turn should encourage a wider portfolio of technologies to compete and succeed within auctions, making them more competitive. This will benefit consumers as costs are driven down across the whole generation industry, rather than focused on a few 'preferred' technologies. It is also hoped that the CMA's findings will encourage DECC to finally publish their assumptions concerning the overspend of the Levy Control Framework, in the name of transparency.

The chancellor's announcements in the 2016 Annual Budget, confirming £730 million for the next three pot 2 auctions, was the first time since coming into power that the government provided a clear statement setting out a level of support for large-scale less established technologies. However, this announcement also made clear that the government viewed this support as primarily beneficial for the development of offshore wind projects.

At the same time, there remains no firm government position concerning the future of Pot 1 technologies, apart from a manifesto promise to ensure no new subsidy for onshore wind development. This is in spite of analysis from the Committee on Climate Change (CCC), published as part of their 5<sup>th</sup> Carbon Budget recommendations, indicated that mature renewable technologies, such as onshore wind and solar, are the most competitive forms of low carbon generation, even considering the cost of back up generation or intermittency costs. Wind generation is even expected to be cheaper than new CCGT on a like for like basis. However the government's lack of firm energy policy and reticence to hold another pot 1 CfD auction is stopping these technologies from deploying.

It is therefore the perception of the renewables industry that the government appears to have already chosen their technology 'winners' and 'losers', without appropriate analysis of the costs and wider benefits of all available solutions. A position which clearly runs counter to the competitive market the CfD scheme was designed to foster. The effect of this has been demonstrated within the recent Commons Energy and Climate Change Select Committee inquiry, where a lack of clarity around the government's long term energy policy was shown to have undermined investor confidence<sup>1</sup>. This in turn has resulted in projects either being paused or scrapped altogether, while pushing up the cost of capital; all of which has negative implications for the cost to consumers.

The REA therefore supports the introduction of a clear process by which an impact assessment and industry consultation justifies the allocation of a budget. It also remains important that the Government maintains, and justifies, the ability to hold separate technology pot auctions, as recognised by the CMA remedy. While current scalable options may be limited, a wide portfolio of technologies will be required to meet our generation gap and decarbonisation ambitions. These technologies are at different levels of maturity and decreasing in costs at different rates. As such, effective support through separate auctions is justified in order to realise long run benefits, such as driving down the cost of future projects and decarbonisation.

***A 'long-run' impact assessment should consider the whole-system benefits provided by a technology.***

The REA strongly supports the CMA in their recommendation for 'short-run' costs to be weighed against any 'long-run' benefits within the impact assessments. It is essential that a balanced approach is taken to ensure the assessment reflects the characteristics and benefits of different solutions. This means recognising those technologies which are the cheapest and most scalable, identified by the CCC as onshore wind and solar, while also quantifying the wider consumer benefits less established technologies offer. This includes technologies like Gasification, Pyrolysis, Biomass generation, Waste to Energy and energy storage, which have the potential to provide significant long term savings to consumers through dispatchable base load generation; as well as the added value of contributing to the decarbonisation of the heat and waste sectors. Recognising these 'whole-system' benefits within the assessment will provide greater transparency in determining which pots, and for what budget, such technologies should compete. Such long-run analysis will help the UK to address the Energy 'Trilemma' through a portfolio of technologies and meet our Carbon Budgets in the most cost effective manner possible.

***Ofgem should be involved in the impact assessments***

Members of the REA have also highlighted how such impact assessments and consultations should involve Ofgem, either as the ones carrying out the analysis or, at minimum, providing a scrutinising role. As has already been discussed, there is a perceived political bias to certain technologies which could be mitigated by Ofgem's involvement. Furthermore, it may help ensure that budgetary decisions around CfD's continue to prioritise the cost effective decarbonisation of the UK energy system, which has been the long standing aim of the CfD scheme. This will ensure a greater level of confidence in the savings that can be expected for consumers. The CMA should therefore consider an order on Ofgem to have a role in the Impact assessment process.

However, it is of course recognised that the final decision on budget allocation must be taken by DECC, in consultation with HM Treasury. It therefore needs to be made clearer by the CMA what obligation is placed on DECC's decision making process by this remedy. Despite the greater transparency, the administrative task of performing an impact assessment does not ensure that DECC takes notice of the findings. In order for the industry to have a sufficient level of confidence in the proposed impact assessment, it is essential that the CMA stipulate how the analysis must be accounted for in DECC's final decisions before the budget for a CfD auction is set.

**Annual auctions with a minimum budget set a year in advance**

The REA agree with the CMA that it is desirable for DECC's final decision on the allocation of CfD technologies and budget to take place in advance of each future auction. In an ideal situation, we agree that having the decision a full year of an auction would be instrumental in providing significant investor confidence to the market.

For the sake of further investor confidence and transparency, we believe the CMA should tighten this remedy by ordering for auctions to be run on an annual basis. Furthermore the budget, set a year in advance, should be considered a 'minimum budget', which will allow DECC to refine it in line with changes in assumptions, CfD attrition & capacity adjustment during the year.

***This provisional remedy must not cause further delays to future CfD allocations***

However, the current market reality must also be taken into account. The last CfD auction took place in February 2015, while the next auction is only suggested to happen near the end of 2016, with no firm date having yet been set. This has left developers and investors in limbo, while suffering expensive delays to their projects. As such, it would be detrimental to the industry, and consumers, if the desire for a full impact assessment and consultation resulted in the 2016 auction, and subsequent allocations, being delayed by a further 12 months. The CfD scheme cannot afford to experience anymore delays which would further damage investor confidence, increase the cost of capital and cause detrimental costs for consumers. As such, the CMA must make clear that this remedy should not be used by DECC to further delay any future auctions.

**2) Allocation of CfDs outside of competitive processes**

The REA welcomes the CMAs provisional remedies in relation to the allocation of CfDs outside of a competitive process. We agree that a thorough impact assessment performed both before and after bilateral negotiations, should be used to demonstrate how the agreement is in the consumers' interest. The first stage of this process could include an assessment of the barriers that are stopping alternative technologies from deploying through the CfD auction and looking at how these could be removed in order to allow them to compete more effectively. Next, and as previously mentioned, this analysis must take into consideration the wider benefits of the technology that is being negotiated. This includes recognising its ability to provide whole system benefits which lead to a lower cost of decarbonisation in the long run, despite not meeting a competitive strike price through the auction mechanism.

However, it is currently not made clear by the CMA what level of obligation will be placed on DECC, and the counterparty, to ensure they follow the findings of the impact assessment. In the case of the assessment done following the completion of negotiations, it should be made clear the level of obligation placed on both parties to reassess the deal if the assessment indicates the agreed contract does not represent value for money for the consumer. If this obligation is not clear from the start, the second impact assessment will be of little value and will not provide a strong enough incentive to ensure the negotiation leads to the best possible deal for consumers.

**3) Locational Transmission Loss Pricing**

Members of the REA have raised concerns in relation to the provisional remedy for the introduction of locational transmission loss pricing, with the additional requirement for generators to cover 100% of the costs. While the detailed modelling performed by the CMA demonstrates savings for consumers in the current energy market, there remain significant concerns as to how these savings will be born out as the UK continues to decarbonise its energy sector and we move to a more decentralised energy system.

**Locational pricing disadvantages remote renewable deployment**

It has been highlighted by generators that the introduction of locational transmission loss pricing is unlikely, in itself, to have a significant influence on the decision of generators to locate in certain regions. Neither is it a major consideration for consumers when considering where to live. It does however create a further cost for those renewable generators who are dependent on specific resources in remote areas. Such location specific technologies such as offshore and onshore wind, marine and hydro generation cannot respond to regional transmission incentives when their generation relies on a resource best found in remote areas with little energy demand. As such, locational transmission loss pricing creates a competitive disadvantage which is out of the renewable generators control, while favouring less location reliant generators, including fossil fuels. Such a remedy therefore runs counter to the UK's decarbonisation targets and could cost consumers more in the long run if the remedy results in a more expensive, and time restrictive, deployment of renewable technologies in order to meet our legally binding climate change targets.

**Locational pricing could also damage embedded generators**

At the same time the move to push transmission losses completely on to the transmission connected generators will likely have a negative impact on embedded generators, who are predominantly renewable. As national transmission losses currently average about 2% a year, the current ratio of 45:55 split between generator and supplier charges means that suppliers must effectively buy excess generation to equate for half the national losses. Suppliers are able to avoid this cost by sourcing power from embedded generators who do not use the transmission network, as their power is used locally and therefore not susceptible to transmission loss costs. The supplier passes this onto the generator as an embedded benefit. With 100% of transmission losses being covered by generators, suppliers would no longer have the incentive to provide transmission loss avoidance as a benefit to embedded generators. Analysis by Cornwall Energy suggests this could equate to a loss of about £0.35/MWh to embedded generators. This therefore again increases costs for renewables at a time when other fiscal support measures, such as FITs, are being reduced or scrapped entirely.

**A broader review of all transmission costs is required to remove barriers to the deployment of a decentralised energy system, which will bring the greatest benefits to consumers.**

The CMA's model predicting the benefits of locational transmission is based on today's centralised energy system. They conclude that the implementation of the proposed remedy would bring a net benefit over ten years. However, this analysis fails to take into account the significant changes the UK grid is expecting to see over the next decade, which could see the grid transformed from the assumptions used in the CMA's model.

In January 2016 the REA and KPMG launched our report on "*Decentralised Energy and Energy Storage*"<sup>ii</sup> which provides a comprehensive review of the status of, and potential for, storage technologies within a decentralised system. It makes clear that both domestic and commercial energy storage are becoming viable investment in 2016. Furthermore, projects are being developed without subsidy support as the value of auxiliary services to both the grid and consumers is expected to provide an attractive return on investment. As such we are expecting the serious role out of storage technologies in as little as 12 months, starting to transform how our energy system operates. Significantly the move to a more flexible energy system over the next few years is expected to bring far greater benefits to consumers than those modelled in the case of locational transmission loss pricing. The National Infrastructure Commission 'Smart Power' reports that energy storage, alongside DSR and interconnectors could save consumers up to £8 billion a year by 2030<sup>iii</sup>. It would therefore seem that the most cost effective route to ensuring a system that benefits consumers is by focusing on the removal of deployment barriers to decentralised systems.

Importantly in order to facilitate these consumer benefits a far broader review of grid operations and charges is required to incentivise the development of flexible solutions, well beyond the issue of just locational transmission loss pricing. The REA, like the National

*REA Response to the CMA Provisional Remedies.*

Infrastructure Commission and Carbon Trust<sup>iv</sup>, have called upon the government to remove the barriers to energy storage deployment. The CMA should note that this work is already well underway with National Grids network charging review, Ofgems's embedded benefits review and DECCs Systems Integration cost review all currently taking place. While changes to EU network codes could also influence how our systems work in the future. As such any changes to the transmission charging regime should be made in the context of these reviews, which could significantly alter the grids charging and operational process well beyond the addition of Locational Transmission Loss Pricing.

As such the REA believe far more is required if true consumer benefits are to be realised from a decentralised system. It is for this reason that the REA also particularly welcomes the CMA's conclusions on smart metering and half-hourly settlement, which will play a key role in enabling consumers to experience the benefits of a decentralised, low carbon energy system and increase deployment of such technologies.

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<sup>i</sup> ECCC (2016) Investor Confidence in the Uk Energy Sector, available at <http://www.parliament.uk/business/committees/committees-a-z/commons-select/energy-and-climate-change-committee/inquiries/parliament-2015/investor-confidence/>

<sup>ii</sup> REA-KPMG (2016) "Report on Decentralised Energy and Energy Storage", available online at <http://www.r-e-a.net/resources/rea-publications>

<sup>iii</sup> NIC (2016) A National Infrastructure Commission Report, available at <https://www.gov.uk/government/publications/smart-power-a-national-infrastructure-commission-report>

<sup>iv</sup> Carbon Trust (2016) Energy Storage Report, Available at <https://www.carbontrust.com/resources/reports/technology/energy-storage-report/>