The co-operative

The Co-operative Group response to the DECC Electricity Market Reform consultation

The Co-operative Group

The Co-operative Group is owned by more than five million consumers and has core interests in food, financial services, travel, pharmacy, funerals and farms. It has an annual turnover of £14 billion, employs around 110,000 staff and operates over 5,000 retail trading outlets serving more than 20 million customers per week.

Following the acquisition of the Somerfield supermarket chain in March 2009, The Co-operative Food is the fifth largest food retailer in the UK. The Co-operative Financial Services is one of the largest and most diversified financial mutual businesses, operating The Co-operative Bank, The Co-operative Insurance and Britannia.

The Co-operative is the UK's number one provider of funeral services, the third largest retail pharmacy chain, a leading travel retailer, supplying the travel needs of more than three million people annually, and is the UK's largest farmer.

The Co-operative Group is pleased to be able to respond to this consultation. We have been actively involved in the climate change and energy policy debate for more than two decades, leading campaigns on carbon reduction in the Climate Change Act, being recognised for our sustainability reporting standards and setting out a strong case for community-scale energy support through the Feed-in Tariff mechanism.

We have extended commercial lending for energy efficiency and renewables from £400m to £1bn in response to increased demand and the number of projects coming forward. In 2011, The Co-operative Enterprise Hub has committed £1m to help communities around the UK develop their own, co-operatively owned renewable energy projects. This follows on from assistance provided to help the formation of seven co-operatively owned wind farms and three small hydro projects. The membership of these wind and hydro co-ops numbers several thousand people who have raised the millions of pounds required to get these projects up and running. Through our Green Schools Programme, The Co-operative has installed solar panels, small wind turbines, biomass boilers and ground source heat pumps in 188 schools. The Co-operative contributed £2m to this which levered in £2m in funding from government. These initiatives form part of our recently launched Ethical Operating Plan which includes commitments to protect the environment and lead in the provision of sustainable and ethical finance.

Executive Summary

Reform of the electricity market will allow for greater efficiency and is much needed and overdue to help the UK meet its stretching carbon and energy targets. We would want to see a better market for investment come from this reform, particularly in renewable energy schemes and embedded generation where there are significant local economic and social benefits in addition to any cost effectiveness assessment.

The Co-operative Group would favour the continuance of the existing twin track approach of an RO and FIT for small scale projects, however understands the reasons behind a desire to review the system of support. There is not enough of a case made to implement a 'one-system fits all' approach to FITs. There would be significant benefit in continuing a fixed FIT scheme for small scale and community installations (up to 5 MW) which could effectively run alongside a CFD (replacing the current RO)

Consultation Response

We have focused our response on those specific areas where we have a track record in delivery or where our members or businesses have a stake, namely on Decarbonising Options and on Implementation Issues. We have not commented on the section on Emissions Performance Standards.

Current Market Arrangements

1. Do you agree with the Government's assessment of the ability of the current market to support the investment in low-carbon generation needed to meet environmental targets?

The Co-operative Group supports government intentions to ensure that electricity is generated cleanly by promoting low carbon technologies and bringing forth new investment at scale. The UK's binding target of 15% renewable energy generation by 2020 which will require about 30% renewable electricity and 12% renewable heat is a massive challenge. The combination of new generation, energy efficiency technology and network improvements will require a level of investment from a broader pool of capital than currently available. It is imperative therefore that the UK is an attractive investment environment through a long term and dependable market place in terms of long term financial return which must be must be paralleled with reducing risks in planning, grid access, technology, construction.

As well as providing the right environment, government needs to ensure effective use of public funding to stimulate private investment. The Green Investment Bank is a key mechanism to deliver support where the market is not the most effective and can help de-risk larger and smaller projects in order to help the market and industry gain maturity.

2. Do you agree with the Government's assessment of the future risks to the UK's security of electricity supplies?

The Co-operative Group supports the Government's 3 key objective criteria – security of supply, decarbonisation and affordability and the 4 delivery principles – cost effectiveness, durability, practicality and coherence. We broadly agree with the future risks of supply analysis – particularly in relation to the energy mix and sufficient capacity. However there is not enough emphasis on the role of the planning system in ensuring the delivery of new capacity – it is only mentioned briefly on p.17 of the consultation. Delays to projects, when we are already up against tight timescales, are the single biggest risk to the government's stated ambitions. More needs to be done working across government and in particular with the Department for Communities and Local Government to ensure that priority energy projects do not get held up unnecessarily. This includes the projects that will fall under the Major Infrastructure Planning Unit but also significant sized projects which will together help the UK make huge strides towards its carbon and energy targets.

Options for Decarbonisation

Feed-in Tariffs

3. Do you agree with the Government's assessment of the pros and cons of each of the models of feed-in tariff (FIT)?

It is our view that the current RO system (introduced in 2002), with various subsequent operational reforms works well and is understood across the industry. The major shortcomings of the system have now been addressed. Our preference would be to leave the existing system in place.

If government is intent on changing the existing system, we consider it is important that any amendments are introduced in such a way that they do not damage investor confidence ensuring a sufficient level of return, certainty and stability for a reasonable period of time. In addition it is important that support of existing projects is maintained and that there is a clear transitional process for those projects in the pre-commissioning pipeline to ensure that such projects remain "on track".

4. Do you agree with the Government's preferred policy of introducing a contract for difference based feed-in tariff (FIT with CfD)?

The Co-operative Group recognises the reasons for the Government's lead option for low-carbon revenue support being a feed in tariff with a contract for difference (CFD) on the electricity price. With the right conditions in place we believe this mechanism has the potential to bring forward investment.

We are concerned that the "one system fits all" approach might discriminate against small scale / community installations where the benefits of localised generation are insufficiently supported. We would favour support the continuation of the current small scale FIT (up to 5 MW). This would recognise the additional transactional costs of smaller generation but local / community benefits.

5. What do you see as the advantages and disadvantages of transferring different risks from the generator or the supplier to the Government? In particular, what are the implications of removing the (long-term) electricity price risk from generators under the CfD model?

Specifically CFD provides the theoretical benefits; removing developer risk, removing premium developer returns (which are then passed on as a higher cost to consumers), providing open access, imposing volume control and importantly remove the hiatus around review points. There are however major complexities and fundamental uncertainties to be resolved before the industry can be confident in its success. The Co-operative Group is keen to work with Government in ensuring that such issues are addressed to the satisfaction of the industry at large and the particular business areas where we are involved and to benefit the communities with whom the Co-operative works.

- Under the current RO system there is a built in protection against "volume overshoot" through the fixed headroom being increased year on year depending on the renewables commissioned during the previous year. It is critical under the new scheme that developers, investors and banks can model

projected investment returns with a degree of certainty and such returns must be attractive within an international investment market place.

- The adopted FIT system must work for all types of renewable generation and cover the different range of technologies and scale of installation
- There needs to be recognition of the benefits of on site generation where such generators consume their own power
- A problem with the RO and potentially any new support mechanism occurs because accreditation only takes place at the time of commissioning which gives rise to considerable uncertainty through the development and build stages of a project. The Co-operative supports the "gated approach" suggested by the REA to provide developer certainty of the level of support they will receive with the project is operational as well as giving Government visibility of the pace of development in each sector.

6. What are the efficient operational decisions that the price signal incentivises? How important are these for the market to function properly? How would they be affected by the proposed policy?

There needs to be careful treatment of technologies reliant on a feedstock (biomass and AD) where the feedstock price fluctuates. The Co-operative (in its previous consultation response on biomass grandfathering under the RO) expressed a view that it would be unnecessarily complicated (and unhelpful to investors) for grandfathering of the RO to provide for a future review of feedstock pricing. If the shift to a CFD FIT results in reduced developer risk but at the same time reducing developer returns, the willingness of developers / investors to "take a view" on feedstock pricing could stifle development in this sector.

Implementation Issues

30. What do you think are the main implementation risks for the Government's preferred package? Are these risks different for the other packages being considered?

The arrangement for setting pricing contracts needs to be carefully handled. It is critical that the body has sufficient resources, knowledge and expertise to deal with a variety of technologies. It is critical that the basis on which pricing is set is totally transparent and tied to market place performance such that investors can accurately model projected project returns. The mechanism must be consistent and dependable and structural changes should be avoided where possible as such changes all too often damage investor confidence.

The body handling contracts should be subject to audit that it delivers the greatest customer benefits. There should be a clear route for the industry to follow if they have complaints regarding how contracts are handled.