Scottish Water Consultation Response
August 2012

A call for evidence on barriers to securing long-term contracts for independent renewable generation investment

Identifying the problem

1	*Please could you provide a summary of your experiences with the PPA market over the past three years? Specific areas for which detailed information would be particularly helpful are set out in the Annex.*

Scottish Water has been seeking to secure a proportion of its electricity supplies through third party Power Purchase Agreement's (PPA) over the last two years or so. This has seen only limited success. Experience has ranged from reaching advanced stage discussions with developers, who have subsequently withdrawn from the market (or worse still, ceased trading) to developers seeking above-market prices for power which are commercially unattractive. PPA market activity has subsided significantly since the announcement of the impending Electricity Market Reform (EMR) and also Renewable Obligation (RO) and Feed-in Tariff (FIT) banding reviews.

2	*Have you seen significant changes to the PPA market over the past three years, and if so, what do you think has driven this? If you have asked PPA providers for explanations of why changes have occurred, what reasons have been provided?*

Scottish Water has not observed significant changes to the PPA market over the last few years, other than a recent reduction in activity. Activity levels would best be described as 'low' over the last two years – with a general dearth of available PPA's being available directly to the end user market.

3	*How does the GB market for PPAs compare to other international markets? If you operate in other markets, how do PPA structures and terms differ? If terms differ what are the drivers behind the differences?*

Scottish Water has no experience of the international PPA market so has no comment to make in response to this question.

4	*What are the factors preventing or encouraging participation in the GB market? How (and why) do you expect these to change over time?*

Scottish Water suggests that the major factor preventing participation is the uncertainty arising from change (or perceived risk of change) to the renewable support mechanisms. This is from both the likely replacement of the RO with EMR/Contract for Difference (CfD) mechanism, and the RO banding review. Developers and investors generally require certainty around the returns on their investments, and current circumstances apparently do not provide this.

5	*Do you expect the EMR package to change the PPA terms that you might offer/receive and if so how do you believe they will change? What do you think is the primary driver for these changes?*
Scottish Water suggests that currently-available information on EMR does not provide sufficient detail for developers and investors to pursue renewable projects in earnest. Details on the mechanism have not yet been published, nor the 'strike price' for different renewable technologies.	
6	*What has been the determining factor in selecting a preferred PPA and PPA provider?*
Scottish Water has sought to establish PPAs with credible developers and operators that have the resources and wherewithal to build and operate renewable generation plant – and that are likely to be in he business 'long term'. The commercial terms are also important (i.e. PPA price, and price-related factors such as inflation/indexation mechanisms). The term (duration) of any PPA is also important.	
7	*Have you seen a change in investment returns as a result of the changing nature of PPA terms and can you provide an example, including how this has been calculated? Do you expect the EMR package to change investment returns, and if so what is the driver for this?*
Investment returns on PPAs are subject to variations in many factors (e.g. development expenditure, capital costs, Renewable Obligation Certificate (ROC) prices, export power prices, etc.). As precise detail on the operation of the EMR has not been announced, it is not possible to comment at this stage whether or not the EMR will change investment returns.	
Options to achieve the Government's objective	
8	*What are your views (costs, benefits and risks) on the potential options discussed in this call for evidence that may be necessary to achieve the Government's objectives?*
Scottish Water suggests that all of the options proposed potentially have merit, however a full response could only be given once the finer details are understood. Scottish Water suggests that, in any market structural changes, third-party PPA's should be accommodated – it is not presently clear how the CfD mechanism will allow this. In addition, steps to improve market liquidity of PPAs are also required.	
9	*What are your views of the potential for market distortions and possible impact on the wider market?*
Improvements to liquidity are likely to remove market distortions, since liquidity should see a tendency for the PPA market to find a proper equilibrium price.	

10	*Can you identify and explain any other viable options (voluntary, competition based, regulatory or otherwise) that should be considered?*

Scottish Water suggests that voluntary measures will only be effective if sufficient incentive is available for investment in third party renewable projects. Competition based measures will only be effective if there are sufficient projects, and hence a high level of market liquidity. Therefore, it is likely that a regulatory approach may be required at the outset. However, it is unclear how such an approach would work. Even with such an approach in place, investment will only occur if returns are acceptable, and if investors have confidence that support mechanisms will remain in place, without modification, for at least the period needed to return the original investment – for many projects likely to be >5 years.