



## **Submission to DECC Call for Evidence:**

### **Barriers to securing long-term contracts for independent renewable generation investment**

**August 2012**

#### **1. About Co-operatives UK**

Co-operatives UK is the national trade body that campaigns for co-operation and works to promote, develop and unite co-operative enterprises. We have a unique role as a trade association for co-operatives. We work to promote the co-operative alternative across many sectors of the economy from high street consumer-owned co-operatives to pubs and renewable energy, healthcare to agriculture, credit unions to community owned shops. Our research with The Co-operative shows that there are now over 40 renewable energy generation co-operatives across the UK, which collectively have raised over £16 million in risk capital for investment. Together the co-operative economy is worth some £33.2 billion, employs 236,000 people and has 12.8 million members. Co-operatives are the largest membership movement in the country.

#### **2. The potential for community energy**

Community and co-operative energy is a vibrant and growing sector in the UK. Recent research by Camco and Baker Tilly<sup>1</sup> estimates there is potential for over 2GW of community-owned renewables in England, or around ten per cent of the total capacity for onshore renewable energy. The potential for Scotland is estimated to be 1GW and for Wales 0.4GW. Therefore, UK capacity could be around 3.5GW, the equivalent of three or four conventional power stations. Community and co-operative energy can be at all scales, from a few solar panels on the roof of a village hall to large scale wind energy developments.

A dramatic scale up of community and co-operative energy would deliver local economic and social benefits and help the UK to meet its stated energy goals and other ambitions, particularly the vision of a strengthened civil society with greater citizen involvement.

#### **3. Government commitment to community energy**

The UK and devolved governments have made strong statements in support of co-operative and community energy. The May 2010 coalition agreement states "we will encourage community-owned renewable energy schemes where local people benefit from the power produced." The new National Planning Policy Framework for England also asks planning authorities to "support community-led initiatives for renewable and low-carbon energy".<sup>ii</sup>

Positive ministerial statements have also been forthcoming, for example the Minister of State for Energy and Climate Change, Greg Barker, made the case in parliament for a specific FIT to reward and encourage community-owned energy:

"Because of the way in which the system was constructed, there is no way of rewarding community schemes. There is no tariff for communities. There is no way of distinguishing between a City hedge fund manager and a village hall because of the way in which the system was constructed by the last government. We will try to change that so that we can specifically recognise community schemes, and we will consult on that work."

#### **4. The difficulties faced by community energy projects**

Community and co-operative energy is still the exception rather than the rule in the UK. This is because, at present, it does not 'fit'. In policy terms, the UK lacks a comprehensive and integrated framework of support for community and co-operative energy schemes. Mainstream commercial scale energy is backed by the existing regulatory structures. Research consistently shows how difficult it is for new entrants to compete alongside the established players for whom the market and regulatory context is designed.<sup>iii</sup>

In recent years, government has understood the need to encourage other types of energy generation, and has put incentives in place for small scale schemes, primarily through FITs, the Renewable Heat Incentive and, potentially, the new Green Deal. However, community and co-operative energy schemes are currently losing out, possibly because they are a hybrid. They exhibit a combination of commercial and social characteristics. They are profit-making, but are motivated by social and environmental benefit. They can't be treated like the big commercial energy companies, but neither do they fit into the individual householder category. Many community and co-operative energy projects are mid-size in generation capacity: from 50KW to 10MW. It is inappropriate to apply the regulation and policy measures designed for much larger, commercial scale generators.

#### **5. The issues with Electricity Market Reform**

Given this policy context, we foresee specific problems with the new proposals envisaged as part of the Electricity Market Reform package, and specifically, the proposed Contracts for Difference (CfD) mechanism which will replace the Renewables Obligation.

At present, it is envisaged that all schemes above 5MW will have to enter the CfD process. Larger community-owned schemes will therefore be obliged to participate. They will encounter two main problems:

**Complexity and uncertainty:** Smaller producers will find it much harder to participate in the market. Given its complexity, the transaction costs are high, and proportionally much higher for smaller generators than larger ones. Whereas larger generators will be able to trade directly, smaller ones will need to work through aggregators, which bites further into revenues. In addition, because of the link to the 'reference price' (as below), revenues from electricity generation are far harder to predict than under the ROC system, which causes uncertainty and increases costs and risks. This is a big problem for community schemes, who struggle to raise investment from banks.

**The Reference Price:** Under the EMR proposals, generators will receive a top-up payment, which represents the difference between the 'reference price' and the 'strike price'. However, the 'reference price' is based on market averages, not the actual amount that the generator receives. For small renewable generators, the actual price they receive will in reality be considerably lower than the reference price. This is because they produce smaller amounts, and because output is less certain. They do not have the buying clout of major producers. So this will cause a perverse outcome in which large commercial players actually get paid more per unit for their power than small community generators.

## **6. The role of Power Purchase Agreements (PPAs)**

Before making our comments on PPAs, we would like to stress that PPAs are not the only difficulty that independent generators face. There is a need for a much wider review of the prospects for independent generators, including community and co-operatively owned projects (see point 7 below). We believe that there is a need for a much wider consultation, rather than this narrow Call for Evidence on PPAs.

One of the barriers to entry for independent generators is the sheer complexity of market and policy frameworks for energy generation. Many prospective projects will not have the technical understanding to be able to respond to this Call for Evidence. If the government is to realise its ambition for a more plural, diverse energy market, it must tackle this complexity.

Turning to PPAs in particular, community and co-operatively owned renewable energy projects are generally small in size (50kW to 10MW), connected to the distribution network and do not participate directly in the wholesale energy market. The route to market for these projects is usually to enter a contract with a licensed energy supplier, through bespoke contracts, or PPAs. These are typically for several years and require significant commitment from both parties, especially for project-financed stations that need to prove secure cashflows over an agreed period to their lenders. Securing a credit-worthy PPA is usually

essential for community and co-operative projects to raise the finances needed to go ahead with the project.

DECC reported in the launch of the call for evidence that smaller/ independent generators were finding it increasingly difficult to agree PPAs with suppliers on favourable and bankable terms. Suppliers take a share of the cashflows arising from renewables generation (power and green certificates), but this share is increasing. If this deterioration continues it will lead to many community and co-operative projects being stalled and possibly being scrapped. This would be a massive blow, especially given the vast potential of such projects (highlighted in Section 2).

More generally, we believe the system of PPAs may well harm the prospects for community and co-operatively owned energy, for the following reasons:

- The Renewables Obligation (RO) is being closed to new projects from 1 April 2017 and replaced with a CfD feed-in tariff scheme. The RO places an obligation on electricity suppliers to source a proportion of the electricity they supply from renewables. Suppliers comply with these obligations by presenting ROCs. Once the RO comes to an end there will not be the same obligation on suppliers to source renewable electricity. These suppliers may not have the same incentive to buy output from independent renewables generators and PPA terms could deteriorate further.
- Terms offered under a PPA can be dependent on the technology. Many community and co-operative projects are intermittent generation (onshore wind in particular). These projects can be offered weaker PPA terms than non-intermittent projects.
- Terms offered under a PPA are often dependent on the size of the renewables project. Typically, community and co-operative generators are smaller than commercial players, so they are offered less favourable terms than larger projects. We believe this is likely to be exacerbated by the changes proposed under EMR.

## **7. The need for a wider review of the prospects for community energy**



The issue of PPAs should not be addressed in isolation. Given the strong commitment to community and co-operatively owned energy continually stated by government (see section 3 above), there is a need for a wider review of the way in which such schemes are treated by the energy market and by regulatory frameworks. The forthcoming Community Energy Strategy, together with the Energy Bill, provide an opportunity for this strategic analysis.

## **8. Further work on these issues**

Co-operatives UK has commissioned technical analysis by Cornwall Energy to

analyse the possible effects of the Energy Bill on community energy, and propose solutions. This will include issues relevant to this Call for Evidence. However given the tight timescale of the Call, we do not yet have research to share with DECC. We will share the research as soon as it is available. However in the mean time we would be pleased to discuss the work informally with the DECC team.

## 9. Further information

Please contact  Co-operatives UK, tel 

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<sup>i</sup> *The potential for the Green Investment Bank to support community renewables*, Camco and Baker Tilly for The Co-operative Group, December 2011 pp 3-4

<sup>ii</sup> National Planning Policy Framework, Department for Communities and Local Government, March 2012

<sup>iii</sup> *Community energy in the UK: a review of the research literature*, Sabine Hielscher, Community Innovation for Sustainable Energy, University of Sussex, [www.grassrootsinnovations.org](http://www.grassrootsinnovations.org)

Figure 1.1.1.1

Figure 1.1.1.2

Figure 1.1.1.3