

MAYOR OF LONDON

Response from the Mayor of London to the DECC call for evidence on barriers to securing long-term contracts for independent renewable generation investment.

1. The Mayor's interest in renewable generation investment

- The Mayor of London welcomes the opportunity to respond to DECC's call for evidence on barriers to securing long-term contracts for independent renewable generation investment.
- The Mayor has ambitious emission reduction targets for London, namely an interim target of a 40 per cent reduction on 1990 CO₂ levels by 2020, 60 per cent by 2025, and at least 80 per cent by 2050.
- Reaching these targets is substantially dependent upon large scale investment in low and zero carbon decentralised energy generation within London, the Mayor's target being that 25 per cent of London's energy be produced from local decentralised energy sources by 2025. That will achieve an annual CO₂ reduction of 3.5 million tonnes and will require £5 -7 billion of investment in London's energy infrastructure, with the resulting creation of jobs, in construction and operation.
- Approximately 25 per cent of the target for distributed energy will be met through renewable sources of energy (as opposed to other zero carbon sources of energy and initially, natural gas).
- The ability of a renewable energy plant to obtain a proper market price for the electricity it produces is fundamental to delivery of this target, since the value obtainable from electricity sales is central to the financial viability of heat networks supplied with heat from combined heat and power systems.
- The Mayor's decentralised energy programme involves supporting the commercialisation of large scale decentralised energy projects for the production of both heat and power. Gas-fired combined heat and power schemes will initially and in the medium term be an important means of getting the new networks up and running. Once established, the heat sources for these networks will be replaced by zero carbon and renewable energy sources in the longer term. It is therefore important that gas-fired CHP schemes needed in the short and medium term to feed new networks with heat also obtain a proper market price for the electricity produced. Without supporting this intermediate step, the Government could undermine the viability of zero carbon and renewable energy sources in the medium -to-long term.
- It is noted that the Government is considering whether similar issues may affect independent gas generator investors. In the case of decentralised gas generation, similar considerations do apply and this response should be taken as applying to both.

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- The Mayor's role is to support the creation of the right conditions to attract investment in renewable and low carbon systems and heat networks in London, rather than for the GLA to own electricity generation itself. This response therefore focuses on the market environment and structure needed to attract investment in renewable and low/zero carbon electricity generation, rather than on the specifics of the pricing and terms of Power Purchase Agreements, which the generators themselves are best placed to provide.

2. Overarching comments on the call for evidence

- The market mechanisms introduced in 2001 under the then New Electricity Trading Arrangements contain costs risks and complexities that are a severe impediment to smaller electricity generators and suppliers needing access to the electricity market. Periodic attempts have been made by government to address this, but the barriers remain unresolved. The 2007 White Paper *Meeting the Energy Challenge* acknowledged the existence of these barriers, but no substantive progress has been made to remove them.
- The Renewables Obligation arrangements have partially insulated smaller renewable generators from the effects of inadequate market access, through the need of the large suppliers to buy Renewable Obligation Certificates (ROCs) from smaller generators with the associated electricity. However, the Electricity Market Reform (EMR) proposals involve the removal of the Renewables Obligation, with the pricing benefit that the ROCs system has given them.
- The call for evidence points to features of the EMR proposals that should cause the output of smaller generators to be attractive to large electricity suppliers and cause the needed demand to enable smaller generators to access realistic prices for their output. None of the incentives referred to is sufficiently powerful to overcome the market disadvantages explained above.
- The Government accepts the need for market reform to make access easier, for example in improving liquidity, and looking at cash-out reform. Government must accompany the introduction of the EMR with assertive and effective reform of the electricity market mechanisms, to ensure proper market access for smaller scale generators and suppliers.
- The GLA has, with London boroughs, been making use of opportunities to improve market access through developing, with the support of the Department of Energy and Climate Change, a form of junior electricity supply licence introduced in principle by Ofgem in its proposals of February 2009 - Distributed Energy – Final Proposals and Statutory Notice for Electricity Supply Licence Modification ('licence lite'). Although the GLA anticipates a number of market barriers in the way of implementing licence lite, it is minded to persist in developing Ofgem's proposals into a useable route to market. However, the prospect of effective implementation of licence lite is greatly enhanced if the electricity market mechanisms themselves are simplified and made less expensive to operate.
- Comments on the options contained in the call for evidence are made below.

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3. Comments on the specific high-level options proposed in the consultation

i) Market-led initiatives

Proposal:

Market participants work to –

- a) Establish PPA contract models consistent with the CfD regime and/or
- b) Develop codes of practice covering issues such as pricing transparency and market participation

Our response:

- These are useful initiatives but they do not address the root of the problems of market access. Solving these problems must involve reform of the existing market mechanisms. In addition to improving liquidity and cash out reforms, active measures to establish competitively priced and accessible aggregation and consolidation services are needed, as referred to below.

ii) Competition measures

Proposal:

Steps to enhance competition could include –

- a) Improving liquidity;
- b) Cash – out reform, to provide more predictable costs of imbalance, which could reduce the costs of managing risks; and
- c) Measures to support independent aggregators

Our response:

- All these steps are important and in particular the proposal to support independent aggregators.
- The prospect of the market developing aggregation or consolidation services to aid access to the market has been considered periodically since the inception of NETA, but such services have not arrived in the volume and at the price needed for them to make the required impact. The parties best able to offer economic aggregation /consolidation/risk management services are the large electricity suppliers, but understandably they have no incentive to compete in the market to provide such services. This is a market failure where regulatory intervention is needed.
- The creation of readily available and cost effective aggregation services would also support the implementation of the licence lite regime for smaller supplier/generators.

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iii) Regulatory measures

Proposal:

- a) An obligation on large suppliers to offer a Power Purchase Agreement to any developer requesting it.
- b) An offtaker of last resort.

Our response:

- Such direct interventions in the buyer/seller relationship are unappealing as they involve the regulator setting a minimum price. However, a significant barrier to smaller generators negotiating better market prices could be substantially reduced through introducing easily accessible and cost effective aggregation and consolidation services, as referred to above.

For further information please contact _____, GLA Climate Change Mitigation
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