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Response to the Consultation on the Electricity Market Reform

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[redacted] is grateful for the opportunity to comment on DECC's Consultation on the Electricity Market Reform.[redacted] would like our response to be publicly available, but ask that it remain anonymous.

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Main message for DECC

[redacted] supports the governments' aim to decarbonise the electricity sector. Nevertheless, replacing the Renewable Obligation (RO) with a **FIT with contract for difference** (CfD) is of particular concern. A FIT with (CfD) will not attract investors willing to develop renewable energy.

- The FIT with CfD is, in fact, a fixed incentive for each MWh produced which does offer **compensation for the risks** taken during the development of a renewable energy project. A wind energy developer bears the risks associated with the project's planning application, including the cost of the environmental impact studies and the length of the procedure. Currently the majority of onshore wind planning applications is rejected, meaning that the investment put into the planning application is lost. The current system of the RO recognises those risks and the exposure to the power price provides a possible upside for the developer. A FIT with CfD will effectively remove the exposure to the power price removing any incentive to invest in renewable plants. The conditions of the FIT with CfD will put off investors who will chose to develop merchant plants, outside of the Government incentive system, to benefit from the upside provided by the electricity price.

- The proposal to introduce **FIT with CfD will be especially unattractive to new entrants.** The Consultation argues that renewable energy operators will have the incentive to sell their output above the average price as they will keep any upside. That assumes that generators have the ability to trade on the intra-day power market, which requires extensive resources. In fact, this is not the case for all renewable energy producers since the cost of such resources is very high. Only the larger utilities have the resources to trade power on the half-hourly market, while smaller organisations, or those companies who have a limited number of renewable generators in their portfolio, may not be able to benefit from the potential upside provided by the FIT.

- Unlike the RO, the proposed FIT with CfD will create an **offtake risk** for renewable producers wishing to sell their power with a long term contract. As FIT with CfD does not provide any incentive for the grid or suppliers to purchase renewable production, renewable producers will struggle to find counterparties willing to buy their power on a long term basis at the market price. As a result, revenues from renewable power will be lower than the FIT price.

- If the RO must be replaced, it should be replaced with a **Premium FIT with an obligation** for the grid to take renewable production as it is produced.

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- The RO must be replaced with a mechanism which introduces priority access to the grid. Renewable electricity is local, sustainable and carbon-free; it should be granted priority access into the grid.
- The Premium FIT is the best mechanism to replace the RO. By maintaining the exposure to the power price, the Premium FIT will provide investors with a possible upside to remunerate the risk taken in the long and complex planning process.

- Onshore wind is the most mature renewable technology which has been operating commercially for over 10 years. There onshore wind supply chain is well established and its costs are not a matter of dispute. As a result, we are not convinced that the level of the FIT should be set by an auction. **Auctions have proved to be a risky, costly and unreliable** policy instrument to deliver renewable capacity.

Consultation Response

Question 4 – do you agree with the Government's preferred policy of introducing a contract for differences based feed-in tariff (FIT with CfD)?

A FIT with a CfD is not a suitable mechanism to encourage the development of renewable energy capacity because:

- Investors need a mechanism which, like the RO, includes the possibility of an upside to remunerate the risks taken in the planning process. A FIT with CfD is exactly the same as a fixed FIT, a guaranteed revenue mechanism which denies generators of the exposure to the market price.
- A FIT with CfD will not allow small renewable generators to benefit from the limited upside possibility provided by selling power on the intra-day market. Trading on the intra-day market requires considerable resources which may not be available to the smaller new entrants to the market. As a result, the opportunity to benefit from the market exposure may only be available to the larger utilities, already present in the UK. This will create a two tier system where the new entrants receive a lower rate of return for their investment in renewables than established players.

The lack of incentive for suppliers to purchase power from renewables is a serious concern because:

- The consultation assumes that renewable energy producers wishing to sell their power production to suppliers with a long term power purchase contract will be able to do so at the market price. We consider that this is unlikely because there is no incentive for suppliers to purchase renewable power as is currently the case under the RO. It is in fact likely that renewable generators will only be able to secure contracts to sell their power at a discount to the market price.
- The cost of financing a renewable energy project is based in part on the revenues that the project will produce. If renewable energy producers secure contracts which are at a discount to the wholesale electricity price, the cost of financing will increase.

Question 31 – do you have views on the role that auctions or tenders can play in setting the price for a feed-in tariff, compared to administratively determined support levels?

In the specific case of onshore wind, there is no need to use auctions to determine the level of support provided by the FIT. Onshore wind plants have been commercially active in the UK for over 10 years and the onshore wind market is now a mature.

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[redacted] is also concerned that determining the FIT price level with auctions would lead to additional delays in the approval of onshore wind projects. This would come on top of the already very lengthy planning permission process.

Question 36 – we propose that accreditation under the RO would remain open until March 2017. The Government's ambition is to introduce the new FIT for low carbon in 2013/14. Which of the options do you favour:

- **All new renewable electricity capacity accrediting before 1 April 2017 accredits under the RO;**
- **All new renewable electricity capacity accrediting after the introduction of the low-carbon support mechanism should have a choice between accrediting under the RO or under the new mechanism.**

Renewable capacity accrediting between the introduction of the FIT and April 2017 should have the option to choose between opting into the RO or the FIT.

Renewable projects accrediting in the 2013 to 2017 timeframe will have been developed under the assumption that they would be part of the RO, with a return based on the revenues provided by the RO mechanism. In an effort to maintain investor confidence, these projects should be allowed to join to the RO.

However, projects should not be forced to join the RO and should have the opportunity to join the FIT instead. Indeed, the RO is being replaced by the FITs in part because it is not suited to all participants. Small-scale developers might prefer the stability provided by the FITs which they should be allowed to receive as soon as the FIT is finalised.