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Dear Minister

Electricity Market Reform Consultation

The Crown Estate welcomes the opportunity to comment on the Government's consultation on Electricity Market Reform. We agree that there is need to review the electricity market in order to achieve the sustainable and secure future energy mix required. This will be important if the UK is to meet its challenging renewable electricity and carbon targets. In particular, The Crown Estate recognises that a significant level of financial investment will be needed to realise these ambitions and appreciates that a stable and predictable electricity market framework, both in terms of policy and price determination, is a pre-requisite to attracting new sources of capital. We also note that the UK will be competing in a global market both for capital and other resources.

The Crown Estate

The Crown Estate manages an estate worth over £7 billion, which contains extensive marine assets, including 55 per cent of the UK's foreshore and the vast majority of the seabed out to the 12 nautical mile limit. Under The Crown Estate Act 1961 The Crown Estate's permission, in the form of a site lease, is required for the placement of structures or cables on the seabed; this includes offshore windfarms and their ancillary cables and other marine facilities. In addition to this, by virtue of the Energy Act 2004 it has the rights vested in it for the development of renewable energy within the Renewable Energy Zone. In carrying out this duty The Crown Estate is concerned to deliver the maximum renewable energy potential of the marine estate, in line with government policy and consistent with the requirement to manage the estate in accordance with the principles of good management.

In its role as steward for the marine estate The Crown Estate has instigated three major Rounds of offshore wind leasing as well as a Round in Scottish Territorial Waters. It has entered into agreements for wave and tidal projects in the Pentland Firth: the world's largest Wave and Tidal programme. In addition, The Crown Estate is facilitating investment in and identifying areas suitable for Carbon Storage. Ultimately, the revenue derived from all of these initiatives is made over to the HM Treasury.

Currently, Round 3 has the target of delivering 25GW of capacity in operation or construction by 2020. As part of this ambitious programme The Crown Estate is investing in the pre-consent works, alongside developers. This co-investment, together with activities being undertaken to accelerate and reduce risk within the Round 3 programme, gives The Crown Estate a unique overview of offshore wind development activity.

The Crown Estate's unique perspective on the UK offshore energy sector allows us to comment on six key points of principle which relate to our responsibilities in managing the marine estate. We do however appreciate the breadth of the Electricity Market Reform (EMR) extends beyond the points raised below.

A. Confidence and momentum must be maintained during the UK's transition to a low carbon electricity sector. Existing generators must be confident that the value of their assets will be maintained and the transition to the new Feed in Tariff (FIT) mechanism should encourage early investment.

An immediate priority is to ensure that certainty for owners of existing assets is maintained. It is essential that these owners and investors are not adversely affected by the changes to the existing support mechanisms. For this reason we welcome the proposal to 'vintage' the RO beyond the date from which it will be closed to new accreditations. This will avoid the need for renegotiation of Power Purchase Agreements (PPAs).

Steps should also be taken to ensure that low carbon generation projects which are expecting to reach a Financial Investment Decision (FID) or Commercial Operations Date (COD) in the period to 2017 are not delayed or otherwise adversely affected by transition uncertainty. The transition from the RO might, for example, introduce an incentive for some developers to delay activity, if they are not certain of meeting RO accreditation deadlines. However, if investor confidence is successfully maintained and the transition is well managed, the period to 2017 will be the single most active in the history of offshore wind.

Avoiding transitional uncertainty is necessary not only to continue a steady trajectory of new projects in key low carbon technologies, but also to allow continued development and maintenance of industrial supply chain capabilities, pipeline efficiencies and investment structures. Maintaining momentum in these areas will be especially challenging due to the inevitable ebb and flow of confidence over the coming years as the EMR proposals and the subsequent legislation and regulatory detail becomes more fully defined and are implemented. We welcome the acceleration of the RO Banding Review in this regard. Practical solutions are required to ensure that transition risks, for projects reaching FID over the next few years, are effectively mitigated.

B. A practical design of a process for awarding FITs to projects is required. The FIT award process should avoid auctions, but should facilitate increased levels of competition as the award process matures.

Development of low carbon generation projects typically requires a significant commitment of funds, with a high degree of uncertainty, over a period of several years until FID and COD. Consenting, supply chain and construction timelines and risk profiles vary significantly between the key technologies. We believe that the Government's proposals to use auctions to set the level of tariff and to determine which projects will benefit from FIT's will not work effectively in this context. The record of successful delivery of energy projects under an auction based approach in the UK and overseas is limited and is likely to add significant risk to the Government's overall objectives of a low carbon transition. Instead, we believe a practical FIT award process could be established, building on the existing mechanism of RO banding reviews. This could evolve over a number of years with increasing levels of competition, thereby reducing implementation risks.

Practical details to define how FiT prices will be determined need to be fully addressed.

Maintaining a broad portfolio of low carbon projects under active development is necessary to ensure a strong future pipeline of project investment opportunities. To achieve this, the process of awarding FiTs must work in concert with the timelines and commitments made by project developers. The new process will need to provide appropriate levels of advance signalling of market demand, and of price (the RO currently performs this role for renewable technologies).

- C. Clear demand signals are required well ahead of the first FiTs being signed, with some indication of the demand for each low carbon technology. An indication of the FiT prices to be paid to different projects is also required.**

The industries required to deliver the low carbon transition need clear and consistent signals from the market in order to deliver infrastructure reliably and cost-effectively. The time horizons for commitment to FiT contracts and prices, COD and capital commitments are likely to vary considerably between technologies. Therefore, a commitment to remunerate a given volume of future low carbon electricity should be, to some extent, technology specific.

A degree of central judgement on technology contributions to the future mix should be an integral part of EMR. This principle is a major challenge: government and regulators must become comfortable that the awarding institutions will be equipped to take these decisions. There will need to be sufficient competitive pricing incentive to ensure that consumers are not burdened with excessive costs. This will be difficult to achieve and the process for FiT award must retain sufficient flexibility, around a baseline commitment, to vary the low carbon technology mix to reflect the evolving relative cost of energy from each of the technologies.

One practical solution for incorporating sufficient flexibility would be to establish a regular publication of a central projection of, and intention to contract, a defined MWh of FiTs by technology group. This intent could be defined over a rolling 10 year horizon and regularly refreshed in the light of actual contracts entered into and updated pipeline and market information.

- D. There is significant momentum behind the Offshore Wind programme and a clear message of continued policy ambition for the programme is required from EMR.**

It should be recognised that the offshore wind industry has to date responded to government policies and signals. This response is evidenced by the substantial pipeline of projects currently at various stages of development¹. This pipeline is sufficient to deliver new capacity up to the National Grid's ambitious ODIS

“Sustainable Growth” trajectory to 2025². There is now great momentum behind the programme, presenting a considerable opportunity for the UK for developing new technologies, creating new businesses and inward investment, resulting in new jobs. The EMR comes at a pivotal time for commitments in development and construction of projects as well as investment in the supply chain. To step back from this ambition would be a missed opportunity for the UK’s renewable targets, carbon reduction commitments and wider Government energy ambitions.

However, EMR provides an opportunity to address one of the key challenges of the programme: ensuring the economics of projects are sufficiently robust to attract the required long term investment. At the same time, the other programme challenges (grid, supply chain, consenting, managing construction risk etc) will require continued focus. Practical solutions to these challenges should be developed in parallel with EMR solutions. It should therefore be an explicit test of EMR solutions that they do not unwittingly add to the challenges in these areas. The UK is entering a critical period of development for the offshore renewable sector where the ability to deliver the targets for 2020 and beyond will be dictated by market decision making over the next 2-3 years.

E. Tailored solutions are required for emerging technologies (wave, tidal and CCS).

We support the Government’s continued commitment to develop and demonstrate these technologies at increasing scale. Effective planning, preparation and implementation of demonstration-scale projects is the key next step for each of these technologies, and this proving stage will remain a priority for a number of years.

The revenue support available to the projects from EMR will need to be tailored to the specific emerging technology. The details of how emerging technologies may access FiT support alongside other funding sources are not yet defined. However where there remain significant technology risks on projects, we do not believe that revenue support is likely to provide a complete solution for securing financing.

We recommend that EMR recognises a short to medium term need to identify specific provisions within the chosen low carbon support instruments to accommodate the particular requirements of these technologies. For example CCS projects and associated support infrastructure would need to consider fuel cost risk with detailed design of any CfD FiT instrument. We suggest that some flexibility and tailoring of detailed FiT contract requirements will be essential for different technologies, whether emerging or not, as a consequence of their different characteristics during development, construction and operating life.

F. The detailed design of FiT contracts will determine whether the required volumes of low carbon power generation capacity are delivered.

² Offshore Development Information Statement

http://www.nationalgrid.com/NR/rdonlyres/99312A31-9D0A-42B6-8098-39D6CCC83A78/45576/Scenario_Paper.pdf

The three options of Premium-FIT, CfD-FIT and Fixed-FIT each have strengths and weaknesses in their appeal to developers and investors. We suggest their opinions should be central to the final decision of which instrument to use. Each option has different level of dependency and interaction with other parts of the package (e.g. carbon price support, establishing wholesale market liquidity), and each would bring its own particular challenges for practical implementation. Each mechanism holds the theoretical potential to attract required capital, provided there is sufficient attention to detail in the design of contracts, processes and regulation. Additionally, the resulting risk/reward balance for investors must create an internationally competitive proposition.

Whether the actual instrument achieves the theoretical potential depends critically on the detailed design of the instrument. There are many risks which the FIT contract terms could be shaped to manage. These include: basis risk, offtake risk, wholesale liquidity risk, wind cannibalisation risk, risks associated with negative wholesale price periods, regulatory risk and change in law, counterparty risk, imbalance cost risk, CAPEX risk between execution and COD, FOREX risk and through-life O&M cost inflation risk. The extent to which the contract terms effectively allocate, underwrite and mitigate these risks will significantly impact the cost and value to the consumer. It is these detailed terms which will determine the extent to which the key assumptions made in the consultation in respect of each instrument are valid. This in turn will affect complexity of the proposition for each technology, and the practical implementation challenges.

We hope that the six key points set out above are of assistance to you in developing your conclusions. We would welcome the opportunity to work with you on these areas as you take forward this piece of work. We would be happy to meet with relevant officials in your department to share our understanding of the possible implications of the proposed reforms on the offshore energy sectors, and to discuss potential practical solutions to the challenges identified above.

We support the Government's desire to ensure that the UK electricity market is fit for purpose as we move forward and see this as an opportunity to create the right conditions so that we have a diverse, secure and low carbon electricity mix. If we can be of more assistance please contact our Senior External Relations Manager, [REDACTED], who will be happy to facilitate.

Yours sincerely

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