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Bringing Energy Together

Combined Heat & Power
Sustainable Energy Services
District Heating & Cooling

Matt Coyne
Department of Energy and Climate Change
3 Whitehall Place
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03 September 2012

Dear Matt,

Market access and power purchase agreements

The CHPA is pleased to provide a response to DECC's call for evidence on Power Purchase Agreements (PPAs). The CHPA wishes to highlight some key principles surrounding the independent generation market impacting both renewable and non-renewable independent generation.

Fundamentally, there are two key aspects if generators are to operate successfully in the electricity market:

1. Access to the market – the ability to sell power in the market.
2. Value in the market – persistent reasonable value for electricity sold to the market

Power purchase agreements (PPAs) enable market access through passing the risks and costs of accessing the market on to a third party. Whilst PPAs may state electricity value in the contract, the underlying electricity value is a reflection of the value that can be secured in the market. The PPA itself does not provide market value merely market access. PPAs are, therefore, useful in a market where value for electricity is available but where achieving that value is problematic due to the risks or costs af accessing the market. The call for evidence notes that PPA terms are becoming less attractive. The problem is not, however, the PPA market, but the underlying loss of value in the market for independent generators.

Currently there are three key incentives in operation or planned for renewable electricity generation in the UK. In this response, we highlight the differences between these and the risk associated with each and how this relates to the PPA market.

1. **The renewables Obligation (RO) provides an incentive AND creates demand for RO generated electricity.** As buying RO Certificates (ROCs) is cheaper than paying into the RO buyout fund, an electricity supplier demand for RO generated electricity was created. This demand for RO electricity ensured the new independent generators under the RO could be sure of achieving a reasonable market price for their electricity. This assurance was reflected in the terms offered in PPAs. If the demand for RO generated electricity cannot be met internally within a vertically integrated company, demand for RO generated electricity from independent generation will persist. Should a vertically integrated company be able to meet its RO requirements internally, it will logically purchase that electricity ahead of electricity generated by competitors. This could, theoretically, lead

to a reduction in demand for independently generated electricity under the RO and be reflected in poorer terms under a PPA, however, the increasing headroom arrangements seek to prevent this effect.

2. **The small scale Feed-in-Tariff (FiT) provides a generation incentive but creates no demand for generated electricity. The price of exported electricity can be fixed.** Under the small scale FiT, there is no demand pull for FiT generated electricity. Generators can, however, opt to choose the fixed export value of £31/MWh. This guarantee of export value enables the generator to assess the long term value of the FiT ahead of an investment decision.

3. **The Contract for Differences (CfD) FiT will provide an incentive but no demand for electricity. The price for exported electricity value cannot be fixed.** The CfD provides an incentive based on the difference between an agreed strike price and market reference price. As with the RO and the small scale FiT, a generator must generate to receive any incentive payment. Unlike the RO, however, the CfD FiT creates no supplier demand pull for that electricity generation. The generator is in a 'must sell' position (to receive the incentive) but there is no assurance of demand on the other side of the market. Unlike the small scale FiT, there is no minimum export price on power. PPAs may still be offered providing market access but the terms will reflect the absence of demand pull or a minimum export price in the market. The result will be that the value for electricity in a PPA under a CfD will be lower than under the RO.

As shown above, it was the RO that ensured value for independent generation. In the absence of supplier demand pull (RO) or a fixed price for exported power (small scale FiT), the limitations of the current market structure for independent generators are revealed. These limitations are reflected in the terms offered under PPAs. The PPA issue is a reflection of the problem of independent generators securing market value, rather than the cause.

The CHPA is concerned that the EMR proposals are likely to make securing persistent value in the electricity market more challenging for all forms of new and existing independent generation. **We would welcome the opportunity to meet and discuss our concerns and how they could be addressed.**

Yours sincerely,

[redacted]

Head of Policy