

9 March 2011

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Your reference

Dear Sirs

Norton Rose LLP response to Energy Market Reform consultation document

Norton Rose LLP is an international law firm with its headquarters in London. We have over 2,000 qualified lawyers, including 430 Partners, and 1,400 support staff. Energy is one of the five key "headlights" on which we have a strategic focus and low carbon energy is the cornerstone of our energy practice. We act for a wide variety of players within the clean energy industry including developers and financial institutions and authorities such as Ofgem. We have played a leading role in the industry working in offshore and onshore wind, biomass, nuclear and solar projects. One of the most notable projects was our work for the Crown Estate where we advised on the Round 3 offshore wind programme.

We do not have any direct financial interest in the outcome of the consultation. We are conscious that certain aspects of the proposals for reform may be to the benefit of some industry players and be to the detriment of others. However, our aim in responding to the consultation document is to ensure that the proposals that are adopted are workable and as effective as possible in achieving the Government's aims. As such, a particular emphasis of our response is the practicality of the proposals, one of DECC's four criteria for effectiveness.

We feel that our in depth experience in the low carbon space acting for all parties enables us to provide a well rounded viewpoint.

Key messages

We applaud the Government's determination to support low-carbon electricity generation as a major step in decarbonising the economy. The consultation document is an important step, but there is much work still to be done even when the key decisions have been taken.

Our key messages for Government are as follows:

- We believe that either Premium FITs or CFDs could be made to work, but the effectiveness of either system will depend very much on the detailed design. There is more complexity in CFDs so the detail will be harder to get right. There is so far, little evidence of these issues having been considered.
- Either system is dependent on a liquid wholesale market and Ofgem's work in this area is highly important. There is a risk of problems if a Premium FIT or CFD is implemented before the liquidity has improved or even before the market knows what measures are being taken to improve it.

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- In grandfathering existing projects, we support maintaining the RO as a "vintaged" system rather than moving to a "Fixed ROC" system under which a central agency will buy and pay for ROCs.
- The overlap between the RO and the new system, so that for a period investors will have a choice of which system to use, is largely illusory. We believe that it would be possible to grandfather projects under the RO at the same point in a project's development as it will be required to sign a CFD or Premium FIT contract, enabling projects to have that choice.
- If a CFD regime is introduced, the averaging period over which the wholesale market price is averaged in order to calculate the reference price should be as short as possible, consistent with practical administration. The basis of the price should be a price or index that can be accessed by generators for hedging purposes.
- Under either a Premium FIT or a CFD, generators may find it harder to achieve revenues close to the wholesale power price or suffer greater discounts under PPAs than at present under the RO (and already perceive this to be the case).
- We believe that a system of auctions to set the strike price (for CFDs) or the level of premium (for Premium FITs) would create major problems and should not be introduced.
- To minimise potential for market disruption, any new regime needs to be simple, readily understandable and provide visibility on the level of support available.

1 Scope of our response

Our response focuses on the reform of the revenue support mechanism for low-carbon generation.

Given the nature of our interest as a provider of legal services to the energy sector, we do not believe it is appropriate for us to address many of the specific questions posed in the consultation document. Rather than doing so, we have sought to provide relevant information to Government on the current market structure and to highlight issues which require consideration in designing a new scheme to ensure that it is fit for purpose. For reference, we think our comments are relevant to the questions listed in Annex A to this letter.

2 General comments

2.1 Level of Detail

As a preliminary comment, the consultation document appears to concentrate on broad economic outcomes and in our view does not give sufficient consideration to the practical detail of what will be needed to implement it. We believe that the consultation document lacks the necessary detail to make a proper comparative assessment of the Government's alternative proposals and an immense amount of work will be required in order to implement any of the options.

In that context, we are particularly concerned that the proposed time-table for implementation may not allow for further consultation. The indications are that after the consultation responses have been analysed and the Government's decision has been published in a White Paper in Spring 2011, the Government will move swiftly to implementation. In our view, any of the proposals can be made to work, but (for example) a well-implemented premium feed-in tariff (**Premium FIT**) may be preferable to a badly-implemented contract for differences (**CFD**), and vice versa. Whilst we have great sympathy for the urgent need to implement any changes in order to avoid a hiatus in investment, **we question whether the proposed implementation timeline and process allows for adequate consultation on the important details.**

2.2 Assumptions underlying the consultation

We are concerned that the analysis may be based on flawed assumptions: the consultation is keen to promote 'economic dispatch' of generators and so favours revenue support mechanisms which maintain market signals; however most renewable and low carbon generation is intermittent or inflexible and so will not be able to dispatch efficiently according to price signals.

Furthermore, if a Premium FIT or CFD is to promote 'economic dispatch' by maintaining effective market signals, it is vital that those signals are accessible by the generator. This may not be the case, and will depend primarily on the generator's ability to manage imbalance itself, or whether this is contracted to a third party under power purchasing arrangements. This is considered further below.

2.3 Interaction with other measures

The consultation document is in fact more about reform of support and subsidy measures than about comprehensive reform of the GB electricity market. As has been acknowledged in the consultation document, the proposals are critically dependent on the success of the parallel work being carried out by Ofgem to improve liquidity in the electricity market. Unless and until the outcome of that work and its effect are known, it is very difficult to predict the efficacy of each of the options in the consultation document. For example, if the measures to improve liquidity are successful and result in a liquid market index for electricity, intermittent generators may have confidence in a CFD as they will be able to access the wholesale electricity price with little discount. But if such measures prove to have little effect, then a CFD is likely to fail and a fixed FIT would be preferable.

In Ofgem's open letter of 3rd December 2010, the regulator observed that improvements in liquidity are required, but intervention is not without cost or risk. We agree, and the more radical the intervention the higher the risk. This introduces risk for the success for EMR. Ofgem had published possible options for intervention as long ago as February 2010, but has decided not to implement any of these options at the present time. Instead, Ofgem has decided to align its work on liquidity with wider market developments (apparently awaiting the outcome of EMR), to continue to develop possible options for intervention, to continue to monitor the market and to continue to press for further development of a liquid wholesale market, with a view to publishing a further assessment in Spring 2011. In effect industry is being asked to select a revenue support mechanism for low carbon generation whilst there is uncertainty surrounding the structure of the wider power market. In doing so, **the Government risks designing a support mechanism which may not be accessible to the very projects it is intended to benefit because of a lack of clarity on measures to promote market liquidity.**

3 Grandfathering of projects accredited under the Renewables Obligation

3.1 Structure of Power Purchase Agreements

Arguably the most important aspect of the reforms is the impact on existing projects. If investors feel they have been short-changed by retroactive application of rules which may reduce their returns or increase their risk, they will be very reluctant to invest in new projects under the new support system no matter how generous it might be (or they will require significantly higher returns than would have otherwise been the case).

In order to understand the impact of any proposed grandfathering scheme, it is necessary to understand the contractual structure of renewable energy projects. The vast majority of such projects (and almost all that have been developed other than by a vertically-integrated utility with a retail supply business) have power purchase agreements (**PPAs**) with a creditworthy offtaker. Almost invariably, these PPAs include the sale of renewable obligation certificates (**ROCs**), climate change levy exemption certificates (**LECs**) and renewable energy guarantees of origin (**REGOs**) (together, **Benefits**) as well as the electricity generated. In a project finance transaction, the PPA is a key document, underpinning revenues which go to debt service. The key objectives of any investor in any grandfathering scheme will be:

- (i) to ensure that the PPA remains in place - without it, any debt financing will default; and
- (ii) to ensure that the commercial terms remain essentially the same, in terms of both price and risk.

The commercial terms of a PPA vary. Each of the "big 6" utilities has their own standard form and the terms are generally subject to a certain amount of negotiation. Moreover certain generators have their own terms and we also see a number of PPAs with novel or unique terms. There is therefore no "one size fits all" solution and it is likely that some projects will be adversely affected by the reforms in any event. However it is important to ensure that the introduction of EMR is done in such a way that the majority of projects are affected to the least extent possible.

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Most PPAs provide for the generator to ensure that all Benefits to which it is entitled are issued and that they are transferred to the offtaker at a price which is a discount to the notional value of those Benefits (Buy-Out Price, Recycle Payment, CCL rate). This discount reflects, in part, the time value of money, as the offtaker will make payment shortly after the ROCs are issued and transferred but they avoid the payment of the Buy-Out Price only on 1 September in the following obligation period - perhaps over a year later. Usually, any new benefits that may become available are treated in a similar way (including the discount) to existing Benefits.

With respect to electricity price risk, some PPAs may act only as a route to market, allowing the generator to access merchant power prices (i.e. power is sold to the offtaker at a % of a wholesale price index, reflecting the trading service provided and imbalance risk taken by the offtaker). However, most PPAs provide at least a degree of revenue certainty through a fixed price or a floor price for all or part of the electricity generated.

3.2 Change in Law provisions

With respect to regulatory risk, PPAs include "Change in Law" provisions, which allocate risk in the event that the regulatory regime changes during the term of the contract. There is no uniform Change in Law clause, as these are negotiated provisions. However, consistent themes do emerge in many (although not all) cases. A "Change in Law" (or "Relevant Change in Law") may apply whatever change occurs; however, in some cases there is a threshold, for example the change may not trigger the change in law provisions unless:

- (a) it makes it illegal or impossible for one or both parties to perform their obligations or it makes their rights unenforceable; or
- (b) it has a material adverse effect on the ability of a party to perform its obligations, or the cost of doing so.

Upon a Change in Law occurring, the parties will usually be required to negotiate in good faith such amendments to the PPA as may be necessary in order to achieve the same "commercial balance" or the same "overall balance of benefits, rights, obligations, liabilities and risks" under the new regime as was originally reflected in the PPA. If parties cannot agree, the matter will usually be referred to an expert (but sometimes an arbitrator) for determination. The experience of NETA and similar situations is that considerable management time and effort could be wasted and some projects may suffer financial distress, if they become embroiled in dispute resolution processes.

In a limited number of cases Force Majeure provisions or even Termination Events may occur following a Change in Law.

3.3 Consequences for grandfathering

The grandfathering option chosen by the Government for existing renewables obligation (RO)-accredited projects will determine how existing contractual arrangements are affected:

- If the RO is "vintaged" in 2017 (as described in paragraphs 15-17 of Annex A of the consultation document), so that the RO becomes a closed "pool" of capacity, there is a modest risk of the Change in Law provisions in PPAs being triggered. Indeed the RO aspects may not have any impact at all, although there is a risk that the proposals for carbon floor price support and targeted capacity payments (which may depress wholesale electricity prices at peak periods) will trigger a claim that a Change in Law has impacted upon the parties' relative commercial balance.
- If the Government decides to move to a "Fixed ROC" system (as described in paragraphs 42-45 of Annex A of the consultation document), the Change in Law provisions in many more PPAs are more likely to be triggered, resulting in a greater likelihood of diverting management time and effort away from new projects and a hiatus in development activity. If a generator no longer is able to sell ROCs to an offtaker under a PPA, the entire PPA may be challenged. It is not always clear that the sale of Benefits (and discount applicable to them) is separate and severable from the sale of electricity (and discount applicable to it).

In order to minimise the impact of the proposals on existing projects, **we would suggest maintaining the RO as a "vintaged" system, at least through to the end of the typical life of a PPA** (say 15 years after the last RO-accredited project, i.e. 2032, or at least 15 years after the new support scheme becomes available in 2013, i.e. 2028).

3.4 Price visibility under transitional arrangements

An important principle in designing the transitional arrangements is that generators will need good visibility of both the availability of, and the level of support (and so a project's anticipated returns) under, both the grandfathered and new regimes. This will allow informed investment decisions to be made and will maintain market confidence.

To achieve visibility in the level of support, the detail of how the level of support is set under both the grandfathered and the new regimes needs to be known. This should also be known early so as not to delay investment decisions. The consultation envisages 'introduction' of the new regime in 2013/14. We would advocate that, to build confidence, the new regime should be operational in 2013/14.

3.5 Timing under transitional arrangements

Central to investor confidence is whether, at the requisite time for accreditation (following commissioning under the RO or upon contract signing under a FIT or CFD), the regime which has been assumed as the project investment base case, is available. With respect to generation accrediting for ROCs between now and 2017, we would urge the Government to consider the timing of accreditation and its interaction with accreditation under the new regime.

We perceive a risk that generators may miss the deadline for accreditation under the RO because of force majeure or other project delays and may have no choice but to elect for a FIT or CFD once the project is already built. Where the FIT or CFD does not yield the expected returns (either under an internal investment case or under project finance loan agreements), there is a risk of default. This is particularly a concern for complex build projects with long construction times where the potential for delays is high.

Question 36 of the consultation seeks views on whether all new renewable energy capacity accrediting before 1 April 2017 should accredit under the RO, or if generators should have a choice of which mechanism to use between the date of introduction of the new mechanism and 1 April 2017. Unless the date of accreditation is changed (see our comments at 4.2 (Detail of a CFD), paragraph 7 (Longstop) below), the first option would seem to lead inevitably to a hiatus of several years in which investment could not proceed. The last date on which a financial investment decision (FID) could be made to begin construction of a new project under the RO would be around 2013/4 for offshore projects and perhaps 2014/5 for onshore projects, so that they are completed and commissioned comfortably (with some tolerance in the programme) prior to 1 April 2017. In contrast, projects proposing to proceed under the new regime would not take the FID until the FIT or CFD is available to be signed in 2017, when the level of support is locked in (especially if they have to participate in an auction at that point and may not succeed in gaining a contract at all). Even if a FIT or CFD could be signed later, following construction, the Government should consider how price visibility can be achieved prior to that date, so that investors have the confidence to take the FID before a FIT or CFD is signed. If investors do not have this visibility, there may be hiatus in investment while investors look to discover pricing. As a consequence of these issues, **we strongly support offering investors the choice of which mechanism to use between the date of introduction of the new mechanism and 1 April 2017.**

4 Issues in relation to Contracts for Differences

4.1 Accessing the Reference Price

With respect to the design of the new regime, we think that both Premium FITs or CFDs can be made to work. However much more detail will need to be developed for the market to have sufficient confidence to invest.

Of the proposals, the CFD is arguably the most complex and the least well known. CFDs create an obligation on each party to pay to the other party difference payments, being the difference between the 'strike price' and the 'reference price'. The consultation document appears to assume that a generator (at least, one that is managed efficiently) ought to be able to receive a steady revenue stream equal to the strike price - being

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the aggregate of the electricity price it receives from the market and the difference payments. We believe that this view is simplistic and does not reflect the true situation, in the following respects:

- Most independent renewable generators (i.e. that are not part of vertically-integrated utilities) do not have their own trading desks and cannot manage the 24-hour trading of electrical output from their projects. Accordingly they tend to contract with a third party (one of the vertically-integrated utilities, or potentially a wholesale trader such as a bank) to provide this service.
- Intermittent generators cannot forecast their output accurately and will either suffer imbalance charges under the Balancing and Settlement Code (BSC), or will contract with a third party to manage and trade their fluctuating output. Generally renewable generators are not in a position to respond to "the efficiencies of the price signal", as suggested by the consultation document.

In practical terms, most renewable generators manage these two issues by transferring the risk to an offtaker under a PPA, in return for a discount on the power price. However, even if they did not do so, they could never capture the average wholesale electricity market price. As such, CFDs will not act as a "top-up" payment in addition to the market price, as suggested by the diagram on page 50 of the consultation document. In contrast, nuclear generators are much more likely to be able to achieve a price for their electrical output that is, or is close to, the average wholesale electricity market price.

In order to minimise the impact of this effect, it is important that the reference price can be anticipated (as would be the case for day or hourly averaging periods). **We therefore suggest that the averaging period for calculating the reference price should be as short as reasonably possible, consistent with practical administration.**

4.2 Detail of a CFD

From our previous experience of drafting and negotiating CFDs in many different contexts, the following issues will be important to be addressed:

1. A liquid, long-term and accessible reference price

CFDs were the primary method of trading electricity under the Electricity Pool of England & Wales, which operated from privatisation until NETA was introduced in March 2001. CFDs also operate (more or less) successfully in other markets where there is an electricity pool, such as the Single Electricity Market (SEM) in Ireland. A mandatory pool provides a fully liquid and transparent market, but we no longer have this in Great Britain. We cannot see any practical way in which a "closed" Pool for low-carbon generation could work satisfactorily or how it would interact with the rest of the bilaterally-traded wholesale electricity market.

- **Setting the Reference Price:** In the absence of a Pool-based reference price, CFDs will have to use some other method of determining the reference price. Potential options include:
 - (a) A market index published by a price reporting agency such as the London Energy Brokers' Association (LEBA), ICIS Heren (Reed International), Argus Media, Platts (McGraw-Hill Group) or others; or a basket of such indices. Such indices suffer from the problem of the data being used to compile them changing over time (certainly over the 20 year time horizon of a CFD), not being published for periods or even closing down altogether. Moreover they are all dependent on honest and consistent price reporting by market players.
 - (b) A notional index compiled by DECC from information which it can require market players to provide and which it can potentially require on a mandatory basis (with sanctions for failing to do so or providing inaccurate data). The main difficulty with such an option is that this index would not be accessible by the market and so cannot be used as a hedge. There is also likely to be a delay in gathering and processing such data, especially if the averaging period which is chosen by the Government is short. This model also has inherent regulatory risk compared to a reference price which can be modelled by financiers.
- **Market disruption:** In circumstances where the selected reference price is not available for any reason, certain fallback methods of determining a reference price may be specified (for

example, see section 7.5 of the 2005 ISDA Commodity Definitions). These could involve using indices from an alternative reference source, quotes provided by a number of reference market makers, using the reference prices for the last period when they were quoted, postponement of the calculation until the next day on which the reference price is quoted, negotiation by the parties to the CFD in good faith or even no-fault termination of the CFD. Whilst these may be an acceptable means of commercial parties agreeing on settlement of their contracts, they do not appear to be very satisfactory for a Government-backed financial support system and we doubt that they will provide the degree of certainty required to attract new investment.

- *Disputes:* Disputes about the calculation of difference payments, or the type of replacement index or other form of calculation to be used in the case of market disruption, are usually settled by expert determination or (less commonly) by arbitration. It is unclear whether such a mechanism will be included in the proposed CFDs and if so, whether it will be consistent across all CFDs so that an issue that affects all parties to CFDs can be settled on a consistent basis across the industry. It is unclear how any industry-wide settlement will sit alongside commercially sensitive disputes.
- *Gaming:* The Government will have to be very careful in designing the system so that the reference price, which is likely to be set by a smaller and smaller number of market players with flexible plant, but which through the CFDs will impact on a wide range of intermittent and inflexible generators who may have little or no influence over it, is not capable of manipulation.

More generally, we think it is very difficult to express a clear preference for this form of support until the Government's proposals on these key issues are made clear.

2. Credit issues

The value of a CFD to a generator will depend critically on the creditworthiness of the counterparty. It appears from the consultation document that the Government is still undecided as to whether it will be a Government agency (such as Ofgem) or perhaps licensed suppliers (with a levelling mechanism, as is the case with the existing small-scale FIT regime). No doubt the financial treatment of the different options (such as its impact on the calculation of the Public Sector Borrowing Requirement, if any) will be a critical factor. If the CFD counterparty is to be a commercial party, we expect generators will require them to provide credit support for the difference payments (and/or any termination payment that may become due if the CFD is terminated early). Given the pressure that utility balance sheets will come under in the next two decades, we think this option will meet stiff resistance - especially as the potential size of their cumulative contractual liability may impact on their own creditworthiness.

Moreover, if the CFD counterparty is not the Government but a commercial party, it is highly likely to require credit support from the generator to secure the payment of any difference payments to be made by the generator to the counterparty. This may be a barrier to market entry or access.

3. Accounting and Tax

We note that a CFD is a derivative product and under derivative accounting rules, there could be significant fluctuations on the balance sheets of counterparties and tax implications. We would urge the Government to look into these aspects in detail before deciding on a particular option.

4. Events of Default and Termination

We can understand the Government's thinking that a contract may be regarded by the market as more robust than a regulatory system such as the RO, so that a generator will have a private law remedy for breach of contract if a future Government were to try to change the arrangements rather than relying on the much more difficult remedy of judicial review.

However, this issue cuts both ways. If the generator were to commit a breach of contract (typically this might include non-payment for difference payments, when due by the generator, after a grace period, certain insolvency events, breach of representation or warranty and other material breaches),

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it might lose the benefit of the CFD when its entitlement under the RO would have continued. On this basis CFDs could be regarded as more risky than the RO by a potential investor.

5. Assignment and transfer

Typically a CFD is not transferable without the other party's consent. If that is to be the case, then the flexibility of owners to sell projects by share sale or asset sale will be reduced or removed. Buyers will require more due diligence in buying a project company's shares (to ensure that the project company contains no unexpected liabilities) and there may be tax implications.

6. Longstop

We understand that Premium FIT or CFD contracts will be signed earlier in the project life (shortly after planning consent is granted and a grid connection offer has been received, around the time of the Financial Investment Decision) than accreditation under the RO. We applaud this change, which will allow a developer to assess the level of returns available and the viability of a scheme prior to construction. We think this should and still could be applied to accreditation under the RO for the remaining period for which it is open - a project could sign a commitment to construct under the RO at the same time and with exactly the same consequences if it fails to construct, as under a Premium FIT or a CFD.

We recognise that there is a risk (decreasing as the project moves from development to construction and commissioning) that, having secured the CFD, a project ultimately does not reach commissioning and commercial operation. We do not agree with the idea of financial penalties being imposed for non-delivery of projects as this will act as a significant deterrent to developers, particularly independents and new entrants. Inclusion of a contractual longstop date would be normal for a commercial contract and mitigates this risk for the Government. However we believe the developer should be entitled to reasonable flexibility for late completion, particularly in the event of delay resulting from force majeure or other circumstances beyond the reasonable control of the generator.

5 Offtake risk

According to DECC's analysis (table 5, page 57) the CFD and Premium FIT models are equivalent in offtake risk to the current regime. This assessment is questionable and the offtake risk applies to both grandfathered projects and projects developed under new scheme.

Under the RO, generators have ROCs to sell. Although licensed suppliers always have the option to pay the Buy-Out Price, there is clear pressure on them to source ROCs in order to satisfy the obligation. In practical terms, the RO creates a market for intermittent renewable generation so that a generator has a low risk of failing to secure a PPA. This incentive will disappear under either a Premium FIT or a CFD system so that, even if a generator is able to secure a PPA, the discount to wholesale market prices is likely to be greater than under the RO. We would expect that vertically-integrated utilities would be likely to be better able to manage this than the independent developers.

Whether this actually happens in practice is too early to say, but there is a clear perception in the market that this *will* happen. We already have experience of project finance lenders expressing a reluctance to agree a merchant "tail" (where the duration of the PPA is shorter than the tenor of the debt) because of the concern that it will be difficult to agree a PPA for the electricity for such a "tail" if ROCs are not being offered as well. (They would not be available if the "Fixed ROC" system of grandfathering is implemented, as described above.) This results in reduced leverage and higher costs of capital.

6 Auctions / tenders to set level of FIT

We disagree strongly that auctions would be an appropriate mechanism for setting the CFD strike price or premium level in a Premium FIT. In short, we foresee the following problems (among others):

- The bidders will have imperfect information on costs, given that these are new and developing technologies. Bidding will contain a significant element of guesswork.

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- Projects located in different places, even using the same technologies but with (for example) different wind resources and water depths, will not be competing on a level playing field. Whilst this may result in lower cost schemes being preferred, this may be to the detriment of the quality of projects being developed. Moreover, the scale of the challenge to the UK is such that encouragement is required for all economically-viable projects and not just those that are cheapest to construct.
- The Government will be required to determine what volume it wants to include in each auction, rather than leaving it to the market to determine how much it can build.
- Auctions will inevitably cause delay, because they are unlikely to be timed exactly when a project reaches the appropriate stage of development.
- If a developer can bid only when it has obtained necessary property rights, planning consent and a grid connection, it may waste a considerable amount of costs if it is unsuccessful in the auction. This may result in lower cost.
- If a developer can bid before it has obtained necessary property rights, planning consent and a grid connection, it will be unable to fulfil any obligation to build the capacity if it encounters problems with those matters.
- There is a risk of a "race to the bottom" or "winner's curse", i.e. those that succeed have to bid so low that they may be unable to develop their projects at the cost they have bid. Exactly this problem occurred with the Non-Fossil Fuel Obligation (NFFO) in the 1990s. The Government has proposed financial security to ensure that projects that are successful in the auctions are actually built; however we believe in the current climate this would constitute a significant deterrent to bidding.
- Price auctions take no account of the quality of projects being developed or any innovative features.

The examples of auctions quoted by the Government in the consultation document are not success stories - quite the opposite. We have set out in Appendix B a brief description of the issues with auctioning in the Netherlands.

Should you have any questions in relation to our response, we would be happy to provide further clarification.

Yours sincerely



Appendix A

Consultation questions to which this response is relevant

Our response is relevant to the following questions:

Q4: Do you agree with the Government's preferred policy of introducing a contract for difference based feed-in tariff (FIT with CfD)?

Q7: Do you agree with the Government's assessment of the impact of the different models of FITs on the cost of capital for low-carbon generators?

Q8: What impact do you think the different models of FITs will have on the availability of finance for low-carbon electricity generation investments from both new investors and the existing investor base?

Q9: What impact do you think the different models of FITs will have on different types of generators (e.g. vertically integrated utilities, existing independent gas, wind or biomass generators and new entrant generators)? How would the different models impact on contract negotiations/relationships with electricity suppliers?

Q10: How important do you think greater liquidity in the wholesale market is to the effective operation of the FIT with CfD model? What reference price or index should be used?

Q30: What do you think are the main implementation risks for the Government's preferred package? Are these risks different for the other packages being considered?

Q31: 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?

Q35: Do you agree with the principles underpinning the transition of the Renewables Obligation into the new arrangements? Are there other strategies which you think could be used to avoid delays to planned investments?

Q36: We propose that accreditation under the RO would remain open until 31 March 2017. The Government's ambition to introduce the new feed-in tariff for low-carbon in 2013/14 (subject to Parliamentary time). Which of these 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 but before 1 April 2017 should have a choice between accrediting under the RO or the new mechanism.

Appendix B

Auctioning to set the level of support - The Netherlands Experience

In the Netherlands, a type of CFD system is in place for renewables. After having sold the electrical output to the grid at market prices, the generator will receive an additional payment from the Government (the 'sliding premium') up to a pre-determined Base Amount. For most technologies, the Base Amount is set annually by the Government after close consultation with market participants. For such projects there is no auction and the subsidies are awarded on a 'first come, first serve' basis. An auction process to set the base Amount applies only in relation to offshore wind projects in the Netherlands.

As a result of last year's tender for offshore wind projects, the Netherlands government selected two projects submitted by the German BARD Group. The tender was designed to award the subsidies to developers that could realise projects against the lowest price. Despite this, the former minister of Economic Affairs was 'disappointed' with the outcome, because of the discrepancy between the cost/kWh as estimated by a consultancy hired by the Ministry and the outcome of the tender, in which the price per kWh was much higher, resulting in the realisation of less offshore capacity for the same amount of subsidy.

The decisions to award the subsidies to the BARD Group caused widespread criticism. The following criticisms have been made against the auction system:

- the tender system should give more weight to criteria other than price (experience, quality, reasonable time of completion);
- in the early stages of the development of offshore wind projects it is often impossible to correctly assess all relevant risks and costs, which leads to a large 'spread' in bids submitted. The price per kWh also depends on scale, construction site, materials, etc. used, which explains part of this spread; and
- the tender system is designed to initiate a 'race to the bottom', in which bidders are encouraged to submit economically unviable bids.

It has therefore been argued that the tender procedure created the risk that bidders with an economically unrealistic bid are selected, at the expense of bidders who have a sound and economically viable business plan. Furthermore, it is argued that innovative technologies cannot be developed under a price driven tender system, as such technologies are, in the beginning, relatively expensive to develop.

On the basis of these arguments, the Dutch energy companies Nuon and Eneco initiated administrative proceedings against the decisions to award the subsidies to BARD. Nuon and Eneco argued that the BARD-bid was not economically viable and that BARD could not ensure that the project would be completed on time, due to a lack of experience. In the decision on objections, the Dutch authorities rejected the objections on the basis that the tender specifications did not allow for the consideration of such factors.

The Dutch experience of using an auction to determine the level of support for offshore wind projects has not been a happy one. In a further blow, the new Dutch Government has recently announced that, in a bid to save €3 billion, subsidies will be cut for most renewable technologies, and potentially exclude offshore wind, solar and biomass altogether.

