renewableUK
The voice of wind & marine energy

A call for evidence on barriers to securing long-term contracts for independent renewable generation investment

Response by RenewableUK

RenewableUK is the leading trade association in the field of renewable power, with over 650 members from across the value chain of the wind, wave and tidal stream sectors. The technologies we champion have the most potential to generate renewable power in the UK at scale, and to bring significant economic development to this country.

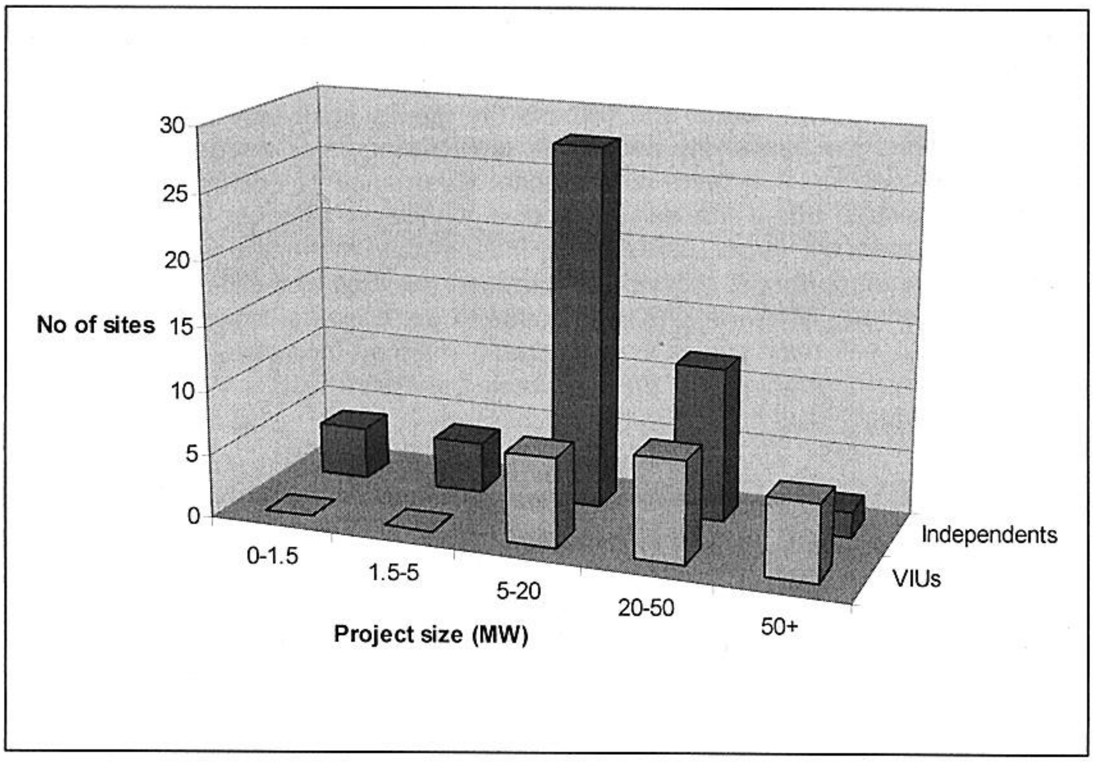
As a trade association, we are not directly party to the terms and conditions available under PPAs, or our generator members' ability to secure such agreements. We leave this to our members to report directly to you. We will seek to establish the place of independent generators in the market and discuss the issues involved with proposed actions that might affect the availability and terms of PPAs or other routes to market. DECC should note, however, that there is significant divergence of opinion within the RenewableUK membership about the existence of a significant problem in this area, between, generally speaking, larger utilities and independent generators. DECC will need to assess the evidence that is provided to it though this Call and determine which course of action is merited. Whatever DECC chooses to do, it is vital that independent generators are able to sell their power in a bankable manner, however, as they will become an increasingly important part of the renewable generation sector in the years to come.

<u>The role of independents in the renewable generation sector</u>

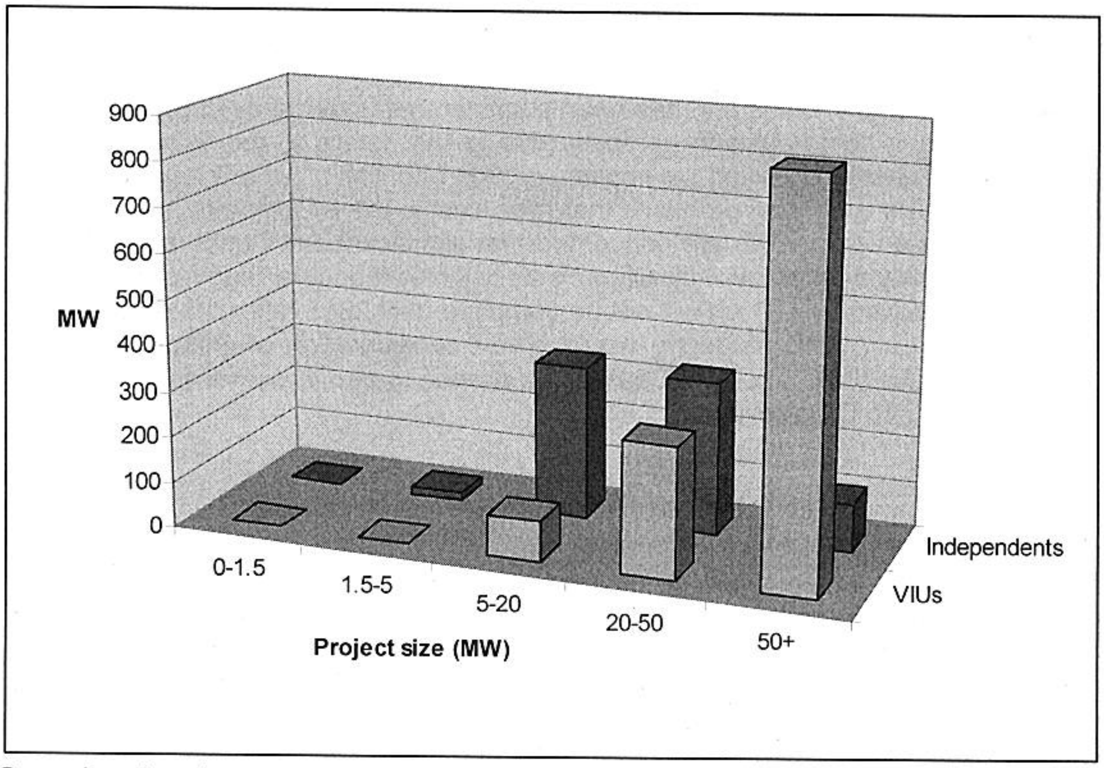
Independent generators are already an important part of the renewable electricity sector and are likely to increase in importance as the investments needed to meet renewable targets ramp up rapidly, beyond the ability of vertically-integrated utilities' (VIUs') balance sheets to absorb. This is particularly the case in onshore wind: while currently the balance of ownership is slightly towards the VIUs, this will likely swing away from them as they focus their capital on offshore wind. Non-VIUs are also players in offshore wind, though they tend to be overseas utilities apart from a small number of true independents. In the medium to long term, financial owners should take a significant role in offshore wind, however, and they will need to have bankable routes to market. In wave and tidal stream, the pioneering developers tend to be independents, though VIUs are well-represented; it is not clear what balance of ownership will emerge in the long term, though it is possible that this will look similar to offshore wind. In general, however, we will focus our comments on the onshore sector, since independents here tend to be smaller and more exposed to any route to market issue.

At present, almost 2,700MW of onshore wind capacity is owned by VIUs, while just over 2,300MW is owned by independents. Of the capacity under construction, nearly 1,250MW is being installed by VIUs and just shy of 800MW is being put in place by independents. However, of the 4,100MW of projects that have been approved but are not yet in construction, nearly three-quarters are owned by independents, while independents are responsible for two-thirds of the 7.5GW in planning. It is also instructive to look at the size of projects that these two developer types bring forward: projects owned by VIUs that are being constructed, have approval or are in planning average 40-60MW, while independents take forward projects averaging 12-16MW. As the number of available larger sites reduces as opportunities are built out, VIUs are likely to leave the smaller sites to specialist developers, and new onshore wind development will increasingly be dominated by smaller players. While there may be a move to smaller project ownership by VIUs as the larger opportunities are 'used up', they will still tend to favour the larger investments in offshore wind and, increasingly, wave and tidal.

The divergence in project sizes being addressed by the different developer types can be seen from the following charts, which show the number of sites and MW of onshore wind currently under construction. VIUs are not constructing any sites under 5MW, have no such projects with consent either, and only two projects of this size in planning; by MW the VIU portfolios at all stages of the development process are heavily skewed to projects over 50MW in size. While there may be some movement away from this polarised situation, this will be a considerable time into the future.



Number of onshore wind sites currently under construction by VIUs and independents



Capacity of onshore wind currently under construction by VIUs and independents

Independent players will primarily be seeking non-recourse project financing to build out their pipeline of projects. Banks have so far required a Power Purchase Agreement (PPA) with a creditworthy offtaker as a condition of providing such finance. Unless banks were to change their position, and there is currently no sign of this, then if there is to be a thriving onshore wind sector, independents will need a clear route to market under a bankable PPA, or an offtake arrangement that gives similar comfort to lenders. Under EMR, such arrangements will need to allow independent generators to realise enough of the market reference price to allow them to make the returns deemed appropriate by Government when setting the CfD strike price.

While the issue of route to market is most acute for onshore wind independents, those developing offshore wind projects who do not also own supply businesses willing to take the resultant power are also facing difficulties in securing a route to market, exacerbated by the scale of the output of these developments. Such developers may have the scale needed to support their own trading desks, and so be able to manage risks effectively, though this is not universally true.

<u>Evidence of a route to market issue</u>

As noted above, RenewableUK is not directly party to the PPA market and thus cannot contribute answers from experience to questions 1-7 in the Call for Evidence. We note that independent generators are reporting difficulties in securing PPAs on bankable terms with VIUs, while these utilities state that they continue to offer competitive offtake agreements. We are unable to verify which of these mutually incompatible statements more accurately reflects the reality of the PPA market.

While the number of projects owned by independents that are currently under construction would tend to indicate that PPAs are available, these deals may have been signed some time ago. If issues in the PPA market have arisen more recently then this may not be reflected in the volumes currently under construction. The volume of projects owned by independents that have consent but are not yet in construction could indicate that there is a problem of securing bankable PPAs.

It is certainly the case that there is and has been considerable uncertainty in the market for power generally and renewables in particular due to the delays to the RO Banding Review and the discussions regarding the implementation ofto EMR. We are hopeful that as this uncertainty is resolved, any problems that may exist in the PPA market will ease, but this is by no means certain. We are concerned that significant extra uncertainty has been added to the policy environment by Ofgem's decision to launch a Significant Code Review on electricity balancing, which will not be complete until 2015, after the projected implementation of EMR. At this stage we would prefer consideration of change to the balancing system to take place after EMR has had a chance to bed in, with the impact of any changes factored into CfDs ex-post.

<u>Liquidity and competition</u>

Liquidity
It is clear that initiatives which result in significant increases in liquidity in the power market will be beneficial for many reasons, in particular to ensure a robust reference price for the CfD and to be the basis for a competitive PPA market. We welcome recent increases in volumes traded in the day-ahead markets, for instance. However, these are necessary but not sufficient to ensure new entrants are attracted to the market and resolve independents' (and their financiers') concerns about their route to market.

Balancing reform
Regarding reform of balancing, any measure that can produce more certainty and predictability with respect to the costs of balancing should enable the risks of managing imbalance to be reduced. Possible measures from the recently launched Significant Code Review directed at simplifying balancing for variable renewables are important for the market and to be welcomed but will not directly lead to an increase in competitiveness in the PPA market and to ensuring that PPA terms are bankable. Other aspects of the SCR could increase balancing costs, however, and these could reduce the willingness of new PPA providers to enter the market. As noted above, the timetable for the SCR is such that changes will not be delivered early enough to address the concerns regarding the current PPA market, and the PPA market as EMR takes effect. We would prefer that this issue is tackled later as it is a complication too far at this point of major power sector reform.

Measures to support independent aggregators
Any measures that increase the number of PPA providers and thereby increase competition will be helpful for generators participating in the market. An aggregation role can play an important part in managing imbalance risk as they are able to manage such risk across a portfolio of generation types. It is possible to view such measures as being a positive development for not only variable generation but also other generation types such as gas fired generation, which will also be looking for competitive terms in their routes to market. However, it should be noted that the UK has been unsuccessful in encouraging such services to date and this would tend to indicate that there are a number of structural barriers to entry. Discussion will be required to identify what effective measures could be put in place to support aggregator roles – assessment of such proposed measures and how quickly such measures could be implemented to address the current market issues will be required.

It is likely, however, that the identification and implementation of measures to support market entry by independent aggregators will not occur quickly enough to allow the development of additional competition in the long term PPA market in the shorter term. As such, reliance on this route will not solve any perceived problem. Consequently, dependence on this route to address any immediate problem with RO-dependent projects appears unrealistic. New aggregators may have a role under EMR, and the nature of the CfD may be more conducive to such players. However, they would have to be in place and providing sufficient confidence to independent generators by 2014, when the new arrangements are meant to be operational.

Market-led initiatives

In general, voluntary, market-led initiatives are attractive in that they could be brought forward quickly and would avoid regulatory intervention, which could be a slow and blunt instrument. We understand that at least some supplier businesses are working on new long-term offtake arrangements tailored to the EMR world. If these were to be commercially viable and bankable for independent generators, then these could form a key part of resolving the route to market issue. This is highly uncertain at this time, however. In general, it is difficult to see why new market-led initiatives should emerge now, at least for RO-dependent projects, when they have not done so heretofore. As noted in the Call for Evidence, progress in this area requires agreement amongst all parties that there is a problem, and the nature of that problem.

The options described in the Call for Evidence, regarding model contract terms and codes of practice, may provide some benefits in making the PPA market easier to navigate for smaller generators. In theory these benefits could be delivered quickly due to their voluntary nature, though consensual processes to generate codes or similar could take considerable time to conclude, particularly if the parties do not agree on the existence or nature of any problem. As with measures to increase liquidity, however, these would not be sufficient in themselves to provide additional competition in the PPA market.

Regulatory measures

While all the initiatives discussed above would be welcome in themselves and could make a difference to the problem perceived by independent generators, there is no guarantee that issues around route to market would be 'solved' by them in isolation or combination. Reliance on them would therefore be a high-risk strategy. If, after consideration of the evidence brought forward by this Call, Government is convinced of the need for a regulatory solution, then there is only the upcoming Energy Bill as a suitable legislative vehicle. It would appear difficult for Government to make a clear decision on the need for a regulatory solution before the Bill is due to be introduced into Parliament. It would appear rational, therefore, to write a power to have a regulatory solution in the Bill that goes to Parliament. This is analogous to Government's approach to the liquidity issue, where backstop powers have been written into the draft Energy Bill to ensure that sufficient liquidity is achieved.

Given the urgent nature of the problem as reported by independent generators, Government will have to consider carefully taking forward action based on those powers in the near term. If, during the passage of the Bill, there is clear, demonstrable and effective progress in other initiatives that address independents' concerns, then it may be possible to withdraw the powers from the Bill. This judgment should be precautionary in nature given the imbalance in threat to the business of independents and VIUs, i.e. the burden of proof that market-led alternatives can deliver and therefore a regulatory solution is not needed should lie with the VIUs. While this deliberation process is under way, DECC should prepare for the use of the regulatory power, so that it can credibly be introduced alongside the rest of the EMR package, We hope that any issues in the PPA market for independent generators will be transitory, and so the power taken in the Energy Bill could be time-limited.

Neither option presented will necessarily deliver a cost effective means of securing route to market for the independent generators without market distortion. The risk of unintended consequences should be considered in full before seeking to implement any regulatory interventions. This will need to be a key part of the assessment that Government undertakes to decide whether to include a regulatory solution in the version of the Bill that is enacted.

An obligation to offer PPAs
While this option could be swift to implement, requiring only amendments to companies' supply licences, we have doubts that this would be an effective measure. This is due to the difficulty of enforcing a requirement to offer commercial terms, particularly as this is what VIUs are claiming they do already. Any obligation would add administrative burden and therefore cost to supplier and which would ultimately require to be factored into the CfD strike price.

Buyer of last resort
Of the two regulatory options in the Call for Evidence, we believe this is the more credible. This does not mean it is free of difficulty, as it may involve the establishment of a new entity, and have implications in terms of liabilities, balance sheets and cash flows. It is possible that such a buyer would 'crowd out' new actors, such as independent aggregators, from the market to provide long-term PPAs. It is also possible, however, that the auctioning of output by the buyer of last resort in short-term lots could be a means for new entrant aggregators and suppliers to build portfolios at lower risk, opening up the market to these new players. Whichever of these is more likely, extreme care would be necessary to ensure that the buyer offers terms that are sufficient to enable independent projects to be delivered, but which allow new players to compete.

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