Department for Energy and Climate Change's call for evidence to help independent renewable generators access the electricity market

Submission from Friends of the Earth England, Wales & Northern Ireland

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Friends of the Earth welcomes DECC's investigation of this crucial issue, although we are deeply disappointed that it has taken this long for it to do so. We, and a wide range of other organisations, raised a number of risks for independent generators posed by the proposals in the original EMR consultation over a year ago, and did so again in response to the White Paper. It is unfortunate that the Department only now appears to be acknowledging these concerns, after the draft Energy Bill has been published, and also that the Bill only looks at one element of the problem facing one section of independent generators as a result of the EMR proposals – that of PPAs – rather than ensuring that the design of Electricity Market Reform in itself works to encourage a greater pool of investors and access to a wider range of participants.

It is worth noting that the process of this consultation itself is further inhibiting the participation of non-traditional players in the energy sector. The shortness of the consultation period, over the summer break, combined with its technically complex nature, is limiting the views the department can hope to get.

The proposals in the draft Energy Bill will further entrench the dominance of a handful of large energy companies. They do nothing fundamentally to alter the existing BETTA trading arrangements, which drive this vertical integration and market concentration. It is unclear how effective Ofgem's separate proposals to increase liquidity will be in encouraging new entrants to the market.

The proposals for Contracts for Difference may work for large, vertically integrated companies who can inherently manage off-take and balancing risks internally, but they do little to address the needs of smaller, independent generators or indeed potential new market entrants from other sectors, such as retail or finance.

With the removal of the obligation on suppliers to purchase renewable electricity, currently provided by the Renewables Obligation, generators using less controllable technologies such as wind (and particularly independent generators without the option of self-supply) may struggle to sell. In the absence of a liquid wholesale market, or such an obligation, the off-take risk represents a significant barrier to new investment, especially from new entrants. It is not clear whether Ofgem's separate review of liquidity will provide the necessary changes.

Independents will be forced to get PPA's or their projects will be unbankable. However, as concluded by the ECC committee report on the draft Energy Bill, they will experience "Difficulties in obtaining the full "reference price" for the electricity they generate, resulting in lower income per unit of energy generated."[i] If this is the case, then significant quantities of investment may be lost.

An underlying critical problem inherent in CfDs is that they provide additional barriers to those who cannot engage in complex trading arrangements (i.e. smaller companies and new entrants in generation markets who do not have trading desks and sophisticated hedging instruments) and risk denying communities and companies who are interested in generating their own renewable energy new forms of finance.[ii] The ECC committee noted that smaller generators will be disadvantaged by "A lack of financial capability to deal with the complexities and uncertainties of CfDs, resulting in high transaction costs".[iii] They also concluded that CfDs in their current form, as well as "introducing unacceptable levels of risk" are "overly complex" and "could result in a more concentrated market". [iv] EMR should seek to implement support mechanisms that broaden the investment pool and diversity in the market place, rather than shutting out new entrants.

It is welcome that DECC are belatedly recognising some of these concerns. But the consultation appears to aim for a sticking plaster approach, trying to 'shore up' the CfD model through various routes, rather than acknowledging that CfDs and current trading arrangements are particularly unsuited to the needs of smaller, independent renewable generators in a number of fundamental ways: the lack of a guaranteed buyer and the lack of priority access to the grid; trading arrangements that disadvantage both smaller and intermittent generators and advantage vertically integrated companies; and a complexity that makes entering the renewable generation market inaccessible to those outside of the traditional energy sector.

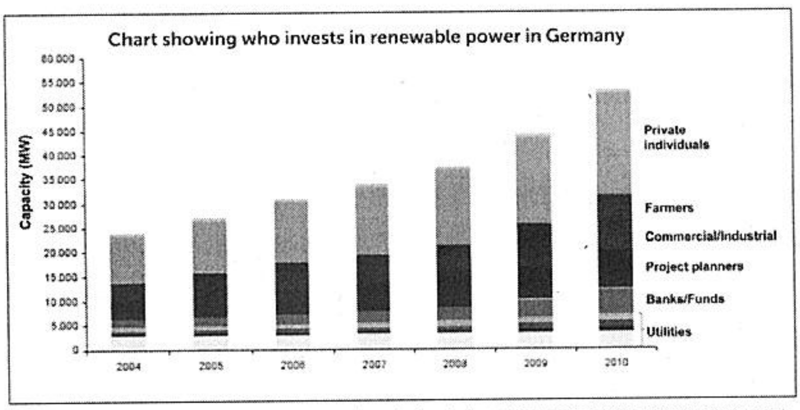
The National Farmers Union told Friends of the Earth that:

"The NFU is among a number of stakeholders representing those with an interest in small-medium renewable generation that stand to be disadvantaged if no provisions are made to provide a simple support mechanism that projects can raise finance on, such as a feed-in tariff, extending beyond the 5MW It will not be possible to raise finance from Contracts for difference as they currently stand, and their complexity adds further financial and other barriers to farmers entering the renewable energy generation market."

There is a significant amount of potential investment in this sector. The German experience demonstrates how successful a Fixed FIT can be to bring forward investment in renewable energy from new players, including non-traditional generators, such as local authorities, farmers and individuals. Over 50 per cent of German renewable capacity is owned by citizens, in contrast to only 13 per cent by the major utilities.[v]

Figure 1 below shows the breakdown of investors in renewable power in Germany.

Figure 1: Chart showing who invests in renewable power in Germany (copyright REA news)[vi]



Billions of investment in German renewable power is coming from everyday people and organisations – and they invest for less than the high returns utilities demand

Volkswagen last year announced an investment of 1 billion euros in renewable projects in Germany, a significant proportion of which is on site. [vii]

The consultation also does not address the many onsite investors in renewable power, for example the commercial or public sector, who are likely to consume the great majority of the power they generate onsite, with only minor exports and limited interest in PPAs.

Incentivising onsite consumption also has some advantages for network management and costs, as well as having proven positive impacts on investment in demand reduction and energy efficiency activity.

A simple, fixed FIT – tried and tested in Germany – offers much wider scope for bringing in new players, potentially accessing a much wider pool of investment capital (essential, given the strained balance sheets of many of the major utilities noted by the consultation).

The ECC committee report on the draft Energy Bill recognises the benefits of a fixed feed-in tariff for smaller and independent generators and recommends lifting the cap on the existing small-scale FIT to "potentially up to 50MW". [viii]

However, there are advantages of a fixed feed-in tariff over contracts for difference at all scales. The Impact Assessment on the initial consultation noted that a Fixed FIT "significantly reduces barriers to entry resulting from revenue risk as it removes price, off-take and balancing risk. This is particularly significant for independent renewables developers. It also therefore largely removes the incentives for vertical integration. In the long term this may mean that more fossil-fuel electricity is traded on the market which will improve liquidity", while the impact of CfDs on barriers to entry and liquidity is likely to be "somewhat less". [ix]

This is our preferred solution to the problem the consultation poses of how to ensure the EMR realises the Government vision of "a competitive and efficient market that attracts a wide range of investment". However, when addressing the narrower question of how to improve the PPAs market for independent generators it is clear that at a minimum any intervention must resolve one of the fundamental defects of CfDs: the lack of a buyer for renewable power, and therefore the high off-take risk. This could be addressed either through an obligation on suppliers or the creation of a buyer of last resort.

Finally, we note that the consultation is also interested in incentivising independent non-renewable generation, namely gas, and that this consultation is to be taken together with the gas strategy when the Government responds. Gas generation must be limited in order to be compatible with the UK's legally binding carbon budgets. The Energy Bill should include a decarbonisation objective of 50g/kWh by 2030, as recommended by the Committee on Climate Change as the most cost-effective way of meeting our carbon budgets.

The Committee on Climate Change has said that a second dash for gas, taking its 2030 contribution beyond 10%, would not be compatible with our legislated carbon budgets[x]. Unlike gas, renewable power is both a relatively immature technology and one that needs to be substantially increased to meet our renewable and carbon target. It follows that the same solutions that are appropriate for renewable generation - such as a guaranteed buyer - are not suitable for gas generation.

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[i] http://www.publications.parliament.uk/pa/cm201213/cmselect/cmenergy/275/27505.htm#a14
[ii] Pers Comm., Second Nature.
[iii] http://www.publications.parliament.uk/pa/cm201213/cmselect/cmenergy/275/27505.htm#a14
[iv] Ibid.
[v] Information from German Renewable Energies Agency Information Platform
[vi] REA news Summer 2012, http://issuu.com/newnorth/docs/rea_news_summer_2012/3?mode=window
[vii] http://uk.reuters.com/article/2011/08/26/greenbiz-us-volkswagen-windpark-idUKTRE77P1NG20110826
[viii] http://www.publications.parliament.uk/pa/cm201213/cmselect/cmenergy/275/27505.htm#a14
[ix] DECC Impact Assessment Electricity Market Reform – options for ensuring electricity security of supply and promoting investment in low-carbon generation p83
[x] Committee on Climate Change Unabated gas-fired generation 24th May 2012