

SUBMISSION TO "CONSULTATION DOCUMENT ON ELECTRICITY MARKET REFORM" -

Cm7983

By [REDACTED]

A personal view with particular reference to Q.31 and Auctions

My background, and why I have a view

My name is [REDACTED]. Although I currently hold directorships in two companies in the renewables sector I make this submission as an individual, based on my previous experience in the electricity and renewables industry. The companies concerned may or may not agree with my comments.

Until its recent dissolution I was Chairman of the government's Renewables Advisory Board for eight years.

I have worked in the electricity industry for more than 40 years and, working at CEGB HQ, was closely involved in the original design and implementation of the UK electricity market at the time of privatisation. As a result I appreciate the enormity of the task facing the EMR team and particularly recognise that the greatly increased number of independent stakeholders in the market today will severely complicate the transition to a secure, efficient, low-carbon market.

From 1997 to 2004 I was Managing Director of National Wind Power Ltd, then the largest player in the UK renewables market. This role grew to encompass overall responsibility for all the renewables interests of RWE npower, including hydro and biomass. I was responsible for bidding into the later NFFO and SRO auctions on behalf of the company. Having retired, I no longer have links with RWE.

As a general statement I applaud the recognition of need to radically alter the UK electricity market. I am not opposed to Feed In Tariffs; indeed the present banded Renewables Obligation has many of the key features of a FIT. Provided investors are given confidence that past and current investment decisions will be effectively grandfathered I believe that the transition can be successfully managed over time to avoid a significant hiatus in investment. This is essential if our binding 2020 renewables targets are to be met.

My particular concern with the EMR consultation is the proposal to introduce auctions. I believe that my experience as a successful bidder in the NFFO and SRO auctions is relevant to this topic.

Q. 31: Do you have views on the role that auctions or tenders can play in setting the price for a FIT, compared to administratively determined support levels?

I recognise that a theoretical economist will cite an auction as an economically efficient process which ultimately provides electricity at the lowest cost to the consumer. However experience in the UK renewables sector during the 1990s through successive auctions indicates strongly that pursuit of this particular economic efficiency led to very low levels of volume delivery: prior to the replacement of NFFO by the Renewables Obligation very little renewables capacity was being installed. In the context of the UK's legally binding 2020 target a similar outcome would be an unacceptable policy failure.

Although the company I headed bid very successfully into all five NFFO rounds I believe that a principal, if not the principal, reason for the failure of the NFFO process was its underlying auction mechanism. The particular features which led to substantial under-delivery were:

- Project developers were required to bid for long term Power Purchase Agreements (PPAs). The Government determined the volume it required for each renewable technology e.g. small wind, large wind, LFG, and selected the lowest priced p/kWh bids for the number of projects which totalled the required volume.
- Without a NFFO PPA there was no chance of funding a UK renewable project.
- Development, consenting and grid connection were, as now, typically taking 5 years to complete. Bidders were therefore required to estimate the capital cost of their projects some 5-6 years ahead of financial close. At a time when the capital cost/MW of wind turbines was falling this led some bidders to be over-optimistic about out-turn costs with the result that it proved impossible to fund such projects. This led to significant under-delivery of volume. Developers who more accurately predicted capital costs were denied PPAs. In recent years turbine prices have varied up and down and predictions have proved very difficult; prices respond to the global market.
- The competitive pressure to bid low energy prices forced wind developers to seek sites with high wind speeds. In many cases high wind speeds are in areas which have proved difficult to consent, principally due to visual or environmental amenity. Once again successful bidders with PPAs proved unable to deliver volume on the ground. Reintroduction of auctions will encourage less experienced developers to bid these difficult sites again; the outcome is unlikely to change.
- There was no "failure to deliver" penalty in NFFO. This was discussed at the time and rejected because it was recognised that development success depended principally upon the UK consenting process which was, and is, largely beyond the control of a developer regardless of the quality of a planning application. It was, and is, unlikely that investment committees will agree to fund very substantial development costs (already money at significant risk) if failure to deliver would result in even further penalty.

- NFFO auctions were “blind”. Secret bids were collected by government and the results were made public on a day of its choosing. Competitive pressure forced developers to keep their project sites confidential, lest an unscrupulous competitor should avoid the cost of early development work and simply bid the same site at a lower price. As a result, affected communities first learned about projects when they were announced by government. Experience has taught us that early sensitive engagement with local communities is an essential element in consenting success. Auctions had resulted in exactly the opposite; developers were on the back foot from the outset. In the mid-1990s consenting rates for wind farms had fallen to extremely low levels.

For all of these reasons I strongly urge that auctions are not part of a reformed electricity market. I believe that a large part of the success of the Renewables Obligation is due to developers and investors knowing what the value of a project’s output will be. The value of the ROC (or at least the Buy Out Price) underwrites the investment.

This probably results in the need for an “administered price” for each technology within the renewables sector. Whilst not ideal from the theoretical economists’ view, we have been managing such a process since the introduction of the RO – especially since banding – and the result has been judged a success in terms of delivery. As Chairman of the Renewables Advisory Board I was responsible for peer-reviewing changes to banding levels etc; the process of “administration” has proved possible and, most importantly, flexible to deal with changes in market conditions.

I am willing to discuss further any of the above if required.

[REDACTED]

[REDACTED]

9 March 2011

