REA response to Electricity Market Reform consultation

1. Introduction

The Renewable Energy Association (REA) welcomes the opportunity to comment on the Electricity Market Reform (EMR) consultation. The Association represents British renewable energy producers and promotes the use of sustainable energy in the UK. These companies are active across the range of renewable electricity, heat and transport fuel technologies.

The REA represents a wide variety of organisations, including generators, project developers, fuel and power suppliers, investors, equipment producers and service providers. Members range in size from major multinationals to sole traders. There are over 650 corporate members of the REA, making it the largest renewable energy trade association in the UK.

The REA's main objective is to secure the best legislative and regulatory framework for expanding renewable energy production in the UK. The Association undertakes policy development and provides input to government departments, agencies, regulators and NGOs.

2. Executive summary

This response focuses on the low carbon support mechanism proposals

- The case has not been made for departing from the RO, however this response does not argue for its retention, despite the fact that most members would favour this.
- New generation *and existing* renewable generation should be given a one-off choice between the period 2013 and 2017 on whether to enter or remain in the RO or enter the new mechanism.
- There is no reason why there has to be a one-size-fits all mechanism (covering renewables, CCS and nuclear). Indeed this is undesirable, as the three have very different characteristics.
- The opportunity should be taken to streamline some of the eligibility requirements for thermal generation, in the new mechanism.
- Fix headroom from 2013, introduce a fixed ROC regime from 2030 at the earliest and grandfather the technologies and feedstocks that were not grandfathered in March 2010.
- Various things must be clarified in the Energy White Paper, in order to give industry clarity and minimise the risk of a hiatus.
- Levels of support must be determined by means other than auctions.
- Accreditation must occur earlier than at the time of commissioning, under the new arrangements.
- There is a case for increasing the threshold for the current feed in tariffs for small scale generation, as this mechanism is easier to access for the non-specialist generator. Currently ineligible technologies should be made eligible.

The above points are elaborated upon below.

We understand the Government's objective is to reform the electricity market arrangements to attract new long term investment, while decarbonising the electricity supply. It is essential that at the same time any reforms do not create uncertainty the UK stays on track to meet its target for 15% renewable energy in 2020. This requires around 30% of our electricity to be met by renewables. We recommend Government uses this opportunity to signal its commitment and high ambition for renewables post 2020, 2030 and towards 2050. The Government's 2050 pathways work illustrates the importance of a diverse mix of low carbon technologies. It is vital that any changes to also support Nuclear or Carbon Capture and Storage do not have a detrimental impact on renewables.

The majority of the REA's members would rather the Renewables Obligation (RO) remain in place, in order to retain stability. In this response we do not expand on the arguments why we believe the RO should be retained but can provide these separately.

The transitional arrangements will be vital in maintaining investor confidence in order to ensure that renewables deployment continues. An announcement on how the RO will be "vintaged" needs to be made as soon as possible for investor certainty. There is wide agreement that the RO should be kept open to new entrants until at least 2017. New generation should be given a one-off choice between the period 2013 and 2017 on whether to enter RO or the new mechanism. Existing renewables generators should also be given a one-off choice over the same timescale, as to whether to depart from the RO and enter the new mechanism. Government may need to consider the provision of bespoke additional comfort to large projects that will be constructed in and around the transitional period. In the absence of this obtaining finance could be difficult due to uncertainties with the new framework and concerns whether a project can commission before 2017 and be eligible under the RO.

The opportunity should be taken to streamline some of the eligibility requirements for thermal generation, in the new mechanism. There are a number of extremely complex and unnecessary provisions under the RO. These can result in perverse incentives The REA has made suggestions over the years on how these can be simplified, and can provide more detail. These should not be replicated in the new arrangements.

To minimise uncertainty and delays to planned investments grandfathering the RO is crucial. There is a preference for the obligation to be grandfathered by the headroom being fixed from 2013. To take into account the diminishing stock of generation capacity a fixed ROC regime could be introduced from 2030 at the earliest. The remaining technologies and feedstocks that were not grandfathered in March 2010 should be grandfathered.

Given the lack of detail in the consultation document it is not possible to advocate one type of tariff over another. Both the Premium Feed-In Tariffs (P-FIT) and Contracts for

Difference Feed-In Tariff (CfD) could be made to work for renewable generation, if designed appropriately. There are specific issues that need to be addressed if Government were to introduce either mechanism, to ensure that investment in renewable electricity continues and wider energy objectives are achieved.

A number of practical and implementation issues need to be addressed and some of these clarified in the Energy White Paper. It is crucial that the industry knows the basis on which contracts will be negotiated, when they will be agreed in the timeline of a project's planning, how long they will be offered for, and if banded how this will be approached. It is these details which will dictate the success of any contemplated tariff.

It is vital that the Government determine levels of support by independent analysis rather than auctions. The REA's members are particularly concerned by the prospect of auctions or tendering for contracts, as this is notoriously difficult to implement effectively. Many remember the problems experienced with auctions under the NFFO regime, as the auctions drove prices ever further below sustainable levels.

Under the RO, accreditation is only at the time of commissioning, which has created a number of problems associated with risk and uncertainty for developers. We welcome that under both PFIT and CFD it is anticipated that clarity will be achieved at the point of financial close / final investment decision and we are proposing that the new mechanism could involve a contracting process with two commitment stages, to provide certainty for project development and also capacity visibility for Government.

3. Objectives

The industry appreciates the Government's objective to bring forth new investment in the UK electricity and wider market. The following are vital issues from a renewable energy perspective.

Meeting 2020 renewables target should be a priority

The UK has a legally binding target of 15% renewable energy by 2020. This is likely to require roughly 30% renewable electricity, 12% renewable heat and 10% renewable transport. We hope the Government gives sufficient consideration and importance to the impacts any proposed reforms will have on investment and deployment rate of renewable technologies.

Reduce the risk of investment hiatus

The transitional arrangements will be vital to ensure there is no disruption to investment and deployment. Sufficient consideration and steps should be taken to reduce the impacts any proposed reforms will have on investment and deployment of renewable energy technologies.

Commitment to renewable energy post 2020

A diverse portfolio of renewable energy technologies will also greatly contribute to the carbon emissions targets, energy security objectives and a number of other objectives including rural diversification, synergy with waste management objectives, employment creation and creation of export industries. It is essential that a high level of ambition for renewables is expressed for the period beyond 2020. Alternative low carbon technologies such as nuclear and CCS, do not share the same long-term sustainability benefits as renewables and should not detract from ambitious future targets for renewable energy.

Realising the benefits of a renewable energy industry

The full economic benefit of a thriving renewables industry has not been fully quantified in terms of market value and job creation. The REA is commissioning work to map the value throughout the whole supply chain, by technology and by geographic region. Government should take a long term approach to developing a domestic renewables industry and the environmental, social and economic benefits it could bring. This work should be published by the summer.

A certain and stable framework

The framework must provide predictability, stability and the right level of support for a diverse range of renewable energy generation technologies. The renewables industry has been subject to constant revision and policy changes since 1998 and Government must now set out clear objectives for deployment and set a stable framework.

4. Assessment of current arrangements

The renewables industry has been working within the current market arrangements, and although there are issues with the RO, particularly in its treatment of thermal renewables, the industry has not called for it to be replaced. Nor does the document provide a sufficient case for replacing the mechanism.

Industry recognises the need for Government to support other low carbon technologies but any change in support to renewables needs to be weighed up against the potential hiatus in investment.

The supporting analysis does not take account of the current wholesale market structure. As a result the conclusions it reaches, in terms of the relative benefits and costs of each proposal is fundamentally flawed.

5. Decarbonisation options: Feed-In Tariffs (Questions 3 to 11)

The lack of detail on the proposals, particularly on CfDs, makes it hard to compare the two leading options.

- Some members feel CfDs could work, and are keen to work with Government to look at the detail of the proposals.
- Others favour P-FITs on account of their simplicity.
- Some support Fixed-FITs, believing these would be more accessible for smaller scale generators. They agree with the consultation document's observation that they would be more cost-effective and have a lower impact on consumers' bills.

We acknowledge that fixed- FITs do not have a link to the wholesale market and therefore do not contribute signals to increase conventional generation at times of high demand / high wholesale prices.

Although individual members have different preferences, the majority would accept that either a P-FIT or CfD could be made to work for renewable electricity generation, if designed appropriately. Government needs to get the level of support for a diverse range of renewable energy technologies right, and ensure the framework design provides industry with predictability and stability.

Assessment of different mechanisms

The Renewables Obligation

If we are to lose the RO, we must look at what has worked well over the years as well as those aspects which work less well. Clearly the policy which replaces it should strive to maintain the effective aspects whilst seeking to avoid a repetition of its shortcomings. These are summarised in the table below.

Table 1 – Characteristics of the Renewables Obligation

• Generators benefit from continually open access (generators can benefit as soon as they commission their plant). Any form of auctioning would result in this being lost.	• The hiatus caused by combination of banding review timing and the fact that the point of grandfathering occurs on full accreditation. This is currently stalling the development of large biomass plant.
• Suppliers have a reason to contract with generators to purchase their power, by virtue of there being an *obligation* on suppliers.	• The RO is very complex in some areas.
• Because generators contract with suppliers and suppliers will not want more ROCs than they require, the volume of capacity coming forward under the RO cannot run ahead of spending requirements. See discussion of "volume overshoot" below).	• Achievement of the target is not guaranteed (suppliers can choose to buy out of their obligation).
• No after-the-event revenue distribution mechanism is required (as all suppliers are evenly impacted by the RO from the outset)	

There are several important objectives for any support mechanism. The various proposals, plus the RO, are scored against these objectives in table 2, below.

Supplier engagement

The existing supplier obligation provides an incentive for ROCs and an indirect demand for the accompanying power under a PPA. The value of this power is typically discounted; one example is to reflect the costs of managing intermittency, so it is possible that the removal of the obligation and consequent ROC demand will lead to a greater supplier discount on renewable PPAs.

Government must ensure there is liquid future access to the market to sell electricity for renewable electricity generators. The preferred solution, for all parties, should be to reform the market arrangements to improve liquidity. This incentive should remain separate from the financial support system itself and avoid complexity and bureaucracy. If liquidity issues are not resolved then a supplier incentive might be necessary to supplement the market. The proposed CFD FIT could facilitate low carbon support using only the prompt portion of the market which is liquidly-traded. This should not however be seen as a substitute to enhancing liquidity in the market as a whole.

Open access

A mechanism which provides continual open access allows generators to benefit as soon as their plant is ready. This avoids a start and stop cycle investment cycle. One of the major issues with the NFFO scheme was that generators could only bid at certain times and they had no knowledge if they missed one bidding round, when the next one, if there were to be one, would take place.

Liquidity and interaction with wholesale market

The Energy Supply Probe (ESP) and Ofgem's work on liquidity has raised a number of concerns relating to the liquidity and market contestability of the GB wholesale electricity market. Ofgem is looking into the liquidity of the market and is due to publish next steps later in 2011. Some members are not confident that Ofgem's review will come forward with sufficiently robust proposals which could be implemented in the timescale needed.

The objective of the Government is to have an increasing proportion of electricity from low carbon sources. This could mean a high proportion of electricity is covered by the low carbon Feed-In Tariff in the future. preferable that the mechanism adopted maintains a link to the wholesale market and provides efficiency signals, incentivising generation when demand is high, and not simply spilling electricity onto the system during periods of low demand.

Volume control

We are concerned that the government may be conservative in its setting of tariffs for the currently more expensive technologies in order to safeguard itself against too much capacity coming forward. If this is the case we will not achieve the targets.

The risk of a volume overshoot is well-illustrated by the current situation facing PV under the small scale Fixed Feed-in Tariffs (F-FITs) for small scale electricity generation. Generally, with Feed-in Tariffs, the Government sets the price and the market determines the volume of electricity delivered. However, the small scale FITs are effectively capped, through the Comprehensive Spending Review (CSR) decision which puts a limit on the amount of consumers' money that can be spent by the year 2014-15. Even though suppliers pass the cost of both the small scale Fixed Feed-In Tariffs and the RO through to customers, Government regards the cost in the same way as it does taxation.

Avoiding hiatus at tariff review points

A hiatus can be created around review points. If a project may not commission before new support levels are introduced, uncertainty is created, and nothing can be progressed until the new levels of support are announced. This is a key issue that needs to be addressed with the introduction of any new mechanism. There should be a point ideally before major investment is committed at which the generator signs a CfD (or for a P-FIT) knowing that as long as they meet the terms of their contract they are guaranteed a certain level of support.

Certainty of achieving target

Government wants to ensure that enough projects are going to be built to meet the 2020 target, but also that it is not agreeing to more projects than needed, which would have a disproportionate impact on consumers' bills. A mechanism that gives Government an early indication what projects are coming forward would be beneficial.

Premium Feed-In Tariffs versus RO

In many respects the RO already works like a P-FIT;

- Generators engage with supply companies for the sale of their power (receiving different market rates depending on their dispatchabily and size etc.).
- The amount of ROC reward on top, this is equivalent to the P-FIT[1].

The important thing is that the RO works in the UK electricity market, making it in some ways superior to a P-FIT. It has the following characteristics:

- **Built in protection against "volume overshoot".** Each year the RO sets a quota, beyond which there is a disincentive to contract (for fear of oversupply of ROCs).

[1] Before fixed headroom was introduced the value of a ROC could vary to a much greater degree. Its theoretical value was directly related to the degree of shortfall between the required quota and the supply of renewable electricity. Now that fixed headroom operates, the variability is reduced. The degree of recycle value is now related to DECC's ability to forecast renewable output (ROC production) in the following year.

Through "fixed headroom" this is increased, each year depending on the volume of renewable electricity generation commissioned during the previous year.

- **No revenue redistribution or fund collection mechanism required.** The RO naturally places an even burden on all electricity suppliers, who then pass the cost to consumers. Therefore no separate fund collection mechanism is required. Under the small scale Fixed Feed-In Tariffs suppliers are obliged to purchase electricity from any prospective generator. A balancing mechanism is required to ensure all suppliers are evenly impacted. This would not be appropriate for a large scale feed in tariff, as the money transfers would be too large. It would also add to the already present barriers to entry for new entrants to the electricity supply market.
- **Suppliers are engaged.** The RO gives suppliers an incentive to engage with generators for the sale of their power. A 1200MW plus CCS or nuclear station may well command both the resources and the market presence to sell its power at good commercial rates in the market; the renewable generator is much less well placed, in the absence of the RO, and may struggle commercially in a CfD or P-FIT regime. Clearly the transaction costs involved in dealing with a larger number of smaller generators (many of whom are intermittent) are higher, than with a smaller number of (dispatchable) larger generators.

P-FITs

P-FITS are similar to the RO, in that the generator benefits from increases in the electricity price (a problem for Government) but suffers when prices go down (a problem for generators). F-FITS are more bankable and more cost-effective but are not linked to the wholesale market.

REA questions why there needs to be a one-size-fits all mechanism given the diversity in scale and nature of the various types of low carbon generation.

The support mechanisms for a number of large nuclear and fossil fired carbon capture and storage projects, perhaps a dozen projects in total may have totally different design issues from those of the mechanism to support tens or hundreds of thousands of renewable scheme

CfD

There are a great deal of questions about how, precisely, CfDs would work. Assessing the implications of a CfD is difficult and will be dependent on the detailed design of the scheme.

A move to F-FITs or P-FITs is likely to produce less of a hiatus than a move to CfDs, if only because this is a model with which potential investors are already familiar in other jurisdictions. The investor community took some time to become comfortable with the RO model. A CfD, whilst not entirely unique, could be a disincentive.

6. Issues for renewable electricity generation

The majority accept it is possible that either a P-FIT or CfD could be made to work for renewable electricity generation, if designed appropriately. This section starts to explore the issues that need to be addressed to make the mechanism work for a diverse range of renewable electricity generation technologies.

The FIT must work for <u>all</u> types of renewable electricity generation

It will be virtually impossible to have one standard contract that covers the needs of all renewable generators. Due to the different nature and the range of technologies it is important that there is a sufficient level of differentiation in contracts for various technologies. This would include build times, level of support, and different indexes might need to be used.

For example, the treatment of generators who pay for their fuel (biomass or waste derived fuels) needs careful consideration due to the ongoing fuel requirement. There are interactions with other power stations, which will compete for different feedstocks, and also the interaction with the RHI to take into account. This treatment could take the form of differentiated FIT levels, indexed with respect to the fuel cost component

Compensation for generators

Some generators will be better placed than others to get a good market price for their power. The proposals must address the following questions:

- How might this be compensated for?
- What will incentivise suppliers to offer a good PPA to a generator?
- What market electricity price might be used?

Small scale generation

It is harder for smaller generators to interact with the market, for these scales it might be more appropriate to support them under the small scale FIT. As noted above, the transaction costs involved in dealing with a larger number of smaller generators (many of whom are intermittent) are higher, than with a smaller number of (dispatchable) larger generators.

Until the market is more liquid and agents take on a role, Government should explore the possibility of extending the small scale FITs. Those technologies that are not currently covered by the FIT scheme will also need to be included, if there is evidence to support the view that smaller generators might be disadvantaged by a move to the FITs scheme.

Onsite generation

There needs to be clarification that renewable generators that consume all their own generation will continue to be supported under the new arrangements. These

generators will have to access the premium payment directly from the fund and not via a supplier.

Autogenerators

It is not clear how the proposed support mechanism helps stand-alone renewable generators. Some communities or industrial applications are located off-grid, where the alternative to an expensive grid connection is a stand-alone system, for example employing a diesel generator. Some of these locations also have excellent renewable energy resources. Due to the expense and low average operating efficiency of stand-alone diesel generators, these locations could benefit greatly from renewable electricity generation, for example in the form of wind-diesel systems. The potential savings of fuel, operating costs and maintenance are large. However, for the time being such renewable energy schemes still require some subsidy to be economically viable. We believe that they should be entitled to a support mechanism, whether it is F-FIT, P-FIT, or CfD.

Similarly, renewable energy schemes should not be penalised if the generating capacity is larger than the export potential of the grid connection, and the renewable energy developer uses the surplus electricity for other purposes, when it is available. These uses might include resistive electric heating, production of hydrogen fuel, or production of synthetic hydrocarbon fuels using low-carbon electricity. All these alternative uses would reduce carbon emissions and reduce fossil fuel use. They also have the potential to help local community engagement and new business developments.

Market Liquidity

The liquidity reforms must improve liquidity of the wholesale market. If this is not possible in the time set for implementation, analysis must be undertaken on the implications of removing supplier obligation with respect to the value proposition generators under the FIT are able to offer.

Limits on Funding

The experience with the small scale Feed-In Tariff illustrate the problems that can occur when there is limit on the amount of funding, which is not communicated clearly to industry. If in any one year there is a limit on the amount of funding available under the FIT this needs to be communicated from the start.

Any unscheduled reviews because of volume concerns are very damaging to confidence as they cast doubt on projects that investors have been developing in good faith.

Certainty for Project Development and Capacity Visibility for Government

A problem with the RO, and potentially any new support mechanism, arises because full accreditation is only at the time of commissioning[2]. This gives rise to a number of problems for some larger or complex projects:-

- Considerable uncertainty for the developer and funder through the process of project development and build.
- Creates a development hiatus in the years ahead of any signalled change in the level or working of the support mechanism, which
- Gives rise to the need for extended periods between (banding/support level) reviews.
- Results in an imprecise and cumbersome mechanism that cannot respond to the market (whether over or under development), and
- Higher than necessary cost as a result of increased risk, whilst
- Not providing Government with feedback in the short and even medium term as to the effectiveness of the mechanism in bringing forward development.

For a new 'contract based' mechanism to avoid these pitfalls a different approach is required. An alternative contracting process with two commitment stages could overcome some of these problems.

Contracting Process with Two Commitment Stages

This approach is intended to avoid the above problems. It involves two stages:-

1) Reservation of capacity (and fixing of the support level) at a first (technical) 'gate', such as planning permission having been obtained, and
2) The project then contracts with the support mechanism (CfD/FiT) at the second (financial) 'gate', when it has reached 'Financial Close'.

By the first stage it is likely that a developer will have secured the site, selected technology and obtained a connection quotation to assess the viability of the project. For the 'gate' it is best to have a simple and definitive measure – such as planning permission – which gives a first level of confidence that the project can be developed. The reservation of Capacity would have a limited life (18/24 months?) during which the project must pass the second (financial) gate, or the reservation falls away and when they re-apply this will be at the then prevailing support level). The intention is that the time to reach the second gate should have be realistic but not too long, so that projects which fail to raise finance do not continue to hold reserved capacity and prevent others from progressing.

Between the first and second gates the project would negotiate fuel and power contracts, as necessary, plus an EPC contract for build and secure funding. The second gate is intended to be at a point where commercial and financial commitment is made that will take the project through to commissioning. This might be described as 'financial close'. But to allow for both third party and balance sheet funding approaches the gate could require evidence of funds being available plus entering into an EPC contract for the build.

[2] Large schemes will suffer more than smaller schemes that can be deployed more quickly

Once the second gate has been passed the contract is firm, conditional only on commissioning before a certain longstop date (perhaps 2 to 10 years - technology dependant – to allow a reasonable period for construction and commissioning). Again if the project does not commission before the longstop date the contracted capacity falls away and can effectively be re-allocated to another project.

It is reasonable that a project that has failed to commission can re-apply and it will then get the prevailing level of support at that time. Again it is important that the time period before lapse be reasonable, but not excessive, since a stuck contract might potentially be tying up capacity. It could be a requirement to report progress every 6 months/year and the regulator have the power to cancel the contract if reasonable attempts were not being made to progress the project.

Not only does this approach provide developers with earlier and greater certainty of the level of support they will receive when the project is operational, but it provides much better visibility for government of the pace of development in each sector. Government will be able to monitor the rate at which projects are brought forward through each stage and the likely expectation of capacity coming on stream. For still greater visibility it could be a requirement to report progress every 6 months so that expected commissioning dates are available for the assessment of the capacity development by key reference dates.

This greater visibility offers government the ability to respond to market developments more immediately. Review and adjustment of the level of support (in light of the rate at which capacity is being brought forward) could even be on an annual basis – requiring perhaps only one year's notice of changes to the level of support without harm to investor confidence.

7. Issues to be resolved in the Energy White Paper

We have been told that it is unlikely the White Paper can clarify all the detail generators might wish to see. Industry will need to know the detail of the practical implementation issues for investors to even consider support under the FIT. We have been asked to set out what is essential in order to maintain the momentum in project development.

It is essential that the White Paper covers the following:

- Clarification of what FIT mechanism will be introduced in 2013 (a CfD or P-FIT)
- Time periods (duration of support and reviews)
- Transitional arrangements and details of the vintaging of the RO
- Whether the FIT will be banded by technology
- If a banding approach is taken, how long will the bands be available and how they will be set
- How strike prices will be set

- At what point in a project's development the contract will be entered into
- Definitions of renewable electricity technologies supported under the scheme, and any other eligibility details
- What reference price index will be used and whether it will be varied by technology and how this might be indexed (CPI/RPI, Coal/Gas index for CCS, Biomass index for Biomass etc)
- How the off-take issue will be solved (will there be an obligation on suppliers, will there be a central buyer, or will generators have to sell into the market?)
- How the contracts will be negotiated (e.g. will these be bi-lateral?)
- For how long a contract will be valid
- How long a generator will be given to complete a project
- The proposals for liquidity and how they will be implemented
- The proposals for balancing market reform

8. Tendering for contracts (Questions 30-33)

REA members do not support the auctioning or tendering for contracts.

- Auctions require surplus bidders but current set up has a surplus of projects. The Government's aim is to secure a sizeable roll-out of low carbon power generation, so availability of projects should not be a constraint
- Projects that form part of an auction should be fungible. This is rarely the case for large offshore wind projects and certainly not the case for new nuclear
- In order for bidders to make an informed offer as part of the auction process, the Government would need to conduct all or most of the pre-FID activities, including site investigations, environmental assessment, technology suitability, grid connection etc. The Round 3 zones have already been awarded and developers have already started such work. Auction would require the Government revoking the awards, compensating the current developers and investing in preparing the full package required for bidders to make informed offers
- Auctioning would remove any medium to long-term visibility for developers, thus removing the possibility of driving economies of scale and industrialization of the supply chain. It will introduce haphazard planning and opportunistic behaviour

9. Institutional Arrangements (Question 32)

The institutional arrangements will need careful consideration and they will clearly be dependent on how the CFDs will work. If for example there is to be a central counterparty to the CFDs then a body to implement this needs to be set up. On no account should the transmission system operator be considered for either this role or to be a counterparty to any capacity mechanism (for which we would prefer capacity payments to be determined by the market rules in any case).

If there is an actual body handling the contracts must have sufficient resources, knowledge, and expertise to deal with the technologies and transactions they are dealing with. The terms and discretion which the contract purchasing agency operates must be clearly defined in advance. The agency should have to demonstrate through ex-post audit that it has adopted a contractual approach that delivers the greatest customer benefits. It should also be subject to performance indicators and service agreements. There should be a route for industry to follow if they have complaints regarding the agency and how it is handling the contracts.

10. Transition arrangements

Transparency and early communication on any of the proposals

There is a significant risk of delay while new market arrangements are put into place. Immediate delay will be minimised by the earliest confirmation of the vintage RO arrangements, sufficient to give confidence that a project can proceed with a low risk of insufficient future revenue from the existing support mechanism. Industry needs clarity over the vintaging arrangements in summer consultation.

2013 to 2017

A one-off choice between the vintaged RO and new support mechanism for each individual project would be the preferred method used during the 2013 to 2017 period. It would allow early lessons to be learnt from the awards of initial CfD contracts and give time for the CfD system to be optimised in response to this feedback, whilst also allowing generators and investors the ability to continue to use the RO scheme that is better understood. This would avoid a large pulse of new projects simultaneously joining an untested CFD scheme in 2017.

Clarification is needed on NFFO agreements that terminate after 2013 and 2017. They should have an option to move into the new mechanism or RO.

If the RO is to close in 2017 it is vital there is no delay in the introduction of the new mechanism in 2013.

Since the publication of the EMR consultation there has been a degree of investment hiatus for large projects that will be constructed during the transitional period. Although there is a one-off choice investors might be nervous that a larger project might not commission before 2017 and may not be eligible for ROCs. They may also delay investment decisions as they may want to observe how the new system works before committing substantial amounts of money.

To ensure the 2020 target is not compromised the Government may want to consider providing some kind of assurance or comfort to larger projects that are constructing during this period, they might want to consider making the point of eligibility for the grandfathered RO scheme at preliminary accreditation or offering a grace period.

Grandfathering

The energy crop uplift, CHP uplift, co-firing and bioliquids should be grandfathered. If government chooses not to grandfather them they should then be given the option to move into the new mechanism.

The CHP 0.5ROC will need to be available beyond 2013, to cater for delay in implementation of RHI.

Calculating the obligation

Fixing the price of a ROC would provide more certainty over future ROC values than relying on DECC to set the level of the Obligation accurately. This proposal could be difficult to implement in PPAs in which ROCs are also sold if the price of a ROC is to be fixed, the key consideration will be how to determine a reasonable ROC value. The process for doing this must be transparent and decisions taken on the same timeline as the banding review. They should also reflect the market price at the time of being set rather than the Governments minimum price, as this would continue to price in the 10% Headroom principle as has been currently incorporated into the ROC scheme.

Due to the problems with PPAs and concern about maintaining investor confidence more of our members support using Headroom to calculate the obligation from 2017. They are supportive of the proposal to fix the ROC price from 2030 to take into account the diminishing stock of generation, and protect against large changes in the ROC price due to small changes in generation.

11. Emissions performance standards (Questions 12 and 18)

The REA is not commenting on this section

12. Capacity Mechanism (Question 19-25)

REA would like to see recognition for the contribution distributed energy could make. We will be submitting more detailed views on capacity mechanisms shortly.

13. Wider impact of arrangements (Question 28)

We think that the changes needed for networks for example suitability for more varied patterns of generation and hence flows and increased value of smart / active network management are functions of the end result of what generation is built and how much additional demand is placed on the electricity system. What market arrangements are used to get the desired portfolio of (low carbon) generation will not itself influence what networks are needed.

Conclusion

Given the level of detail in the consultation document it is not possible to advocate one type of tariff over another. It is possible that both the Premium Feed-In Tariff (P-FIT) and the Contract for Difference Feed-In Tariff (CfD) can be made to work for renewable generation, if designed appropriately. There are specific issues that need to be addressed if Government were to introduce either mechanism, to ensure that investment in renewable energy continues and wider energy objectives are achieved.

The REA is keen to work with Government to ensure the new mechanism works for renewable electricity generation technologies, considers the role for other renewable energy technologies (renewable gas and other renewable fuels) and ultimately ensures the UK meets its 2020 renewable energy targets.

10 March 2011