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

Dear Matt Coyne,

Ecotricity is an independent renewable energy supplier and generator, with over 60,000 customers across the UK. Ecotricity was founded in 1995 and we built our first windmill in 1996. We were the first company in the UK to offer green electricity. We own and operate 53 windmills and the country's first large scale sun park. One in nineteen of all the onshore windmills in England are Ecotricity's. We already have 19 windmills with planning approval, waiting to be built and a further 78 windmills for which we are seeking planning approval.

As both an independent generator and supplier that specialises in renewable energy, the terms of PPAs and the state of the PPA market are highly important issues for us. We are particularly well positioned to provide an insight into the issue from both sides of the market.

Identifying the Problem

Question 1: *Please could you provide a summary of your experiences with the PPA market over the past three years? Specific areas for which detailed information would be particularly helpful are set out in the Annex.*

From a supplier perspective, Ecotricity has seen an increase in generators seeking PPAs. We have found it challenging to come to agreements because generators generally value the power more than suppliers. This is due to the added risks associated with trading and balancing that suppliers incur as a result of buying power in non-firm volumes via PPAs.

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As a generator we have found financiers more demanding in the details of PPAs and more risk averse.

Question 2: *Have you seen significant changes to the PPA market over the past three years, and if so, what do you think has driven this? If you have asked PPA providers for explanations of why changes have occurred, what reasons have been provided?*

Yes, we have seen significant changes. There has been a worsening of conditions for generators. The biggest factors contributing to this are regulatory and financial uncertainty.

Question 3: *How does the GB market for PPAs compare to other international markets? If you operate in other markets, how do PPA structures and terms differ? If terms differ what are the drivers behind the differences?*

Ecotricity does not operate in other markets.

Question 4: *What are the factors preventing or encouraging participation in the GB market? How (and why) do you expect these to change over time?*

Regulatory and financial uncertainties combined with barriers to entry such as the cost of licences and credit, will play a part in preventing any increase in participation.

Question 5: *Do you expect the EMR package to change the PPA terms that you might offer/receive and if so, how do you believe they will change? What do you think is the primary driver for these changes?*

Yes, we do expect the EMR package to change PPA terms. We expect certainty to increase but the price offered for power to decrease. The most significant aspects of the EMR are the end of the Renewables Obligation, which will reduce the value of renewable power for suppliers; and the introduction of CfDs, which increase suppliers' risk.

Question 6: *What has been the determining factor in selecting a preferred PPA and PPA provider?*

The key factor from both sides is bankability. The developer needs the certainty that it is contracting with a credit worthy counterparty in order to secure finance for development. The supplier needs to know that the generator can be relied upon to deliver the power that they claim to be able to.

Question 7: *Have you seen a change in investment returns as a result of the changing nature of PPA terms and can you provide an example, including how this has been calculated? Do you expect the EMR package to change investment returns, and if so what is the driver for this?*

Returns in the wind market have reduced and we expect the EMR to further reduce returns, while making them less volatile. We are happy to discuss this further in bilateral meetings.

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Options for Achieving the Government's Objective

Question 8: *What are your views (costs, benefits and risks) on the potential options discussed in this call for evidence that may be necessary to achieve the Government's objectives?*

We have decided to combine our responses to questions 8 and 9.

Question 9: *What are your views of the potential for market distortions and possible impact on the wider market?*

Market-led initiatives: Standard PPA Terms, Voluntary Code of Practice & Self Aggregation

Standard PPA terms are likely to result in lower prices being offered and reduce innovation. They would, however, create more bankable and robust PPAs.

We are not opposed to the concept of a voluntary code of practice, but it is likely to take a long time to draw up a code to ensure enough stakeholders are happy with. A voluntary code can on the one hand be ineffective, or on the other hand be backed up by the threat that non-compliance will result in it becoming mandatory, making it effectively non-voluntary.

Although self-aggregation could reduce error risk and therefore make purchasing power through PPAs more attractive, the effect would be marginal and the potential benefits have been overstated.

Improving competition: Improved wholesale market liquidity and supporting independent aggregators

Improving wholesale market liquidity is a vital requirement for the GB energy market and should be a priority regardless of PPA concerns. Current developments improving this should not be relied upon. We are not convinced that market developments or liquidity enhancing proposals from Ofgem will be sufficiently effective or implemented quickly enough to have a material impact on the PPA market. Furthermore, even if liquidity were improved, this would not be enough to improve the PPA market for generators.

The entrance of independent aggregators should not be relied upon. Various past policies, such as the New Electricity Trading Arrangements (NETA) in 2001, were touted as a potential way of attracting aggregators, but the results have failed to materialise. A key reason for this is that aggregators need significant amounts of collateral, which makes entry difficult, especially for independents.

Financial Incentive: suppliers charged CfD costs in relation to amount of fossil fuel electricity supplied

We strongly support the principle of this proposal, but are concerned that it would be complex and raise prices. We are also concerned that it would create a disincentive for

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essential gas generation. This would be problematic for the development of wind power as flexible gas fired power stations are vital for balancing intermittent wind generation.

A better approach would be to attach carbon credits to renewables. This would reward suppliers that purchase renewable energy making it unnecessary to penalise the purchase of fossil fuel generated power. We recognise that this effectively creates a new support mechanism, but it is one that should be considered.

Off-taker of last resort

An off-taker of last resort will not improve the state of the PPA market unless it is combined with an obligation to source renewables. On its own, an off-taker of last resort will push prices down as suppliers will be inclined to bid only up to this point. It may also reduce the incentive on generators to accurately forecast and therefore increase imbalance costs.

Obligation to offer terms/obligation to offer PPAs

An obligation to offer terms would be an expensive solution but it could work if combined with a standard set of terms, as proposed under "market-led initiatives". This would prevent suppliers opting out by demanding very high discounts or unreasonable terms.

Question 10: *Can you identify and explain any other viable options (voluntary, competition based, regulatory or otherwise) that should be considered?*

The best way to improve the PPA market would be to put an obligation on suppliers to source a specified amount of renewable energy, backed by REGOs. This level should increase using a "headroom mechanism". This would ensure that the increase in the amount suppliers are obliged to purchase is greater than the increase in the supply of renewables. This would need to be managed carefully to prevent a windfall, but if undertaken properly it would ensure that renewable power remains valuable to suppliers and gives developers the power to negotiate more favourable terms.

For Independent Developers

As an independent developer/generator Ecotricity supplies power through PPAs, however we do this through an internal standard transfer pricing arrangement: the generation arm of our company sells to the supply side. Questions A-F of this section are therefore not relevant to us.

Question G: *Have financiers become more or less risk averse and if their risk appetite has changed, how has this impacted the PPA terms they are requesting to secure project finance?*

Our experience is that financiers have become substantially more risk averse. Many no longer accept our internal transfer pricing and insist that a Big Six supplier be the counterparty as a condition of their finance. This has made obtaining finance increasingly difficult.

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For PPA Providers

Question a): *Have you seen an increase in the number of requests that you have received for the provision of PPAs?*

Yes, we have seen an increase in the number of PPAs requested by generators.

Question b): *Have you have been able to respond to a larger or smaller proportion of the PPA requests for tender? If your ability to offer PPAs has increased or decreased over this period what have been the drivers (commercial or otherwise) for this change?*

There has been no change in the number of PPAs that we have been able to respond to.

Question c): *Have the terms that you have been able to offer in response to PPA tenders changed, and if so how have they changed? What are the drivers for this?*

The amount we are prepared to pay for power has decreased. This is because we face higher imbalance costs due to market volatility.

Question d): *Have you been able to win more or fewer PPA tenders based on the terms you have offered?*

We have won fewer PPAs than previously.

Question e): *How do you think EMR and the CfD will influence the terms that you are able to offer in response to PPA tenders?*

We believe that the EMR will make it harder for us to offer good terms to generators. The extent of this will depend on the precise measures adopted but we believe that at its core the EMR is highly flawed.

The collateral required when signing CfDs will present huge credit risks to suppliers. One of the Big 6 has come out and said that this risk could affect their credit rating; if it is risky for the Big 6 then it could be fatal for independent suppliers. For this reason we have requested that DECC consider an opt-out for suppliers with fewer than 250,000 customer accounts. Without such an opt-out, independent suppliers will have no room to play with when it comes to risk exposure. We would not be able to offer anything but the lowest prices and least favourable terms to generators.

This risk from CfD collateral will be combined with more volatile cash out prices, arising from the increase in intermittent generation, and the end of the Renewables Obligation (RO). Together these will make PPAs substantially less attractive to suppliers and result in far less favourable terms for generators across the board.

We are concerned that the EMR is the product of a failure by the Government to recognise the fundamental problem of our current electricity market and network: they were set up to supply electricity from centralised constant sources with a few large players. The market

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and network are not amenable to intermittent, distributed generation by multiple small players and the EMR will not resolve this problem.

A better solution is to ensure that renewable generation is financially viable, through the use of a supplier obligation, and create a single central purchaser for renewable power. This could work in a similar way to the NFPA and auction power to suppliers through a single platform.

There must also be more focus on upgrading the network itself. This would involve more regional interconnection, and a substantial investment in both storage and ways to directly connect generation to end user.

<u>Conclusion</u>

Ecotricity agrees with the DECC's starting point that the PPA market has substantially deteriorated for generators. This is due to regulatory and financial uncertainty. As a generator we have found financiers increasing cautious and as a supplier we have been forced to offer lower prices and unfavourable terms.

None of the solutions proposed by DECC will be sufficient on their own. However, a variation on the financial incentive; which rewards suppliers for using renewables rather than penalising use of fossil fuel generated energy; would be effective. A combination of standard PPA terms and an obligation to offer PPAs would also result in positive improvements for generators.

The most effective way of improving the PPA market would be to have an increasing obligation on suppliers to source electricity from renewable sources. This obligation should increase faster than the rate of renewable energy supply.

The EMR will make matters worse for the PPA market. This is due to the increased risks to suppliers and the end of the RO. This risk will be substantially greater for independent suppliers and will act as a barrier to entry into the market. DECC should therefore consider an opt-out for suppliers with fewer than 250,000 customer accounts, in line with other obligations. However, even with this opt-out our position remains that the EMR is highly flawed and must be seriously reconsidered.

Ecotricity welcomes any further contact in response to this letter. Please contact Emma Cook on 01453 769301 or emma.cook@ecotricity.co.uk.

Yours sincerely

[redacted]

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