**Offtaker of Last Resort Advisory Group – Second Meeting**

**Wednesday 16th October 2013 09:00 – 11:00**

**Minutes and actions**

**Attendees:**

**DECC attendees:**

Alex Weir (chair)

Tim Warham

Darryl Croft

Matt Coyne

Jessica Henry

Adam Harper

Michelle Toussaint-Bourne

Helena Crow

**Advisory Group attendees:**

Maria Paz Garcia Alajarin, EDP Renewables

Andrew MacLellan, Energos

Ravi Baga, EDF

Stuart Noble, Scottish Power

Christian Pegrum, Eon

Phil Broom, GDF Suez

Charlie Garrood, PwC

Martin Bell, Ofgem

David Handley, RES

Simon Proctor, Good Energy

Dima Rifai, Paradigm Change Capital Partners LLP

Nick Gardiner, BNP Paribas

Edward Crosthwaite Eyre, Baringa

**Apologies:**

Robert Owens, Smartest Energy

Keith Patterson, Brodies

Konstantin Suplatov, PwC

Ben Cosh, Green Company

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|  | **Scheme Review** | | **Paper 2.02 Scheme Review** | | | **Adam Harper** |  |
| After introductions, Adam Harper (AH) presented paper 2.02 on the proposal for the scheme review of the offtaker of last resort mechanism.  The following points were raised in discussion of the options for scheme review:   * Confirmation that, for a specific project, the terms of the OLR would be grandfathered at the point of CfD award, i.e. any changes resulting from a scheme review would only apply to projects that have not yet signed a CfD. * Changes to the Backstop PPA terms that would be considered within the Annual Update would only be applied if PPAs in the open market had shifted significantly in nature. Backstop PPA terms may need to be altered to retain a consistency of provisions. * Confirmation that the backstop PPA could be accessed at/for any period of time [subject to considerations within the forthcoming ‘Timings’ paper], and that the terms would need to reflect long-term open market PPAs at the point of CfD award. * Similarly, the backstop discount would only be changed as part of the Annual Update in response to substantial changes in open market PPA discounts that meant the Backstop was at risk of no longer being a ‘last resort’ or was no longer providing sufficient comfort to lenders over adopting a wider range of routes-to-market. * It was noted that the lead times for developing projects (e.g. offshore wind) are significant and may require any changes to the OLR to be signalled well in advance. This problem has been noted in relation to the CfD strike price setting and will likely be dealt with in a similar manner. Since it is proposed that OLR terms are grandfathered from the point of CfD award (almost certainly pre-construction) developers should get early comfort.   On reporting for the scheme review, the discussion saw the following points raised :   * The annual updates may be considered a risk if they encourage regular changes to the OLR mechanism. AW pointed out that the updates would primarily fulfil a reporting function, evaluating market conditions. However, if market conditions change substantially this may require changes to the OLR mechanism – for example if the backstop is no longer providing sufficient comfort to lenders over adopting a wider range of routes-to-market; hence it is important to allow for regular testing of market conditions. * Looking at the offtakers’ bids within the OLR mechanism (under competitive allocation) would be one form of reporting. However, AW explained that this would only provide information at the point of entry to the OLR, and that Government would need information on market conditions preceding this, particularly if there have been no backstop PPAs issued. * There was brief discussion on whether PPAs (and the headline details therein) might be covered by REMIT. The group was unclear; DECC welcome views. * There was agreement that it might be feasible to require generators to submit details of their route to market and financial model as a condition of eligibility for the OLR. * There was agreement over the importance of ensuring that any information is anonymised and not publicly accessible.   These points prompted discussion around the impact of the OLR on the open PPA market:   * Noted that market discounts falling below the backstop discount might incentivise offtakers holding long-term PPAs to terminate these, with the generator accessing the backstop and the offtaker making them good for their loss. * Noted that the scheme review would enable an increase in the backstop PPA discount if the gap between the backstop and open market discounts narrowed. * General agreement that this issue would only become a problem if market conditions deteriorated seriously, allowing suppliers to socialise their costs. It was agreed that this would be picked up a later meeting. | | | | | | | |
|  | **Eligibility** | | **Paper 2.01 Eligibility**  **Baringa Paper 2A** | | | **Darryl Croft** |  |
| Darryl Croft (DC) presented paper 2.01 on the proposed eligibility criteria for the offtaker of last resort mechanism.  On assumptions of market risks, points raised included:   * On imbalance risk – forecasting of intermittent output continues to improve, reducing the proportion of output exposed to imbalance costs. However, forecasting will never be perfect, and the costs of residual error are sensitive to cash-out prices. Although all generators face imbalance risk to some degree, the point was made that intermittent generators (wind in particular) are more likely to be out of balance in the same direction as the market, leading to much higher and more uncertain imbalance costs than baseload plant. * The group generally agreed that the OLR should be open to those that would otherwise be required to take on long-term PPAs that remove their imbalance risk in order to secure finance. * There was debate on whether solar PV would require long-term PPAs under the CfD, given projects *had* been financed under the RO against shorter-term contracting strategies. It was argued that lenders were now very confident over revenues from ROCs allowing this approach under the RO, but that the CfD (at least initially) *would not* provide the same guaranteed income, and hence long-term PPAs may be required. * On liquidity risk, there was concern that, whilst promising, Ofgem’s liquidity reforms and other measures to maintain/improve liquidity are unlikely to provide enough certainty to financiers that they will no longer require long-term PPAs for baseload generators– initially, debt providers are unlikely to take any risk over reference prices. Until the mechanism is seen to be working, investor confidence is unlikely to improve. * This was challenged by others on the basis that the CfD contract should *ensure* the reference price is always derived from a liquid product. It was generally agreed that the only revenue risk remaining for baseload generators under a CfD would be liquidity, and that long term PPAs may no longer be required. However, concern focussed on the time that it would take lenders to get comfortable with the CfD and the enduring risks before they would be willing to lend in the way DECC expect. There was an open question over how *useful* a backstop PPA would be for baseload generators if it were set significantly below the reference price. Some considered that this would still give comfort to lenders and increase the number of routes-to-market available.   On Nascent technologies (e.g. wave and tidal):   * Whilst there was agreement that strike prices had been set on the basis that wind and wave projects would be equity-funded, the point was made that excluding nascent technologies from the OLR might make it difficult for these investors to refinance post-construction. These technologies are already viewed as being risky, so the question was raised as to why not allow access to the OLR in order to reduce that risk. However, it was noted that these risks were reflected in the strike price, and that there are risks to providing a backstop discount at the wrong level. * A question was raised about whether different discount rates would be applied to each technology – this will be discussed at the meeting on Pricing. * It was also noted that ACT was not included in the list of technologies anywhere. Would that be considered a nascent technology as well?   On project size:   * There was general agreement that there may be risks to a supplier, under regulatory allocation, to being assigned a very large (e.g. 500MW) project under the OLR mechanism – although this might depend somewhat on the level of discount and the compensation paid under regulatory cost assessment. * It was pointed out that it is not correct to assume that all large projects are balance sheet financed. * There was agreement that it is possible to split a project’s output between different offtakers under the OLR in order to spread the burden– clarity would be needed on how this process would work through an allocation system. * Overall, it was agreed that it would be preferable to have no size cap on eligibility, and the ability to split projects between offtakers. There was also agreement that it would be useful to allow a project to put a portion of its output into a backstop PPA. This might allow for different approaches from UJV partners.   On Investment Contracts:   * The group disagreed with the proposal to exclude IC projects from the OLR, on the basis that (a) they *would* account for the policy in their decisions on whether to proceed with the IC, despite having no certainty over the policy detail, and (b) they would know the policy detail by the time they reached FID on the IC projects. * The group were concerned that the enduring CfD might thus appear more attractive, leading to a deferring of investment that the IC had been designed to avoid.   General points:   * It was raised consistently during the discussion that an OLR mechanism open to all generators may be preferable from an industry perspective. An open mechanism is likely to encourage more suppliers to enter the market and increase the availability of PPAs. * DECC agreed with the points raised, although pointed out that the inclusion of technologies that are unlikely to need the OLR mechanism may increase consumer liabilities. In this case, it may be better to keep the mechanism contained and managed. However, the option of keeping the OLR mechanism open to all generators will be considered as the policy details are finalised later in the year. | | | | | | | |
| **3.** | | **Forward Look** | |  | **Alex Weir** | |  |
| It was noted that an extra meeting date (14th November) has been set up to allow for a separate discussion on pricing in the backstop PPA. | | | | | | | |