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# OFFTAKER OF LAST RESORT ADVISORY GROUP

# DISCUSSION PAPER 2.01: SCHEME REVIEW

### Scheme Review Overview

**Headlines:**

* 1. The offtaker of last resort (OLR) mechanism is intended to be transitional, and only open to new generators until the market for bankable PPAs is sufficiently robust. A periodic review process is therefore proposed to monitor conditions in the open market and the performance of the OLR mechanism.
  2. The proposed review process would be for annual updates combined with a comprehensive review in 2018/19 to align with the end of the first EMR delivery plan period.
  3. The intention is for the annual updates to have only a limited scope, serving primarily to update market participants on key performance measures. Annual reviews may also consider whether additional generation technologies should be eligible for the OLR, and whether the discount or terms of backstop PPAs need to be changed.
  4. The comprehensive review would consider whether the OLR should remain open to new generators, and if so whether any changes should be made to the scheme design, including the allocation and levelisation mechanisms.
  5. Any changes at either the annual updates or the comprehensive review would only apply to new generation projects (other than changes that do not ‘go to value’ – for example, to the allocation or levelisation mechanisms), with existing generators’ right of access to the mechanism and the terms of backstop PPAs grandfathered from the date on which their CfDs were signed[[1]](#footnote-1). There would be consultation before implementation of any recommended changes.

**Key Questions:**

* 1. Do you agree with the proposed combination of annual updates and comprehensive review?
  2. Does the proposed approach strike the correct balance between being clear about the intentions of the process whilst allowing sufficient flexibility in its implementation?
  3. Does the group have any suggestions for data sources to inform scheme reviews?

### Introduction

* 1. The OLR mechanism is intended to be a temporary measure, remaining in place only until the market for bankable PPAs is sufficiently robust and lenders, generators and offtakers have become comfortable with the CfD regime. This paper is concerned with the procedure for considering closure of the scheme, as well as reviewing its terms to ensure that it continues to achieve its objectives whilst remaining a “last resort” option for generators.
  2. This paper is only concerned with changes to the scheme for *new* generators, with existing generators’ rights of access to the OLR mechanism and terms of their backstop PPAs being grandfathered from the date on which the CfD was signed.
  3. The paper sets out a preferred approach for reviewing the scheme. It suggest a timetable for each review, identifies the factors that might be taken into account as part of the review process, and provides a non-exhaustive list of changes to the scheme that might arise as a result.

### Assessment Criteria

* 1. The design of the review procedure should align with the criteria set out in Table [1] below.

**Table [1]: Assessment criteria**

|  |  |
| --- | --- |
| **Criteria** | **Description** |
| **Availability of financeable routes to market for independents** | * The scheme should not be removed unless the identified market failure has been addressed * The scheme review procedure should provide sufficient certainty to potential developers. |
| **Minimise system costs** | * Review process should allow removal/ change of the scheme when necessary, and with sufficient speed to minimise system risks or costs. |
| **Impact on suppliers** | * Provides sufficient certainty to suppliers to allow them to appropriately manage any increased cost or risk |
| **Potential for market distortions** | * Need flexibility to change scheme to respond to any adverse impact on the PPA or generation market * Needs to be compatible with the transition to competitive CfD allocation |
| **Practicality and cost of implementation and administration** | * Administrative cost of review need to be proportionate * Necessary data need to be available * Review timetable to be aligned with similar processes where possible |
| **Legal risk and potential compliance cost** | * Review should be transparent and objective, whilst providing sufficient discretion to the Secretary of State to minimise the possibility of Judicial Review * Process needs to incorporate relevant legal requirements (e.g. consultation and State Aid clearance) |

### Review Options

* 1. Three broad options have been considered for scheme review:
     1. ***Time-based removal trigger***: Explicit expiry date placed on the OLR mechanism, with assurances that the scheme will be closed to new generators on this date but no sooner.
     2. ***Volume-based removal trigger***: Restricting the OLR mechanism to a certain volume of CfD generation, with the scheme being closed to new generators once the total capacity of CfD generators exceeds the threshold.
     3. ***Annual update plus comprehensive review***: Annual updates of the scheme to report on a number of market parameters. Under normal circumstances the scheme would not be changed at this point. A comprehensive review including consideration of whether the scheme should remain open to new generators would take place in 2018/19 to align with the end of the first EMR delivery plan.

### Options assessment

**Table [1]: Assessment of options against appraisal criteria**

|  |  |  |  |
| --- | --- | --- | --- |
| **Criteria** | **Time-based** | **Volume-based** | **Update+Review** |
| **Availability of financeable routes to market for independents** | * No guarantee failure will have been addressed | * Only closed if renewables being built, but no assessment of whether market failure remains. | * Will not be closed before 2018 * Scheme only closed if no longer required |
| **Minimise system costs** | * No flexibility to respond to excessive costs | * Cannot respond if overly- generous * Caps total exposure to customers | * Flexibility to change on annual basis if required |
| **Impact on suppliers** | * Highly predictable mechanism | * Highly predictable mechanism | * Largely predictable, but potential for changes that could impact suppliers |
| **Potential for market distortions** | * No flexibility to change scheme to respond to market distortions | * No flexibility to change scheme to respond to market distortions | * Can adjust to realign with market * Review aligned with CfD Delivery Plan |
| **Practicality and cost of implementation and administration** | * Simple and certain process, minimal administrative complexity | * Simple and certain process, minimal administrative complexity | * Some burden on participants, mitigated by aligning with existing reporting |
| **Legal risk and potential compliance cost** | * Low risk if not changed but JR possible if change required | * Low risk if not changed but JR possible if change required | * Gives SoS discretion but lays out scope to provide transparency |

* 1. As can be seen from Table [1], one concern with both the time- and the volume-based trigger is that they present a risk that the removal of the scheme would be poorly aligned with the market need:
     1. The OLR mechanism could be closed too early, putting future developments at risk.
     2. The mechanism could be ineffective, with no option for changing it.
     3. The terms of backstop PPAs might be overly generous and poorly aligned with market offerings.
  2. As such, the preferred option would be for annual updates with limited scope, combined with less frequent, more comprehensive reviews.

### Design choices for preferred option

* 1. At the launch of the scheme, the intention will be to set out details of each aspect of the scheme (such as the discount and terms and conditions of backstop PPAs) covering the period until the end of the EMR Delivery Plan (2018/19).
  2. The performance of the scheme and its impact on the wider market will be assessed as part of the **annual updates** to the EMR delivery plan.
  3. The intention would be to leave the scheme unchanged until the end of this period. That said, adjustments could be made during this period if the Secretary of State deemed it necessary.
  4. At the end of the first EMR Delivery Plan period the intention would be to remove the scheme, although a **comprehensive review** would first take place. If at this point there is seen to be a continuing need for the scheme, it could be kept in place, although perhaps with a number of design or parameter changes.

Annual Updates

* 1. DECC would report on the performance of the scheme itself and the wider PPA market as part of the **annual updates** to the EMR delivery plan.
  2. The update could report on a wide range of market information. This could include:
     1. Volume of CfD generation brought forward by independent developers (i.e. developers without a significant supply base in the UK)
     2. Volumes of CfD generation under PPAs at different tenors for both OLR-eligible and non-eligible plant
     3. Average discounts seen in the market for PPAs of different tenors, and key Terms & Conditions
     4. Level of competition in the PPA market (for all tenors) as measured by the diversity of offtakers
     5. Financing strategy of CfD plant by PPA tenor and OLR eligibility
     6. Size distribution of CfD projects with different PPA tenors and OLR eligibility
     7. Number of generators that have accessed backstop PPAs in the past year, and their installed capacity
  3. **Data availability** will be a consideration here. There are a number of possible sources:
     1. The CfD counterparty body may be able to provide information on the identity of CfD-holding generators. It might also be possible for the counterparty body to provide (anonymised) information on generators’ financing structure and route to market if this is required under terms of CfDs.
     2. PPAs may fall within the terms of the EU REMIT regulations, in which case the discount and terms of these agreements would be available to Ofgem. This information may need first to be aggregated and anonymised.
     3. If PPAs are excluded from REMIT, Ofgem may be able to request this information using its general monitoring powers under Part 1 of the Electricity Act 1989.
     4. It could be possible to require generators to lodge details of their project financing structure and PPAs with Ofgem in order to be eligible for the OLR.
  4. Although the scheme would not, as a matter of course, be changed as part of these updates, some alterations may be necessary. Table [2] sets out parameters that may and may not be open to change as part of the annual update process.

**Table [2]: Scope of Annual Updates**

|  |  |
| --- | --- |
| What might change? | Why? |
| * + Increase the bPPA discount | * + Discounts in the open PPA market have increased considerably making bPPA discount too favourable to be a true “last resort” option |
| * + Decrease the bPPA discount | * + Developers are failing to finance projects based on the combination of market PPAs and revenues under the bPPA. The revenues under the bPPA are too low for finance providers. |
| * + Change the bPPA terms | * + Terms and Conditions offered in the PPA market have changed substantially, so the bPPA needs to be adapted to remain comparable |
| * + Make additional technologies eligible | * + Excluded technologies become commercially viable and can provide robust imbalance data |
| * + Relax capacity-based eligibility constraint | * + Assuming a MW cap is placed on projects, this may be relaxed if this is distorting the market. Alternatively, it may be possible to overcome the technical requirement for having a cap. |
| What should not change? | **Why?** |
| * + Allocation mechanism | * + Unless a backstop PPA is triggered it is unlikely to be necessary to review this |
| * + Levelisation formula | * + It is not intended to change the process for assessing or socialising costs unless there is a strong case to be made. |
| * + Removing generators | * + In order to provide foresight for market participants, it is not intended to exclude technologies that had previously been eligible in the annual update process |
| * + Reducing MW cap | * + Again, to provide certainty this cap should not be reduced unless there is a clear need to do so (e.g. severe supplier impact) |
| * + Scheme removal | * + It is assumed that the scheme will continue to remain open to new generators until the end of the first EMR delivery plan period |

Comprehensive review

* 1. The comprehensive review would occur in 2018/19 to align with the end of the first EMR delivery plan.
  2. The primary objective for the review would be to consider whether or not the scheme should remain open for new generators. The review would also consider whether, if the scheme is to remain open to new generators, any aspects of the design would need to be changed, with all the parameters identified in Table [2] being potentially within scope.
  3. In addition to the sources of data identified for the annual updates, the comprehensive review would likely include a Call for Evidence.

### Questions for Advisory Group

**Question 1**

* Is the combination of annual updates and comprehensive review the right one?

**Question 2**

* Does the proposed approach strike the correct balance between being clear about the intentions of the process whilst allowing sufficient flexibility in its implementation?

**Question 3**

* Does the group have any suggestions for data sources to inform scheme reviews?

1. Note that there may need to be a mechanism for adjusting the terms of grandfathered backstop PPAs if required due to changes in law or regulation. This will be explored further in the paper on backstop PPA terms. [↑](#footnote-ref-1)