

## **Ofgem Project Discovery Response from RES**

RES is one of the world's leading independent renewable energy project developers with operations across Europe, North America and Asia-Pacific. RES has been at the forefront of wind energy development since the 1970s and has developed and/or built more than 4.6GW of wind energy capacity worldwide, including projects in the UK, Ireland, France, Scandinavia and the United States, with a large additional portfolio under construction and in development, both onshore and offshore. RES built its first wind farm in Cornwall in 1992 and since then has built more than 560MW in the UK and Ireland, representing more than 12% of the UK's current wind energy capacity.

The RES Group is active in a range of renewable energy technologies, including large-scale biomass and solar power generation and on-site heat, power and cooling installations (biomass heating, solar PV and thermal and ground source energy). RES also offers design consultancy for sustainable built environments.

RES is an influential market leader with strong environmental, engineering and commercial credentials and has actively engaged in supporting the development of the renewable energy sector in the UK and abroad. Engaging with stakeholders, statutory authorities and policy makers is an important part of RES's business model both at a project and at a national level. We therefore welcome the opportunity to provide comment on the Project Discovery consultation. As a developer of wind and biomass projects in the UK the structure of the UK electricity market is of great importance to RES as it has a direct impact on our income. Our international experience enables us to compare the current GB market and the Project Discovery proposals with markets and support schemes elsewhere.

### **The case for change**

RES agrees that in the longer term the structure of the UK's energy markets is likely to need to adapt if they are to successfully bring on the amounts of low carbon and renewable generation needed to decarbonise the sector. We are not averse to changes in the longer term but do not consider that the case has been made for significant changes in the near term. It is interesting to note that the DECC/HMT Energy Markets Assessment suggests that energy security is not at risk until after 2020, significantly after Project Discovery's conclusion.

If changes are proven to be needed in future their introduction must be carefully managed to ensure they do not destabilise the industries they are meant to help. The importance of investor confidence and the impact it has on financing costs is stressed throughout the Project Discovery report. The need to minimise regulatory uncertainty should therefore be uppermost in government and regulators' minds.

The renewables industry and the wind sector in particular is currently leading the UK's transition to a decarbonised energy sector. It is achieving this under existing market and support arrangements. There is almost 2GW of wind capacity due for deployment over the next five years. This rate of development and the level of financing required to fund it indicates that the market is working and does not need to be reformed. It also illustrates the momentum which exists in the industry. Progressing unnecessary reforms at this time would risk undermining this momentum and stalling deployment.

## Headline Comments

We will comment on specific areas for consideration, some covered in the Project Discovery proposals, others not. Due to the lack of detail of the proposals it is difficult to comment on the specific proposals with any confidence. Proposals which have the potential to be successful could, if implemented without proper consideration, have hugely negative impact on deployment.

### *The Renewables Obligation*

RES is strongly supportive of the Renewables Obligation. It is working well and financiers are sufficiently confident in the mechanism that they are willing to make finance available based on the scheme. The financial crisis had an impact on developers' ability to raise finance and increased the cost of the finance available. In March 2010 RES became one of the first developer to secure project finance for a major wind project following the financial crisis. One of the key factors which brought banks and other financiers back to the market as early as it did was their confidence in the Renewables Obligation mechanism. Such understanding and confidence takes a long time to evolve and its importance in securing the deployment required to meet the 2020 targets should not be underestimated.

The structure of the RO creates not only incentives but also penalties for non delivery and specific targets that utilities can be measured against. This balance has been crucial in driving the high rates of deployment experienced in the UK and the willingness for developers to continue progressing projects in an hostile planning environment. Such incentives are likely to be lacking in a FIT. When considering options for support schemes, the incentive for development created and the importance of targets placed on utilities should be considered as well as the overall cost of the scheme.

### *Centralised Renewable Electricity Market*

RES firmly believes that renewables should continue to operate within the mainstream wholesale market. Hiving off renewables, variable renewables in particular, will have a detrimental impact on renewables' ability to successfully contract in the market. Any changes made to the market should apply to the whole market. Renewables are likely to make up 35% of the market by 2020, so it should not be treated as a marginal player, it must operate in the mainstream electricity market.

When citing examples of market and support structures which exist in other countries it is important to consider the context in which the schemes operate. The Spanish centralised renewables market example outlined in the report did not mention the Spanish wholesale market is a pool based market and that there would be considerable implications for introducing such a scheme alongside a bilateral market such as exists in the UK. Suppliers would be unlikely to contract forward within the renewables market, instead contracting for the vast majority of their needs in the bilateral market. This would potentially leave the renewables market operating as a distressed seller. Considering alternative structures in isolation from the context in which they have been successful introduced elsewhere is likely to lead to unintended consequences.

### *Minimum carbon price*

We would support the introduction of a minimum carbon price provided as a general contribution to the government's climate change policy and providing certainty to utilities to drive investment decisions. However, it should not be considered an alternative to direct support for renewable electricity.

### *Improved price signals*

We can see merit in improved price signals. The market appears to suffer from a lack of liquidity and that this should be addressed as rapidly as possible.

### *Improved ability for Demand Side Response*

RES considers that demand side response can offer benefits to the electricity markets in reducing the amount of generating capacity required to meet exceptional peak demand and for shifting within day demand profiles to lower daily peaks. Demand side response was shown to be highly effective for the gas market over the 2009/10 winter when interruptible contracts operated with great success. Whilst demand side response can reduce the system requirements, the challenge of achieving effective demand side response should not be underestimated.

### *Renewables Tenders*

We are opposed to the concept of renewable tenders and do not consider that they could work within the current UK planning regime. A similar scheme was tried under the NFFO and failed to deliver. The critical uncertainty is with regard to securing planning consent in the UK. Given the time taken to achieve planning consent in the UK, a renewable tender would only work once a project has been consented. The reason for this is that it takes 4 to 5 years to achieve consent, during that time the turbine prices will vary enormously, so a winning tender will be awarded to the most optimistic assessment of turbine prices and the delivery of renewable energy will be dependent on a gamble on future turbine prices. However it is equally unreasonable to expect a developer to have secured planning consent before bidding into a tender. Securing planning consent for a project often requires substantial outlay; it would be unreasonable to expect developers to undertake such expense without security that it would secure success to the support scheme.

### *Capacity tenders*

We do not consider there to be sufficient variation in projects for nuclear or CCS to be supported through a competitive tender process. There would be too few projects and bidding companies to ensure proper competitive pressures within the auctions. The document suggested locational bidding as well. Such further differentiation would further reduce the competitive potential of such auctions.

### *Central Energy Buyer*

We do not consider that a centralised energy buyer is necessary. The UK has competitive energy markets which have evolved to work effectively. Whilst it is likely that some changes will be needed in future, we are not currently convinced such radical reform is needed or that such reform would be workable. We do not support the proposal.

### *Enhanced Obligations*

We consider that enhanced obligations on suppliers and other market participants could provide useful tools to ensuring greater security of supply. The Renewables Obligation has demonstrated how a well targeted obligation with the correct balance between incentive and penalty can deliver specific policy objectives. It would not be unreasonable to expect that similar obligations could increase the amount of reserve fuels held by certain power stations, or the level of highly flexible capacity on the system.

## **Responses to Questions Posed**

### **Question 1: Do you agree with our assessment of the current arrangements?**

#### *Levels of investment*

We agree that there is an unprecedented level of investment required in the UK's generating capacity over the next ten years. It is vital that where investment is already coming forward, such as in the wind sector, that this investment momentum is not undermined.

### *Uncertainty over a Carbon Price*

We agree that the uncertainty over the future cost of carbon hampers deployment of some low carbon generating technologies. A secure and robust carbon price could help deployment of low carbon technologies which rely on a certain carbon price; however, most renewable technologies will require support above the carbon price, at least in the short and medium term. A certain carbon price must not lead to reductions in the amount of support for renewables. Many renewables developers have invested based on carbon price assumptions which were above the price at the time. Reducing uncertainty surrounding the carbon price should not lead to reductions in the level of support for renewables.

### *Short term prices*

We agree that short term prices do not sufficiently reflect value consumers place on supplies. We also agree that incentives to build peaking plant are not sufficiently strong, although we do note the planned development of a couple of OCGT peaking stations.

### *Interdependence with other markets*

We agree that interdependence on other markets exposes the UK to some additional risks but consider that in general interdependence provides greater security through increased diversity.

### *Price of Energy*

We agree that the price of wholesale power is likely to rise over the next ten years as a result of both increases in input fuel prices and tighter system margins. This is likely to have an impact on the affordability for some consumers. We believe that energy efficiency can help mitigate the problem to some degree.

**Question 2: Are there other aspects of the current arrangements which could have a negative impact on secure and sustainable energy supplies, or costs to customers?**

We are not aware of issues not covered in the document.

**Question 3: Do you agree that the five issues we have highlighted are the most important?**

We broadly agree that the five issues are important. We have some reservations over the focus on the potential negative aspects of the UK's interdependence on international markets. As well as exposing the UK to risk of volatile international energy prices, it also provides valuable security of supply. RES supports plans for increased level of interconnection between the GB and Irish and continental electricity networks. Whilst increased interconnection will increase the GB market's exposure to international electricity prices there are significant potential benefits to such exposure. The UK will be able to take advantage of lower prices on continental markets and will have access to a larger market in times of high electricity output (for example when wind output is high at times of low demand). This will have a beneficial impact on the GB market.

**Question 4: Do you have any comments on our description of what might happen if no changes are made to the current arrangements?**

Ofgem's concerns over the cost and availability of finance are excessive and misplaced. RES secured finance for its Hill of Towie project in March 2010; it was one of the first major projects financed following the financial crisis. Our experience indicated that there remained many sources of finance available, but the cost of the finance was higher than it had previously been. Higher financing costs are due to the impact of the global economic crisis on the financial markets, not specific risks in the energy markets. Solutions to the problem should, therefore, be sought in the financial markets not the energy markets. Restructuring support for renewables to lower risk in an attempt to lower the

cost of financing is entirely misplaced. The regulatory uncertainty created is likely to compound the impact.

*Question 5: Do you believe that our policy packages cover a sufficient range of possible policy measures?*

Yes, we believe the package is sufficiently broad.

*Question 6: Do you have suggestions for variants to these policy packages?*

Without more detailed packages it is not possible to discuss variations on the proposals.

*Question 7: What other policy measures do you believe should be considered, and why?*

RES does not consider that the need for change has been demonstrated and believe that the current policy measures, namely the Renewables Obligation, is working very effectively.

*Question 8: Do you agree with the assessment criteria that we have used to evaluate the policy packages?*

We do not agree with Ofgem's assumption that the cost of securing finance will fall as more radical reforms are pursued (i.e. the cost of securing finance will be lower in package E than package A). We also do not necessarily agree that there is a greater chance of meeting the targets the more radical the reform package. OFGEM need to be aware that the more radical reform packages will delay investment until the market becomes familiar with the new operating environment. Many investors lost significant sums under the last market transition as their original investment scenarios were undermined. Another radical change will seriously undermine project delivery and the ability to meet the renewable targets.

*Question 9: Do you have any comments on our initial assessment of each of the packages?*

The proposal for renewable tenders seems to ignore many crucial aspects of project development. It would not be possible to have penalties for non-delivery of projects as project developers could not be certain of when or if they would receive planning consent. Developers would not want to secure consent for a project unless they were certain that project would be supported, which they would not be certain of if they had to bid into tenders post consent.

Similarly the risks associated with the level of support from a tender would make financing much more difficult than it is at present. The UK's experience with NFFO would suggest that tender based support is no guarantee of securing certain levels of deployment.

We do not believe that it would be possible to have locational tenders given the difficulty in finding and securing consent for suitable locations for wind farms.

*Question 10: Do you agree with our summary of the key benefits and key risks of each policy package?*

As outlined above we do not agree with the basic assumption that the more radical reform packages have greater probability of achieving the objectives or will lead to lower costs of capital. We do not agree that the renewable tender proposals will lead to greater levels of certainty for renewable developers and do not agree that such a policy would bring on greater deployment than either package A or B.

*Question 11: Do you have a view on which package is preferable, or alternative policy measures or packages that you would advocate? We are particularly interested any analysis you may have to support your views.*

We have not undertaken analysis of the proposed packages. We do not consider that change is required at this stage, although do recognise that some adjustments to the electricity market are likely to be necessary as we get nearer to 2020.

Two key points we would wish to make are the need to keep renewables within the same market framework as other generators and not create a separate market for renewables. Also that the renewable tender proposals seem to be entirely misconceived given the UK's consenting regime and development timelines.

*Question 12: Do you agree with our assessment of the timing for important investment decisions?*  
No, we do not agree.

*Question 13: Do you believe that early actions should be considered?*

We do not believe that early actions should be considered as the need for change is not apparent and existing market structures and support measures continue to work effectively, especially for renewables.

*Question 14: Do you think that the issues are such that policy measures should be considered as a package or should they be considered on a case by case basis?*

Each policy measure should be considered on a case by case basis but with a holistic view of the whole market and the potential for unintended consequences elsewhere in the market.

We would welcome the opportunity to discuss further the comments made in this response.