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Dear Ian

PROJECT DISCOVERY NFPA RESPONSE

Attached is the response to the Project Discovery consultation on behalf of the Non-Fossil Purchasing Agency Ltd.

Yours sincerely

A R Wood
Managing Director

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NFPA PROJECT DISCOVERY CONSULTATION RESPONSE

Introduction

1. NFPA is the nominated person under the Non-Fossil Fuel Obligation Saving Arrangements Order 2000, as amended. Its subsidiary, NFPA Scotland, performs the same role in respect of the SRO. The total quantity of renewable electricity sold by NFPA and NFPA Scotland during 2009 was 4.5TWh. NFPA has a further subsidiary, NFPAS, which operates auctions on a commission basis for ROCs, renewable power contracts and Renewable Transport Fuel Certificates.

Responses

2. The company's responses mainly concern the proposals where they relate to renewable energy and are categorised by Policy Package.

Targeted Reforms (A)

3. The main feature of this package in respect of renewables is the setting of a floor price for carbon. Since this is envisaged as a longer term price signal to encourage investment in low carbon generation, it will, as the consultation recognises, suffer from obvious difficulties in making sufficiently accurate forecasts. The acknowledged effect of such a floor price would be that the wholesale price of (brown) electricity would rise and this increased revenue would add to the subsidy available from the RO (and FITs) in a modest way. This additional revenue stream would appear to have the potential at least to give rise to concern amongst investors about the future stability of the Renewables Obligation. Ofgem has also observed previously that a structural feature of the RO is that the subsidy is in addition to any increase in the wholesale energy price and that this feature is inherently inefficient (the subsidy does not fall as the cost of brown power rises).

Enhanced Obligations (B)

4. This package envisages an obligation on suppliers to demonstrate sufficient contracted capacity over a three to five year period to cover their customers' demands. This does not really look suitable for a dynamic supply market. One supplier's apparent customers five years hence might be expected to turn out to be those of another in practice. There must be potential for this to destabilise the supply market: a supplier who begins to lose market share would, in addition to the usual business problems this would provoke, potentially find himself with 'stranded capacity' contracts. It would also be very difficult to fit small but growing suppliers into this model, and there are obvious issues with new entrants.

Enhanced Obligations with Renewables Tenders (C)

5. The Renewables Tender aspect of this package has clear echoes of the Non-Fossil Fuel Obligation. Indeed the practical effect of instituting such a system in the current electricity market (the NFFO was originally set up under the old electricity pool) should be that prospective renewables generators have available to them what they need, long term contracts with a price guarantee, and the suppliers will have what they want, namely the ability to purchase over a relatively short term. There is an implication that this system would replace the Renewables Obligation. This seems neither necessary nor desirable. These tenders could be let such that the schemes did, where appropriate, attract ROCs but the right to these ROCs would be purchased with the power by the supplier who bought the output in exactly the same way as the current NFFO auctions operate. Continuing to operate the RO alongside the tender system in this way would be beneficial for investor confidence because of the continuity provided by the continuance of the RO structure. It would also mean that generators who were not successful in the tender operation, or did not wish to participate, would have an alternative option.

6. NFPA's experience and expertise is particularly relevant to this package. The company would therefore welcome the opportunity to contribute to the further development of this model.

Capacity Tenders (D)

7. This package would be a radical departure from the current market. Some of the arguments given above for package (C) concerning the need for long term arrangements for generation and short term for suppliers could potentially apply. However, the effect on the overall market would be far greater than would be the case for the first three packages. The potential scale of the levy on consumers to guarantee the contracts would be very large indeed. It is not at all clear that the current electricity trading arrangements could stand the strain.

Contract Electricity Buyer (E)

8. This package looks to be a total departure from the current market practices. It would involve even more upheaval than package (D) and would require much more evidence than is provided in the consultation to justify such a step.

Further Information

9. Clearly NFPA has considerable experience in operating systems which have potential relevance to some of these proposals, most notably package (C). The company would be happy to respond to any requests for information on discussions which might prove useful in developing the proposals in the document or variations on those proposals.

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