Project Discovery – RenewableUK response

RenewableUK was established in 1978 and is the representative body for companies active in the UK wind, wave and tidal energy market. Its membership has grown rapidly over recent years and now comprises nearly 600 companies, representing the vast majority of connected wind, wave and tidal capacity. This year, the organisation rebranded from BWEA to reflect our diversification into non-wind renewables. The UK has a rich variety of renewable energy resources and the largest wind, wave and tidal resources in Europe. These resources must be exploited to meet UK, European and Global needs to reduce greenhouse gas emissions and avert the runaway effects of global temperature rise.

With membership that covers the technologies that will provide the large bulk of the growth in renewable electricity to meet our 2020 targets, RenewableUK is keenly interested in any discussion of current market arrangements and their possible change. Consequently, we have read the output of Project Discovery with considerable interest, along with the other market arrangement analyses that have been published recently. There appears to be an emerging consensus that change of some kind is required, though we would agree with the sentiment of Government's Energy Market Assessment that this is not required urgently; the case for urgency has not been convincingly made by Ofgem in Project Discovery or others elsewhere. Reform undertaken in haste could lead to severe market disruption through regulatory uncertainty, so RenewableUK urges caution on this subject.

When the NETA/BETTA trading arrangements were introduced, there was considerable concern in the renewable energy sector that the system would be a barrier for participation in the market by variable renewables like wind. Due to considerable effort by all market participants, this has proved not to be the case, and the trading arrangements are working efficiently and effectively in the main. In this sense the market is not 'broken', and therefore there is no case for disruptive reform in the near term. We are also not convinced that the current market cannot deliver investment, given that the wind power sector alone is gearing up for delivery of about 2GW a year over the next five years.

However, we do believe that in the longer term, the changes in generation mix required to decarbonise the power sector could pose significant challenges to the current market arrangements. With a mix including large amounts of high capital/low operating cost capacity, trading arrangements based only on short-run marginal costs may not be appropriate. This should be an issue for the period from about 2020 onwards, so as we move towards that year there should be a considered review of the arrangements to assess whether they are fit for the purpose of integrating a large proportion of renewables into our mix and otherwise delivering energy security and reliability at reasonable cost to the consumer. Such a review would have to weigh the potential requirement for change to deliver these goals against the need for regulatory stability and investor protection needed to assure capital flows. If that balance were to indicate that change is needed, it must be well signalled, taken forward confidently, and the transition planned meticulously. For the absence of doubt, we do not believe that there is an urgent need to change the market arrangements, but that in the 2020 timeframe there may be merit in addressing these issues comprehensively. We await the next stages of the process set out in the Energy Market Assessment to see whether it conforms to these requirements.

The focus in any change should be on evolutionary steps to current arrangements rather than wholesale reform; radical change will risk market disruption, which would impede the UK's ability to meet environmental or security of supply goals. Ofgem and Government should make very clear to investors that radical change to the UK's energy markets is not under consideration.

In considering fundamental changes to established regulatory norms, the following key principles must be applied:

- **Investor perspective.** The arrangements must facilitate investment in new generating capacity, particularly the renewable plant necessary to meet our 2020 targets, and growth beyond that date to encourage industrial development.
- **Transparent prices.** How prices are set must be clear to all parties, so that players can deduce what the price should be given a set of certain market conditions. This is necessary to ensure investor confidence that their price forecasts are well-grounded.
- **Appropriate generation mix.** Any new system should incentivise the appropriate mix of generation types to deal with large volumes of variable renewable generation, particularly wind power. This may mean capacity payments.
- **Demand side participation.** New trading arrangements must actively facilitate the participation in the market of the demand side at all scales.
- **Evolution not revolution.** Any changes should aim at incremental improvement rather than radical upheaval, to reduce the risk of hiatus in development when a clear investment landscape is required.

- **Robust price for carbon.** While this is not related to the power trading arrangements *per se*, it is important for the market to have clear signals about low-carbon generation across the board.

Given that the current arrangements are working in the shorter term, we believe that there is time to generate thorough understanding of the issues before moving to debate options for reforms, if any are required. Government and Ofgem must now work with industry to fully work through the implications of the huge change required in the generating mix; discussion of particular options is premature. Given that Ofgem has put out some ‘building blocks’ for market change in the Project Discovery work, however, we feel it is important to comment on them.

- **Minimum carbon price.** A minimum carbon price is less distortive than many of the other options to encourage low carbon investment, and, as noted above, is not a change to the market arrangements *per se*. We agree with Ofgem’s view that it should be set forward, though we understand there are potential practical issues with a UK-only floor price.
- **Improved price signals.** In theory, sharper price signals in the balancing market would help provide stronger incentives for the back-up thermal plant needed to complement wind. However, it does not resolve the fundamental problem of regulatory risk – where market players fear intervention if they put high bids into the balancing market. Moreover, there are some concerns that cash-out prices are polluted by the inclusion of constraint costs in them.
- **Centralised renewables market.** Creation of such a market represents a transfer of balancing risk from renewable operators to the rest of the market. Arguably it is more efficient to leave the risk with those parties best able to understand and manage it. In many situations this will be the renewables operators themselves, though there may be a case for some changes to the current market arrangements for smaller renewable generators who are less able to manage such risks.
- **Renewable tenders.** Tenders for renewable capacity are unworkable and very undesirable due to 'winner's curse' problems (i.e. if the bid is won it is probably because the winner has underestimated costs the most). Experience with the Non-Fossil Fuel Obligation tenders does not give us confidence that such a system will deliver the capacity required.
- **Central energy buyer.** This is a complete move away from market arrangements and very undesirable for philosophical and practical reasons. On the former, market signals are very good at incentivising an appropriate, diverse and efficient generation mix; on the latter, if the buyer makes mistakes in amounts of capacity required or prices to be paid, there are serious risks of interruption of supply.

We believe that the value in our feedback lies in our views on the options set out by Ofgem. Consequently we have not attempted to answer the direct questions in the consultation document.