RES Response to Ofgem's Consultation

'The Retail Market Review – Findings and Initial Proposals'

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 5GW of wind energy capacity worldwide, including projects in the UK, Ireland, France, Scandinavia and the United States. RES built its first wind farm in Cornwall in 1992 and since then has built more than 560MW in the UK and Ireland. We also have 85MW onshore wind projects under construction and 282MW consented. RES is headquartered in the UK, and is an example of a strong, sustainable British company. We have over 900 employees worldwide of which nearly 400 are in the UK.

The focus of Ofgem's Retail Market Review is increasing contestability in the retail market but it also touches on wholesale market liquidity. This response focuses on the wholesale liquidity proposals outlined in the consultation rather than the retail side of the market as this is the area which impacts RES the most. As a large independent renewable electricity generator RES is keen to ensure that the GB wholesale electricity market has high levels of liquidity. We consider there to be substantial gains to be made from a highly liquid wholesale market.

At present the bi-lateral nature of the market and lack of liquidity means we require Power Purchase Agreements (PPAs) with one of the Big 6 suppliers in order to secure project finance for our developments. At present PPA terms typically include discounts on the wholesale electricity price and ROC value. We have concerns that the removal of the obligation on suppliers to procure renewable electricity put forward as part of the Government's Electricity Market Reform (EMR) proposals will reduce suppliers' interest in offering PPAs to renewable generators. We fear that as a result PPA terms will deteriorate and greater discounts will be applied. It is therefore vital that the wholesale market is made highly liquid so that independent generators are not reliant upon PPAs with utilities for a route to market.

We consider that an objective of the work to increase liquidity should be for new renewable electricity projects to be able to secure project finance without a PPA from a utility. Traders' level of activity and financiers' confidence to lend money under such a wholesale market should be the ultimate test of the efforts to increase liquidity. If traders do not become established in the market or if finance is not available to projects accessing the market direct then Ofgem should consider the liquidity proposals to have failed.

To date RES has relied upon PPAs with utilities as its route to market; we have not been active participants in the wholesale market. As a result we are not experts in the details of traders' requirements for the wholesale electricity market. This response will focus on high level issues that we consider are important outcomes of liquidity rather than the intricacies of the proposals themselves.

Headline comments:

- The liquidity review should be more closely aligned with the EMR, including the headline objectives and implementation timeframe. Ofgem's proposals should consider the outcome of the Energy White Paper in the summer to ensure that the measures proposed by Ofgem are aligned to those in the White Paper.

- A full analysis of the liquidity proposals, including the implications of the proposals should be published to enable independent participants to properly assess the proposals.
- It is vital that financiers and traders are satisfied with the detailed structure of the market intervention. Ofgem should not consider the proposals a success unless financiers and traders are satisfied that they can operate efficiently within them.
- It is important that the review and alternative proposals are outlined alongside the implementation of the primary proposals. This will prevent delays in introducing stronger measures should the primary proposals fail to deliver.
- Ofgem's focus should be on delivering liquidity in the short term markets. We would expect that this would lead to greater liquidity in the longer term markets.
- Ofgem must ensure that the auction arrangements do not undermine utilities' incentives to make PPAs available to the market.

The liquidity proposals should be closely aligned to the process of Electricity Market Reform
The successful outcome of the EMR hinges on there being high levels of liquidity in the wholesale electricity market. It is therefore vital that Ofgem and DECC work in a holistic manner to ensure that the wholesale market structures and characteristics needed by the EMR proposals are delivered in the timescales necessary. In particular the Contract for Difference (CFD) proposal, under which the current obligation on suppliers to procure renewable electricity would be removed going forward, requires a highly liquid market.

Financiers must be happy to make available project finance for projects without long term PPAs with utilities. If there is insufficient liquidity in the wholesale market and investors are not satisfied that renewable generating stations will be able to freely trade their positions in the market, then financiers will continue to require independent generators to enter into long term PPAs with utilities. Once the obligation on suppliers is removed they will no longer be incentivised to contract with renewable generators, our fear is that the discounts applied to PPA terms will then increase. This will either mean that generators might not be able to secure reasonable value for their output, or if PPA discounts are reflected in the CFD strike price, that consumers will end up paying more for the CFD than is necessary. Under the EMR it is expected that there will be new types of investors who will essentially be operating as independent generators. The greater number of independent generators, coupled with deteriorating PPA terms would result in consumers paying too high a price for supporting renewable electricity.

High levels of liquidity, which would remove the need for PPAs, would therefore reduce the cost of the support mechanism. It is vital that liquidity is delivered in advance of the introduction of the EMR. Delays would force new projects into PPAs in order to secure financing.

Full analysis of the implications
It is not clear from the consultation document precisely what the implications of the various proposals are. Similarly it is not clear how or why Ofgem considers that the various proposals will deliver the liquidity desired. The majority of the market participants able to undertake their own analysis of the implications of the proposals are the big utilities who could have vested interests in

maintaining the status quo. In order for a unbiased assessment to be undertaken it would therefore be necessary for a full independent assessment to be carried out. This would ensure independent market participants are able to properly analyse the implications of the expected outcomes. This would enable those less familiar with the intricacies of trading arrangements to better understand the proposals and whether they will be suitable for their needs.

Financiers and traders must be satisfied with the market
RES does not have significant experience in the trading arrangements in the UK market. To secure project finance for our developments it has been necessary to secure long term PPAs with utilities. As a result we are not able to comment with authority on the detailed and specific needs of the market in order for high levels of liquidity to be available. It is vital that Ofgem ensures its proposals fit with the needs of potential traders in the market and financiers. If these parties do not consider there to be sufficient liquidity, or suitable trading arrangements to operate in the market, then the proposals will have failed in their aims.

Ofgem should engage with the potential traders and the finance community at an early stage and seek their input into the detailed development of the proposals.

Robust review and alternative mechanisms should be developed at the outset
The proposals indicate that where possible market solutions will be sought in the first instance. Whilst we support the development of market solutions we are concerned the Big 6 appear reticent to engage with the proposals. There is a substantial risk that this leads to a number of years delay to robust and fully arrangements being in place and delivering the liquidity necessary. For example the proposals state that reserve prices will be permitted but that if they are seen to be frustrating the outcome of the auction that further action will be taken. The fear is that the time taken to gather evidence of reserve prices frustrating the outcome of auctions and suitable remedies to be developed, consulted upon and introduced will add three or four years to the time taken to establish correctly functioning auctions. This is far too late for the proposals to support the introduction of the EMR. It is therefore vital that strong and robust alternative measures to developed alongside the introduction of the primarily proposals. This will ensure that those participating in the auctions understand what the outcome will be should they frustrate the auction process and, should the auction process be frustrated the situation can be rectified quickly.

Focus on short term liquidity
RES considers that the focus of Ofgem's liquidity proposals should be the short term markets, such as the within day and day ahead markets. This will drive liquidity in longer term products. Focussing on longer term products with the expectation of driving liquidity into shorter term products is plausible but is likely to take longer to establish sufficient liquidity in the shorter term products that are vital to the EMR. Given the importance of liquidity in short term products under the EMR this should be the priority for the liquidity measures.

Auctions must not disincentive utilities form making PPAs available to the market
Ofgem must ensure that any mandatory auction does not disincentivise the utilities from offering PPAs to renewable (or other independent) generators. Until a fully liquid electricity market is

established utilities will remain the most important counterparty in offtake agreements and that the push for liquidity should not undermine this.

Responses to the questions posed:

Question 8: Do stakeholders consider that low electricity market liquidity constitutes a barrier to entry in the domestic retail supply market?
RES is not in a position to comment in detail on the entry barriers in the retail market. It would appear that the primary barrier to entry in the domestic retail market is the scale and complexity of the market. These barriers would be very difficult to remove.

Question 9: Do stakeholders consider that our two proposed interventions (the MA and the MMM) could improve the ability of the wholesale electricity market to meet independent participants' needs, and will ultimately improve the likelihood of retail supply market entry?
We consider that the MA and MMM could improve liquidity in the wholesale market but we are not in a position to comment on whether the specific proposals as set out will deliver the objectives. Our priority is to ensure that the wholesale market situation is improved for independent generators rather than retailers. The objective of the proposals on liquidity should be to provide a sufficiently robust market that independent traders enter the market. It is therefore important that Ofgem secures advice from potential traders to ensure that they would be confident operating under such arrangements. Similarly it is important to ensure that financiers are happy making finance available under the arrangements.

Question 10: Subject to the result of out further wholesale market assessment, do stakeholders consider that both interventions could be necessary to meet the objectives stated in questions 8 and 9?
We consider that both interventions could be necessary to increase liquidity. We are, however, not certain that the objectives will be met if the proposals are implemented. It is important that Ofgem secures the input of potential traders and financiers to ensure that the proposals meet their needs.

Question 11: Do stakeholders consider that there are other intervention options we should be developing?
We have not considered other interventions.

Question 12: On the basis that we could decide to take forward these interventions so stakeholders have comments on the indicative design choices we have made, as set out in Appendix 2. In particular, views are welcome regarding our initial position on each of the following:

- *Volume requirements*

Without a clear analysis of the proposals it is not possible to comment on whether the level of MA should be 10, 15 or 20% of a supplier's generation.

It should be noted that the EMR aims to increase the number and range of investors in the electricity sector. In the Liquidity Proposals report published in February 2010 Ofgem stated that in 2009 the Big 6 represented around 68% of total output. However, this is likely to decline over time. It will therefore be necessary to ensure that the growing proportion of non-utility generation has a fully liquid market within which to operate. When determining the percentage of suppliers' output needed to pass through the MA in order to deliver liquidity, the decline in suppliers' share of total output should be taken account of.

- *Product requirements*

We do not have a clear view on the specific product requirements. We consider that liquidity in short term products is vital to the success of the EMR and, as a result, that should be the focus of Ofgem's work.

- *Frequency*

We do not have a strong view as to the required frequency.

- *Governance arrangements*

We do not have a strong view as to the required governance arrangements.

- *Participation*

We do not have a strong view as to the required level and range of participation.

- *Platform*

We do not have a strong view as to the requirement of the platform, however, using an existing platform is likely to enable the system to be set up much more quickly that if a new one was required.

Question 13: Do stakeholders have any comments on the costs and risks of our proposal, or any alternative suggestions that you have put forward, to take action to improve wholesale electricity market liquidity?

We consider there to be a significant risk that liquidity is not delivered to level or in the timeframe required for the successful introduction of the EMR proposals. Liquidity is vital for the proposed Contract for Difference to work efficiently and it is vital that the market arrangements are established in good time to allow traders and financers to become confident operating before the CFD is introduced. Without a fully liquid market independent generators will remain dependent upon PPAs with utilities. This could cause a substantial increase in the cost to consumers of the move to decarbonise the electricity sector.

We are keen to become more involved in Ofgem's liquidity work and would welcome further opportunity to discuss further these comments or any questions you might have.