MAINSTREAM RENEWABLE POWER

OFGEM Consultation

Electricity Balancing Significant Code Review: Draft Policy Decision

Mainstream Renewable Power Response

22 October 2013

Ofgem/Ofgem E-Serve
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Dear Andreas Flamm / Dominic Scott,

Electricity Balancing Significant Code Review Consultation Response

About Us

Mainstream Renewable Power is a leading independent renewable energy company developing projects across several continents. The Company expects to be a major provider of renewable capacity for the UK and has 9500MW in its development pipeline.

We are developing onshore wind and solar projects in Europe, North America, South America, and South Africa. In the German North Sea, we are developing the 1500 MW Horizont project.

In the UK, we are developing two large offshore wind projects. In Scottish territorial waters we are developing the 450 MW Neart Na Gaoithe project. Through the SMartWind consortium, we are developing the 4000MW Hornsea Round 3 zone. The first phase of 1GW within the zone is being developed with our partners, Siemens Project Ventures and Dong Energy. Going forward, we will retain a minority ownership stake in our projects, seeing them through construction and into the operation phase. This position makes us particularly sensitive to regulatory uncertainty, as we are responsible for attracting investment into a project, enabling it to be built and commissioned.

We are also developing onshore wind plant in Ireland to directly connect to the GB network before 2020. The project ("Energy Bridge") will be facilitated by the execution by the UK and Irish governments of an Inter-Governmental Agreement in late 2013.

Executive Summary

Renewable generation will play a major role in decarbonising the electricity system and it is desirable to create the necessary price signals to stimulate innovation in the demand side and balancing technologies

- Given the significant role that variable renewable generation will play in decarbonising the electricity system, we recognise the need to address long standing concerns with the current arrangements in the calculation of cash out prices
- We are supportive of the continued use of cost reflectivity – i.e. those that cause costs should be responsible for managing them
- We need to see clear workable incentives for balancing providers to invest in appropriate measures and those who require balancing services to be able to secure them at a competitive rate and in a clear and transparent manner
- OFGEM's proposed approach to incorporate many of the non-costed actions into the cash out prices as set out in the consultation is welcomed, however we have concerns in both the way these are being implemented and the impact they will have on investment decision making unless there are changes made to the EMR framework.

Given the expected change in technology mix, efficient balancing costs will rise (the consultation sets out an assumed balancing cost of £12-15/MWh in 2030). There has to be an appropriate mechanism to pay for these increased costs within the EMR framework. Unless this is addressed, investment in variable renewable generation is unlikely to be forthcoming

- The quantitative analysis undertaken for this consultation highlights the increase in balancing costs that can be expected as the generation mix changes – cash out prices are expected to increase in level and become more volatile
- These will undoubtedly feed through into higher balancing cost assumptions made in power purchase agreements (PPAs) that are required to deliver independent renewable projects
- Under the EMR proposals, there is currently no mechanism to reflect these additional risks into investment decision making – it is also unclear how these assumptions have been incorporated into the calculation of CfD strike prices
- This concern needs to be addressed by OFGEM/ DECC as part of the wider electricity market reform proposals

Electricity Market Reform was initiated to deliver a holistic solution that would deliver major policy goals over an investment timeline. We are now witnessing additional policy measures with complex interactions which will take time to understand. We would welcome these measures being included as part of a single over-arching policy roadmap to deliver a decarbonised power system

- Investors are already having to deal with an unprecedented level of change as a consequence of electricity market reform
- Complexity can be managed if uncertainties are minimised and the direction of travel is clear
- To that aim, we would welcome the creation of one integrated policy roadmap that incorporates cash out and future trading arrangements reform. This would deal with the timing, magnitude and interaction of any prosed changes

- Without this framework in place, OFGEM needs to mindful of the level of change that is being introduced. With regard to this consultation, we would suggest a phased approach to implementing more marginal cash-out prices. This should have a clear monitoring process in place to understand its impact and review its effectiveness throughout the transition period. We would suggest introducing a PAR of 100 followed by a PAR of 50 at a later date.

Question Answers

Question 1: Do you agree with our proposal to make cash-out prices more marginal?

- We believe that a decarbonised electricity solution which incorporates a high degree of variable generation will require a clear pricing signal to stimulate more innovative ways of balancing the system – for example through flexible demand side and storage
- To deliver these technologies, it is essential that any modifications to cash out arrangements will deliver a predictable pricing signal that potential investors can base their investment decisions on
- It is notable that there have been a number of changes made to cash our arrangements since the introduction of NETA
- Therefore, while we support the proposal to make cash-out prices more marginal, we believe that a gradual introduction would be more appropriate.

Question 2: Do you agree with our rationale for going to PAR1 rather than PAR50? Are you concerned with potential flagging errors, and would you welcome introduction of a process to address them ex-post?

- As a variable renewable generator, we would be concerned with an immediate move to PAR1
- Although there has been a significant amount of analysis undertaken as part of this consultation, we believe that a move to cash out prices calculated on the last MWh of balancing action will inevitably lead to a significant risk premium being built into the balancing cost in PPAs
- Given the level of changes being experienced in the market, we would also question whether any quantitative analysis, no matter how thorough, can fully represent the level of behaviour change that can be expected
- As set out above, we are concerned that changes to the cash out arrangements have not been incorporated in the design of the CfD under EMR
- Without any mechanism to compensate the variable generator, moving to more marginal cash out arrangements in isolation will increase the basis risk and adversely impact the cost of capital and ultimately the investment decision itself

Question 3: Do you agree with our proposals for pricing of voltage reduction and disconnections, including the staggered approach?

- We agree that voltage reduction and disconnections should be priced into the calculation of cash out prices and support the staggered approach

Question 4: Do you agree with our assessment of the interactions with the CM and its impact on setting prices for Demand Control actions?

- We note that changes to cash out arrangements were proposed as part of Project Discovery - well before any decision was taken to introduce a capacity market under EMR
- Some investors believed that sharpened cash out prices would be sufficient to bring forward investment in new conventional generation
- Given that DECC has confirmed that a capacity market will be introduced from 2014, with associated penalties for non-delivery during periods of system stress, the modifications to cash out arrangements are no longer a necessary solution to manage the issue of security of supply
- However potential investors in the capacity market will need to make an assessment of the income that can be expected from the energy only market when formulating any bid into the capacity auction
- Therefore it is essential that any changes to cash out arrangements must be clear prior to submission of the first auction wherever possible.

Question 5: Do you agree that payments of £5/hr of outage for the provision of involuntary DSR services to the SO should be made to non-half-hourly metered (NHH) consumers, and for £10/hr for NNH business consumers?

- We agree that payments for the provision of involuntary DSR services should be made but are not in a position to comment whether the level is appropriate.

Question 6: Do you agree with the introduction of the Reserve Scarcity Pricing function and its high-level design? Explain your answer.

- We understand the logic of the proposal to make reserve more cost reflective and agree that it currently acts to dampen cash out prices
- Although we agree in principle with the introduction of an RSP function and note that this has been used in other energy markets, this is a complicated issue to evaluate and implement
- We would welcome further engagement on this issue

Question 7: Do you agree with our rationale for a move to a single price, and in particular that it could make the system more efficient and help reduce balancing costs? Please explain your answer.

- We agree with the rationale in moving to a single cash out and the removal of the artificial spread under the existing dual cash out arrangements
- The quantitative assessment undertaken for the consultation highlights this issue to be of particular benefit to variable renewable generators
- Given that an increasing level of generation will be financed under EMR which uses the market reference price in the day ahead market for the CfD, it is questionable whether player behaviour can be accurately assessed

- All players will be aware of the nature of the CfD and the need to achieve the reference price with consequential risks of gaming between the day ahead and outturn markets

Question 8: Do you have any other comments on this consultation, including on the considerations where we did not propose any changes?

- No comment

Question related to the accompanying Impact Assessment:
Question 9: Do you have any comments regarding any of the three approaches we have taken to assess the impacts of the cash-out reform packages?

- No comment

Question 10: Do you agree with the analysis of the impacts contained in this IA? Do you agree that the analysis supports our preferred package of cash-out reform? Please explain your answer.

- No comment

Question 11: Do you agree with the key risks identified and the analysis of these risks? Are there any further risks not considered which could impact on the achievement of the policy objectives? Please explain your answer.

- As set out above, although we support the overall direction of these policy changes, we have concerns over the linkages to the electricity market reform proposals
- In isolation, they will almost certainly lead to higher balancing costs being reflected in PPAs with the consequential risk that investments may not be forthcoming
- We would suggest that OFGEM continues to engage with DECC on how a suitable framework could be put in place that allows for reviews in cash out prices to be reflected in the assumptions made within the strike price calculation of the CfD

Question 12: What if any further analysis should we have undertaken or presented in this document? Do you have any additional analysis or evidence you would like to contribute to support the development of the EBSCR towards its Final Policy Decision?

- No comment.

MAINSTREAM RENEWABLE POWER

Please do not hesitate to contact us if you have any questions on the above. We would welcome the opportunity to answer your questions and discuss our suggested amendments to the strike price in more depth.

Yours sincerely,

Tim Pyke

Head of Regulatory Affairs

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