CO2Sense response to the Electricity Market Reform Consultation

Introduction to CO2Sense

CO2Sense welcomes the opportunity to comment of the Electricity Market Reform consultation. CO2Sense is currently a wholly owned subsidiary of Yorkshire Forward established to help the region's companies prosper in a low carbon economy.

CO2Sense helps companies in the **environmental sector** to grow by developing new markets, providing support and technical advice, and by providing access to finance to help them to grow their businesses.

CO2Sense helps the region's top companies and organisations to **reduce their carbon emissions** by helping them to access low carbon energy and to adapt their business plans to the effects of climate change.

CO2Sense are also working to enable the development of a **carbon capture and storage** (CCS) network in the region. This could attract tens of £billions of investment and support thousands of jobs for local companies in sectors such as engineering, manufacturing and project management.

Over the past 3 years CO2Sense have been an active investor in renewable energy projects in the scale of 50kW up to 5MW. The developers we work with are generally new market entrants or first-of-a-kind commercial demonstrations of new technology. These investments have provided us with direct experience of renewable energy projects. CO2Sense has also acted as a ROC agent, and we were the consultant responsible for securing the first waste wood ROC accreditation for a power generation project in the UK.

Our response

Our response focuses on the following areas of the proposals for low carbon support mechanisms presented in the consultation;

1. Assessment of the current arrangements;
2. Feed in tariff models;
3. Transitional arrangements; and
4. Auctioning.

Each of these areas is addressed in turn below.

1. Assessment of the current arrangements
   - The renewable energy generators that we work with have been successful under the current market arrangements. Although there are issues with the Renewables Obligation, in particular with the arrangements around thermal renewables, our clients have not called for its abolition or replacement.
   - If one or more of the proposed FIT models is put in place, then they need to be at least as effective as existing arrangements if current levels of investment are to be maintained and indeed increased over the coming years.
   - Any change to the current system should only be made where there is a clear and demonstrable benefit. In our view, the consultation document does not provide sufficient case for replacing the Renewables Obligation mechanism.

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- CO2Sense recognises the need for government to support other low carbon technologies but any change in support for renewables needs to be weighed up against the potential hiatus in investment.
- In terms of revenue uncertainty in the electricity market, we view this as a significant risk. Our projects have been able to secure appropriate Power Purchase Agreements (PPA), normally 2-3 years in length to match their forecasting and meet their lenders' expectations. What has created far greater uncertainty for developers have been changes and reviews of the ROC, ROC banding and eligibility of technologies, especially for biomass fuelled plants. For example, one dedicated biomass power plant (3MW) utilising SRF could not secure debt finance until clarity was achieved on ROC eligibility of solid recovered fuel (SRF), delaying the project by at least 6 months.
- We are concerned that the proposed reforms will not be sufficient to deliver first-of-a-kind CCS investments. Therefore a supplementary mechanism, such as the CCS Levy will still be required.
- We are supportive of the principal of FITs to support CCS investments. However the CfD FIT exposes CCS fossil fuelled operators to long term fuel market risk and could make projects un-bankable.

2. Feed in tariff models
   - From the information provided within the consultation document and the Redpoint report, we believe that the FIT with Contract for Difference (CfD) and the Premium FIT could be made to work for renewables. However, more details are required on the practicality of the proposals for a full judgement to be made.
   - In addition to the Government's assessment of the pros and cons of each of the models of feed-in tariff, we have the following reservations –
     - FIT with CfD and Premium FIT expose generators to the market price for electricity. Therefore, smaller intermittent generators would be at a disadvantage under these models as they are less able to negotiate good electricity prices than larger, baseload generators.
     - The FIT with CfD is more complex to understand than the Premium FIT or Fixed Fit. As a result, generators with a limited understanding of electricity markets (e.g. commercial on-site generators such as warehouses, factories, industrial estates) may be discouraged from entering the market.
   - Given the above two points, we suggest that the threshold for small scale FITs be increased to 10 MW.

3. Transitional arrangements

The investment community is very nervous of any changes to incentives. This has been felt throughout the banding of the RO and implementation of the small scale FIT. With many projects taking three years to develop and contract, any form of uncertainty which will have impacts four years in advance has caused projects to be placed on hold.

The earliest confirmation on how the RO will be vintaged is essential to keep delays to a minimum. CO2Sense believe that the three year overlap window when projects can select the new mechanism or the RO would be helpful as it would provide more investor confidence. This will enable any issues with the new mechanism to be ironed out before a full move over from the RO. Furthermore, this more gradual transition will minimise the risk of a hiatus as developers and investors await the start of the new mechanism in 2013.

If the decision is made to abolish the RO in 2017, it is essential that the new mechanism is introduced efficiently and on time in 2013.

4. Auctioning

CO2Sense has significant concerns over the use of auctions in setting the price for a feed-in tariff, compared to administratively determined support levels. Emerging technologies are a key area of activity for CO2Sense. Our experience has shown that in all projects that we have invested (6 to date) projects have over-run on cost and suffered significant delays (up to a year). An auction process would require very accurate cost projections early in the development process. This may lead developers to overstate capital costs during the auction, or receive a level of support that makes the project unfeasible.

CO2Sense believe that the administrative approach is far better suited than auctions for setting the price for a feed-in tariff. The experience of auctions under the NFFO regime is still at very strong in generators minds and we fear that a return to such a system will only reduce investor confidence. Furthermore, given that the principles of the administrative approach are already established within the RO banding review process, we strongly believe that this approach to setting the tariff price is retained.

Conclusion

CO2Sense do not believe the consultation document provides enough detail to provide a view on any of the tariffs presented. It is clear that both Premium Feed-in Tariff (P-FIT) and a Contract for Difference Feed-in Tariff (CfD) can be made to work for renewable energy , as long as it is designed appropriately and introduced in a manner not to cause an investment hiatus.