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YOUR REF./DATE:
EMR consultation

OUR REF.:
EMR response

PLACE/DATE:
Oslo, 10.03.2011

To whom it may concern

Please find enclosed Statkraft's response to the EMR consultation.

We very much welcome the opportunity to provide our views on the proposals. Our response outlines a number of issues which Statkraft considers must be taken seriously as the policies are developed in greater detail.

We plan to make very significant investments in the UK in the coming years, in particular in Round Three offshore wind, as part of the Forewind Consortium. We therefore take the development of EMR policies very seriously. We would be very happy to facilitate a meeting between our Chief Executive and the Secretary of State if that would be of use.

We would be very happy to provide further information on any aspect of our response, and we look forward to working closely with DECC as the EMR process moves forward.

Please do not hesitate to get in touch on [REDACTED]
should you require anything from us at this stage.

Yours sincerely,

[REDACTED]

Statkraft - Response to Electricity Market Reform Consultation

Introduction

As a European leader and a major investor in renewable energy projects in the UK, Statkraft welcomes the Government's publication of proposals to reform the electricity market. We are grateful for the opportunity to provide our views on the proposals.

We recognise that there may be a need to improve market arrangements in order to enable the long term growth in low carbon generation which is critical in order to tackle climate change and provide security of supply. This response outlines a number of issues which Statkraft considers must be taken seriously.

Our views on electricity market reform are guided by our business model – as an independent merchant generator – as well as by our experiences in a number of other markets.

We start from the principle that a well designed and liquid power market that provides clear price signals to investors and operators is a vitally important basis and starting point for any reforms. Such a market will deliver the best results for all stakeholders.

We also believe that, wherever possible, integration of European power markets and the harmonization of policies across borders would yield the desired outcomes more effectively than measures implemented piecemeal in individual markets.

However, we do recognise that the UK has a particularly urgent need to deliver investments in new, secure low carbon electricity generation. A well designed and liquid market, together with some additional support measures, can facilitate decarbonisation of the energy sector and development of renewable energy in a cost-effective way.

Reform of the renewable support scheme

As a major investor in renewable energy projects the most critical element of the EMR from our perspective is the support scheme for renewable energy projects.

We have found the Renewable Obligation Certificate (ROC) regime to be a successful mechanism for attracting investors to offshore wind and other renewable projects in the UK.

We do recognise that the Government wishes to move to a Feed-In-Tariff (FIT) approach to supporting renewable investments in the future. We believe that a premium FIT model is significantly preferable to a Contract-for-Difference (CfD) approach. A premium FIT is a relatively simple mechanism with many similarities to the RO. A premium FIT will also maintain clear market price signals to generators, helping to ensure appropriate market development, affordability and security of supply.

We believe that, subject to it being properly designed and set up with an appropriate tariff regime, we would be able to invest with confidence in the UK market under a premium FIT.

The CfD model is a highly complex mechanism that would involve very significant changes to the way in which the market operates. As an independent generator, we do not share the view that there is a need for Government to take on long term power market price risks. We are comfortable with

handling this risk – it is a core part of our day to day business and indeed part of our competitive strategy.

We believe that there are significant practical difficulties, in particular related to tariff level setting, the establishment of a liquid market reference price, and the need to maintain effective price signals to guide generators' behaviour. The CfD also represents a major shift away from an effective, functioning power market to one in which the government will play a major role, and reduces upside potential, potentially minimising its attractiveness to investors.

We believe that this combination of practical risk and enhanced political intervention in the market means that a CfD model is highly unlikely to either materially reduce the cost of capital, or to attract significant new or additional investment into the UK market.

A premium FIT should be technology specific as a minimum, and we believe that DECC should consider the potential for a zone or round specific approach, recognising the variable costs of different offshore wind projects in particular.

We believe a premium FIT will be a strong mechanism for attracting new and major investment into the UK power market, while also maintaining an efficient market that is affordable for consumers.

Introduction of a carbon price floor

As outlined in our response to HM Treasury's consultation on a carbon price floor, Statkraft believes that the most effective way to establish a carbon price is through the market under an EU Emission Trading System (ETS) that is based on tightened emission reduction targets sufficient to allow climate targets to be reached. However, we recognise the view of the UK Government that the EU ETS does not currently deliver sufficient investment signals to incentivise the scale of low carbon generation that the UK requires.

We hope that the Government will carefully consider the interdependence of the carbon price floor and other EMR mechanisms. If the expected impact of a carbon price support level influences the basis for a future Premium FIT, any later change to the carbon price support level would have a damaging effect on investors in low carbon electricity generation.

Introduction of a capacity mechanism

When considering how to ensure that the UK has adequate capacity to ensure security of supply we believe that attention should be initially focused on delivering a well functioning wholesale power market and on European wide measures that provides clear market price signals for investment and de-investment. Additional measures should ideally be European-wide in order to promote market integration. A capacity mechanism could potentially diminish the role of the power market and may lead to price distortions, reduced liquidity and barriers for trade and market integration.

That said, we recognise that there may be circumstances in future in which concerns about capacity margins require the introduction of specific capacity mechanism. If that is the case, it should be designed in a way that limits any market distortion.

Wider issues

There remain a number of further issues that must be addressed if the UK is to deliver the investments required to meet its security of supply and decarbonisation goals.

The EMR consultation refers to Ofgem's review of the market liquidity and notes that this is an important issue. Statkraft considers improved market liquidity and contestability a critical issue for the success of EMR. We therefore think that measures to improve market liquidity should have stronger emphasis and not be left solely to Ofgem to regulate.

More widely, major challenges for the deliverability of increased renewable and offshore capacity include predictability for grid costs, both tariffs and guarantee requirements. These questions have been declared Ofgem's responsibility to solve. We believe that DECC should remain involved in steering Project TransmiT to ensure a timely and effective process.

Likewise, timeline and uncertainty regarding concession procedures are key challenges that have not been addressed to an extent that would reduce the risk resulting from this issue.

Finally, we would emphasise that while the EMR process may be necessary, major market revisions inevitably create uncertainty not just for investors and developers but also for the supply chain. It is important that the Government maintains momentum and avoids any delays that will further this uncertainty.

Responses to questions:**Current Market Arrangements****1. Do you agree with the Government's assessment of the ability of the current market to support the investment in low-carbon generation needed to meet environmental targets?**

Statkraft believes that the Renewables Obligation has proved to be an adequate mechanism for driving investments in offshore wind and other renewables. However we do recognise that there may be a need to improve market arrangements in order to enable the long term growth in low carbon generation that is needed if the UK is to secure supplies and tackle climate change.

In addition to the proposals outlined in the Electricity Market Reform consultation, we believe it is vital that market liquidity is improved. We believe that improving market liquidity should be treated with the same degree of importance as other proposed market reforms.

2. Do you agree with the Government's assessment of the future risks to the UK's security of electricity supplies?

We broadly agree with the Government's assessment of future risks to security of supply.

As DECC develops EMR policies we believe that it should further consider how the UK can be better integrated into the European market as a means of ensuring security of supply. With this in mind we hope that DECC will continue to give serious consideration to the option of establishing interconnectors between Norway and the UK. Access to Norway's flexible hydropower system could improve the security of supply in the UK.

Options for Decarbonisation**3. Do you agree with the Government's assessment of the pros and cons of each of the models of feed-in tariff (FIT)?**

and

4. Do you agree with the Government's preferred policy of introducing a contract for difference based feed-in tariff (FIT with CfD)?

We do not agree with the Government's assessment of each of the FIT models. We believe that a premium FIT will prove to be a better option for delivering the Government's objectives than the CfD model. We believe that the CfD is likely to be problematic to deliver in practice, and will not deliver a reduced cost of capital.

We make the following observations about the proposed CfD model and about the premium FIT:

Practical difficulties

- The CfD model is a substantially more complex scheme to set-up, operate and participate in than either the existing Renewable Obligation or a premium FIT. A move from the RO to a CfD therefore represents by far the biggest shift in policy and practice of the possible options.
- This major shift creates two main risks. First, faced with such a complex new scheme and the increased implementation risk it carries, an investment hiatus is likely to develop, delaying schemes at all stages of planning and delivery and putting achievement of targets at further risk. Second, even once implemented, it will take the market, especially the finance sector, considerable time to properly understand a CfD and price it accordingly. As a result, the cost of capital could be higher during this transitional period, impacting on the viability and deliverability of schemes.
- A CfD also carries the biggest implementation risk of the two proposals. Without a liquid market reference price, there is a danger that the CfD will be set at the wrong level, undermining the scheme from the outset. Likewise, we do not believe that an auctioning system is a viable approach to tariff setting. International experience has not been successful and it is practically difficult to auction for long term contracts for technologies – like offshore wind – that have not yet reached maturity. In addition, risk connected to deviation from the price index used in a CfD may be very significant. This risk does not exist under the RO or a premium FIT.

Political risk

- We are concerned that the transfer of risk – and therefore cost – from the market to the government could prove impossible to sustain economically or politically over the long-term.
- A long term, contracted price for power potentially exposes Government to very significant liabilities in the event that power prices are low. This additional burden could become unsustainable and cause the government to move away from the CfD model. We believe that investors may question the long term viability of a CfD as a result, and will price that risk accordingly. If power prices go low under a premium FIT, there is no such liability for Government.
- Finally, the CfD model would represent a very significant shift away from reliance on a functioning market, requiring the Government to manage the market to a large extent. We do not believe that the Government's intention is to move away from a functioning energy market to this degree.

Cost of capital and attracting investors

- As a result, we do not believe that the reduction in the cost of capital that the consultation suggests is realistic. In fact, our internal assessment is that the CfD mechanism will not materially reduce the costs of capital for balance-sheet financed renewable projects, compared to investments under the RO or a PFIT. Our discussions with the banking sector support this assessment.
- One factor in this is that construction, technology, operational, concession and grid-related risks all play a far greater part in putting off investors than the form of the support mechanism. Currently, once schemes are constructed they are relatively easily refinanced – the blockage is a result of lack of investor confidence in the deliverability of schemes, rather than their operational finances. The government would have a far greater impact on reducing the cost of capital by addressing these issues.

- We also fear that a CfD may actually reduce the attractiveness of the renewable energy sector for investors. Whilst the reduction in long-term risk inherent in a CfD may attract additional investors, our discussions with the banks and finance community lead us to believe that the complexity of, and lack of upside potential in, a CfD could in fact result in a net reduction in investor interest and therefore hinder access to capital in the sector. There is therefore unlikely to be any reduction in costs passed on to consumers as a result.

Implications for generators

- Generators would be put at a significant disadvantage by the increased level of income visibility that wind projects would have under a CfD, as a result of the given income level per MWh. This is a particular problem for the financial health of generators when there are relatively few suppliers in the market – as is the case in the UK at present. This added advantage for suppliers may lessen the likelihood of new entrants in the market, a stated aim of the EMR, without any attendant benefits for consumers.
- The removal of price signals from the market by a CfD would remove any incentive for developers to take power market development into account when making investment decisions, potentially resulting in more unstable power market development.
- Likewise, in a CfD with a very short term index, there will be neither a price signal nor incentive to the market to maintain availability at periods of highest need. In offshore wind projects at distance from the shore, the operation and maintenance regime is in the early stages of development and will be set down over coming years, necessitating the steady evolution of procedure and practice, as well as the necessary supply chain. It's imperative that this regime evolves in a way that is responsive to the market, rather than in isolation to it.
- The consultation's analysis of the relative benefits of the different FIT models rests in part on the view that Government should take on the long term power market risks that are currently held by developers. As an independent generator, we do not share this view and are not seeking this transfer of risk away from us and onto the Government. We are positioned to take long term power market risks – this is a core part of our business and something that we are both comfortable with and indeed have built into our profitable operation. Transferring this risk to the Government as proposed in the CfD model will not reduce our cost of capital but could negatively impact on our business model, reducing our ability to deliver renewable energy schemes. Indeed, we see the the risk connected to deviation between the received price for a wind power plant and the market index price as harder to manage than market risk.

Premium FIT benefits

- In contrast, a premium Feed-in-Tariff poses a much lower risk to the market and to investors, because it is similar in form and operation to the Renewables Obligation, a mechanism that has become familiar, understood and accepted by industry and the finance sector and which has been proven to successfully drive investment. A move to a premium FIT is a much smaller policy shift and much lower risk.
- Our analysis is that the introduction of a premium FIT will create a smaller investment hiatus, enabling a much smoother flow of schemes coming forward and enabling targets to be met.

- Because a premium FIT is still linked to the prevailing market price it offers much clearer signals to the market and will support more stable power market development. It will also incentivise the evolution of an efficient and timely operation and maintenance regime for offshore windfarms, that maximises capacity at times of highest need.

We therefore believe that a premium FIT should be introduced, rather than a CfD model FIT.

5. What do you see as the advantages and disadvantages of transferring different risks from the generator or the supplier to the Government? In particular, what are the implications of removing the (long-term) electricity price risk from generators under the CfD model?

The CfD model aims to remove price risk from the generator or supplier, ensuring that it is held instead by Government. Removing the long term market risk should in theory attract other sources of capital, but given the complexity and remaining risks for investors under the CfD scheme we question to what extent this will materialise.

As detailed in our response to Questions 3&4, Statkraft is geared to take long term power market risk – we manage price volatility and risk on a day to day basis as well as long term. The merchant business model of Statkraft and other utilities makes us well positioned to take on market risk. Transferring this risk to the Government as proposed in the CfD model will hardly reduce our cost of capital. As an independent generator and developer we would identify construction risks, technology risks and operational risks, together with grid related risks (tariffs, guarantees, timing) and uncertainty regarding concession processes as more prominent than long term market risk. Effectively addressing these issues would have a far greater impact on cost of capital than the introduction of a CfD.

As set out in our response to questions 3&4 above, we believe there are a number of additional problems with moving price risk from generators to government under a CfD model FIT. These include market index price risk, political risk arising from the increased liabilities and costs for the state, the potential for unstable power market development, and the considerable implementation challenges. We actually see the risk connected to deviation between the received price for a wind power plant and the market index price as harder to manage than market risk.

The practical difficulties of implementing a CfD system, and the political risks of increased state intervention in the market with a CfD system mean that the extent to which investors will reflect a theoretical reduction in risk in the cost of capital is minimal.

6. What are the efficient operational decisions that the price signal incentivises? How important are these for the market to function properly? How would they be affected by the proposed policy?

As an intermittent source of generation wind power, like some other renewables, is low marginal cost generation, and its production pattern cannot be adapted to follow market signals. However, price signals to keep availability high at times of greatest need remain important – as they will affect maintenance scheduling and duration.

In a CfD model with a very short term index, there will be no incentive to the market to have a high availability at times of high demand.

The relative immaturity of the offshore wind industry and its supply chain – and in particular the lack of experience of operating major offshore farms of the kind that will be developed under Round Three – means it is important that incentives are in place from the start for supply chain practices to develop in an efficient manner that reduces costs for generators and consumers alike.

7. Do you agree with the Government's assessment of the impact of the different models of FITs on the cost of capital for low-carbon generators?

As detailed in our response to questions 3&4, we believe that the consultation's estimates for the reduced cost of capital under a CfD model are too high. We do not believe that our cost of capital will be reduced under a CfD model.

8. What impact do you think the different models of FITs will have on the availability of finance for low-carbon electricity generation investments from both new investors and the existing investor base?

The Renewable Obligations regime has attracted a large number of capable investors to participate in Round 3. A premium FIT is largely similar to the ROC system and would thus be expected to provide continued interest by investors. A CfD however represents a fundamental change and could potentially motivate existing investors to re-evaluate their engagement.

We do not find that market price risk is the problem with getting access to project finance – technical risk is a much more significant factor. The problem with accessing finance is most pressing for projects in the construction phase, because the risk of technical failure or delay is seen as too great. This problem is not impacted at all by the proposals.

In principle, as the CfD takes away long-term market risk, it could be attractive for some investors. But for others it will be less so because it also limits the potential upside. Conversations we have had with representatives of banks and the finance community indicate strongly that the CfD is too complex and risky as a model to facilitate increased capital allocation to the sector.

A fully fixed FIT would be easier for non-utility investors to relate to than other models – but because the CfD is a complex and highly opaque mechanism we do not believe it will deliver this benefit to existing and potential investors.

We believe it is worth reiterating that despite the consultation's comments about the complexity of the RO, the RO is now a well known and understood mechanism within the industry and with the finance sector. A move to a CfD model will represent a very significant shift. It will take time for the market to understand this new mechanism, and price it accordingly, and the transition may well result in additional cost. Given the need to attract very significant investments in the near-term to meet the UK's security of supply and decarbonisation goals, we believe that such a major shift in approach would be a mistake.

9. What impact do you think the different models of FITs will have on different types of generators (e.g. vertically integrated utilities, existing independent gas, wind or biomass generators and new entrant generators)? How would the different models impact on contract negotiations/relationships with electricity suppliers?

We expect that vertically integrated generators will be able to operate comfortably under either proposed model of FIT – because they have both generation and supply businesses and may be less affected by the change to a CfD.

We are concerned that one impact of a move to a CfD system for independent generators will be to provide suppliers with total transparency on generators' income – significantly weakening generators' negotiation position with suppliers and thus handing them an artificial market advantage, potentially driving up cost across the value chain.

10. How important do you think greater liquidity in the wholesale market is to the effective operation of the FIT with CfD model? What reference price or index should be used?

Under a CfD model, because income depends on an index, it is important that it is a liquid index. Creating a CfD may create liquidity if all generation chooses to trade through the reference market, but it may also lead to volatile pricing.

There remains a very significant problem with liquidity in the UK market because of the degree of vertical integration.

In our view the key question for identifying a reference price or index is judging how long term the reference is set for. In order to create incentives to have high availability when prices are high, the reference price should not be very short (eg ½ hourly), but rather monthly or longer. However, the longer the reference period, the higher the remaining price risk. This remaining price risk is very difficult to actively manage for intermittent generation.

Scrapping the RO will take away the obligation from suppliers which could reduce their incentive to source power from renewable generators. To avoid a negative impact on renewable generators from this, improving the market liquidity will be very important.

11. Should the FIT be paid on availability or output?

The FIT should be paid on output. To base it on availability would increase the complexity of the system and would represent a further move away from a market system.

Options for Market Efficiency and Security of Supply

19. Do you agree with our assessment of the pros and cons of introducing a capacity mechanism?

and

20. Do you agree with the Government's preferred policy of introducing a capacity mechanism in addition to the improvements to the current market?

We believe that regulatory attention should be focused on delivering well functioning wholesale power markets and European-wide harmonized measures to provide investment and disinvestment signals, and thus to provide security of supply.

We are concerned that significant market interventions like the capacity mechanism could diminish the role of the electricity market, may lead to price distortions, reduce liquidity and create barriers for trade and market integration.

Market imperfections and special considerations could however justify market interventions, like introducing a capacity mechanism. Such a mechanism may have a role to play in providing security of supply in a tightening market in future as significant amounts of capacity is decommissioned. However, delivering improved liquidity should be a priority for DECC before seeking the introduction of a capacity mechanism. If a mechanism is to be introduced, it is important that it is done in such a way that doesn't significantly reduce wholesale prices or liquidity.

21. What do you think the impacts of introducing a targeted capacity mechanism will be on prices in the wholesale electricity market?

The design of the capacity mechanism will determine whether more capacity is made available for the market thus leading to lower prices, or whether existing capacity will be held in reserve thus leading to higher prices. Note that we mean 'lower' or higher' in comparison to a market without a capacity mechanism, not in comparison to today's market prices.

22. Do you agree with the Government's preference for the design of a capacity mechanism:

- a central body holding the responsibility;
- volume based, not price based; and
- a targeted mechanism, rather than market-wide.

We have not developed a clear view of the details of how a capacity mechanism in the UK should be designed, but we strongly suggest that the design should limit the distorting impact on the wholesale power market.

23. What do you think the impact of introducing a capacity mechanism would be on incentives to invest in demand-side response, storage, interconnection and energy efficiency? Will the preferred package of options allow these technologies to play more of a role?

A capacity mechanism has the potential to incentivise investments in demand-side response, storage, interconnection and energy efficiency, though much of this could also be achieved through the wholesale market by introducing price signals on the demand side – for example through ½ hourly pricing for consumers.

We strongly believe that interconnection has a major role to play in managing intermittency and periods of high demand, and that capacity through interconnectors should therefore be allowed to participate in any capacity mechanism.

24. Which of the two models of targeted capacity mechanism would you prefer to see implemented:

- Last-resort dispatch; or

- Economic dispatch.

See response to Q22.

25. Do you think there should be a locational element to capacity pricing?

We do not see a clear need for including a locational element to capacity pricing. This would add additional complexity to the system, and could reduce liquidity. This could also penalise capacity that is located away from demand but which could still make a significant contribution to capacity needs.

Analysis of Packages

26. Do you agree with the Government's preferred package of options (carbon price support, feed-in tariff (CfD or premium), emission performance standard, peak capacity tender)? Why?

We very much support the Government's ambitions to reform the UK electricity market in order to support the transition to a decarbonised electricity mix and ensure security of supply.

However, for reasons outlined in full above, we believe that the preferred package of options is likely to face very significant practical barriers to implementation, and will not deliver the necessary investments in a way that minimises costs for consumers.

In particular, we believe that the proposed CfD model will not reduce the cost of capital and will be extremely difficult to implement in a way that retains the confidence of existing investors and attracts new entrants. We believe that a premium FIT will be a more effective mechanism for achieving the Government's goals.

We broadly support the introduction of carbon price support, and believe that an Emissions Performance Standard has a role to play in ensuring that the UK's future electricity mix has a reduced carbon intensity. The need to introduce a capacity mechanism is not clear to us, though we will not rule out that it may have a role in ensuring security of supply in a tightening market.

We would urge that attention is given to increasing market liquidity in the first instance, as this may reduce the need for an additional capacity market.

27. What are your views on the alternative package that Government has described?

We believe that the alternative proposed package is significantly preferable to the Government's preferred package, for the reasons outlined in our response to questions 3&4. We believe that a premium FIT has the following significant benefits:

- It is the closest to the Renewables Obligation, which has been successful and proven in driving investments and is understood and accepted by the industry
- As a merchant generator, we are positioned to take long term power market risks. As a CfD removes market risk from the asset owners to the Government, it may not give a support level sufficient to attract investments from merchant generators

- A Premium FIT gives developers better incentives to time investments according to market conditions, and will therefore support a more stable power market development
- Unlike the CfD, a premium FIT does not rely on having a liquid market reference price – which does not currently exist
- While the CfD is theoretically capable of reducing long term power market risk, the wider risks and complexity of the scheme make it questionable whether it can attract new sources of capital and reduce capital costs
- A premium FIT is significantly easier to implement than a CfD model
- As a significantly less complex mechanism, the premium FIT will minimise the risk of a major investment hiatus and the loss of investor confidence in the UK market

We therefore believe that a premium FIT should be introduced. We believe that it should maintain a technology specific approach – and Government may want to consider the benefits of a zone/round specific approach given the differing costs of offshore wind projects. Any technology neutrality in the support scheme will seriously endanger timely Round 3 offshore wind investments.

28. Will the proposed package of options have wider impacts on the electricity system that have not been identified in this document, for example on electricity networks?

Transmission issues, development, tariffs and guarantees are key issues for developing the UK renewables sector in general, and growth in offshore wind in particular. Whatever low carbon generation support model is chosen, these issues must be taken into account.

The socialisation of grid cost including the offshore grid would allow for a model with less differentiation of support levels. This could be advantageous from an administrative point of view.

29. How do you see the different elements of the preferred package interacting? Are these interactions different for other packages?

It is important that support levels under a FIT take account of the carbon price floor level. It will also be important that if the carbon price floor is changed or removed in future, then this is compensated for under the FIT support. Investors will consider the whole market package when making decisions, and it is important that any changes to individual mechanisms over time do not damage the overall level of support provided to low carbon generators.

There may be an interaction between the capacity mechanism and the carbon price floor. If a carbon price floor disengages high levels of fossil-fuel fired capacity from the market this would reduce reserve margins and may mean that a capacity mechanism is required sooner.

Implementation Issues

30. What do you think are the main implementation risks for the Government's preferred package? Are these risks different for the other packages being considered?

The key implementation risk for the preferred package relates to the CfD model. Specifically, we believe the risks will be:

- How to set a price index that suits all generators – intermittent and non-intermittent
- How to ensure that the index represents an accessible market price
- How to define tariff levels, and whether there will be a tariff level set for all technologies with stated adjustment factors, or whether there will be technology specific tariff levels
- What mechanism to use to agree on tariff levels – we believe that auctioning is highly unlikely to be suitable for price setting
- Who will be the counterparty for the CfD

As set out in the answer to Q27, the implementation risks for a premium FIT are substantially lower.

In general, the greater the level of market intervention from Government, the more likely it is that there will be significant unforeseen consequences.

31. Do you have views on the role that auctions or tenders can play in setting the price for a feed-in tariff, compared to administratively determined support levels?

- Can auctions or tenders deliver competitive market prices that appropriately reflect the risks and uncertainties of new or emerging technologies?
- Should auctions, tenders or the administrative approach to setting levels be technology neutral or technology specific?
- How should the different costs of each technology be reflected? Should there be a single contract for difference on the electricity price for all low-carbon and a series of technology different premiums on top?
- Are there other models government should consider?
- Should prices be set for individual projects or for technologies
- Do you think there is sufficient competition amongst potential developers / sites to run effective auctions?
- Could an auction contribute to preventing the feed-in tariff policy from incentivising an unsustainable level of deployment of any one particular technology? Are there other ways to mitigate against this risk?

We are concerned by the proposals to use auctioning to set support levels. International experience with this approach has not been widely successful, and it is difficult to auction for technologies, like offshore wind, that have yet to reach maturity. In practice, we do not believe that it will be possible to deliver competitive market prices that also deliver a fair return for investors in renewable technologies through an auction system.

We believe that there must be a technology specific approach – and Government may also want to consider the benefits of a zone/round specific approach given the differing costs of offshore wind projects. Any technology neutrality in the support scheme will seriously endanger timely Round 3 offshore wind investments.

We believe that the banding system for ROCs has been broadly successful and that the government may follow a similar system for setting support levels under a PFIT rather than moving to a new and unfamiliar system.

32. What changes do you think would be necessary to the institutional arrangements in the electricity sector to support these market reforms?

We do not have a strong view on the institutional arrangements necessary for supporting market reforms. We do however believe that DECC should adopt greater responsibility for overseeing the development of market liquidity given its importance and the relative lack of action and progress so far.

33. Do you have view on how market distortion and any other unintended consequences of a FIT or a targeted capacity mechanism can be minimised?

Introducing a premium rather than CfD FIT would avoid significantly distorting the existing market.

We also believe that the proposed capacity mechanism should not be introduced before it is necessary to do so, and that when introduced, it should be designed in a way that limits any market distortion.

34. Do you agree with the Government's assessment of the risks of delays to planned investments while the preferred package is implemented?

We agree that the risk is significant. We have seen for more than two years that there have been very few new concessions for offshore wind and also very few new tenders for turbines. This may be a result of the round system – the time delays between Round Two and Round Three are very large. Further regulatory uncertainty can significantly add to the investment hiatus.

We are concerned that the major changes proposed are likely to take longer to implement than stated. If this is the case, there are likely to be further delays to investment.

35. Do you agree with the principles underpinning the transition of the Renewables Obligation into the new arrangements? Are there other strategies which you think could be used to avoid delays to planned investments?

We agree with the principles.

36. We propose that accreditation under the RO would remain open until 31 March 2017. The Government's ambition to introduce the new feed-in tariff for lowcarbon in 2013/14 (subject to Parliamentary time). Which of these options do you favour:

- All new renewable electricity capacity accrediting before 1 April 2017 accredit under the RO;

- **All new renewable electricity capacity accrediting after the introduction of the low-carbon support mechanism but before 1 April 2017 should have a choice between accrediting under the RO or the new mechanism.**

To avoid an investment hiatus, a two tier approach until at least 2017 will be necessary. This will be particularly important if a CfD is introduced. The Government should recognise the challenges inherent in a transition between two systems when you have projects under development with very long delivery times. A developer may for example find that different parts of a major wind farm are under different schemes, causing additional complexity. We believe that there should be some flexibility in any transition regime to manage this.

The development and commissioning period for an offshore wind project can extend over a number of years. DECC has introduced phasing for large offshore wind projects where a large project will be accredited in the RO scheme in phases up to 5 years. There should be an opening so that projects that are accredited for their first phase in 2017 should also be eligible for ROCs for later phases up to the 5 years maximum.

37. Some technologies are not currently grandfathered under the RO. If the Government chooses not to grandfather some or all of these technologies, should we:

- **Carry out scheduled banding reviews (either separately or as part of the tariff setting for the new scheme)? How frequently should these be carried out?**
- **Carry out an “early review” if evidence is provided of significant change incosts or other criteria as in legislation?**
- **Should we move them out of the “vintaged” RO and into the new scheme,**
- **removing the potential need for scheduled banding reviews under the RO?**

We believe that both onshore and offshore wind should be grandfathered. We do not have a view on other technologies.

38. Which option for calculating the Obligation post 2017 do you favour?

- **Continue using both target and headroom**
- **Use Calculation B (Headroom) only from 2017**
- **Fix the price of a ROC for existing and new generation**

If the RO is to be phased out, then the ROC market will be less and less liquid over time. We therefore believe that the price of ROCs should be fixed for existing and new generation.