scottish renewables

Contracts for Difference Team
Clean Power Strategy and Deployment Directorate
Department for Business, Energy and Industrial Strategy
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Delivered via email

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To whom it may concern,

Consultation Response: Contract changes for Allocation Round 5

Scottish Renewables is the voice of Scotland's renewable energy industry. Our vision is for Scotland leading the world in renewable energy. We work to grow Scotland's renewable energy sector and sustain its position at the forefront of the global clean energy industry. We represent over 330 organisations that deliver investment, jobs, social benefits and reduce the carbon emissions which cause climate change.

Our members work across all renewable energy technologies, in Scotland, the UK, Europe and around the world. In representing them, we aim to lead and inform the debate on how the growth of renewable energy can help sustainably heat and power Scotland's homes and businesses.

Scottish Renewables welcomes the opportunity to provide our view on the proposed amendments outlined in this consultation and our full response to the consultation questions is attached in the annexe to this letter.

We would like to highlight the following points:

- **CfD Merchant Nose**: Scottish Renewables understands the motivation to prevent generators from delaying their CfD for commercial reasons and we appreciate that the legitimacy of the CfD could be undermined if renewable generators are perceived to be profiting unduly from increased power prices at a time when many energy consumers are struggling to pay their bills. By a considerable margin, renewables provide the cheapest electricity and by locking generators into the agreed strike price the CfD is a well-established mechanism to ensure that this cheap power translates to reductions in consumer bills. However, for several reasons, the period of merchant generation allows

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developers to submit lower strike price bids when applying for a CfD. Given the complexity of delivering these large scale infrastructure projects and the multitude of risks that need to be managed, it is by no means clear that the increase in strike prices resulting from eliminating the merchant nose won't in fact result in a net negative impact on the consumer. We therefore urge BEIS to consider in detail the impact of removing the merchant nose on consumers over the entire lifetime of the projects that are brought forward via the CfD. As far as reasonably practicable, BEIS should be sure that consumers will not be being made unintentionally worse off by the proposals set out in this consultation.

- **Powers of the LCCC:** SR has significant concerns over the proposed new powers to allow the LCCC to unilaterally determine whether commercial operation has begun. Firstly, it is unclear exactly how commercial operation is defined. And, secondly, there will in some cases be legitimate reasons why a generator might disagree with the LCCC's decision. We therefore propose that the LCCC is required to give generators 10 working days' notice of its intention to issue a Unilateral CO Notice. This will give generators a chance to challenge this decision and provide a window for generators to submit supporting evidence.
- **AR5 Parameters and Budget:** The proposals set out in this consultation, primarily those relating to the intention to prevent generators from delaying their CfD for commercial reasons, will impact the revenue base of projects at a time when projects are already facing severe challenges. Developers are experiencing increases in costs far exceeding headline rates of inflation, and volatility in international markets is expected to persist, further adding to the risks and uncertainty that developers must factor into their CfD bids. It is therefore of critical importance that the AR5 parameters and budget reflect this reality, as well as the impact of any policy changes. We believe that the CfD must now focus on delivering volume, both to ensure that climate targets remain within reach and to reduce consumers' exposure to fossil fuel prices as soon as possible. BEIS must therefore show sufficient ambition when finalising the design of AR5. Recent experience in Europe, where the latest auction round in Spain was woefully undersubscribed because policymakers failed to account for the new reality of developing renewable energy projects in a post-Ukraine invasion world, demonstrates the dangers of getting this wrong.

Scottish Renewables would be keen to engage further with this agenda and would be happy to discuss our response in more detail.

Yours sincerely,

Andrew MacNish Porter

Policy Manager – Economics and Markets
Scottish Renewables

Annexe: Responses to individual questions

CfD start date

1. *The Government welcomes views on the proposal to amend the CfD Standard Terms and Conditions to prevent generators delaying the CfD start date for commercial reasons.*

2. *The Government welcomes views on the proposed amendments in the draft Standard Terms and Conditions published alongside this consultation document to require the start date to occur within 10 business days of the OCPs being completed or commercial operations commencing.*

3. *The Government welcomes views on the general approach to ensuring that LCCC can effectively unilaterally determine when a generator is capable of generating under the CfD.*

4. *The Government welcomes views on the proposed amendments in the draft Standard Terms and Conditions published alongside this consultation document relating to the Unilateral Commercial Operations Notice.*

Scottish Renewables accepts the Government's proposal to prevent generators from delaying the CfD start date for commercial reasons. However, this regulatory amendment will likely impact a wind farm's revenue base. Therefore, as noted in the consultation document, the impact on consumers of doing so may be net neutral or negative as applicants will adjust their strike price bids to factor in the loss of merchant revenues ahead of commencing generation under their CfD contract.

When deciding whether to implement this proposal, BEIS should consider several factors that could lead to eliminating the merchant nose having a net negative impact on consumers.

As acknowledged in the consultation document, the merchant nose facilitates lower strike prices by giving flexibility to developers to manage a range of variable risks. It also improves the financing strategy of projects, allowing for earlier equity repayment and more favourable debt terms since financiers are more willing to take a degree of merchant risk at the front end of the CfD rather than the end, further reducing strike price bids. The merchant nose also gives developers a degree of insulation from unforeseen increases in commodity and supply chain costs.

Given the complex risks involved in delivering large infrastructure projects like offshore wind farms, eliminating the merchant nose and the benefits it offers in managing these risks means that it cannot be guaranteed that the result won't increase in strike prices, resulting in a net negative impact on consumers. Therefore, whilst we support the Government's desire to uphold the integrity of the CfD scheme by preventing generators from benefiting unduly from high wholesale prices, particularly at a time when many consumers are struggling, we would urge BEIS to consider carefully whether eliminating the merchant nose will, in fact, be in the long-term interests of energy consumers.

If proceeding with the proposal to prevent generators from delaying the CfD start date for commercial reasons, in terms of how this is achieved, we consider that the proposed requirement in Condition 3.6 for a generator to fulfil OCPs as soon as reasonably practicable may achieve the same policy outcome as the introduction of a Unilateral CO Notice i.e., prevent generators from delaying OCPs to delay start date notice. We also have specific concerns over the proposal to give the LCCC the power to unilaterally determine whether a generator is capable of generating under the CfD and the process by which this decision is reached.

Firstly, it is unclear how exactly 'commercial operation' will be defined when the LCCC is considering whether to issue a Unilateral CO Notice. It is also unclear whether progress (or lack thereof) towards fulfilling OCPs will have any bearing on the decision of the LCCC to issue a Unilateral CO Notice. Further, more detailed information on the process and criteria the LCCC will use to decide whether to issue a Unilateral CO Notice should be provided. We would also propose that the LCCC only has the power to issue a Unilateral CO Notice after the original TCW start date as set out in the CfD bid has passed. We believe that issuing a Notice before the TCW start the date specified in the CfD bid would represent an overreach of the policy as a delay would not have occurred.

If a Unilateral CO Notice is issued, there will in some cases be valid reasons why a developer might disagree with the LCCC's decision. We therefore propose that the LCCC is required to give generators 10 days' advance notice of their intention to issue a Unilateral CO Notice. This window will give developers a chance to provide LCCC with evidence to support their challenge as well as LCCC time to consider whether their decision should be reversed. We also propose introducing a set of clearly defined parameters, agreed on with industry, for generators to prove legitimate delay (e.g. through grid delay, OFTO delay, disputes with contractors, additional testing etc.). This will make it easier for LCCC to make the correct assessment when deciding whether to issue a Unilateral CO Notice.

We also believe that the LCCC should only be able to issue a Unilateral CO Notice when a project or phase is within its TCW and is proven to be generating at full capacity. If the LCCC issues a Unilateral CO Notice earlier than this, it is likely to have a commercial impact on the project. If BEIS intends to give the LCCC the power to issue a Unilateral CO Notice prior to a project reaching the start of the TCW and/or full generation capacity, this needs to be clarified as well as the impact on the CfD start date and 15-year term.

We also note that as per the proposed changes to Conditions 3.35-3.37 that unless and until the remaining OCPs are completed the generator would not be able to receive difference payments but would still be liable to pay difference payments from the time that commercial operations are deemed to have begun in the event that the reference price falls below the agreed strike price. Scottish Renewables understands that once OCP conditions are met after the Unilateral CO Notice is issued, difference payments to generators are then backdated and paid to the generator in a lump sum. We believe these payments should be indexed to CPI inflation for the period they remain unpaid so that they retain their real value whilst the generator is completing the remaining OCPs.

Assessment of Impacts

5. *The Government welcomes views on any impacts explored in the assessment, or alternative approaches to meet similar objectives, that we should consider for:*

(a) Preventing delays to the CfD start date for commercial gain

(b) Other consequences of the contract changes to prevent delays to CfD start dates not currently considered

Scottish Renewables does not have any views on the assessment of impacts set out in the consultation document in addition to the points we have already raised in our answer to questions 1-4.

However, we would urge BEIS to ensure that the conclusions from this assessment and any associated policy changes are reflected in the AR5 auction parameters.

Amendments to data provision requirements

6. *The Government welcomes views on the proposed approach to simplifying the reporting requirements for generators*

Scottish Renewables welcomes the proposed simplifications of generators' reporting requirements.

Amendments to Private Network contract definitions

7. *The Government welcomes views on the proposed amendments to the definitions in the draft CfD Private Network Agreement published alongside this consultation document.*

No comments.

Methodology for determining the interest rate for the repayment/recovery of subsidy

8. *The Government welcomes views on the Interest Rate Methodology proposed and its application within the contract.*

Scottish Renewables supports developing a replacement to the 'Reference Rate Methodology' and renaming the methodology the 'Interest Rate Methodology'.

We also support adopting the Bank of England Stirling Overnight Index Average (SONIA) compounded rate. However, we aren't entirely clear why an additional percentage point is used, so clarification around this point would be welcome. Without a clear justification for this additional one percentage point, we believe that only the SONIA rate should be used.