Call for Evidence on introducing non-price factors into the Contracts for Difference Scheme

Solar Energy UK
Consultation Response

About us

Since 1978, Solar Energy UK has worked to promote the benefits of solar energy and to make its adoption easy and profitable for domestic and commercial users. A not-for-profit association, we are funded entirely by our membership, which includes installers, manufacturers, distributors, large-scale developers, investors, and law firms.

Our mission is to empower the UK solar transformation. We are catalysing our members to pave the way for 40GW of solar energy capacity by 2030. We represent solar heat, solar power and energy storage, with a proven track record of securing breakthroughs for all three.

- Respondent details (for consultations)

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- Would you like this response to remain confidential? No
- Submission date: 22 May 2023

Introduction

In summary, the top-up model is considered to be the most workable.
If non-price factors were to be introduced, industry consultation and the announcement of any changes should be completed at least two years ahead of an allocation round as the preparations required by developers are likely to be significant.

The review of electricity markets arrangements (REMA) remains ongoing and options are currently being assessed around changes to the current CfD, within this process. We recommend that any proposed introduction of non-price factors be made in conjunction with the resulting output from the REMA Mass Low Carbon Power chapter to ensure that any policy changes are joined up.

The importance of not making radical changes to the existing system of CfDs cannot be stressed enough. Any reform that introduces uncertainty reduces investor confidence, and the introduction of non-price factors may create a policy environment that undermines the business case for new projects – such as the proposed project monitoring and financial penalties.

In terms of a mechanism for implementation, views are invited on:

1. To what extent do you support the top-up model as a mechanism for implementing Non-Price Factors and are there are any unintended consequences that come from this model?

We consider there to be several criteria for a non-price factor implementation mechanism to successfully deliver the targeted policy objective. These criteria include:

• A clearly visible financial value to developers and project investors for implementing the non-price factor.

• A sufficiently high level of confidence (with evidence) that this financial value will be delivered in practice so that developers and project investors can include this value in the core investment case for a project.

• A transparent process for the application of the mechanism, with a quantitative basis for its application, that will allow developers and investors to carry out their own independent assessment of how the mechanism will apply in practice.

Out of all the candidate mechanisms, we consider the top-up model to be the only one with the potential to meet each of these three criteria.

2. To what extent do you support the bid re-ranking model as a mechanism for implementing Non-Price Factors and are there are any unintended consequences that come from this model?

3. To what extent do you support the model of amending the valuation formula as a mechanism for implementing Non-Price Factors and are there are any unintended consequences that come from this model?

SEUK does not support either of the above models set out in Questions 2 and 3, as they both fail on all three criteria.

• The potential value of each is not clear.

• It is very uncertain as to whether they will work in practice.

• It is not possible to say in advance how an auction might clear in either case
.
An unintended consequence of either approach could be that a project without non-price factors is uplifted to a non-price factor clearing price under the pay as clear auction design.

4. Are there any additional risks of unintended consequences (e.g., for renewable energy deployment, auction design/competition and consumers) you have identified with certain models and think should be considered?

We believe that the fundamental tests for any model should include assessments of:

• What is the increase in risk to the project in achieving the required level of revenue?

• What is the corresponding increase in the cost of capital?

We consider the main risks of introducing non-price factors to be:

• An increase in cost that is greater than the value that can be secured through non-price factors.
• A high level of uncertainty about the implications of non-price factors, resulting in a hiatus in renewables investment.

Please see Question 7 for risks associated with technology type and project size.

5. Ways in which the models for a mechanism for implementation could be improved?

No comment.

6. Are there alternative mechanisms that government should be considering (including models outside of the CfD mechanism)?

Yes, we believe that there are a number of policy mechanisms that could, and should, be considered in place of non-price factors in the CfD. As identified in the Call for Evidence, these include:

• System Flexibility and Managing Variability

• Operability

• Locational signals

These policy mechanisms are being reviewed through the REMA process.

7. Which projects (in terms of size) and technologies do you think should be eligible for non-price factors?

Decisions on technology size and eligibility should be based on the policy goal of each individual non-price factor. There are a number of risks associated with these considerations:

<u>Size</u>:

• There is a risk that some non-price factors may be ineffective or inappropriate for smaller-scale projects.

• However, if there is a minimum size threshold for applying a non-price factor, this may create a perverse incentive to limit project size, particularly when close to the threshold.

<u>Technology type:</u>

• If any non-price factor is applied only to a subset of projects bidding into an auction round, those projects subject to that non-price factor may be disadvantaged.

• Any decisions to place limits on technology type should be accompanied by a clear rationale.

In terms of potential non-price factors, views are invited on:

8. Are the factors outlined above on addressing capacity building, sustainability, skills and innovation, the right ones to meet supply chain challenges, and are there are any unintended consequences or issues in terms of monitoring, that could come from these?

We believe capacity building, sustainability, skills and innovation policy objectives would be best addressed via the next REMA consultation. Any proposals to introduce non-price factors into the CfD would be best done in conjunction with the ongoing work from the REMA mass low carbon power workstream on the underlining mechanism

9. Are there alternative non-price factors that should be considered?

Solar projects participating in the CfD can enable a range of environmentally and socially beneficial activities – including rewilding and restoration schemes that align with wider environmental and land use policy aims and which go beyond mandatory biodiversity net gain requirements. Whether as part of the CfD regime, or another mechanism, it would be helpful for these benefits to be formally recognised.

10. Is valuing non-price factors the right approach to address the specific issues identified related to system flexibility, operability and locational signals, and could there be any unintended consequences or better ways to address these issues through the CfD scheme or other policy instruments?

The guiding principles when considering potential non-price factors should include the following criteria:

No viable alternative: There is no other policy mechanism available that will be as effective or efficient.

No duplication of policy mechanisms: As a general rule, the duplication of policy mechanisms should be avoided, as two (or more) mechanisms are likely to interact in a complex and inefficient way. This is closely linked to the previous principle. If there is an existing mechanism to incentivise a given policy goal, then a non-price factor should not also be applied, unless it is clear that the existing mechanism cannot be fully effective. In that event, the existing mechanism itself should be closely scrutinised.

Clearly defined outcome: There is a precisely defined outcome for the non-price factor that can be quantified, with a clear pathway for delivery through the non-price factor should application. The desired outcome must be transparent, quantifiable and measurable.

Clearly defined value: The value of the outcome (for the consumer and the UK) can be defined with a reasonable level of confidence, for comparison with the cost of delivering the non-price factor should.

Timing of incentive matches project decision-making: The incentive from the non-price factor can be quantified and taken into account at a time in the project development life cycle when the developer has the ability to respond effectively to the incentive in decision making. This may mean that the non-price factor is more effectively applied at the stage of lease allocation (for offshore wind), with the CfD allocation used as a check.

Developer is able to respond: Either a project-specific response to the non-price factor is feasible (with scope to make a meaningful difference), or the project can engage in an industry-level initiative which has been fully established prior to the application of the non-price factor.

Failing to meet each of the above criteria risks non-price factors being:

• applied at the wrong time, at the end of the project development cycle, after key decisions have already been taken.

• applied at the wrong level (i.e. a project level), when the issues raised are at a sector-wide level or even a system-wide level, requiring a holistic policy response, rather than a project-by-project approach.

• applied by the wrong party, as the CfD administrator has insufficient direct knowledge of the issues raised and is not able to obtain enough information from other parties to identify the appropriate actions.

The importance of not making radical changes to this system cannot be stressed enough. Any reform that introduces uncertainty reduces investor confidence, and the introduction of non-price factors may create a policy environment that undermines the business case for new projects – such as the proposed project monitoring and financial penalties.

11. Are there any other issues identified in the REMA case for change that could be addressed through non-price factors?

No comment.

12.What financial value would need to be attributed to the potential factors outlined above to incentivise ambitious behaviour for each topic?

No comment.

In terms of quantifying and valuing non-price factors, views and invited on:

13. Are there alternative ways of measuring and monitoring the non-price factors than the examples outlined in this Call for Evidence. The government would also be interested in your views on whether there are any factors where a more qualitative method of assessment would be more appropriate?

No comment.

4. How we could measure non-price factors to value system flexibility, operability, and location?

No comment.

1**5. Of the models for implementing non-price factors (top-up, bid re-ranking or valuation formula), are some likely to be more effective for certain non-price factors than others?**

While the top-up model has the potential to meet all the three criteria set out in response to Question 1, we consider all prosed non-price factors to carry risks (see response to Question 10).

In terms of compliance, views and invited on:

16. Are the compliance and penalty options for non-delivery appropriate and proportional, and whether other alternatives could be considered?

No comment.

In terms of timing, views are invited on:

17. When would be the best moment to introduce non-price factors in the CfD process and is the government's initial suggestion (up to 2 years in advance) appropriate?

The Call for Evidence notes that other countries operate non-price factors at seabed leasing stage, but the UK model is different in so far as the Crown Estates have oversight of this process. Further consideration is required as to how non-price-factors would suit the UK CfD arrangements and how they would be suited to technologies other than wind.