Solar Energy UK

Consultation Response

Proposed Amendments to Allocation Round 7 and Future Rounds

March 2024

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 70GW of solar energy capacity by 2035. 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
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Introduction

We welcome proposals to introduce provisions for repowered projects to become eligible for CfDs; those to streamline the appeal system and to introduce hybrid metering (Qs 1-12 and 16-20). However, we have concerns regarding proposals to move from CPI to PPI, while welcoming the intention to reduce project exposure to inflation volatility (Qs 28-37). This response is made on behalf of the UK solar sector.

We thank you for considering our response.

Response to consultation

Section 1 – Proposals for Allocation Round 7

Repowering

1. Do you agree that the eligibility criteria for full repowering appropriately balances CfD policy objectives of supporting decarbonisation, ensuring security of supply, and minimising costs to consumers?

The inclusion of repowered projects within CfD eligibility is to be welcomed, and we agree that only full repowering should meet the criteria for eligibility. Looking ahead, the repowering of solar projects will also become increasingly relevant, and we urge DESNZ to be proactive in developing the policy framework to enable this, at the earliest possible stage.

2. Do you agree that use of the power generation cost assumptions to define end of operating life is an appropriate metric to capture those projects which will be seeking to fully repower in each allocation round?

It is important that there is a clear definition of end of operating life for existing renewable generators. We expect CfD generators to have built in a merchant business case given the 15-year contract length and improvements in efficiency – and therefore believe the operating life assumptions are appropriate for these assets.

However, earlier projects may look to decommission before the 25 years proposed in this consultation (e.g. after 20 years – when support under NFFO and RO end). As the consultation recognises, there is potential for a significant drop in future wholesale prices, as more renewable capacity comes online. This issue is faced by any project at the end of its support. This means that projects at the end of their support run the risk that low wholesale electricity prices do not cover their operational costs, particularly if it is located in an area with high transmission network charges.

Entering into such contracts for existing projects would also have the benefit that if prices are high, as has been seen recently, consumers would be protected from those high prices through the CfD payback mechanism.

In such cases where projects may come out of their RO or NFFO agreements and choose to decommission due to a lack of ongoing support, a 5-year gap between decommissioning and repowering under a CfD would result in 5 lost years of potential generation, which would not be a beneficial outcome for the consumer.

We recommend a detailed review be carried out to confirm the likely commercial operating life of the earlier renewable generators in practice before any decision is made.

3. Do you consider that each project should need to at least retain capacity, or do you foresee any challenges with this assumption?

Developers will always seek to maximise the commercially viable capacity at a given site, and for this reason, we do not believe that a requirement for repowering capacity to be equal to or greater than the existing (previous) capacity is necessary.

The repowering of projects will usually be subject to the same planning, environmental, grid and other constraints as new build projects. If a repowered project does not retain capacity, it will almost certainly be due to one or more constraints preventing this.

Introducing a restriction will limit the opportunity to diversify the site; to co-locate renewable technologies, batteries or other flexibility solutions. These changes could provide important system benefits but would be restricted under this requirement.

4. Do you agree full repowering of onshore wind sites meets each of the repowering eligibility criteria and should therefore be eligible for AR7? What evidence do you have to support this?

N/A

5. Do you agree that all other technologies do not meet the eligibility criteria for AR7? If not, why not and what evidence do you have to support this position? We are particularly interested in any costs data and definitions you may be able to provide on the full repowering of respective technologies.

We agree that all other technologies do not meet the eligibility criteria for AR7.

However, we would encourage DESNZ to be proactive in formulating a repowering policy framework for solar PV in anticipation of the future decommissioning pipeline.

In the interests of policy certainty, we ask that DESNZ set out an intention to support the repowering of Solar PV from AR8. As stated previously, we do not believe there is any reason why projects shouldn't be allowed into the CfD if they can repower earlier than the DESNZ's expected operating lifetimes.

6. Is enabling forward bidding for repowered projects required to better enable repowering via the CfD? What impact would enabling forward bidding have on reducing non-generation periods between decommissioning and recommissioning of the site?

We welcome the proposal to enable forward bidding for repowered projects. Keeping the time period between the existing and the repowered site to a minimum will allow generators to maximise the total renewable output of a site, in turn maximising the contribution to the delivery of our climate and energy targets.

Appeals

7. What are your views on the three options outlined? Is there one option in particular which, in your view, would be the most suitable to take forward in helping to deliver an increased certainty of delivery timelines for applicants?

While we welcome the intention to move to a more streamlined approach to appeals, developers would generally prefer a longer, more certain auction process with more ability to enter the auction – rather than a shorter auction with greater risk / more likelihood of exclusion.

We therefore support Option 1 – publish a fixed timeline, though recommend that this be taken forward whichever option is selected. We do not consider it appropriate to change the grounds of appeal, as proposed within Option 2 and have concerns that Option 3 would add greater risk. Bringing forward the deadline to an earlier stage increases the risk of delays in securing planning consent or a grid connection offer leading to exclusion from the allocation round entirely.

8. If we were to follow Option 2, i.e. changing the grounds for appeal, what kind of reasons for an appeal should be ruled out? Would there be any unintended consequences in taking this approach e.g. by removing the right to appeal due to clerical errors?

We do not support the changes proposed within Option 2.

We consider these changes, e.g. to introduce penalties for minor clerical errors, to be unnecessary, and as having the potential to jeopardise significant investment in renewable energy infrastructure – thus jeopardising deployment objectives.

9. If an appeals process happens ahead of the allocation round formally opening, as with Option 3, should projects be able to be approved with conditions, provided they are met before the formal application window closes? If yes, what conditions might be appropriate?

We do not support Option 3 as we consider the additional risks associated with it to negate any potential benefits. While the ability to pre-qualify for a CfD without planning secured – for example - may seem beneficial, in practical terms we have significant concerns that this would introduce additional risk – for developers, and for delivery against capacity targets.

10. If an appeals process happens ahead of the allocation round formally opening, as with Option 3, should we require developers to agree that they will not change the capacity of their main bid post submitting their application, to increase certainty when setting auction budgets?

We believe developers should not have to declare their capacity until the main bid is submitted and that flexibility in bid strategy should not be limited by any pre-qualification requirements, as proposed in Option 3.

We think Option 1 strikes the best balance in achieving the desired outcomes of a change to appeals policy, enabling greater certainty in the CfD process.

11. If we were to change the application and appeals window for AR7, or later allocation rounds, are there any transitional impacts that we need to be aware of?

Any changes will need to be announced and communicated as soon as possible for AR7. We recommend moving forward with Option 1.
Any proposal to move ahead with Option 3 should be carefully considered, as stated above. Were Option 3 to be introduced, it should be implemented from AR8 at the earliest.

12. Are there times in the year where you would prefer not to have the auction results released (which in turn may trigger contractual and milestone processes)?

We recommend that the Christmas break, and proximity to it – either in December or January - be avoided.

Co-located generation and hybrid metering

16. To what extent do you agree with the identified challenges that the current CfD metering requirements creates, as set out?

We agree that the current CfD metering requirements restrict the flexibility that sites with multiple technologies are able to provide and with the examples of restrictions given.

17.To what extent do you agree that introducing hybrid metering would support innovation and more flexible use of CfD-supported renewable generation?

We welcome proposals to introduce hybrid metering, which will support innovation and more flexible use of renewable generation. While not all sites with co-located technologies will use hybrid metering, we expect that many sites will embrace this change.

18. Specifically, to what extent could hybrid metering remove barriers to the deployment of low-carbon hydrogen?

Hybrid metering will enable more flexible use of renewable power. However, we are not aware of any technology specific barriers that this would address.

19. Could you provide any evidence on the potential cost savings that could arise from introducing hybrid metering?

The direct cost savings include the avoided cost of registering and metering separate balancing mechanism units (BMUs) on a single site. Although not large, this will be helpful for smaller scale sites.

20. What would be the potential drawbacks or unintended consequences, including any potential for gaming, of introducing hybrid metering?

We are not aware of any potential drawbacks or unintended consequences of introducing hybrid metering. The potential for gaming will be minimised by the requirement to continue to report CfD generation at the time of generation.

Section 2 – Considerations for Future Allocation Rounds

Should CfD indexation be updated to better reflect inflation risks?

28. The Government is interested in views on whether a change in the inflation-indexation of CfDs could help to future-proof projects against macroeconomic shocks in future. Please provide supporting evidence where possible.

In principle, we welcome proposals to update the indexation methodology to provide greater inflation protection during the construction period of future CfD projects. However, the detailed design of any alternative approach will need careful consideration – and consultation – as the industry has concerns that a move from CPI to PPI, for example, may increase, rather than decrease, price volatility.

We believe that the most effective way to mitigate future macroeconomic shocks is through the setting of appropriate Administrative Strike Prices in each CfD Allocation Round.

If changes to CfD indexation are considered further, and during the project construction phase, we ask that further engagement with developers and supply chain be undertaken ahead of any next steps. Full CPI indexation must be maintained post-construction for the rest of the CfD contract period.

29. Do you consider that a change to the way CfDs are indexed in future could better protect against inflation risk for developers, whilst also protecting electricity consumers from unreasonable costs? Please provide supporting evidence wherever possible.

In principle we agree that a change in the way that CfDs are indexed may better protect developers against inflation shocks, for example, through tracking the actual inflation experienced by projects. However, this potential for improved protection needs to be balanced against the complexities of providing such a bespoke approach. We believe that there could be a risk to solar projects if the proposed inflation metric is less correlated with panel prices than CPI.

30. Do you think electricity consumers, who ultimately fund CfDs, should bear greater construction risk through more comprehensive inflation protection to accommodate commodity price increases?

As noted in response to Question 29, indexation that tracks actual inflation for developers as closely as possible is likely to be most beneficial to consumers. This is likely to result in lower cost to the consumer than developers incorporating a greater risk premium for inflation in CfD bids.

Conversely, the potential cost to the consumer of new generation foregone – and delivery of carbon reduction targets delayed - due to inflation spikes, should also be taken into consideration.

31. The Government is interested in views on the significance of commodity price risk for developers. How significant are these risks compared to labour costs, cost of debt and exchange rate risk?

Commodity price risk is one of the most significant overall project risks and is therefore often more volatile than labour costs and exchange rates. However, that is not to say that the impact on labour costs and exchange rates are not significant, as labour cost increases have, in some cases, outweighed the CPI during recent macro-economic shocks
The cost of debt also needs to be considered and has a significant impact on overall project cost.

32.The Government is interested in views on how to define the period in which renewable generating projects are most likely to be exposed to fluctuations in key input costs, and therefore benefit from greater inflation protection. Please provide supporting evidence wherever possible.

Most key input costs are fixed by the time a project takes its Final Investment Decision (FID). The CfD auction process takes up to around 6 months from the submission of bids to award of CfD and FID coincides roughly with the end of the 18-month CfD Milestone Delivery Date.

This means that costs remain open for about 2 years between the submission of a CfD bid and reaching FID – during which time the project is most exposed to fluctuations in costs. Before the submission of CfD bids, cost increases can be incorporated into this. After this point, costs will be locked into supplier contracts, or linked to an index such as CPI.

We therefore recommend that the period of greatest cost fluctuation exposure is defined as the ~2 year period from the submission of CfD bids to the end of the 18 month MDD. If indexation under the CfD cannot be backdated to the submission of bids, then the starting date should be the date of signature of the CfD.

33. The Government is interested in views and evidence on whether indexing strike prices to PPI during the construction phase of a project would better reflect increases in project costs than CPI. Please provide supporting evidence where possible. We are interested in an assessment of both the short-term and long-term impacts that this change could have.

We recommend that CPI is retained, and that the CfD does not move to PPI.

Like CPI, PPI is a complex index with many inputs. However, PPI has a significantly greater volatility and wider range of values compared to CPI, meaning that the difference between actual costs and the index could be much larger with PPI compared to CPI. This increases the risk to the developer and reduces the effectiveness of indexation in reducing the financial risk to the project, when compared to CPI.

Any changes to include PPI need clear evidence of the benefits, with a clear start and end point in the contract to allow for the correct project forecasting. If exploring PPI indexation further, we ask that DESNZ discuss potential impacts in detail with developers, investors and the supply chain to assess whether this could be a helpful additional metric.

The introduction of any PPI indexation in the construction phase should not change the full CPI indexation used for the rest of the CfD contract. Which as noted above is a clear and investable indexation arrangement.

34.The Government is interested in views and evidence on the implications of indexing strike prices to PPI in the construction phase of a CfD project on investor confidence, and the overall effect this could have on project hurdle rates.

We do not support a move to PPI, switching away from CPI, for the reasons set out above.

35.Over the last 10 years, PPI has historically been more volatile than CPI, but has also tracked higher overall. What effect do stakeholders think this could have on CfD bids? Please provide supporting evidence wherever possible and assess both the short-term and long-term impacts.

One way of illustrating the impact of the greater volatility of PPI is to calculate the indexed strike price for a project after 2.5 years of construction, occurring during over the two extremes of an increase (2020-2022) and reduction (2014-2016) in PPI over the last 10 years. After 2.5 years, for PPI, the indexed strike price range is 0.94 to 1.3.1, whereas for CPI the indexed strike price range is 1.05-1.16**.**

The risk of a mis-match in the PPI trend and the trend in actual costs for the project is increased by the greater volatility of PPI. Because PPI values can change quickly and are sometimes negative, there is a higher risk of a mis-match arising, compared to an index that changes more slowly and is almost never negative.

Investors will find it difficult to manage this increased risk from the PPI index and it could increase, rather than reduce, the project hurdle rate, compared to the use of CPI.

36.What trade-offs (for example, partial indexation later in the contract) or protections should the Government consider to retain consumer value for money?

We do not support proposals to move to partial indexation and do not believe that this will provide greater value for the consumer or sufficiently reduce project exposure to inflation risk.

37.Are there alternative proposals that could offer similar benefits that the Government should explore and if so, what are these and why? Please provide supporting evidence.

A number of support schemes for renewables in other countries use a bespoke index, based on a basket of the main commodities, for renewable support schemes. Some use indices for labour and service costs in addition to raw materials and components, and such approaches would be worth further consideration.

However, consideration should also be given to the fact that different technologies may warrant different approaches (due to differing inputs), which may result in some technologies being treated, inadvertently, more favourably than others. This risk may be mitigated if all technologies were allocated different CfD pots but would result in technology-based capacity allocations – moving away from a more agnostic approach.