



Support for Wave And Tidal Generation Joint response from REA and BWEA

The Scottish Executive is to be commended for seeking to take timely action to target support at the wave and tidal sector at the crucial stage where it is aiming to make the transition to commercial activities.

The potential resource is very large, and there is a unique opportunity for Scottish industry to benefit from the growth of this sector both in Scotland and globally through exports.

However, the proposals in this consultation lead to substantial changes to the Renewables Obligation Scotland "RO(S)", which may have implications way beyond the marine renewables sector. The REA and BWEA are not convinced that the proposals have addressed these issues so as to offer the necessary certainty that there will not be disproportionate adverse impacts elsewhere in the market. Unless this is adequately addressed our members will not accept this approach as the right way forward.

This response highlights the problems with the Executive's proposal, and then suggests three optional ways forward:

1. Collaborative working with the DTI on improving the Marine Deployment Fund
2. Other direct funding approaches
3. A variation on banding the RO(S), as put forward by the Scottish Renewables Forum (SRF) in its submission to this consultation

The advantages and disadvantages of these options are discussed.

Comments on the proposals in the consultation document

Timing of the proposed Marine Obligation (MO)

The Scottish Executive began examining the options for supporting marine technologies at a time when the DTI was not considering modifying the RO to deliver differing levels of revenue support to different technologies.

The original intention of the Executive was to award multiple ROCs for wave and tidal output, but it was realised that this route required primary legislation. This could not have been implemented in the timescale sought by the Executive (April 2007). The Energy Review has subsequently indicated that Government will consult on multiple ROCs – also referred to as ‘banding’ – the type of mechanism the Executive had originally hoped to introduce. The timescale envisaged could see the RO become banded by April 2009 at the earliest.

Therefore the Scottish Executive’s Marine Obligation (MO) could have been in operation a minimum of two years, but most probably three years, before the implementation of banding. If the change to the RO delivers the same objectives as the MO, then it could be expected that the MO will cease and projects will move to multiple ROCs instead, or some other grandfathering arrangements could be implemented¹.

If the UK Government’s proposals for banding come to fruition, therefore, the MO will have been established, at considerable cost in time and effort, to support a small number of projects, totalling a few tens of MW at most. This is obviously a less than optimal use of resources, and it is clear that a UK-wide interim support mechanism before banding is introduced would be preferable and desirable.

Interaction with the Energy Review’s proposals

Paragraph 5.41 of the Energy Review states

5.41 The DTI, the Scottish Executive and the Department of Enterprise, Trade and Investment in Northern Ireland are committed to maintaining a strong UK-wind ROC market, operating on a consistent basis, and will work together to ensure that this is delivered. This includes liaising with the Scottish Executive to promote complementarity with their current proposals for prioritising support to marine energy.

The Executive needs to bear in mind the implications of the Energy Review. There could be a risk that the primary legislation enacted to implement banding might undermine the MO. Alternatively, the introduction of banding the RO could have implications for the operation of the RO(S) and, within it, the MO. At the other extreme, it is possible that the options for implementing banding UK-wide would be limited by the need to protect a Scottish MO.

Appropriate support measures for wave and tidal energy

The marine renewables industry is at the stage of R&D and deployment of pilot and pre-commercial devices. It is widely acknowledged that a combination of grant funding and revenue-based support is most appropriate at this stage. We believe that clear, comprehensible tariff arrangements such as the Portuguese feed-in tariff are also appropriate. Our attitude to support measures is set out in the recently published report, Path to Power².

¹ NB, grandfathering arrangements for the MO could prove particularly difficult, as values of projects could be highly volatile.

² See <http://www.bwea.com/pathtopower/>

Unlike the Portuguese tariff, the SE proposal - although revenue based - is far from straightforward. Its complexity is likely to put investors off, particularly if they have a choice between investing in projects on the basis of measures they understand readily, as opposed to those that are more difficult to evaluate.

Under buy-out option 2 there is clearly the potential for the value of Marine ROCs to be extremely volatile.

Furthermore, the target is not certain, being subject to periodic review. This creates uncertainty over the rest of the RO(S) as well as the MO, which creates difficulties for all when it comes to agreeing power purchase contracts. Investors would be wary of making investments when there is such a great potential for political intervention.

Penalty for failure

Wave and tidal technologies are at an early stage of development. The proposals would operate by applying a “penalty for failure” on suppliers, which is inappropriate at a time when proven technology is not available, and thus the risk of technology failure is relatively high. There are also considerable difficulties to be overcome in terms of consenting and providing suitable grid connections, which may delay installation of projects, and, if care is not taken, could be penalised heavily through no fault of suppliers. If suppliers invest in a project which subsequently under-delivers, they will not only have lost some capital, but will subsequently have to buy-out of the obligation. This double penalty would deter investment.

Value for money for consumers

The cost to consumers will be increased by the Scottish Executive’s proposals. A 0.5% marine band (assuming a £150/MWh buy-out), carved out of a 7.9% RO(S) would give rise to an additional cost of some £18m. Whereas the principle of increased costs has already been established within the RO mechanism, and indeed there may be a degree of public support for measures that specifically stimulate the marine sector, the current proposals may result in the consumer paying a penalty for failure, rather than towards commissioned projects.

A problem not addressed in the consultation document is what would happen to the buy-out fund under recycling option 2, if no marine ROCs had been generated within an obligation period.

Competition issues

There are significant competition issues with buy-out recycling options 2, 3 and 4. For example, under the Executive’s favoured recycling option, suppliers without a significant supply base in Scotland will see a reduction in the value of the obligation of between £4-6.3/MWh, the exact amount depending upon the level of arbitrage engaged upon.

Therefore Scottish supply companies will have an unfair advantage in comparison with those without a market in Scotland. They would be able to offer more attractive PPAs to renewable electricity generators irrespective of the technology – or simply pass the additional value directly to their shareholders.

We believe option 1, which does not create the incentive to arbitrage, and does not pose these competition issues, is the best of the 4 options presented. We acknowledge that this costs Scottish suppliers more, whilst the benefits are shared between all suppliers. However, Scottish suppliers will be able to pass these additional costs to Scottish consumers.

Arbitrage and complexity

We firmly believe that any change that re-introduces an incentive to arbitrage should be avoided. It was precisely because of the distortion caused by arbitrage that the obligation was changed in the 2005 Order. The buy-out pots were amalgamated last year, and it would be a backward step to separate them again.

A related issue is that of increased complexity in the system. The RO and ROS are already complicated systems, which have been open to an amount of 'gaming' (though this has been reduced through recent changes). Adding in complexity would both risk gaming, unless great care is taken in the design, and also possibly deter investors. If the returns on investment are difficult to calculate and uncertain, then investors may conclude that more straightforward ways to use their capital are better.

Geographical location

As acknowledged in the consultation paper, State Aid rules may require the fund to be applicable to projects across the whole of the UK rather than Scotland alone. This would mean that the Scottish consumer is subsidising the industry in England and Wales, and this would raise questions about its political acceptability.

Alternative suggestions

Amending the Marine Renewables Deployment Fund (MRDF)

Our clear preference for supporting the marine renewables at this stage is for an additional funding mechanism outside the RO. The most obvious means to provide additional funds is through the Marine Renewables Deployment Fund (MRDF), though we have deep reservations about the conditions that are currently imposed upon awards under this scheme, as set out in the joint response by BWEA, REA and SRF to the MRDF consultation. We believe that if the MRDF is to underpin the development of the marine sector effectively, until banding is introduced, then these conditions will need to be reformed, and the fund 'topped up' so that more projects can be supported.

We suggest that the Scottish Executive and DTI should work together to achieve these ends.

The £42m MRDF, administered by DTI, provides a 25% capital grant, along with £100/MWh revenue support for seven years. There is a support cap per project of £9m in total, which is adequate for developments of only a few MW each. Each technology type can be supported only once, so the MRDF provides no intermediate step for a technology developer between the first multi-machine projects and larger-scale developments in a banded RO. We believe that there need to be more stepping stones to operating in the commercial arena of the RO.

The MRDF did not attract robust applications in the single round of bidding undertaken so far: this is partly due to unfamiliarity with the system on the part of companies, but largely because of the unduly restrictive conditions on the award of grants. If UK Government wishes the MRDF to provide effective support for the sector, it should work with the industry to reform these conditions.

Alternative direct funding by the Scottish Executive

Although the DTI scheme will help fund first generation demonstration projects (and as such it is welcomed), it is not at sufficient scale to kick-start the sector as a whole and additional support is required. We agree with the Scottish Executive therefore that further stimulus is essential for the sector to progress.

The total support required to deliver an initial capacity of 100-200MW could be well in excess of £200m. We assume this to be beyond the resources of the Executive, even with additional support from DTI/Treasury. The recently announced Energy Review, however, may help provide a solution but only from 2009/10 onwards.

We would be pleased to work with the Scottish Executive on alternative mechanisms to cater for this gap period. A figure of some £20m has been mooted as the likely level of funds required, though this assumes that projects supported would move to the banding system on its introduction and transitional funding would cease: at the moment, it is still uncertain as to whether banding will be introduced, and if so at what level, so there would be a residual risk that the Scottish Executive would have to commit significant funds over a long period. This sum (and the risked higher level of support) would be a substantial financial commitment for the Executive, and may need to be raised from other sources, such as the SRO surplus fund.

A consideration for both the above alternatives is that the Energy Review suggests ruling out projects which were supported by grants from being able to access multiple ROCs at a later date.

A variation on banding the RO(S)

If the Scottish Executive is not to be swayed from going down the route of amending the RO(S), we suggest that the Executive considers the proposal put forward by the Scottish Renewables Forum. Those promoting this approach believe that it could overcome many of the problems highlighted in the first part of this response.

We have some reservations over the SRF proposals, specifically as it may end up running in parallel with a banded RO and we fear that investors will not be prepared to commit until it is clear that the two schemes will not interact in an adverse manner. Investors will want to fully understand their options regarding switching to any multiple ROC band and, given the lead times associated with the legislative process, it is entirely conceivable that projects would not be implemented during the window between 2007 and 2009 or 2010.

If a way can be found to deliver predictable, stable, revenue-based support for marine project developers, which can be demonstrated not to interact with the RO, either now or in its future form, we would be delighted to give it our support.

Conclusion

We are highly supportive of the Scottish Executive's objectives. We also recognise the very narrow room for manoeuvre available, given the constraints of the enabling legislation.

Considerable resources will be required to implement a change to the RO(S), and later possibly to retract it. We believe these resources could be more effectively directed at other means of improving the prospects for marine renewables outside of the RO(S), such as improving the Marine Deployment Fund.

In short, if a Marine Obligation is implemented in April 2007, in advance of possible new RO arrangements following shortly afterwards, significant confusion could result. While it may be possible to design an MO that minimises interference with the rest of the RO, BWEA and REA would prefer a UK-wide solution that gives support outside of that system.