

25 September 2013

EMR Delivery Plan Team
Department of Energy and Climate Change
3 Whitehall Place
London SW1A 2AW
By email to: emrdeliveryplan@decc.gsi.gov.uk

RE: CONSULTATION ON THE DRAFT ELECTRICITY MARKET REFORM DELIVERY PLAN

Dear Sir / Madam,

Thank you providing the North London Waste Authority with the opportunity to respond to the draft Electricity Market Reform Delivery Plan Consultation.

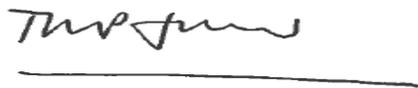
Background

In north London around 846,000 tonnes of waste is collected from homes and businesses by the seven north London councils – Barnet, Camden, Enfield, Hackney, Haringey, Islington and Waltham Forest. Nearly half of that waste is incinerated at an energy from waste incinerator and nearly a quarter is sent to landfill. Of that 846,000 tonnes of waste around 700,000 tonnes comes from households in north London. At the moment over 31% of north London's household waste is reused, recycled or composted.

Currently, the NLWA is engaged in a major procurement exercise which seeks to realise substantial carbon and other environmental benefits through the production of Solid Recovered Fuel (SRF) from municipal waste, and the subsequent use of that fuel to generate energy in the form of both electricity and heat. In particular, our interest lies in how the Electricity Market Reform may affect projects within the waste market and how renewable energy incentives can be used to provide greater market certainty to the EfW projects and bidding community as part of the development of long term strategic infrastructure.

The following response is subject to Member approval and comment. We will update the response if there are any changes as a result of consultation with Members. If you require any further clarification of the points raised in our response or have additional queries please do not hesitate to contact me.

Yours sincerely,



Tim Judson
Director of Procurement

CONSULTATION QUESTIONS

In relation to the consultations put forward within the Electricity Market Reform Consultation Document, the North London Waste Authority has set out its response below:

Strike Price Methodology

1. Do you agree that CfD strike prices should be set comparable to the Renewables Obligation for the period 2014/15-2016/17? If not, why and what alternative would you propose?

The Authority agrees that CfD strike prices should be set comparable to the Renewables Obligation for the period 2014/15 to 2016/17. As referred to within the consultation document, given that CfDs will be offered alongside the RO for generation stations commissioned before the end of 2016/17, setting strike prices that are less attractive than the RO during this period would cause developers to adopt the RO instead, leaving no demand for support with CfDs.

2. The methodology for setting Renewables Obligation-comparable strike prices is described in Box 1 and the resulting strike prices are in Table 1. Do you agree that the strike prices we have set offer support that is comparable with the Renewables Obligation? Please provide evidence to support your position

The Authority does not agree that the strike prices set offer support comparable with the RO. The methodology applied in deriving the strike price appears reasonable, however, the underlying assumptions and in particular the lower financing costs which have been changed to reflect what is perceived to be a lower risk rate without adequate evidence is of concern. It is also not clear how the strike price has been adjusted for the shorter contract terms that CfD provides.

Additionally, the Authority is concerned that the point of measurement of eligible electricity is not consistent with the RO and that parasitic load is not eligible for CfD. This appears counterintuitive as the parasitic load would otherwise be met by the use of fossil fuels. The renewable electricity which displaces fossil fuels should be taken into account when measuring the amount of electricity eligible to receive CfD payments.

As a waste disposal authority, our primary concern is sustainable waste management, a duty we have to carry out as economically as possible irrespective of whether there are Government subsidies in place. To illustrate this we take an EfW Plant example. An EfW Plant is built to deal with waste that cannot be recycled or reused. The production of energy in the form of either power and or heat is secondary to the waste disposal function. A developer will build the EfW Plant irrespective of the electricity price as the primary reason for the plant is disposal of waste. In order to recover costs a gate fee is charged. The impact the electricity subsidy (be it RO, CFD or some other subsidy) has on an EfW operator is that they are able to reduce the gatefee charged and therefore make it more economical to dispose of waste. If there is no electricity subsidy the gatefee either remains the same or is increased to take account any loss of subsidies. Our view, therefore, is that it is incorrect to assume that there is a reduced cost of financing for investors i.e. the hurdle rate should not be adjusted.

The production of energy from an EfW plant will make a significant contribution to meeting renewable energy targets by displacing fossil fuels and it is therefore appropriate that it continues to attract renewable subsidies.

3. We propose that where technology costs are expected to decline, strike prices should decline over time to reflect technology cost reductions and ensure value for money. Do you agree that this the most appropriate basis on which strike prices should change over time? If not, why and what alternative would you propose?

The Authority understands that if technology costs are expected to decline then it may be reasonable to reduce the strike prices. However, the Authority's view is that the grandfathering regime as applied to the RO which ensures that support for a project is not withdrawn or reduced in value one granted is applied to the CfD regime and in particular to AD and EfW technology. Our understanding of recent EfW projects suggests that the CAPEX for these facilities are rising due to factors such as: the cost of finance, currency exchange, inflationary effects and investment on better plant efficiency and availability. This will likely remain the case for the foreseeable future and therefore, renewable subsidies will need to reflect this.

4. Do you believe that the recommended strike prices shown in Table 1 change over time in a way that appropriately reflects technology cost reductions and ensures value for money?

Our response concerns the Strike Prices for EfW and AD with or without CHP. The Authority agrees with the analysis that for EfW there is limited scope for further cost reduction and as mentioned in our response to question 3 costs are likely to increase at or beyond RPIx and therefore a flat strike price is less appropriate than a strike price which rises over and above CPI during the delivery period.

The Authority is, however, concerned that this approach has not been adopted for AD with or without CHP. As referred to in the Government Review to the Banding Review (GRBR), AD costs are not expected to reduce over time as predicted. The PB report¹ also suggests that no new sources of data were derived for AD. Therefore there is no basis to assume that AD costs will decrease over time.

The Authority believes that the CPI indexation of the Strike Price along with a shortened timeframe of 15 years, reduces the attractiveness for large scale long term renewable energy projects. As wholesale electricity prices and variable costs associated with waste management operations continue to increase in line with or beyond RPIx, the benefit of the CfD scheme will be eroded, thereby reducing project viability through increased payback. EfW projects typically span 25 years or longer, so it is important that the level of support is maintained and remains constant to provide market certainty over the life of the project.

Consultation Question

5. Do you agree with the key assumptions underpinning the strike price analysis, as described in Box 2, and in particular:

¹ **Electricity Generation Costs Model – 2013 Update of Renewable Technologies**

- The technology costs
- The build constraints
- The hurdle rates
- The decision to update our assumptions on the level of tax paid by developers, based on advice from KPMG
- The Power Purchasing Agreement discounts

Please provide evidence to support your position

The Authority is concerned to see that for both EfW and AD, the same technology costs and build constraints which formed the basis of the RO Banding review have been used to underpin the strike price analysis. This is particularly of concern as the GRBR points out that for EfW of the responses received 72% disagreed with the costs analysis and subsequently the decision was made not to reduce the level of support for EfW. The PB report also concluded that no new sources of data were derived. It therefore appears that underestimated costs have been used to develop the strike price for EfW. Similarly, the same comment applies to AD with or without CHP.

As stated in our response to question 2, the Authority does not believe that there is a basis for modifying the hurdle rates to take into account a reduced hurdle rate for EfW and AD. Our view is that there is no evidence to suggest that the cost of finance for EfW and AD will reduce as a result of the CfD scheme.

The Authority itself does not buy and sell electricity in a manner to be able to comment on the applicability of the PPA discounts. However, market intelligence reports seem to suggest that it is reasonable to assume a 10% PPA discount for a baseload embedded generator selling its output to an electricity supplier under a medium to long term PPA . Similarly a 10% discount appears reasonable for LECs and in this regard the Authority agrees with the PPA discount.

Analysis from the System Operator

6. Do you agree with our judgement that setting strike prices consistent with Core Scenario 32% (described above and in the Report from the System Operator at Annex E) is the best way to balance the Government's objectives of renewables deployment and affordability?

The Authority has no comment on this question.

Strike Prices by Technology

7. Do you agree with our proposed approach by technology?
Please provide evidence to support your position

Yes the Authority agrees that there is merit in taking into account individual technologies in setting out the Strike Prices.

Other renewable technologies without strike prices

8. We have not set a strike price for co-firing plants because our preference is for conversions, which are more sustainable and provide higher levels of renewable generation. Do you agree with this approach?

The Authority has no comment on this question.

9. Government's 2012 Bioenergy Strategy concluded that support for new dedicated biomass should be treated with caution given the lock-in risks for this technology and its relatively high costs of carbon abatement compared to biomass co-firing/conversions. In line with this conclusion, we have not set a strike price for dedicated biomass without CHP. Do you agree with this approach?

The Authority has no comment on this question.

10. We have not set a strike price for standard bioliquids, as we do not wish to divert this technology from more suitable sectors such as transport. Do you agree with this approach?

The Authority has no comment on this question

11. We have not set a strike price for geopressure since the technology is at development stage, and no geopressure projects have come forward through the Renewables Obligation. Do you agree with this approach?

The NLWA has no comment on this question

Capacity Market

12. Do you agree with our proposed reliability standard of 3 hours LOLE?

The Authority has no comment on this question

13. Do you agree with the methodology underpinning the reliability standard – that is to calculate this using the value of lost load and the cost of new entry? If not, please explain why and provide supporting evidence

The Authority has no comment on this question

14. Do you agree with the analysis of the value of lost load as described above and in Annex C? If not, please explain why and provide supporting evidence.

The Authority has no comment on this question.

15. Do you agree with our estimate of the cost of new entry as described above and in Annex C? If not, please explain why and provide supporting evidence.

The Authority has no comment on this question.

16. Do you agree the reliability standard should be reviewed every five years to reflect any future evidence in the value of lost load and the cost of new plant entry?

The Authority has no comment on this question.

17. Do you agree with the proposed methodology for the auction demand curve? If not, please explain why and provide supporting evidence.

The Authority has no comment on this question.