



## Electricity Market Reform First Delivery Plan

### Introduction

In line with the Government's timetable for implementation of the Electricity Market Reform ("EMR"), the Department of Energy and Climate Change ("DECC") published for consultation the first draft Delivery Plan on 17 July 2013 (the "First DP Consultation"). The Government has committed to publishing an EMR Delivery Plan every five years, with Annual Updates being provided during each interim year. Each Delivery Plan will publish key decisions on the EMR and will be consistent with the Levy Control Framework ("LCF"), which establishes a financial cap on the total amount of levies that can be imposed on consumers via energy bills.

The First DP Consultation concentrates on two key areas of EMR:

- (a) renewable strike prices for the new Feed in Tariff Contracts for Difference ("CfDs"); and
- (b) a reliability standard for the Capacity Market.

DECC is seeking responses to the First DP Consultation by 25 September 2013, with a final first Delivery Plan being published by the end of the year (subject to Royal Assent of the Energy Bill).

The First DP Consultation should be considered alongside the Government's policy document entitled "*Electricity Market Reform - Delivering UK Investment*" which was published on 27 June 2013 and provides investors with an indication of the principal CfD contract parameters and key terms.

### Strike prices

The CfD is a long term private law contract that pays the generator the difference between an estimate of the market price for electricity (the reference price) and an estimate of the long term price needed to bring forward investment in a given technology (the strike price).

During the period in which strike prices are set administratively, each Delivery Plan will publish the strike prices available for renewables in the following five year period.

The First DP Consultation contains draft strike prices for the period 2014 – 2019 together with justification for individual technology support levels, as summarised in **Appendix 1** attached hereto. The draft strike prices have been published

following detailed analysis from National Grid who have assessed the level of financial support required to meet the Government's objectives of (i) meeting its renewable energy target (being 30% of Britain's electricity being generated by renewable energy sources by 2020); (ii) maintaining security of supply; (iii) minimising the cost to consumers in promoting non-fossil fuel generation; and (iv) maintaining EMR expenditure within the LCF.

According to DECC, the draft strike prices have been set at a level which is relatively comparable to the Renewables Obligation ("RO") with adjustment being made to give regard to:

- (a) the reduced CfD term of 15 years (rather than 20 years as under the RO);
- (b) the greater revenue certainty provided by the CfD model (via the removal of wholesale price risk) which is expected to result in lower capital costs; and
- (c) the removal of exposure to ROC price volatility.

The Government has not published strike prices for carbon capture and storage (CCS) and nuclear generation - instead, details of the CfD allocation and price setting arrangements for these technologies will be published in early August 2013. With regard to:

- (a) tidal range (tidal barrage and tidal lagoon) - the Government has confirmed that CfD support will be available, however, no strike prices have been published due to lack of available cost data and likely variation between projects. DECC will therefore consider appropriate strike price and CfD contract term on a case by case basis; and
- (b) geopressure - this technology type is regarded as being at an early developmental stage and, consequently, no strike price is currently being offered as there is limited potential to set a reliable figure due to the absence of operational projects. The Government will continue to monitor the need for geopressure support during development of the CfD regime.

Critically, the Government has confirmed that CfD support will **not be available** to biomass co-firing, dedicated biomass and standard bioliquids. It is important to recognise that the

Government's proposed stance, both in respect of the level of strike prices and the absence of CfD support for these technology types, is subject to consultation. It is therefore critical for interested parties to provide a consultation response themselves or through an appropriate interest group if they feel that the Government's current proposals are unacceptable or unfounded.

## Capacity market - reliability standard

The Capacity Market is intended to protect consumers against the risk of supply shortages by putting in place reliable, standby capacity that can be called upon when needed. In return for making standby capacity available, generators will be paid a predictable revenue stream (thereby incentivising investment funding) but will face penalty charges if they fail to provide capacity when required.

The Government is intending to run the first capacity auction in late 2014 for delivery in 2018/2019 (subject to State Aid clearance). In determining the amount of standby capacity required, the Government is intending to use an enduring reliability standard as a measure of the risk that electricity demand is not met in any given year as a result of insufficient capacity (thereby resulting in voltage reductions and potential disconnections). This reliability standard will allow a demand curve to be established ahead of each capacity auction which will enable the Government to assess its capacity requirements against likely cost, thereby determining the most cost efficient amount of standby capacity required when balanced against likely system outage/failure.

The First DP Consultation sets out in detail the methodology and calculations used to determine the draft reliability standard and demand curve and is seeking stakeholders' responses regarding its suitability.

## Other points to note

- (a) EMR is intended to benefit consumers throughout the UK and, as such, will apply (in full) to England, Scotland and Wales. With regard to Northern Ireland, the Northern Ireland Executive (to whom energy policy (excluding nuclear) is devolved) have agreed that CfDs will be made available in Northern Ireland, however, it is yet to be determined whether different strike prices will apply. The

Capacity Market will not apply to Northern Ireland due to the Irish Single Electricity Market already using a capacity mechanism.

- (b) Notwithstanding that the Government believes that CfDs will make it easier for independent generators to agree long-term offtake contracts, concerns remain as to how this market will develop. The Government is therefore working with stakeholders to develop a voluntary code of practice and sample long-term contracts for the sale of electricity, which can be used as the basis of commercial negotiations.
- (c) The Government is currently considering whether additional CfD support should be made available to renewables projects being developed on Scottish Islands as it is recognised that the economics of development are significantly different to mainland projects.
- (d) DECC is responsible for ensuring that EMR expenditure remains within LCF limits. CfDs will therefore initially be issued on a first come first serve basis before moving to allocation rounds when a material portion of the CfD budget has been committed. Further details regarding the allocation process will be published later this summer.

## Who to contact

### **Ross Fairley** Partner, Head of Environment and Energy

Mobile: 07785 500949  
DDI: +44 (0) 117 902 6351  
ross.fairley@burges-salmon.com

### **Nick Churchward** Partner, Environment and Energy

Mobile: 07527 385904  
DDI: +44 (0) 117 307 6998  
nick.churchward@burges-salmon.com

### **James Phillips** Partner, Environment and Energy

Mobile: 07980 994176  
DDI: +44 (0) 117 902 7753  
james.phillips@burges-salmon.com

Burges Salmon LLP, One Glass Wharf, Bristol BS2 0ZX Tel: +44 (0) 117 939 2000 Fax: +44 (0) 117 902 4400  
6 New Street Square, London EC4A 3BF Tel: +44 (0) 20 7685 1200 Fax: +44 (0) 20 7980 4966

[www.burges-salmon.com](http://www.burges-salmon.com)

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## Appendix 1 - Summary of Proposed Strike Prices

Note:

- (a) Stepped reductions in strike prices have been introduced for those technologies which are predicted to benefit from cost reductions as deployment increases.
- (b) The strike price secured by a generator will be determined by the date of **plant commissioning** rather than entry into the CfD and support will be paid on net renewable generation.
- (c) It is intended that the same strike price will be available to CHP and non-CHP plants on the basis that CHP plants will receive additional support for heat generation under the RHI. Adjustments of the strike prices may be made depending on the outcome of the recent RHI consultation.

| Technology  | Strike price (£/MWh, 2012 prices) |         |         |         |         |  | Government commentary |
|---|-----------------------------------|---------|---------|---------|---------|--|-----------------------|
|   | 2014/15                           | 2015/16 | 2016/17 | 2017/18 | 2018/19 |  |                       |
| Advanced conversion technologies ("ACT") (gasification and pyrolysis) | 155                               | 155     | 150     | 140     | 135     | <ul style="list-style-type: none"> <li>■ ACT strike price applicable to those technologies previously eligible for RO support bands for standard and advanced gasification and pyrolysis.</li> <li>■ Cost reductions expected over time as technologies mature - strike prices set to reduce in parallel with those for offshore wind.</li> </ul>              |                       |
| Anaerobic digestion (with or without CHP) (>5MW)                      | 145                               | 145     | 145     | 140     | 135     | <ul style="list-style-type: none"> <li>■ Strike prices set to incentivise cost reductions towards end of First DP period.</li> <li>■ Government response pending regarding provision of RHI support for heat output of biogas (including AD).</li> </ul>   |                       |
| Biomass conversion  | 105                               | 105     | 105     | 105     | 105     | <ul style="list-style-type: none"> <li>■ Shorter contract term being provided to biomass conversions (payments to end in 2027) to ensure consistency with Government's sustainability objectives set out in Bioenergy Strategy.</li> <li>■ Flat strike price offered to reflect shorter contract term and expected increase in imported fuel costs.</li> </ul> |                       |
| Dedicated biomass with CHP  | 120                               | 120     | 120     | 120     | 120     | <ul style="list-style-type: none"> <li>■ Flat strike price offered to reflect fuel costs being a large proportion of biomass generation.</li> <li>■ Includes dedicated energy crops.</li> <li>■ Government response pending regarding revised RHI tariffs for heat from biomass CHP.</li> </ul>  |                       |
| Energy from waste with CHP <sup>1</sup>                               | 90                                | 90      | 90      | 90      | 90      | <ul style="list-style-type: none"> <li>■ Flat strike price offered as limited scope for future cost reductions.</li> <li>■ Seen as a valuable component of technology mix due to concurrent production of heat and electricity.</li> </ul>   |                       |
| Geothermal (with or without CHP)                                      | 125                               | 120     | 120     | 120     | 120     | <ul style="list-style-type: none"> <li>■ Government has commissioned an external report on the potential of geothermal power in the UK – its findings will be incorporated in setting final strike price.</li> <li>■ Government response pending regarding provision of RHI support for direct heat use from deep geothermal.</li> </ul>                       |                       |

| Technology            | Strike price (£/MWh, 2012 prices) |         |         |         |         | Government commentary  |
|-----------------------|-----------------------------------|---------|---------|---------|---------|--|
|                       | 2014/15                           | 2015/16 | 2016/17 | 2017/18 | 2018/19 |  |
| Hydro (>5MW)          | 95                                | 95      | 95      | 95      | 95      | <ul style="list-style-type: none"> <li>Flat strike price maintained as cost reductions are well advanced, therefore limited potential for future savings.</li> </ul>   |
| Landfill gas          | 65                                | 65      | 65      | 65      | 65      | <ul style="list-style-type: none"> <li>Covers both the closed site and heat recovery bands under the RO.</li> <li>Strike price has been set close to CfD reference price to provide certainty of income, however, additional support not required as landfill gas technologies are already well advanced.</li> </ul>   |
| Offshore wind         | 155                               | 155     | 150     | 140     | 135     | <ul style="list-style-type: none"> <li>Strike price set at a level and trajectory which will bring forward new generation whilst recognising that costs are expected to fall by 2020.</li> </ul>   |
| Onshore wind (>5MW)   | 100                               | 100     | 100     | 95      | 95      | <ul style="list-style-type: none"> <li>Strike price based on current RO level of support as onshore wind costs have not changed significantly since most recent RO reduction. Further reductions from 2017 to incentivise future cost reduction.</li> </ul>  |
| Sewage gas            | 85                                | 85      | 85      | 85      | 85      | <ul style="list-style-type: none"> <li>Flat strike price maintained as cost reductions for sewage gas technology are well advanced (as currently reflected in relatively low level of RO support).</li> </ul>  |
| Solar PV (>5MW)       | 125                               | 125     | 120     | 115     | 110     | <ul style="list-style-type: none"> <li>Small scale (&lt;5MW) solar PV will continue to be solely supported under the small scale Feed-In Tariff regime.</li> <li>Strike price applicable to building-mounted and ground-mounted installations.</li> <li>Large scale solar PV will continue to have a significant role in renewable generation, subject to cost reductions and technology advancement. Strike price level and trajectory set to support increased deployment whilst incentivising cost reductions.</li> </ul> |
| Tidal stream and wave | 305                               | 305     | 305     | 305     | 305     | <ul style="list-style-type: none"> <li>Includes tidal stream and tidal array.</li> <li>Regarded as early-stage technologies which require high level of revenue support with limited cost reduction expected.</li> <li>Strike prices intended for first 30MW capacity of each project. For higher capacity projects, additional MWs expected to be offered a strike price of £155/MWh (to be determined).</li> </ul>   |

(Footnotes)

<sup>1</sup> Energy from waste without CHP is not supported under CfDs.