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LESSONS FROM THE FIRST CFD AUCTION

Words:
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The results of the first Contracts for Difference (CfD) allocation round (the new UK support mechanism for non-fossil fuel technologies) were announced in February. A total of 27 contracts worth £315m had been offered to projects with a delivery capacity of over 2GW. The results were hailed as a huge success by the Government. Wind was the big winner with 750MW of onshore wind and 1.1GW of offshore wind being awarded CfD. None the less, there were clearly projects that were unsuccessful in the auction and wave and tidal, despite having a minima allocated to them in the 'Less Established Budget', did not feature. So, was it really a success and what can the wind and marine sectors learn from the first auction?

By way of reminder, the principles behind the CfD are that successful projects are awarded a strike price for all of the eligible electricity they generate for a maximum of 15 years. The agreed strike price operates against a market reference wholesale price of electricity. If this reference price is lower than the strike price awarded, the CfD Counterparty will pay to the generator the difference between the two prices whereas if the reference price is higher than the strike price awarded, the generator will have to pay the difference to the CfD Counterparty. The hope and aim of the CfD regime is to provide the generator with a predictable and stable revenue stream for its electricity.

Developers now run the risk of spending money up front with no guarantee of success in the CfD auction.

It was initially envisaged that CfDs would be allocated on a first come, first served basis. However, with a mix of budget constraints and new EU State Aid rules appearing it became apparent that 'constrained allocation' i.e. auctions, would be necessary. Auctions, of course, throw technologies into competition with each other and inevitably led to strike price bids at a lower level than the Government's originally envisaged 'administrative strike prices' for the relevant technologies.

The effect of competition is apparent from the award announcements. Onshore wind, with an administrative strike price of £95MW/h achieved in the case of the Brenig Wind Farm, £79.23MW/h. The offshore wind projects EA1 (East Anglia) and Neart Na Gaoithe were successful for delivery years 2017–18 and 2018–19 at £119.89MW/h and £114.39MW/h respectively measured against an offshore wind administrative strike price at £140.

Some key lessons from the allocation/auction are:

- Allocation risk is very real. Competition was, and will in the future be, fierce with technologies and projects competing against each other. Onshore wind was relatively successful this time but will undoubtedly face a challenge from solar going forward. To qualify to apply to bid for a CfD projects need to demonstrate they have both planning and grid connection in place. To reach this position developers would have spent significant amounts of money. Under the Renewables Obligation so long as the project was constructed it qualified for support. Developers now run the risk of spending money up front with no guarantee of success in the CfD auction.

Image:
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- The budgets available for the CfDs from the overall Levy Control Framework (LCF) are very low. The LCF cap appears inadequate to support anywhere near the amount of renewables deployment the UK could achieve. If Government is not careful this may threaten the UK's important position in this market. There are still no clear signals on post-2020 funding that will be available.

- Whilst hailed as a success by Government in driving down costs it can only be judged a success if the projects actually get built. Back in the 1990s we saw the Non-Fossil Fuel Obligation system failing because awarded prices were inadequate to justify the build out of the projects. It is in everyone's interest to ensure there is not a repeat of this.

- It is true to say that the CfD auction has concentrated the industry's mind on driving down the costs of renewables, which needed to happen. The supply chain in particular will feel this over the coming years at it comes under pressure to drop equipment prices.

- In our experience there is a huge amount of confusion over the allocation of CfDs, bidding strategies and the rules governing the auction system. There is a need for greater dissemination of information and proper and simplified guidance on auction rules and allocation from DECC and the delivery bodies to allow proper competition and access to all developers in the sector.

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- Those in non-fossil fuel development ought to be spending time now becoming familiar with CfD allocation and auction rules to the extent they have not already and learning from the first auction results. With the Renewables Obligation due to phase out in 2017, developers of future projects may have no option but to compete in this CfD process. The CfD contract runs to over 500 pages and it is essential that applicants understand the obligations they are entering into ahead of the auctions. The contract contains some ongoing key deadlines and milestone dates which do not allow projects to drift, so success in the auction is only the start.

- For each allocation round there is a pre-qualification process to ensure that a project is eligible to bid for a CfD. The first allocation round has highlighted this process as crucial. A number of developers and projects were thrown out at this stage due to mistakes. The lesson going forward is that developers need to be rigorous in filling out forms and providing relevant information.

- The first allocation has demonstrated that CfDs do not work for small, nascent technologies. This is particularly relevant for the wave and tidal sector. The CfD was never designed to incentivise smaller scale projects. Wave and tidal schemes at this stage of their development are relatively small. The marine energy sector has recognised that demonstration plants and marine test facilities need to lobby Government to modify the regime or to have access to a different form of incentive.

With the first allocation/auction round only just having finished, the Government has already started tweaking the regime in readiness for the next round in October 2015, however it is unlikely there will be fundamental changes. The first allocation was somewhat of a trial run. What will be key in the future is measuring actual deployment that is achieved under the CfD. Only time will tell, but undoubtedly the key area for the renewables sector to focus effort on in persuading Government to produce more realistic and increased CfD budgets.

Biography

Ross Fairley is a partner and Head of Renewable Energy at Burges Salmon solicitors. The team advises on all types of renewable energy projects including wind (onshore and offshore), wave and tidal, hydro, solar, biomass, geothermal and innovative waste to energy technologies. Ross advises clients on legal/regulatory aspects of the energy sector including incentives, grid, fuel procurement and power sales. He has substantial experience in marine renewables and offshore wind, covering projects in all Crown Estate rounds. For further details, please feel free to contact Ross at ross.fairley@burges-salmon.com or on 0117 902 6351.

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