

Energy UK response to the non-price factors into the CfD scheme call for evidence

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About Energy UK

Energy UK is the trade association for the energy industry with over 100 members - from established FTSE 100 companies right through to new, growing suppliers, generators and service providers across energy, transport, heat and technology.

Our members deliver nearly 80% of the UK's power generation and over 95% of the energy supply for 28 million UK homes as well as businesses.

The sector invests £13bn annually and delivers nearly £30bn in gross value - on top of the nearly £100bn in economic activity through its supply chain and interaction with other sectors. The energy industry is key to delivering growth and plans to invest £100bn over the course of this decade in new energy sources.

The energy sector supports 700,000 jobs in every corner of the country. Energy UK plays a key role in ensuring we attract and retain a diverse workforce. In addition to our Young Energy Professionals Forum, which has over 2,000 members representing over 350 organisations, we are a founding member of TIDE, an industry-wide taskforce to tackle Inclusion and Diversity across energy.

Executive Summary

Energy UK welcomes the opportunity to comment on the non-price factors into the CfD scheme call for evidence DESNZ has launched. Energy UK has worked in collaboration with our members on our response, and we aim to make it clear that whilst looking at NPFs is good, the CfD scheme is not the most appropriate mechanism to deliver NPFs. There could be significant implications and complications from trying to put additional factors on CfD auctions at such a crucial time for the UK's net zero transition.

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Energy UK, in discussion with our members, has considered three criteria that any NPF should adhere to before being implemented.

The key criteria include: -

- There is a visible financial value to developers and project investors for implementing the NPF.
- There is a sufficiently high level of confidence (with evidence) that this financial value will be delivered in practice so that developers and project investors can include this value in the core investment case for a project.
- There is a transparent process for the application of the mechanism, with a quantitative basis for this, that will allow developers and investors to carry out their independent assessment of how the mechanism will apply in practice.

We would also like to flag that the Supply Chain Plan already acts as an NPF to the CfD scheme. Energy UK would like to emphasise that none of these models must be implemented into the CfD scheme, there are better alternative ways of bringing NPFs into play. However, if they are implemented they should achieve the criteria above at a minimum for changing the CfD scheme.

1. To what extent do you support the top-up model as a mechanism for implementing Non-Price Factors and are there any unintended consequences that come from this model?

The proposed "top-up" model could meet these criteria, if selected carefully and applied in a targeted way. However, this model has both advantages and potential challenges. The introduction of a top-up to the strike price for projects that score high on non-price factors could encourage developers to invest in projects that align with the government's deployment targets and address industry challenges. This could lead to positive outcomes in areas such as local job creation, supply chain development, and environmental stewardship.

While the model is the least complex option to implement, determining the appropriate value for the top-up could indeed be challenging. It is essential to strike a balance between incentivising projects without overcompensating applicants, maintaining value for money, and adhering to subsidy control principles.

The top-up model could lead to an overall reduction in the government's ability to control the impact of the CfD on electricity bill payers. It is crucial to assess the potential consequences of this model on the affordability of electricity for consumers and the competitiveness of the UK energy market.

In conclusion, EUK could cautiously support the introduction of the top-up model as a mechanism for incorporating non-price factors into the CfD scheme, provided that it is carefully designed and implemented to avoid unintended consequences and meets the criteria set out above. We recommend engaging with industry stakeholders to refine the model and ensure that it delivers the intended benefits while maintaining value for money and promoting a competitive energy market. The government must be careful though, to ensure that this is viewed as a "top-up" and that the primary aim of the contract is still to deliver the renewable project, any penalties incurred must be viewed through this lens.

2. To what extent do you support the bid re-ranking model as a mechanism for implementing Non-Price Factors and are there any unintended consequences that come from this model?

Although the bid re-ranking model could be feasible and some members believe will be more effective in delivery, it will clearly be more challenging to meet the criteria set out above, compared to a top-up model.

Our thoughts on the two sub-models and the overall bid re-ranking model are that this sub-model incentivises projects with high non-price factor scores by effectively reducing their bid price for bid stack ranking. However, setting an appropriate value for the bid price reduction could be challenging,

as it must balance the interests of promoting non-price factors without significantly impacting the auction's competitiveness and value for money.

This sub-model appears to introduce a more direct weighting mechanism, where bid price and non-price factors are assigned specific weights that determine a project's final score for auction ranking. While this method provides a clear way to account for non-price factors, setting appropriate weightings for non-price factors could be challenging and might require periodic adjustments to reflect changing priorities and market conditions.

We recommend engaging with industry stakeholders to gather insights and feedback on the proposed bid re-ranking model. Without a clear methodology that the industry understands, both models risk creating too much confusion. Engaging with industry would help identify potential challenges and unintended consequences, while also refining the model to better balance the competing interests of promoting non-price factors, maintaining value for money, and supporting renewable energy deployment.

The bid re-ranking model presents a more direct approach to incorporating non-price factors into the CfD scheme, it also involves more changes and potential complexity compared to the top-up model. We encourage the government to carefully consider the trade-offs associated with the bid re-ranking model and engage with industry stakeholders to ensure its effective design and implementation.

3. To what extent do you support the model of amending the valuation formula as a mechanism for implementing Non-Price Factors and are any unintended consequences come from this model?

It will be very difficult to meet the criteria set out with any degree of certainty for this model. For that reason, it is the least favoured of the model options and one Energy UK believes should not be pursued any further.

By amending the valuation formula to consider non-price factors, this model could incentivise projects to perform better on these factors and thus increase their chances of winning a CfD. However, determining the appropriate reduction in estimated budget impact and its relationship with non-price factor scores could be challenging and may require periodic adjustments to reflect changing priorities and market conditions.

This model could potentially create a free-rider effect, where projects with lower non-price factor scores might still benefit from those with higher scores, as more projects could secure a winning bid. Additionally, this model represents a significant change to the role of the CfD budget and could weaken its ability to control costs to consumers. Implementing this model would also increase the complexity of the auction process, as it introduces a different valuation formula for running the auction and estimating consumer costs.

While the amending valuation formula model provides a novel approach to incorporating non-price factors into the CfD scheme, it also introduces increased complexity and potential risks related to the free-rider effect and weakened budget control. We recommend that the government carefully assess the trade-offs and potential unintended consequences associated with this model and consider engaging with industry stakeholders to refine and optimise its design and implementation. As it is currently written, it is unclear if this model would work in practice.

4. Are there any additional risks of unintended consequences (e.g., for renewable energy deployment, auction design/competition and consumers) you have identified with certain models and think should be considered?

A key risk of introducing an NPF is that it increases the level of financial risk for a project, which in turn could increase the cost of capital for the project, leading to a further increase in cost over and above funding the measures to deliver the NPF. This is an important factor that needs to be included in the assessment of any candidate NPF.

Introducing non-price factors may create an uneven playing field among projects, favouring those with resources or expertise to address these factors. This could distort competition and potentially discourage smaller or less experienced developers from participating in the auction process.

By incorporating non-price factors, there is a risk that projects may allocate more resources to address these factors, potentially leading to a reduced focus on price competitiveness. This could result in higher overall costs for consumers.

Unintended consequences in auction design could lead to inefficient allocation of contracts, possibly hindering the deployment of renewable energy projects or favouring certain technologies over others.

Introducing non-price factors may increase the complexity of the auction process, making it more challenging for developers to navigate and potentially increasing the administrative burden on both the government and the industry. This could result in higher costs and longer lead times for projects. The increased uncertainty and volatility in auction outcomes, make it more difficult for developers and investors to predict and plan for future projects.

This is not in any way to say that NPFs should not be considered, but that the government must thoroughly analyse the potential impacts of each model and engage with industry stakeholders to ensure the chosen approach maintains a competitive, transparent, and efficient auction process that supports renewable energy deployment and provides value for consumers.

5. Ways in which the models for a mechanism for implementation could be improved?

Introducing non-price factors in a phased manner, starting with pilot projects, can help identify potential challenges and unintended consequences. This approach allows for adjustments to the models based on real-world experiences and stakeholder feedback. However, this cannot be done at a slow pace and impact 2030, 2035 and 2050 ambitions.

Clearly define the non-price factors and their corresponding scoring systems to ensure transparency and avoid misinterpretations. This will also help developers understand the expectations and prioritise their efforts accordingly.

The government could periodically review and update the non-price factors to ensure they remain relevant to policy objectives, market conditions, and technological advancements. This will help maintain the effectiveness of the models and align them with current priorities.

Provide resources and support for developers, particularly smaller or less experienced ones, to better understand and address non-price factors. This could include workshops, training, and knowledge-sharing platforms that promote best practices and encourage innovation.

The definitions and reviews could easily be achieved by continuous engagement in open dialogue with industry stakeholders to gather feedback and insights on the models' effectiveness and potential improvements. This collaboration will contribute to a more refined and effective implementation process.

Throughout all of these, efforts should be made to simplify the models and minimise the additional complexity introduced by the incorporation of non-price factors. This can be achieved, potentially, by streamlining processes, using clear and concise guidelines, and providing user-friendly tools and documents for developers.

6. Are there alternative mechanisms that government should be considering? (Including models outside of the CfD mechanism)?

A fundamental principle for designing a policy mechanism is that it should be targeted as closely as possible to the desired change in behaviour. NPF can only provide indirect signals for a change and will be inherently less effective than alternative mechanisms that target an issue more directly.

We recommend that alternatives are always considered first and an NPF is only considered as a last resort.

An inherent limitation of NPF is that these will only apply to CfD projects. The volumes of renewable generation taking other routes to market are increasing and it is important that these projects also play their role in tackling the candidate issues for NPF. This is another reason to consider alternatives to NPF first.

7. Which projects (in terms of size) and technologies do you think should be eligible for non-price factors?

If an NPF that is only applied to a subset of projects bidding in a CfD auction will potentially disadvantage the projects with the NPF. Consequently, as a general principle, there needs to be a clear reason why the NPF would be limited in the extent of application, both by size and by technology.

One reason to limit the extent would be if an NPF is tailored to a particular technology. In that case, it would not be appropriate to apply it to other technologies. However, the CfD auction design would then need to be modified to take account of this difference between technologies. This may require a restructuring of the pots available, which Energy UK already advocates for.

If there is a minimum size threshold for applying an NPF (maintaining consistency with the supply chain plan at 300MW for example, though Energy UK has no strong opinion on this figure), then this could create an incentive to limit the size of projects, particularly when close to the threshold. However, it is also possible that some NPF will not be effective or appropriate for smaller-scale projects, which may be more limited in the options available. For NPF relating to supply chain actions, it will be important that the ability to respond to any NPF applied to all sizes of projects for a given technology is not dependent on the project scale.

In summary, the decision on technology eligibility and size depends heavily on the policy goal of each NPF. However, Government must ensure there is a level playing field and fair competition between projects competing in the same auction.

Smaller projects often face greater challenges, such as access to financing and limited economies of scale. Including them in the non-price factors eligibility can help level the playing field and foster diversity in the renewable energy sector for those projects that can deliver a strong outcome for an NPF. These projects could include community-owned renewables, rooftop solar installations, and small wind or hydro projects.

For large-scale renewable projects, such as offshore wind farms, large-scale solar, and onshore wind, can have significant impacts on the environment, local communities, and grid infrastructure. These impacts can cause delays in getting the projects started and generating. Ensuring their eligibility for non-price factors can encourage developers to address these challenges and contribute to sustainable and responsible development as well as foster closer relationships with local communities.

Supporting innovative and emerging technologies, such as floating wind, tidal energy, and advanced energy storage solutions, is crucial for future renewable energy deployment. Including these technologies in non-price factor, eligibility can help foster innovation and accelerate their commercialisation.

The final thing to consider is technologies that facilitate grid integration, such as smart grid solutions, demand response, and energy storage systems, which play a critical role in the energy transition. Ensuring their eligibility for non-price factors can incentivise their adoption and help create a more resilient and flexible grid.

In terms of potential non-price factors, views are invited on:

8. Are the factors outlined above addressing capacity building, sustainability, skills and innovation, the right ones to meet supply chain challenges, and are there any unintended consequences or issues in terms of monitoring, that could come from these?

Energy UK believes several key principles should guide the decision-making process on whether an NPF should be introduced: -

1. NPFs should only be introduced if there are no alternative policy mechanisms that could achieve the same objective in a more effective or less costly way.
2. The introduction of NPF should not undermine fair competition between projects, developers and technologies.
3. NPFs should be able to be implemented in a reasonable timescale with minimised administrative burden and costs for developers.
4. NPFs should have a precisely defined outcome that can be quantified and have a clear pathway for delivery through the NPF application.

The factors listed in the Call for Evidence should be assessed against these principles. The factors relating to capacity building look most suitable for consideration for NPF. The promotion of sustainability, skills and innovation are better incentivised by more direct mechanisms.

Implementing these factors may increase the administrative burden for both developers and regulatory authorities. Ensuring proper monitoring and compliance with non-price factors may require additional resources and expertise.

Balancing multiple non-price factors can make project evaluation and selection more complex, which could slow down the auction speeds. Developing clear and transparent criteria, as well as an appropriate weighting system, can help mitigate this challenge.

While the inclusion of non-price factors could help some small projects, it may also create an additional barrier for some projects with limited resources, causing the opposite impact that was in our response to Q7. Providing support and guidance for smaller developers in addressing non-price factors can help mitigate this concern.

Focusing too much on specific non-price factors may lead to an overemphasis on certain aspects, potentially neglecting other important considerations. A balanced approach considering the wide range of factors contributing to a sustainable and resilient renewable energy sector is essential. There might be trade-offs between different non-price factors, such as maximising local content versus minimising environmental impacts. Acknowledging and addressing these trade-offs transparently can help ensure a more holistic approach to project evaluation.

However, Energy UK does have concerns that the position of these NPFs at this stage in the CfD scheme will not have a significant impact on the issues identified in the consultation. It is likely too late into the process to have the desired outcome.

9. Are there alternative non-price factors that should be considered?

Given the significant risks, uncertainties, and potential distortions that any NPF introduces to the CfD allocation process, the application of an NPF should be treated as a last resort, only to be considered when no other policy mechanism is available or effective.

Another key consideration is that, as the number of NPF increases, the impact of each NPF will be diluted. This is because developers have a finite amount of time and resources and, as they divide their attention between more and more NPF, their ability to focus on each will be reduced. For this reason, we strongly recommend that NPF are only used for one or two top-priority policy objectives that meet the criteria we have set out in our answer to Question 8.

Although there are many potential candidate issues for NPF, considering these key considerations, we are not aware of any other NPF options that should be considered.

10. Is valuing non-price factors the right approach to address the specific issues identified related to system flexibility, operability, and locational signals, and could there be any unintended consequences or better ways to address these issues through the CfD scheme or other policy instruments?

As stated in our answer to Question 8, we believe several key principles should guide the decision-making process on whether an NPF should be introduced: -

1. NPFs should only be introduced if there are no alternative policy mechanisms that could achieve the same objective in a more effective or less costly way.
2. The introduction of NPF should not undermine fair competition between projects, developers, and technologies.
3. NPFs should be able to be implemented in a reasonable timescale with minimised administrative burden and costs for developers.
4. NPFs should have a precisely defined outcome that can be quantified and have a clear pathway for delivery through the NPF application.

The factors listed in the Call for Evidence should be assessed against these principles.

We assess that there are other policy mechanisms available to address the system issues mentioned in the CfE relating to this question. These alternatives should be pursued as a first step and a high priority.

11. Are there any other issues identified in the REMA case for change that could be addressed through non-price factors?

It is not clear if there are other issues identified by REMA that an NPF could resolve at present.

12. What financial value would need to be attributed to the potential factors outlined above to incentivise ambitious behaviour for each topic?

It is challenging to provide specific financial values for each potential factor, as the appropriate value to incentivise ambitious behaviour may vary depending on the technology, project size, regional context, and market conditions. Furthermore, assigning a financial value that is effective in incentivising positive outcomes without overcompensating or undervaluing projects can be difficult.

In terms of quantifying and valuing non-price factors, views and invited on:

13. Are there alternative ways of measuring and monitoring the non-price factors than the examples outlined in this Call for Evidence? The government would also be interested in your views on whether there are any factors where a more qualitative method of assessment would be more appropriate.

We believe that NPFs that require qualitative assessment should be kept to a minimum as it will be difficult to score qualitative outcomes objectively across projects.

Subject to this guiding principle, alternative ways of measuring and monitoring non-price factors can involve both quantitative and qualitative methods, depending on the specific factor being assessed. It is important to strike a balance between ensuring accurate and objective evaluation while allowing for flexibility and context-specific considerations.

The government could require developers to provide detailed self-assessments, including the measures they have taken to address non-price factors. Regular reporting can be used to monitor progress and ensure compliance with commitments.

Alternatively, engage independent experts to assess and verify developers' claims related to non-price factors. This can provide an unbiased assessment of projects and help maintain transparency and trust in the evaluation process.

Either of these methods could be used to develop standardised scoring systems or metrics to evaluate non-price factors, such as a sustainability index or a grid flexibility score, which can be used to compare projects objectively given all industry's clear understanding.

This would allow the government to gather input from various stakeholders, including local communities, industry experts, and non-governmental organisations, to ensure a comprehensive understanding of the non-price factors and their impacts.

In cases where quantitative measurement is challenging or less meaningful, qualitative assessment methods can be used to evaluate factors such as community engagement, social impact, or innovation. This may involve expert judgment, narrative descriptions, or other qualitative data.

14. How could we measure non-price factors to value system flexibility, operability, and location?

Measuring non-price factors to value system flexibility, operability, and location would be extremely challenging. It is already difficult to quantify the value when assessing policy mechanisms to directly address these factors. Translating these factors into an NPF for CfD allocation will add another layer of judgement and uncertainty.

15. Of the models for implementing non-price factors (top-up, bid re-ranking or valuation formula), are some likely to be more effective for certain non-price factors than others?

Subject to the principles set out in our answer to Question 8, we have the following comments.

1. Top-up model: The top-up model is most suitable for factors where the goal is to incentivise developers to commit additional investments to support government deployment targets or address industry challenges. It might be more effective for factors related to supply chain development, sustainability, and innovation, as these factors often require additional upfront investments. The top-up model provides a straightforward approach, offering financial support to projects that score high on non-price factors.
2. Bid re-ranking model: The bid re-ranking model can be more effective for factors where the aim is to create a balance between price and non-price factors in determining successful projects. This model may work well for factors such as system flexibility, operability, and location, as it allows projects with better performance on these factors to compete against projects with lower bid prices but poorer non-price factor performance. The bid re-ranking model directly affects the bid stack ranking, making it possible for projects with high non-price factor scores to win a CfD ahead of projects with lower prices but lower non-price factor scores.
3. Valuation formula model: The valuation formula model is more suitable for factors where the objective is to encourage projects to maximize their performance on non-price factors while minimizing their impact on the allocated budget. This model may be more effective for factors that influence the overall cost of renewable energy deployments, such as capacity building and grid integration. By reducing the estimated budget impact of projects with high non-price factor scores, the valuation formula model incentivises developers to focus on these factors to improve their chances of winning a CfD.

In summary, the effectiveness of each model depends on the specific non-price factors and the desired policy outcomes. A combination of models or a tailored approach for different factors might be

necessary to effectively address the diverse range of non-price factors and achieve the desired objectives.

In terms of compliance, views and invited on:

16. Are the compliance and penalty options for non-delivery appropriate and proportional, and whether other alternatives could be considered?

The compliance and penalty options mentioned for non-delivery involve regular monitoring meetings, proportionate financial penalties, and ensuring that penalties are “sufficiently large to act as a credible disincentive to non-delivery”. However, these penalties cannot be so severe or so easily applied that they would deter investment in renewable projects. Achieving a greater amount of capacity through CfDs must remain the priority when considering penalty options. There must be clarity on when and why penalties would be incurred by the industry.

In terms of timing, views are invited on:

17. When would be the best moment to introduce non-price factors in the CfD process and is the government’s initial suggestion (up to 2 years in advance) appropriate?

Introducing non-price factors in the CfD process is a significant change, and it is crucial to choose the right moment to ensure a smooth transition and allow stakeholders to adapt to the new requirements. The government's initial suggestion of introducing non-price factors up to 2 years in advance could be appropriate, but it is essential to consider stakeholder readiness. Assess the readiness of industry stakeholders, including developers, investors, and regulators, to adapt to the inclusion of non-price factors in the CfD process. Introducing non-price factors too early could create confusion and uncertainty while introducing them too late might not give stakeholders enough time to adjust.

Ensure that the introduction of non-price factors aligns with relevant policy and regulatory developments, including any changes to the wider energy market and subsidy control principles. This will help create a coherent policy environment and minimise the risk of unintended consequences. The government must consider the current market conditions and trends when determining the best moment to introduce non-price factors. The introduction should ideally coincide with a period of stability and growth in the renewable energy sector. At present, there are significant concerns and challenges within the energy market which will necessitate changes. NPFs must not constitute additional confusion.