Inflection Point
ENERGY CONSULTING

CfD Allocation Round 2

Some things we know, some things we don't know and what it might mean

9/11/2016

While the world was digesting developments across the Atlantic this morning, our own Department for Business, Energy and Industrial Strategy was busy uploading a very full set of documents, many relevant to the second Allocation Round for the Contract for Difference low-carbon support mechanism. This helps potential bidders start to find their way around the process, but it is by no means the complete deal. So here is an assessment of what we know for sure and what isn't so clear, plus some analysis of where it leaves us.

What we know

Dates

While the Draft Budget Notice was a bit sketchy with the dates of the Round (it would be "opening in April 2017"), the Supply Chain Plan Final Guidance is more forthcoming. The Round Eligibility Window will open on 3 April 2017, and close on 21 April 2017. When after that date sealed bids are invited depends on whether there are any appeals over refusals of eligibility by the Delivery Body. Assuming there are none, then the earliest that bidding will occur is early June, with the results public in the middle of that month. If the process drags out due to appeals, then it could be as late as September before the results are known.

For those required to submit a Supply Chain Plan, there is a window of only one week to submit them, from 9-13 January 2017, with word of acceptance or rejection due six weeks after that. While it might be possible to resubmit a revised plan after a rejection, there is no guarantee that these could be assessed in time for the Eligibility Window opening.

Budget profile

Only the years 2021/22 and 2022/23 are open for bidding, with a flat budget profile of £290m (in 2011/12 money). Bear in mind, however, that phased projects can be delivering in the two years after their first Target Commissioning Date, so they could be delivering up to 2024/25. The budget use will be assessed over this whole period, with any project that causes the £290m cap to be breached at any time rejected.

Budget amount

As noted, the budget is £290m, though in 2012 money (which, confusingly, the Administered Strike Prices are quoted in), this translates into £295m. There is some ambiguity in the text of the Draft Budget Notice Accompanying Note, however, which states that the final budget "may vary due to updates in the underlying assumptions (such as fossil fuel prices)." This may have significance given what we (don't) know about Reference prices (see below).

Offshore is by far the favoured technology

The current Government continues to smile on offshore wind pretty much to the exclusion of everything else. The 'fuelled' technologies (AD, ACT and dedicated biomass with CHP) are collectively subject to a maximum of 150MW, and the marine technologies are denied a minimum that would allow them to secure contracts. Remote island onshore wind is not included in this round, but instead there is a short consultation document on its future inclusion in Pot 2 which absolutely reeks of Government's intention to drop it at the first opportunity.

Administered Strike Prices

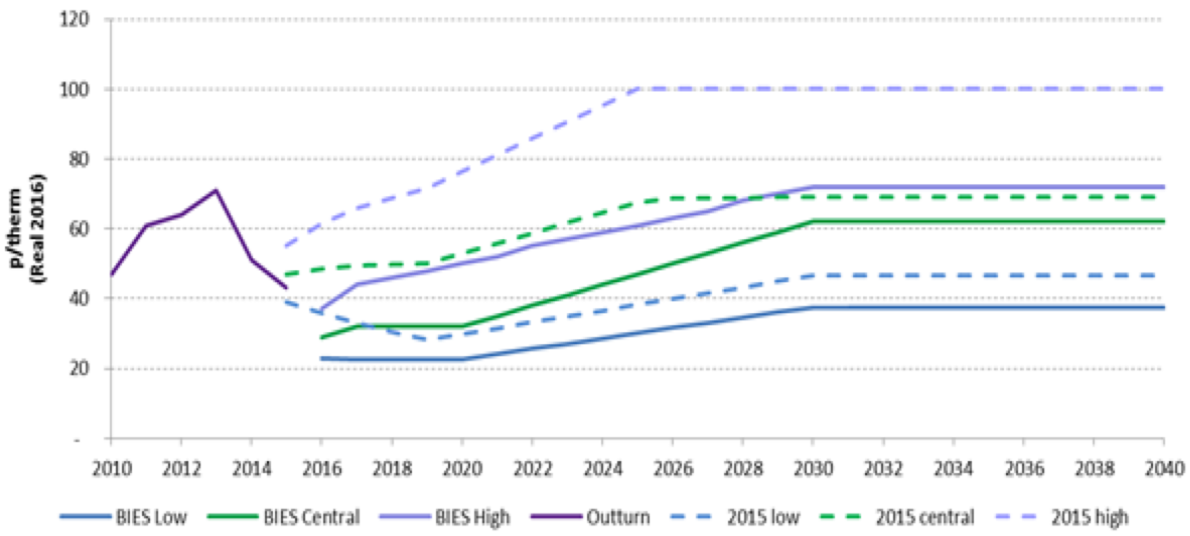
The £100-105/MWh for offshore wind is entirely as expected from Budget 2016's announcement of future rounds. There have been some tweaks to the other technologies, but nothing spectacular. It was nice of BEIS to set some strike prices for wave and tidal stream, but ultimately pointless without a minimum to allow access to them. There is no ASP for geothermal at present, but a separate call for evidence on where that should be set has been opened. It seems unlikely that it will come in low enough to trouble offshore wind bidders.

What we don't know

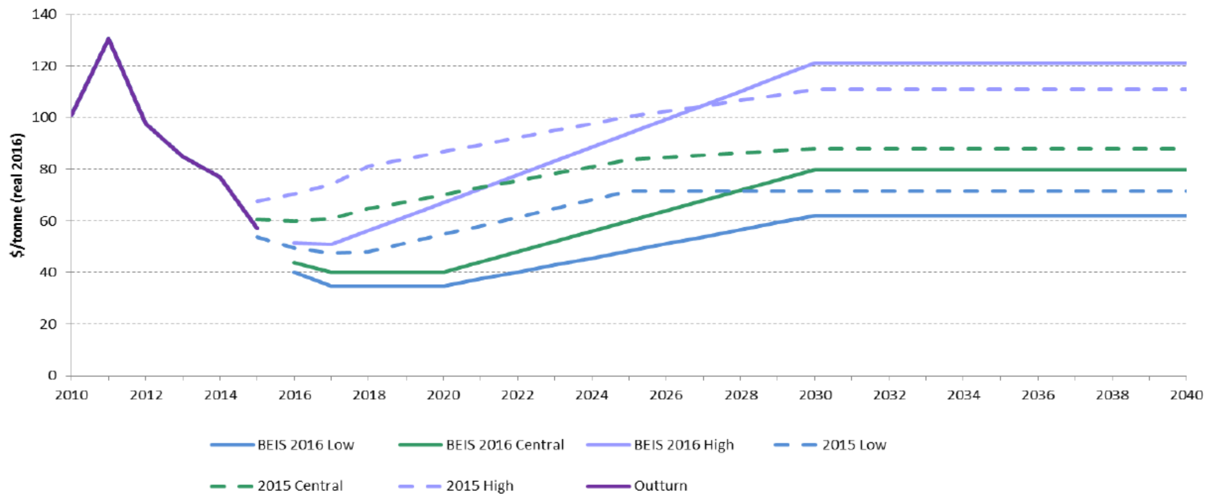
Reference prices

This comes under the heading of Known Unknown. The Reference prices that will be used to assess budget usage of individual projects were not published today, as we did not get a Draft Allocation Framework. However, we did get updated projections for fossil fuel prices, which are down about one-third for gas and more than one-third for coal – see graphs below.

BEIS view of gas prices to 2040, in 2015 and 2016



BEIS view of coal prices to 2040, in 2015 and 2016



This can only mean that Government's view of wholesale power prices is that they are headed down from their last publication in November 2015, where they were in the range £45-60/MWh (in 2015 money), generally rising over the period 2015-25. Note that fossil prices are still expected to rise over the period 2020-30.

<u>What does it mean?</u>

Assuming that offshore wind's bid prices drop significantly from AR#1, and the fuelled technologies do not, then it is unlikely that the 150MW maximum will be troubled, and that offshore wind will sweep the board. How much capacity will end up with a contract is the key unknown, however, with four main factors determining this:

- *Bid prices*: Clearly, the lower bid prices go, the more capacity can be contracted. With news from Denmark of €50/MWh from Kriegers' Flak, expectation will be high that bids will be considerably lower than the ASPs, but it is hard to know how far down developers are willing to go.
- *Reference prices*: As noted above, what numbers BEIS will use for Reference prices are not at all clear. It may even be that the budget for this round is adjusted upward if these forecasts dip even further, though that might be a tough one to get past Treasury.
- *Lumpiness*: It is possible, through the mechanics of the allocation process, that there will be budget left on the table due to the lumpiness of offshore wind projects, reducing winning capacity. It is possible for the Secretary of State to squeeze some extra money into the pot ahead of bidding, but this is flying blind, with no detail from the Delivery Body about the bidders.
- *Bidding strategies*: How developers approach their bids will determine how much capacity can come through. If bids tend to be in the second of the two available years, with phases weighted to the back of the three year period, then that would allow larger projects as this capacity will be assessed against higher wholesale prices, as well as having the opportunity to factor in an extra year of cost reduction. Equally, developers may wish to go early to allow for an opportunity for earlier cash flow. This would limit the capacity possible.

Overall we might expect somewhere in the range of 1-2GW of offshore wind projects to succeed. This is obviously a rather large range but it is hard to be more precise without knowing more about the Reference prices in particular.

So, there is plenty to play for and much ground still to cover. But now we know more than we did at 6.59am this morning. Here's to knowledge and facts. We're going to need them.