Renewable developers have borne the brunt of a significant downturn of late. This brief alert gives an overview of how these factors have, or are expected to change.

**Overall, has this created the perfect storm for renewables developers?**

**Background**
Historically small developers supported by the Renewables Obligation (RO) mechanism have received revenues via four main avenues: the wholesale electricity price; the Renewables Obligation Certificate (ROC); the Climate Change Levy (CCL) and Embedded Benefits.

**The wholesale electricity price**
Since January 2013, the UK electricity price has fallen by around 42%\(^1\), driven by a combination of a rapid decline in global oil and gas prices; the movement away from operating the UK as an ‘energy only’ market; and the increasing penetration of low/zero marginal cost renewables cannibalising the market.

In the past, lenders and financial institutions have committed capital on the basis of a central or low power price forecast. However, recent declines have been so severe that current prices are at around 65% of central forecasts made in 2013.

There are potential disruptors to this trajectory, including the Government’s planned consultation on the early closure of coal plant. But for the foreseeable future, forecasts are expected to reduce further and the forward curve is flattening.

**Renewable energy revenues**

- **Figure 1: N2EX Day Ahead and Peak/Baseload Forwards versus Central Forecast Curves**

**The Renewables Obligation Certificates**
Under the RO, the Department of Energy and Climate Change (DECC) sets the ‘headroom’ for each financial year which (typically) involves them forecasting renewable generation and adding 10%. Suppliers in the UK are then obligated to purchase ROCs amounting to this ‘headroom’ figure. The intention is that demand outstrips supply, requiring 10% of suppliers to purchase ROCs at the Ofgem set ‘buyout price’. Funds received by Ofgem are then ‘recycled’ back to the market in what was historically perceived to be a 10% rebate (or c. £4/MWh). This rebate was considered additional to the ROC price (some technologies earn +/- 1 ROC/MWh).

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\(^1\) Average N2EX day ahead power – March 2013, compared to the same measure during March 2016 – adjusted for CPI inflation.
However, over the last several years with a high annual penetration of renewables and a raft of operational efficiencies being achieved, DECC’s ability to reliably forecast renewable generation has decreased. In the past two years, ROC recycle rates have been just £0.24 and £0.60 respectively. Just 0.9% of suppliers accessed the Ofgem Buyout Price mechanism in 2014/15.

The 2015/16 ROC market is on a cliff edge. KPMG analysis suggests that the market could be oversupplied by several million ROCs and we are starting to see evidence of this being priced into e-auctions, per Figure 2.

**Carbon Price Floor:** Further, in the March 2016 Budget, the Chancellor announced that he intends to set out the long term direction for the CPF mechanism in his Autumn Statement later this year. Any plans to remove the CPF would, based on current forward European Union Allowance (EUA) prices, have a negative impact on wholesale electricity prices from the date of removal (most likely 2021/22 onwards).

**Embedded Benefits**

Where a developer is an ‘embedded generator’ it avoids the charges involved in holding a generation license and transmission network charges.

However, Ofgem has previously stated that it does not believe that this is cost reflective. As such, KPMG expects Ofgem to review Transmission Network Use of System Charge (TNUoS) and Balancing Service Use of System (BSUoS) pricing to ensure a level playing field across all forms of generation.

Further, following its Energy Market Investigation, the Competition and Markets Authority (CMA) has recently published its recommendations which included an order for National Grid to move to zonal based pricing for attributing transmission losses across generation.

Taken in isolation, depending on a developer’s location its embedded benefits accrued via transmission losses could change.

**The Climate Change Levy**

**Levy exemption certificates:** In the past, renewables developers were entitled to an exemption from the CCL. This exemption was realised via Levy Exemption Certificates (LECs) which had a value to renewable generators of around £4/MWh. In the July 2015 Budget, the Chancellor removed the exemption effective 1 August 2015, removing this revenue stream from developers.

Continued price declines will impact the revenues of developers who face a floating ROC price or suppliers who take on this risk for developers. Moreover, if excessive ‘banking’ of ROCs occurs, this could put the following years under even more supply pressure.

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**Fix, quit or bust**

In aggregate, or in isolation, these changes have the ability to threaten the viability of many businesses. If action is taken now, developers still have options to ‘fix’ their portfolio. However, waiting until the eye of the storm could result in ‘quit’ or ‘bust’ being the only options.

A number of complex factors are at play in the UK energy market. KPMG would be happy to expand upon any of the enclosed in more detail as required.

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**Figure 2: 2015/16 e-Power ROC clearing prices**

Source: e-POWER (2016)

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