

Alternative Energy: Feed me

Subsidies for alternative energy are an emotive issue. BRAVE Partners looks at one of the more controversial – feed in tariffs.

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Feed me

“Paying for solar energy in Newcastle is just nuts”, boomed Jeremy Nicholson, Director of the Energy Intensive Users Group, at the recent UK World Energy Council (UKWEC) workshop on “How will UK electricity be supplied over the next decade?”. Most of the audience nodded, there were few dissenters from this view.

Affordable energy

Few now doubt that energy supply needs to change radically over the next 30+ years. Even if you do doubt global warming, which most don't, oil and gas is becoming harder and more expensive to find. Shale gas is currently cheap and shale oil extraction is on its way, but overall there will be more people using more energy and the quick win finds are largely gone. The Deepwater Horizon issue shows the difficulties in extracting fossil fuels today, let alone tomorrow.

“In most current projections for meeting the UK carbon reduction targets for 2050, the cost and risk accelerates dramatically the more renewable energy in the mix.”

Christopher Cloke-Browne
Managing Partner

The issue that the world grapples with is not that there are not other ways of producing energy; but that there are not that many other ways of producing energy that are cost effective compared with fossil fuels.

The cost of green

Whilst everyone at the UKWEC workshop was agreed that the cost of energy will rise going forward, the issue that Jeremy Nicholson and John-Baptiste Galland, of EdF, put forward was that energy in the UK must remain competitive compared to other countries. This means

that renewable energy must be efficient. Not only was Jeremy Nicholson scathing about solar panels in the north of the UK, he was equally as concerned about offshore windfarms – and rightly so.

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There is a difficult balance to be struck. Emerging renewable technologies are likely to be more expensive in their initial phases. Some support for these technologies does make sense. However, the current forms of government support are often very blunt instruments. Feed in tariffs is one such instrument that is growing in use. These have just come to the UK and they could easily fuel a rash of solar panels in the north of the UK.

Arbitrary not economic

Feed in tariffs are set arbitrarily and not based on economics. The UK feed in tariff for electricity covers the entire UK. It is designed to encourage individuals to install renewable energy sources to meet government targets on renewable energy production. The tariff therefore has to be high enough to make solar installations in the north of the UK economic.

“Subsidy” is a bad work in market economies. Feed in tariffs are just dressed up, blunt subsidies that are designed to meet arbitrary renewable energy targets, not the technological and economic needs of a long terms, stable and sustainable energy source.

Carbon is not the only issue

The other issue with blanket schemes for subsidising renewable energy is that most people will go for the easiest or cheapest options: currently wind and solar. As BRAVE Partners has commented before, there are many issues associated with connecting a large proportion of renewable energy onto the UK grid. To name two:

- Grid balancing (the wind might not blow during half time of the world cup final and all those toilets won't flush and kettles won't boil)
- Providing the actual cables to connect offshore wind.

All of these items have a cost and a cost that accelerates as the proportion of a particular energy source increases. If carbon is considered evil that should be paid for, then so should a technology that imbalances the grid severely.

From feast to famine

Feed in tariffs should not however be seen as a panacea for project financing. Banks which had a field day financing Spanish renewable energy projects against generous feed in tariffs are now looking concerned as the government reviews its budget in the deficit driven days of austerity. Speculation is rife that the Spanish government will withdraw the feed in tariff levels, even for existing projects. In many cases, the loss of revenue is not fully absorbed by the equity, putting the bank debt at risk of default.

In the Spanish case, BRAVE Partners thinks that it is unlikely that the government will make changes that would drive the debt of existing projects towards default. The risk in the Spanish banks and the structural damage to the economy would be too great. This does not, however, mean that the owners of these loans are not seeking insurance on the risk – something else that BRAVE Partners can advise on.

BRAVE Partners' services

BRAVE Partners is a strong believer in alternative energy, but a strong proponent of economic, not political drivers. As the situation in Spain shows, political drivers for project economics can prove fickle. The firm will review any sensible business plan and seeks to work with management teams to construct robust business plans that are clearly investable.

BRAVE Partners also works with the existing holders of investment, equity and debt, of alternative energy projects to assist them in identifying the risk factors and mitigating them where this is cost effective.

Interaction

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- Feed in tariffs have arrived in the UK, much to the chagrin of Jeremy Nicholson of the Energy Intensive Users Group (EIUG).
- BRAVE Partners agrees with the EIUG, renewable energy must be competitive – that is cost effective and the firm believes that feed in tariffs contain too many perverse incentives.
- Spain is demonstrating that projects that rely on government policy for their economic success can prove risky.
- BRAVE Partners works with management teams to construct economically viable business plans that do not rely on fickle government policy.
- BRAVE Partners works with existing investors in alternative energy projects to identify and mitigate risks, including those that arise from government policy.

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