

IMPAX

FINANCE & STRATEGY FOR ENVIRONMENTAL TECHNOLOGY

PIU Energy Project

I am writing in response to the PIU Energy Project note entitled Objectives and Uncertainties in Energy Policy written for the Stakeholder Workshop on 20 July 2001 and, in particular, to the questions raised in that note.

Introduction

Impax Capital Corporation Limited ("Impax Capital") was founded in 1994 as a financial advisory House with an exclusive focus on the environmental infrastructure and technology sector ("EIT" sector). We have raised over £200m in equity and debt for project sponsors and projects in the UK both within and outwith the NFFO framework. We advise multinational, medium and small size companies on merger and acquisition work within the sector — in the UK and continental Europe — and have completed consultancy work for the European Commission and the UK Government. We have taken a proactive role in the Renewables Obligation consultation process led by the DTI and were invited to present to industry participants on the bankability of the RO towards the end of 2000. We are a member of the PIU Panel on Renewable Energy.

Question responses

The following are some "headline thoughts", numbered as per the question numbers in the original PIU note:

Page 3, Q2. In relation to energy security, what are the main risks faced both in the shorter and longer term?

Political risks can affect security of supply of gas from overseas markets in both the shorter and longer term. The financing implications of those political risks for the building of essential infrastructure in the exporting country - or along the intermediate access route - may precede the physical delivery of product by many years and thwart or delay delivery of that product.

For example, I recall in my former capacity as Head of Project Finance at a major international lending institution, how some banks refused to participate in a large export credit agency guaranteed loan for Gazprom despite the loan carrying 100% SACE (Italian export credit agency) guarantee, on the grounds that the financial status of the borrower (Gazprom) was unclear and lenders did not wish to participate in a transaction relying, from the outset, on their ultimate security (SACE).

The conclusion is that the availability of export credit cover does not assure financeability of projects in politically unstable regions; and this could impinge on the UK's security of supply in the longer term.

Page 3, Q3. Are environmental objectives likely to become more important in relation to other objectives?

Yes, but the political implications of meeting those objectives and paying for them will have to be faced and overcome.

Page 3, Q4. What (serious) trade-offs can be foreseen between energy policy objectives in the future?

Meeting environmental and security of supply objectives will involve a higher cost to the consumer; and higher prices for any fundamental commodity are politically sensitive.

Page 4, Q2. Will at least one renewable energy technology achieve radical cost reductions?

Wind power has achieved steep cost reductions over the past 10 years in the UK but only within the context of 15 year NFFO electricity offtake contracts with a highly creditworthy counterparty (NEPA). Take away the fixed certainties of NFFO and add the cost implications of building offshore, and costs are still likely to rise - even with the prospect of larger project sizes.

NETA poses a serious problem for any intermittent technology like wind where the opportunities for volume replication are, arguably, the most promising. Our view is that renewables will need a "Pool" of their own quite separate from NETA with distinct rules of engagement for balancing and settlement. This "Pool" would establish a base energy price for renewables in a more predictable - and less vicious - way than is ever likely to emerge from NETA. The ROC and other value streams envisaged under the RO would be added to this base energy price as currently proposed.

The two systems might be expected to run in parallel for ten years or longer - whatever it takes to re-configure a transmission and distribution network designed for central generation. The idea needs to be developed further but it should be considered at a time when the present arrangements show every sign of imposing bankruptcy and forced consolidation on sectors of this nascent industry.

The old Pool was itself a transition arrangement. The function of a renewables "Pool" would be, once again, to bridge transition.

Melville Haggard
Executive Director

