Department of Energy and Climate Change
Electricity Market Reform

CLA RESPONSE TO THE CONSULTATION

BACKGROUND

The Country Land and Business Association represents some 35,000 members who collectively own and manage over 130,000 businesses, and about half the rural land in England and Wales. Our members are both electricity consumers for domestic and business activities and are increasingly both investing in and supply sites and feedstocks for renewable energy projects.

We have developed an expertise in renewable energy issues responding to member demands and have been at the centre of policy formulation for more than 10 years, producing our own papers, working with others (including the Royal Commission on Environmental Pollution and the Sustainable Development Commission) as well as engaging with Government as a stakeholder in the design of the Feed In Tariff and Renewable Heat Incentive.

We recognise and share the concerns of government that (without a carbon price that would export much of UK business, seriously damaging our economy) the market is unlikely to adopt investments that secure the path to a low carbon electricity system with the current incentives.

That said, there is a key issue for domestic and SME electricity generators (and potential investors). What this sector requires is support for renewable generation that is accessible, transparent and secure. This is provided by the current Feed In Tariff. It is simply not feasible that a Contract For Differences (CFD) could operate to support small scale generation, as we point out below.

CONSULTATION QUESTIONS WITH CLA RESPONSES (IN RED)

The Government's objective for the consultation process is to develop the evidence base on the options for reforming the electricity market. Therefore, respondents to this consultation are asked to provide evidence and supporting information to backup any opinions expressed in their response.

Current Market Arrangements

1. Do you agree with the Government's assessment of the ability of the current market to support the investment in low-carbon generation needed to meet environmental targets?

The CLA shares the Government's concern that the existing market framework is unlikely to deliver the step change in low carbon generation required.

2. Do you agree with the Government's assessment of the future risks to the UK's security of electricity supplies?

Yes, CLA is concerned that price spikes and electricity supply shortages may be exacerbated by the over-provision of wind generation on the system before demand management or cost effective storage can be provided to deal with intermittency.

Options for Decarbonisation

Carbon Price Support

This is the subject of a separate HM Treasury / HMRC consultation. Readers of this consultation with specific comments on the carbon price support mechanism should cover these in a separate submission to the HM Treasury / HMRC consultation, which can be found at http://www.hm-treasury.gov.uk/consult_index.htm

Feed-in Tariffs

3. Do you agree with the Government's assessment of the pros and cons of each of the models of feed-in tariff (FIT)?

The consultation states:

"35. To supplement the modelling results, the Government has also considered the impact that the different models of FIT might have on attracting new entrants and new sources of finance to invest in low-carbon electricity generation. Chapter 2 highlighted the scale of the investment challenge: while the Government would expect the investor community to respond to the increasing maturity of the renewables and low-carbon generation market by providing new sources of finance, given the scale and pace of investment needed to meet the UK's targets at the end of this decade, means there are risks to not taking action now to attract new sources of finance.

36. Compared with the baseline (i.e. low-carbon support limited to renewables), the Government expects all of the models of FIT to be able to attract new investors in low-carbon generation more generally. However, because (as per Box 5 below) they result in a lower risk investment, fixed FITs and CfDs might be more attractive to a wider group of investors – in particular, smaller independent generators and institutional investors."

The CLA's members have experience with the previous contract fro difference tendered by auction prior to the Renewables Obligation – the Non Fossil Fuel Order system.

This did not reduce the cost of capital, and conferred unsupportable risks on businesses bidding for contracts, such that in the biomass generation sector a number of them were made bankrupt or otherwise failed, and only a very few of the successful projects were built, while many more incurred huge costs without winning contracts.

We regard a contract for difference FIT as being unworkable at any level below 5MW.

We think that new investors will take a considerable time to learn the CFD system and gain confidence in it: It was at least three years before finance became available for projects under the RO, and even then it was limited to only the most common technologies.

Moreover, unlike in Germany, where the costs of capital for renewables are kept low by institutional investors (such as pension funds who undertake their own direct investment), in the UK the City appears to demand significantly higher rates of return, which is largely returned to bankers acting as middlemen.

4. Do you agree with the Government's preferred policy of introducing a contract for difference based feed-in tariff (FIT with CfD)?

No: It is in theory an elegant system, but as stated previously it is wholly unsuitable for the investment market for smaller scale generators (up to 5MW), where we see CFD costs outweighing the advantages. The current FIT is proposed to meet 2% of demand by 2020 (but with sufficient funding may achieve much more at small scale, delivering wider advantages than bulk generation). This generation would not happen if CFD was imposed at small scale.

Moreover we fear CFD may impose significant financing delays for larger generators as lending institutions seek to come to terms with the new system. At the very least, we recommend cross party support should be secured before any CFD is introduced to reduce political risk.

The consultation states:
65. Another benefit of a FIT over a low-carbon obligation is that the investor gets certainty when they sign the contract about the level of support they would receive, rather than the support level being set after construction, once the installation is built and connected to the grid, i.e. with ROCs generators are exposed to the policy risk that the level of support changes in between an investment decision and the project being accredited under a obligation based scheme.

This statement shows a fundamental misunderstanding of the existing FIT registration procedure managed by Ofgem. We wish that DECC were correct, but under the UK FIT at present investors bear the whole of the risk (design, planning and other consents, construction, commissioning, connection and registration) before they are assured of a FIT payment.

The costs of capital for existing FIT investors would be reduced if projects could pre – register in the current market (particularly in the light of political risk to FIT levels with emergency reviews and accelerated changes to support levels).

5. What do you see as the advantages and disadvantages of transferring different risks from the generator or the supplier to the Government? In particular, what are the implications of removing the (long-term) electricity price risk from generators under the CfD model?

As a business organisation representing electricity consumers as well as small scale generators we see the larger risk to our members' interests arising from guaranteed price premia for large scale renewable or low carbon generation delivering super – profits to generators owing to increasing electricity prices, unnecessarily pushing up electricity prices to the consumer. We thus see CFD as potentially a useful tool for managing the cost to the public of large scale projects.

However, we urge caution: it is not without risk, many of which have been recognised (if not addressed) in the consultation. We advise that cross – party support is essential if CFD is to achieve its objectives.

Our guiding principles inform the CLA response. Firstly, any changes to the supporting framework should protect existing investors in renewable energy and secondly, it should be user-friendly for smaller-scale energy businesses.

It is essential that the proposals work to maximise investment in renewable power at all scales to ensure CLA members can benefit and help the UK meet the 30 percent renewable electricity target.

6. What are the efficient operational decisions that the price signal incentivises? How important are these for the market to function properly? How would they be affected by the proposed policy?

In the current market at small scale there is almost no gaming of generation: few FIT generators are connected by half hour meters and thus there is no advantage to be had. At larger scale investors are constrained by their loan agreements to maximise generation.

In the longer term, and subject to reform of the electricity distribution system (linking district network operators with suppliers is fundamental) there may be a market opportunity for dispatched power or constraints to meet or reduce peak demands at small scale but given that under the current FIT electricity market price signals are the same as for fossil generators (when wholesale market sale of the generation is chosen) there is no disadvantage in leaving small scale generation up to 5MW supported under the current FIT.

7. Do you agree with the Government's assessment of the impact of the different models of FITs on the cost of capital for low-carbon generators?

We fear that the Government's desire to secure long term low cost finance has been stymied by the uncertainties that its management of FIT has introduced. The emergency review of FIT for large scale solar announced on 7 February has rattled lenders, reminding them that political risk is written large across the sector. We are thus by no means convinced that CFD will reduce the costs of capital.

The solar review has unintended consequence including:

- Decreased availability of reliable and secure sources of energy for the UK – will further continue reliance on energy from foreign entities
- Further delays in the UK's ability to decrease carbon emissions – will result in significant future liabilities of penalty payments
- Damaged International reputation within the Financial and Green communities – will increase the number of job losses in manufacturing, construction, finance, technology and service industries in the UK
- Businesses will face an increased cost in their Climate Change Levy – with limited production output of small scale systems businesses will not be able to avoid the costs of the Climate Change Levy

The model that has been demonstrated to reduce the costs of capital is the FIT system enjoyed in Germany. This is certainly slightly more expensive than the proposed scheme but it has at the same time delivered a significant boost to the German economy, driven down lending costs, and delivered a much higher level of investment and delivery of renewables than has been achieved in the UK.

The German PV FIT scheme adds more value to their economy than it costs and has created 50,000 jobs. The sector has a structured strategy for taking a 12% global market share by 2020, anticipating €14billion exports and 130,000 jobs.

Sources: European Commission Report on Progress on Renewable Energy 2010
http://ec.europa.eu/energy/renewables/reports/doc/2011_list_renewable_energy_targets.pdf
The True Value of Photovoltaics for Germany, AT Kearney, 2010;
Directions for the solar Economy PV Roadmap 2020, Roland Berger Strategy Consultants and Prognos AG, 2010

8. What impact do you think the different models of FITs will have on the availability of finance for low-carbon electricity generation investments from both new investors and existing the investor base?

Only a well funded conventional FIT on the German model (without political shocks) is assured of success in funding, and accordingly must be maintained, at least for projects with less than 5MW.

We are not in a position to guess what the financing availability would be for CFD, save to say that our members (collectively our members own half the rural land and assets thereon in England and Wales with a net gearing of less than 12%, and thus have extremely good access to debt finance) would be excluded from financing any projects owing to the costs of access to a CFD scheme.

9. What impact do you think the different models of FITs will have on different types of generators (e.g. vertically integrated utilities, existing independent gas, wind or biomass generators and new entrant generators)? How would the different models impact on contract negotiations/relationships with electricity suppliers?

We expect that, at least initially, as for the introduction of the RO, only vertically integrated large scale businesses will enter the CFD market, with finance drawn from their balance sheets. We think it most unlikely to encourage new entrants even at large scale, and certainly not at small to medium scale.

10. How important do you think greater liquidity in the wholesale market is to the effective operation of the FIT with CfD model? What reference price or index should be used?

No comment.

11. Should the FIT be paid on availability or output?

This depends on the decision made on capacity payments.

Emissions Performance Standards
12. Do you agree with the Government's assessment of the impact of an emission performance standard on the decarbonisation of the electricity sector and on security of supply risk?

13. Which option do you consider most appropriate for the level of the EPS? What considerations should the Government take into account in designing derogations for projects forming part of the UK or EU demonstration programme?

14. Do you agree that the EPS should be aimed at new plant, and 'grandfathered' at the point of consent? How should the Government determine the economic life of a power station for the purposes of grandfathering?

15. Do you agree that the EPS should be extended to cover existing plant in the event they undergo significant life extensions or upgrades? How could the Government implement such an approach in practice?

16. Do you agree with the proposed review of the EPS, incorporated into the progress reports required under the Energy Act 2010?
17. How should biomass be treated for the purposes of meeting the EPS? What additional considerations should the Government take into account?

18. Do you agree the principle of exceptions to the EPS in the event of long-term or short-term energy shortfalls?

Questions 12- 18:
The CLA supports improving emissions standards, but considers a fully functioning carbon market would be the most efficient method of driving this, as well as supporting carbon saving and sequestration.
Clearly the EU ETS has failed to deliver carbon prices that are calibrated to the real external costs of carbon, and needs to be improved to secure a better assured price, reducing political risk, but taking care not to set levels that simply export UK business replacing production with imports that may in fact bear a higher carbon footprint..

Options for Market Efficiency and Security of Supply
19. Do you agree with our assessment of the pros and cons of introducing a capacity mechanism?

20. Do you agree with the Government's preferred policy of introducing a capacity mechanism in addition to the improvements to the current market?

21. What do you think the impacts of introducing a targeted capacity mechanism will be on prices in the wholesale electricity market?

22. Do you agree with Government's preference for a the design of a capacity mechanism:
• a central body holding the responsibility;
• volume based, not price based; and
• a targeted mechanism, rather than market-wide.

23. What do you think the impact of introducing a capacity mechanism would be on incentives to invest in demand-side response, storage, interconnection and energy efficiency? Will the preferred package of options allow these technologies to play more of a role?

24. Which of the two models of targeted capacity mechanism would you prefer to see implemented:
• Last-resort dispatch; or
• Economic dispatch.

25. Do you think there should be a locational element to capacity pricing?

Questions 19 -25:
The CLA agrees that a targeted capacity mechanism may be necessary, particularly as the incentives to intermittent power tend to increase instability in the market. We are not in a position to comment on the potential mechanisms.

Analysis of Packages

26. Do you agree with the Government's preferred package of options (carbon price support, feed-in tariff (CfD or premium), emission performance standard, peak capacity tender)? Why?

The CLA broadly supports the proposed direction of travel for large scale electricity generation provided only that smaller projects (under 5MW) are not included in the reform, and are treated separately under the existing FIT.

27. What are your views on the alternative package that Government has described?

We consider it looks risky.

28. Will the proposed package of options have wider impacts on the electricity system that have not been identified in this document, for example on electricity networks?

We see reform of electricity network regulation to deliver adequate support and incentives for smart networks with significant levels of distributed generation as lying outside EMR but as being equally important.

29. How do you see the different elements of the preferred package interacting? Are these interactions different for other packages?

No comment

Implementation Issues

30. What do you think are the main implementation risks for the Government's preferred package? Are these risks different for the other packages being considered?

31. Do you have views on the role that auctions or tenders can play in setting the price for a feed-in tariff, compared to administratively determined support levels?

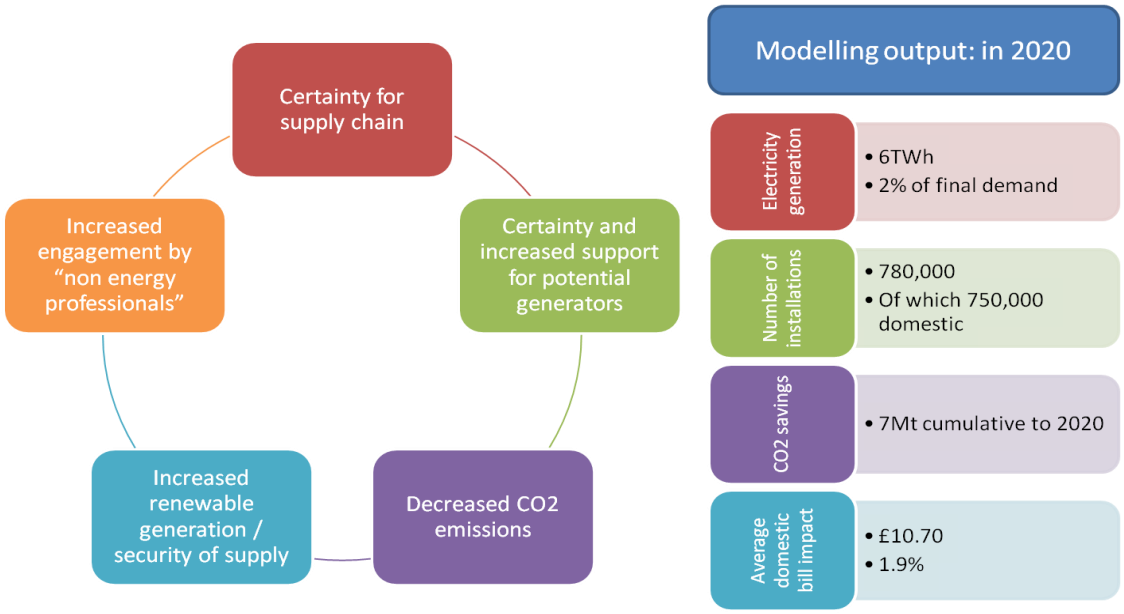
• Can auctions or tenders deliver competitive market prices that appropriately reflect the risks and uncertainties of new or emerging technologies?
• Should auctions, tenders or the administrative approach to setting levels be technology neutral or technology specific?
• How should the different costs of each technology be reflected? Should there be a single contract for difference on the electricity price for all low-carbon and a series of technology different premiums on top?
• Are there other models government should consider?
• Should prices be set for individual projects or for technologies
• Do you think there is sufficient competition amongst potential developers / sites to run effective auctions?
• Could an auction contribute to preventing the feed-in tariff policy from incentivising an unsustainable level of deployment of any one particular technology? Are there other ways to mitigate against this risk?

Questions 30 and 31

The CLA can confirm from experience with NFFO that tender/auction mechanisms exclude smaller investors and have extremely high entry costs.

We regard them as deeply inappropriate for the growing (and important) SME/domestic generation sector, which should be guaranteed FITs, with prices set in an iterative process taking account of industry information - as they do with some success in Germany).
We think it would be inappropriate to seek to apply prices revealed by auctions of large scale low carbon generation to projects below 5MW, which do not enjoy the economy of scale but confer other recognised benefits.

(See the DECC chart below)



32. What changes do you think would be necessary to the institutional arrangements in the electricity sector to support these market reforms?

We repeat that reform of the Distribution Networks and supplier relationship is overdue if we are to achieve distributed generation and demand management in an 'electricity internet'.

33. Do you have view on how market distortion and any other unintended consequences of a FIT or a targeted capacity mechanism can be minimised?

We argue that an unintended consequence of applying CFD across the board would be to stop investment in small scale generation dead.

34. Do you agree with the Government's assessment of the risks of delays to planned investments while the preferred package is implemented?

We think there are large risks of delay and failure of finance to come forward.

35. Do you agree with the principles underpinning the transition of the Renewables Obligation into the new arrangements? Are there other strategies which you think could be used to avoid delays to planned investments?

Yes and no.

36. We propose that accreditation under the RO would remain open until 31 March 2017. The Government's ambition to introduce the new feed-in tariff for low carbon in 2013/14 (subject to Parliamentary time). Which of these options do you favour:
• All new renewable electricity capacity accrediting before 1 April 2017 accredits under the RO;
• All new renewable electricity capacity accrediting after the introduction of the low-carbon support mechanism but before 1 April 2017 should have a choice between accrediting under the RO or the new mechanism.

A choice is preferable.

37. Some technologies are not currently grandfathered under the RO. If the Government chooses not to grandfather some or all of these technologies, should we:
• Carry out scheduled banding reviews (either separately or as part of the tariff setting for the new scheme)? How frequently should these be carried out?

Yes, every two or three years under a fixed programme ('No surprises'). As Greg Barker promised in his speech before Christmas, what business needs is Transparency, Longevity and Consistency.

• Carry out an "early review" if evidence is provided of significant change in costs or other criteria as in legislation?

No. Absolutely not: see the unintended consequences for solar detailed in our answer above.

• Should we move them out of the "vintaged" RO and into the new scheme, removing the potential need for scheduled banding reviews under the RO?

No. Absolutely not: see the unintended consequences for solar detailed in our answer above.

38. Which option for calculating the Obligation post 2017 do you favour?
• Continue using both target and headroom
• Use Calculation B (Headroom) only from 2017
• Fix the price of a ROC for existing and new generation

Target and headroom for ROC. It is what investors have based their calculations on.

ANNEX A Renewables:
Maintaining investor confidence during the implementation of the Government's new market mechanism

1. Renewable electricity is key to our low-carbon energy future and is a vital component of the UK's diverse energy mix. The UK has some of the best natural renewable energy resources in Europe, and we recognise the importance of maintaining industry confidence and creating stable conditions for investment, in order to deploy renewable electricity to the levels needed to meet our 2020 targets and beyond.

2. Until 2017 we propose to support renewable investments using the following measures:
• Banding Review accelerated to give early certainty on RO tariff levels
• New support mechanism introduced in 2013 or 2014.
• RO maintained so schemes can accredit under the RO until 2017.
• Seeking views on whether to offer a choice of support mechanisms up to April 2017.
• Eligible Schemes accrediting after 31 March 2017 will receive support under the new scheme.

The CLA is shocked that the current FIT is not mentioned in the above list. We do not believe that you intend to close off opportunities for small scale generation, and assume this is an oversight.

We have stated above that our proposal is that the current FIT (up to 5MW) should continue as planned, subject only to regular reviews of the levels of payment, and some detailed administrative improvements to reduce red tape.

Whilst the Government's ambition for FIT is only some 2% of supply by 2020, it has the potential to do far more, especially if fossil fuel prices continue to outstrip Government's projections. Moreover, distributed generation is a key part of a carbon agenda that includes demand management.

3. The current Renewables Obligation (RO) is designed to provide up to 20 years' support for large scale renewable electricity projects, and will run until 2037. We propose that the RO will remain open until 31 March 2017, the point at which the length of support offered begins to reduce.

4. This document consults on options for the future structure of the UK electricity market, and within this, how we will support renewable energy. Government recognises that there is a significant existing Renewable Electricity investor community, and we aim to prevent a hiatus in renewables investment. We are therefore seeking industry views on the best means to transition to a new scheme.

5. After 31 March 2017 our aim is that projects receiving support under the RO should continue to receive support in line with our current grandfathering policy. The RO system would be 'vintaged' to ensure this. We are consulting on the best means to 'vintage' the RO.

Renewables support up to 2017
Banding Review Timetable
6. On 10 December 2010 we announced a new, faster timetable for the Renewables Obligation Banding Review, which will give earlier notice of support levels for generation that will accredit between 1 April 2013 and 31 March 2017 (and for those technologies that are not currently grandfathered).

7. We will consult on RO Banding Levels for 2013-2017 from Summer 2011. The full timetable for the new Banding Review will be:

- February 2011 Completed review of costs and potential deployment
- May 2011 Completed modelling of different Banding Scenarios
- Summer 2011 Announce Banding Scenario to industry for consultation
- Autumn 2011 Government response
- April 2013 New bands brought into force

Maintaining the Banded RO

8. As stated in the Coalition Agreement, we will maintain a banded RO system. We propose that new renewable electricity generating stations will be able to accredit under the RO until 31 March 2017, the point at which the length of support available under the RO would otherwise have begun to decline.

9. We are consulting on a new mechanism to support all low-carbon. The Government's ambition is to introduce a new feed-in tariff for low-carbon in 2013/14 subject to parliamentary time. This means that projects making the decision to invest after the new scheme is introduced will know what form of support they should receive should they accredit after 31 March 2017.

10. Accreditation under the RO will be available until 31 March 2017. Subject to industry views, the Government proposes to either:
a. Accredit all new renewable electricity capacity before 1 April 2017 in the RO system
or
b. Offer a choice of the RO or the new support mechanism for new renewable electricity capacity accrediting after the introduction of EMR in 2013/14, but before 1 April 2017

11. We will consult on the indication of RO Banding Levels for April 2013 by Summer 2011, and confirm by Government Response in Autumn 2011.

RO only until 2017

12. If we accredited all renewable electricity capacity under the RO until 31 March 2017, and under the new EMR mechanism thereafter, this would mean that there was only ever one support mechanism for new renewable electricity available at a single time.

What about FIT?

Choice of RO or new system between 2013 and 2017

13. Offering a choice of mechanism might reassure investors who are considering developing projects before tariff levels under the new system are known. Those investors who would only invest under a new scheme which gave more revenue certainty would have the opportunity to do so at an earlier stage.

14. There would be additional administrative complexity in having two mechanisms open to accreditation simultaneously, but having the option may provide additional certainty, and we would welcome views on this.

Q. We propose that accreditation under the RO would remain open until 31 March 2017. A new support mechanism for low-carbon would be introduced in 2013/14. Which of these options do you favour:
• All new renewable electricity capacity accrediting before 1 April 2017 accredits under the RO;
• All new renewable electricity capacity accrediting after the introduction of the low-carbon support mechanism but before 1 April 2017 should have a choice between accrediting under the RO or the new mechanism.

Provided headroom is maintained under the RO, an option to choose between the two systems is preferable.

‘**Vintaging’ the RO in 2017**

15. We propose to close the RO to new accreditation from 1 April 2017. All projects accredited under the RO would receive their full 20 years’ support (subject to the end dates set in the RO). Therefore, the entire RO system would be ‘vintaged’ from 1 April 2017.

16. ‘Vintaging’ the RO system would effectively mean that it would no longer be open to accreditation for new stations. The RO would continue to operate, but support levels in terms of number of ROCs will not change (subject to a decision on grandfathering technologies, as discussed below).

17. The closure of the RO to new investment will create a closed pool of capacity which will decrease over time as we approach the end date for the RO of 31 March 2037.

Technologies not currently grandfathered

18. Some technologies are not currently grandfathered under the RO – co-firing, bioliquids, CHP, and energy crops. We are now considering whether bioliquids produced from wastes and advanced conversion technologies should be grandfathered.

19. Grandfathering is the policy intention to maintain a fixed level of support for the full lifetime of a generating station’s eligibility for the RO, from the point of accreditation. In 2008, following consultation on banding and grandfathering, grandfathering was introduced for all technologies except those with a fuel cost or income. This was because we recognised the need for flexibility to amend support levels should fuel prices change. In particular:

- Generators entering the market in different years could receive different levels of support, yet would compete for the same fuel stock, thereby potentially distorting the market (as one would be able to pay more than the other).
- Equally, if fuel prices went down, existing generators would be overcompensated at the cost to the consumer; whilst if fuel prices went up the projects would no longer be economic.

20. Following representations from a number of developers, suggesting that the lack of grandfathering meant that lenders and equity providers were withholding investment for biomass plants, the previous administration launched a consultation in March 2010. Working extensively with industry and the finance community to assess the evidence we concluded that a greater degree of revenue certainty was needed to bring biomass forward and in the Government Response to Biomass Grandfathering the current administration set out our decision to:

• Grandfather Anaerobic Digestion, Advanced Conversion Technologies, Dedicated Biomass using solid biomass or biogas and Energy from Waste;

• Not to grandfather Bioliquids, Energy Crop uplift or CHP, but to make a more detailed assessment of bioliquids using wastes and advanced conversion technologies; and

• To continue our policy not to grandfather co-firing.

21. We will consider whether the remaining technologies and feedstocks should be grandfathered by 2017. There is therefore a risk that grandfathering them at the support levels existing at 1 April 2013 for the remainder of their lifetimes may over- or under-compensate those technologies. If we do not grandfather them, there is a risk that investors may be reluctant to invest.

22. In the event of over-compensation this would mean that the value for money of the RO is reduced and consumers pay too much for generation from these technologies. In the event of under-compensation this would mean that those technologies are not sufficiently incentivised to generate. This could have implications for renewables deployment to 2020 if generation does not come forward as expected.

23. In the event that we chose not to grandfather some or all of the technologies mentioned above, there would be a requirement to periodically review their level of support by way of scheduled Banding Reviews post 1 April 2017. On the current expected schedule we would carry out a banding review for existing installations in these technologies for support they receive from 1 April 2017 to 31 March 2021, and at four-yearly intervals thereafter.

24. We would be grateful for views on these options.

The CLA is grateful for the opportunity to comment. We are clear that on current trajectory the RO will fail to deliver the target for renewable electricity generation. While there are other factors, it remains the case that without secure financing investment will dry up. It is for this reason that grandfathering is an essential part of the support mechanism.

We agree that co-firing biomass should not be grandfathered (it is cheap but a grossly inefficient use of valuable biomass).

We argue grandfathering should be extended to Advanced Conversion Technologies for any biomass (whether waste derived or clean biomass)

We do not agree that grandfathering is appropriate for simple mass burn waste technology (incineration with energy recovery). Government should not offer the worst environmental option guaranteed support.

Accordingly, and notwithstanding the potential for modest overcompensation (which will be reduced as and when generation under the RO gets closer to targeted headroom) the CLA argues grandfathering should be guaranteed as follows:

- Anaerobic Digestion
- Advanced Conversion Technology
- Dedicated Biomass Generation with solid biomass
- Energy Crop Uplift

We argue CHP should qualify for support under the Renewable Heat Incentive.

Mass burn waste should not be grandfathered, even where recovered refuse fuels are used. Indeed we suggest that existing RO support for this should be reviewed.

Devolved Administrations

25. Currently the RO schemes for England & Wales, Northern Ireland and Scotland all operate in unison. While there are some minor differences in support levels, all three obligations are implemented in the same way and the buyout funds are unified.

26. Government policy on support for renewables is executively devolved to Scotland and fully devolved to Northern Ireland. Therefore, they have control over their RO mechanisms, and can decide whether to follow the England & Wales mechanism in its choice of transition option and closing to new accreditation from 1 April 2017.

27. Scottish Ministers have publicly stated their support for the current RO system, but will consider their position on the wider EMR proposals. The extent of any new support scheme for low-carbon as regards Scotland and Northern Ireland will be subject to discussions between UK and Scottish and Northern Irish Ministers, and to the final design of the new scheme itself.

28. Government recognises the benefits of a unified system that provides ROC price stability and a fair distribution of costs across UK consumers. In the event that Devolved administrations decided to pursue a separate policy, we would need to consider the implications of this for the operation of the RO going forward. Further details will be in the Government's White Paper in Spring.

Devolved Administrations: which technologies are grandfathered

29. As the RO is a devolved policy, Devolved Administrations have authority over which technologies are grandfathered in their current system. In England and Wales co-firing, bioliquids, CHP, and energy crops are not grandfathered. In Scotland, grandfathering for biomass and waste technologies is subject to a Scottish Government consultation taking place this autumn.

30. In the event that the Devolved Administrations opted to close down the RO as we propose for England and Wales, they will have the further option as to whether to grandfather the technologies in the same way as proposed for England and Wales.

Calculating the Obligation in the Grandfathered System

31. As the grandfathered RO continues to operate it would be necessary to continue to set the Obligation level.

32. The Obligation level for the RO is currently set with reference to two Calculations, A and B.

33. Calculation A sets the Obligation level by using the fixed targets contained in Schedule 1 of the Renewables Obligation Order 2009 (rising to 0.154 ROCs/MWH in 2015/16), applied to DECC projections of the expected licensed supply level.

34. Calculation B involves the Secretary of State for Energy and Climate Change estimating the amount of ROCs which are likely to be issued during the Obligation Period being calculated, and then adding 10% 'headroom'. The larger of the two results for A and B determines the Obligation level.

35. While we could continue to carry out these two calculations, after 2015/16 the fixed targets are flat at 15.4%. Under the current system it is expected that in 2016/17 the RO will be set by Calculation B as the level of generation will be higher than 15.4% and will continue to increase until at least 31 March 2017. However, this is uncertain and depends on the amount of new renewables capacity that comes forward between now and then. If Calculation A is lower than Calculation B in 2017/18, then we would expect Calculation A to continue to be lower than Calculation B from that point, on until significant amounts of capacity start to leave the RO as it decommissions or reaches the 20-year limit on support.

36. There are therefore a number of options for calculating the obligation for a grandfathered RO:

Continue using both calculations

37. Under this option, Government could extend the fixed targets beyond 2015/16 and continue to use both Calculations to set the obligation going forward.

38. However, following the expected level of decline following 2027, the fixed targets would become substantially higher than the level of capacity, increasing the ROC price, but without the potential for it to attract new investment, thus providing unnecessary subsidy.

From 2017/18 use Calculation B – 'Headroom' - Only

39. Calculation B would be more likely to allow us to take account of the decline in the amount of capacity as it occurs after 2027. However, retaining Calculation B would require continued resource in DECC to carry out the annual calculations and publication of the obligation level.

40. It also risks the obligation being set too high or too low due to plant retiring before the end of its 20 years' support, or because of flawed assumptions about the amount of capacity likely to come forward and the load factors for that year. Too high would mean that excess rents were paid, too low and the ROC price might crash with the consequent effects on investment in generation accredited under the RO. This risk exists currently but may be exacerbated as the size of the obligation shrinks post 2027.

41. Industry have also expressed their ongoing concern that they need as much clarity on the obligation level as early as possible.

Move to a 'Fixed ROC' system

42. An alternative to the transition process outlined above would be to change the existing RO to a 'Fixed ROC' system at the next banding review implementation date.

43. This would involve fixing the price of a ROC and requiring Ofgem (or another delivery agent) to buy the ROCs, funded through a levy on energy suppliers. The Fixed ROC scheme would then, as outlined above, remain open to new accreditation until 1 April 2017 when it would close and be replaced by the new scheme.

44. Introducing a Fixed ROC system would mean that the scheme no longer operated through placing an obligation on energy suppliers. This would remove the requirement to carry out an annual obligation-setting exercise and need for a buy-out mechanism with associated revenue recycling. The reformed scheme would give generators a guaranteed price for the ROC through to 2037, indexed to inflation.

45. There would be a number of implementation issues, for example the impact on current Power Purchase Agreements, the impact on suppliers in paying for a levy which would need to be paid more frequently than annually. We would be grateful for any views on this. We would also need to consider the potential impact of this option on the public finances before taking it forward.

Question 34: Do you agree with the Government's assessment of the risks of delays to planned investments while the preferred package is implemented?

Yes. But we would be interested to hear why Government argues a "fixed ROC system" is in practice any different from a Feed In Tariff?

The CLA agrees that this is the most favourable option, and would support a move to "FIT ROCs."

However, we do not know whether the RO is treated any differently in public finances to the FIT. If describing the support scheme as a public guarantee of payment rather than an obligation on suppliers makes it harder to justify to the Treasury we would be prepared to support the less favoured option B.

Fundamentally, Transparency Longevity and Consistency demand guarantees of stable long term support. Ideally this is delivered through FIT, but option B may (if managed carefully) offer a second best substitute. (Second best as it introduces a further level of political risk).

Question 35: Do you agree with the principles underpinning the transition of the Renewables Obligation into the new arrangements? Are there other strategies which you think could be used to avoid delays to planned investments?

Depending on the Treasury attitude to the accounting of expenditure, the project would be de-risked were FITs to be adopted across the board. However, we accept that this may give rise to excess profits as electricity prices rise.

Question 36: We propose that accreditation under the RO would remain open until 31 March 2017. The Government's ambition is to introduce the new FIT for low-carbon in 2013/14 (subject to Parliamentary time). Which of these options do you favour:

• All new renewable electricity capacity accrediting before 1 April 2017 accredits under the RO;

• All new renewable electricity capacity accrediting after the introduction of the low-carbon support mechanism but before 1 April 2017 should have a choice between accrediting under the RO or the new mechanism.

Question 37: Some technologies are not currently grandfathered under the RO. If the Government chooses not to grandfather some or all of these technologies, should we:

• Carry out scheduled banding reviews (either separately or as part of the tariff setting for the new scheme)? How frequently should these be carried out?

• Carry out an "early review" if evidence is provided of significant change in costs [or other criteria as in legislation]?

• Should we move them out of the "vintaged" RO and into the new scheme, removing the potential need for scheduled banding reviews under the RO?

Question 3 : Which option for calculating the Obligation post 2017 do you favour?
• Continue using both target and headroom
• Use Calculation B (Headroom) only from 2017
• Fix the price of a ROC for existing and new generation

The CLA argues that fixed price ROCs are the best option, provided that this does not cause problems in the accounting of public support.

We again point out that this section has not addressed what happens to the current Feed In Tariff during the period to, and after 2017.

We argue the current FIT should continue as planned (with digression) but without interruption.

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