Feed-in Tariffs Scheme

Government response to question 1 of *Feed-in tariffs scheme: consultation on Comprehensive Review Phase 1 – tariffs for solar PV*

19 January 2012

COVER PAGE

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Executive Summary

1. On 31 October 2011, the Government published a consultation on Feed-in Tariffs (FITs) for solar photovoltaics (PV). This document set out proposals for responding to developments in the solar PV sector, particularly a substantial increase in deployment prompted by falling PV prices. Specifically, the consultation sought views on:-

   (i) reducing the generation tariffs for solar PV installations to a more sustainable level consistent with providing a reasonable rate of return;

   (ii) applying the new generation tariffs from 1 April 2012 to all new solar PV installations with an eligibility date on or after an earlier 'reference date' which we proposed should be 12 December 2011;

   (iii) introducing new multi-installation tariff rates for aggregated solar PV schemes i.e. where a single individual or organisation owns or receives FIT payments from more than one PV installation, located on different sites; and

   (iv) strengthening the link between FITs and energy efficiency by introducing a new energy efficiency requirement for FITs for solar PV for installations after 1 April 2012.

2. The consultation closed on 23 December 2011 and a total of 2,392 consultation responses were received which we have analysed carefully. In the light of that analysis, this present document sets out as far as possible, within the constraints imposed by ongoing legal proceedings[1], the Government's decision on the proposals for reduced generation tariffs (as covered in question 1 of the consultation document).

Government decision on new solar PV tariffs

3. We have decided to bring forward our decision on this aspect of the consultation, with the aim of going some way towards alleviating the current uncertainty pending the outcome of the legal proceedings in relation to the Government's consultation proposals.

4. This decision should also help to manage the impact on the FITs budget if DECC loses the appeal and the current tariffs continue until 1 April 2012. This is because the impact on the budget for every new installation in that scenario, would be more than twice the impact than if the tariffs were reduced.

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[1] On 21 December 2011, in R. on application of Friends of the Earth Ltd and others v. Secretary of State for Energy and Climate Change, the Administrative Court ruled that the approach proposed in the consultation document of implementing new tariffs from a reference date earlier than the coming into force date of legislation giving effect to the new tariffs was unlawful. The Government appealed against the decision, and on 13 January 2012 the Court of Appeal heard the appeal and reserved its decision. A date has not yet been set for handing down of the Court of Appeal's judgment.

5. With these two aims in mind, the Government intends to give effect to the new tariffs by amending the FIT payment rate table in Annex 2 to Condition 33 of the Standard Conditions of Electricity Supply Licences, subject to the Parliamentary process set out in the Energy Act 2008. Our intention is that these amendments will be made before 3 March 2012, following completion of the 40 day period of laying before Parliament required by section 42 of the Energy Act 2008, and will come into effect on 3 March 2012, applying to all installations with an eligibility date on or after that date.

6. The following changes will be made to the generation tariff levels for all installations with an eligibility date on or after 3 March 2012[2]:-

Band (kW Total Installed Capacity (TIC)	Current generation tariff (p/kWh)	New generation tariff from 1 April 2012 (p/kWh)
• 4kW (new build)	37.8	21.0
• 4kW (retrofit)	43.3	21.0
>4-10kW	37.8	16.8
>10-50kW	32.9	15.2
>50-100kW	19	12.9
>100-150kW	19	12.9
>150-250kW	15	12.9
>250kW-5MW	8.5	8.5*
stand alone	8.5	8.5*

* Note that these are the current tariffs which we are not proposing changing and which, like all other current tariffs (but not the new tariffs) will be adjusted in line with the Retail Price Index from 1 April 2012.

7. In practice, this would mean that from 1 April 2012, solar PV generators with an eligibility date on or after 3 March 2012 would be eligible for a lower tariff (as set out in the table above). In

[2] It is important to note that the eligibility date of a solar PV installation is likely to be after its installation date, since the installation must have been commissioned and an application for FITs must have been received by a FIT Licensee (or Ofgem, in the case of installations with a capacity greater than 50kW).

"Eligibility Date" is defined in Condition 33 of the Standard Conditions of Electricity Supply Licences as:

"the date as regards a particular Eligible Installation from which eligibility for FIT Payments commences which shall be the later of the date:

(a) as applicable, of

(i) receipt by the Authority of a FIT Generator's written request for ROO-FIT Accreditation in a form acceptable to the Authority; or

(ii) receipt by a FIT Licensee of a FIT Generator's written request for MCS-certified Registration;

(b) on which the Eligible Installation is Commissioned; or

(c) of Implementation".

line with the proposals set out in the consultation document, generators with an eligibility date between and including 3 March 2012 and 31 March 2012 would be eligible for the current tariffs in respect of electricity generated in this period only, before moving onto the lower tariffs from 1 April 2012.

8. The Government's power to make these changes was not an issue in the present legal proceedings, and is therefore not dependent on the outcome of its appeal. Pending the outcome of that appeal, no decision has yet been taken on the generation tariffs for installations with an eligibility date on or after the proposed 12 December 2011 reference date and before 3 March 2012. The draft licence modifications which are being laid before Parliament now on a precautionary basis therefore contain no changes to the tariffs for those installations.

9. For the avoidance of doubt, **if the Government wins its appeal it reserves the right to stand by our original proposal. This means, subject to the Parliamentary procedure in the Energy Act 2008, standing by our proposal to make further licence modifications to reduce the generation tariffs for some or all installations with an eligibility date on or after 12 December 2011 and before 3 March 2012.** However, we can confirm that, in that event, the tariffs those generators will be eligible for will be no lower than the tariffs set out here, and any tariff reductions for those installations will apply only in respect of electricity generated on or after 1 April 2012.

New solar PV tariffs – consultation feedback and way forward

10. We recognise that a majority of respondents disagreed with the proposed new tariffs for solar PV. A summary of our analysis of responses to this question is set out at Annex B. As this shows, a number of reasons were cited by those disagreeing with the proposed tariff changes including arguments that the scale of the proposed reductions was too steep; the assumptions on PV prices incorrect; and the target return of 4.5% to 5% too low.

11. Many other respondents accepted that the current tariffs were too high and did need to be reduced. A number from within the solar industry agreed that the rates proposed would still allow a reasonable rate of return (in most circumstances), as manufacturing and other costs associated with solar PV had come down significantly, and were still reducing.

12. These respondents accepted that the tariff cuts were needed in order to protect the budget so that the scheme would remain available for future generators; indeed some expressed concern that if cuts were not made soon enough, or were not severe enough, the budget for FITs could be exhausted and the Government might be forced to close the scheme altogether.

13. We have carefully considered all the feedback from the consultation. While we recognise that the scale of the proposed reductions in tariffs is significant, we continue to consider that this is justified and necessitated by the magnitude of the recent reductions in the costs of solar PV. It is important to note that, while a key factor, the capital and operating costs of solar PV are not

the sole considerations when it comes to calculating the rate of return provided by a particular tariff. Other factors are also important including increased electricity prices (which increase the value of the bill savings associated with consuming electricity generated on-site)[3].

14. In the light of this, we continue to consider that a significantly lower tariff is needed to provide generators with a rate of return of 4.5% to 5% for well located installations. We are not persuaded that a higher rate of return would be reasonable given the focus of the FITs scheme on encouraging non-energy professionals such as householders and communities to consider small-scale low-carbon energy generation, and given the current investment climate.

15. We are also mindful of the budgetary constraints for the FITs scheme and the associated benefits of driving tariff reductions so that as many people as possible are able to benefit from the scheme. This wider aim is also relevant to the wider commitment set out in the consultation document, to keep the ongoing level of FITs tariffs, together with the target rate of return and the ongoing appropriateness of this, under review through phase 2 and in future.

Next steps on FITs comprehensive review

16. We intend to announce our decision on the other aspects of the phase 1 consultation by 9 February 2012, in time for any resulting legislative changes to come into effect from 1 April 2012. This will include a decision on tariffs for installations with an eligibility date on or after 12 December 2011 and before 3 March 2012, if the outcome of the Government's appeal is known, together with decisions on the proposals for new multi-installation tariff rates and a new energy efficiency requirement. That announcement will be supported by a full Impact Assessment covering all aspects of the Government's decisions following the consultation. In the meantime, Annex A provides the headline analysis of costs and deployment that supports the decisions set out in this document.

17. At the same time as publishing the wider outcome of the phase 1 consultation, we are also aiming to publish a set of proposals for the next phase of the comprehensive review of the FITs scheme, which will be the subject of a further consultation. As previously foreshadowed, this will consider the tariffs for other non-PV technologies and administrative aspects of the FITs scheme. It will also include proposals for introducing new cost control mechanisms for FITs to ensure that the scheme's aims are met in a manner which is affordable within the control framework set for DECC levy-funded spending[4].

18. The full phase 1 decision document, combined with the consultation proposals for phase 2, should provide greater clarity on the future of PV tariffs beyond 1 April 2012.

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[3] An explanation of the rate of return calculation for domestic PV is available from the Department's website at http://www.decc.gov.uk/assets/decc/11/consultation/fits-comp-review-p1/3742-explanation-rate-return-calc-domestic-pv.pdf.

[4] Further details regarding the Levy Control Framework are available from the Department's website at http://www.decc.gov.uk/assets/decc/11/funding-support/fuel-poverty/3290-control-fwork-decc-levyfunded-spending.pdf.

Annex A | Analysis of costs and deployment

The analysis presented below sets out estimates of deployment and costs for PV installations to end of March 2012, to illustrate the different financial consequences of the measures described in this document to apply reduced tariffs to new installations from early March rather than from 1 April. The analysis does not cover new installations after the end of March.

A fuller analysis, covering all FIT technologies and assumptions for growth in PV from April 2012 under different deployment scenarios, will be presented alongside the Government response to the phase 1 consultation.

PV Deployment forecasts

The level of deployment of solar PV from January 2012 to the end of the financial year (i.e. 31 March 2012) is still very uncertain particularly taking into account changes in the costs of solar PV, the effect of the proposed 12 December reference date and the potential for further cost controls and tariff changes to be introduced in future.

Two different deployment scenarios have been developed to give a range of deployment and costs up to the end of March 2012. As part of the rationale for the measures described in this document is managing the budgetary impact of the Government being unsuccessful in its appeal against the Administrative Court's judgment and the current tariffs continuing until 1 April 2012, both scenarios are based on this eventuality.

(a) **Reflecting the policy provision described in this document** . For the estimate of PV costs under an early March reference date assumption, the lower end of the range assumes continuing levels of deployment in January similar to those seen to date, then an increase up to around 250MW in February before falling back in March. The higher end of the range follows this pattern but approaches the highest deployment rates seen in the month to 12 December 2011.

(b) **Reflecting a situation in which the policy provision described in this document has not been implemented and tariff changes are instead implemented to apply to installations from 1 April only**. Under this scenario, we would assume a continued high level of PV deployment throughout March for both the higher and lower cost and deployment ranges. This additional deployment is estimated to cost around £100m in subsidy costs per annum from April 2012 onwards, around an additional £1.5bn over the lifetime of the tariff.

Capacity installed (MW) PV only	**April 2011-March 2012**	**Total PV capacity estimated by 31 March 2012**
Tariff changes apply to installations from 3 March	1,190 to 1,340	1,300 to 1,450
Tariff changes apply to installations from 1 April	1,380 to 1,520	1,490 to 1,630

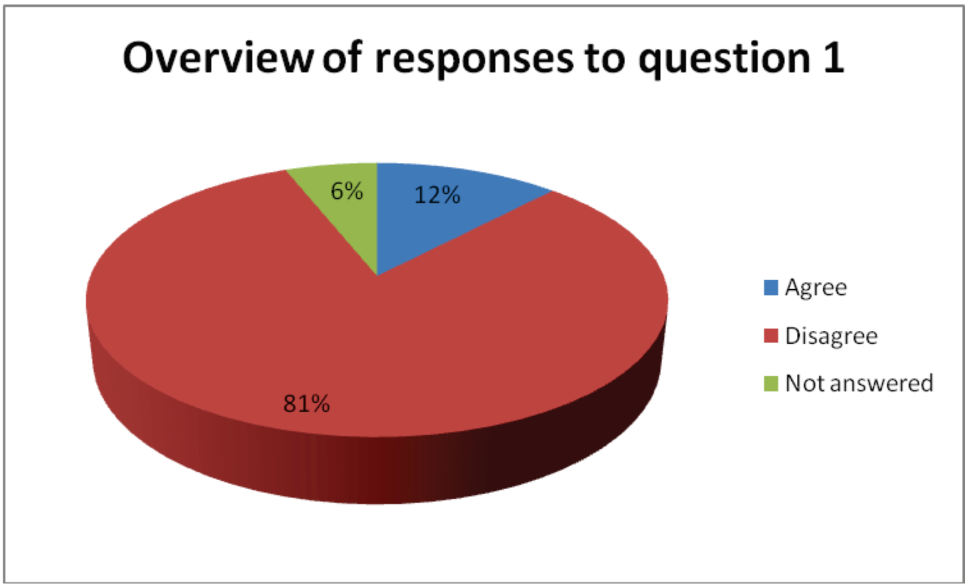
Costs

The above deployment patterns would lead to the following costs profile:

	£m, nominal, undiscounted					*£m, real, discounted*
	2011/12	**2012/13**	**2013/14**	**2014/15**	**Comprehensive Spending Review period total**	**Lifetime (25 years)**
Tariff changes apply to installations from 3 March	140 to 150	460 to 510	480 to 530	500 to 550	1,590 to 1,750	7,100 to 7,900
Tariff changes apply to installations from 1 April	140 to 150	570 to 620	590 to 640	610 to 670	1,910 to 2,080	8,700 to 9,500

Annex B | Summary of responses to Question 1

Question 1: Do you agree or disagree with the proposed new tariffs for solar PV? Give reasons to support your answer.



1. As shown by the pie chart above, around eight out of ten respondents disagreed with the proposed new tariffs for solar PV, compared to one in ten who agreed. This summary focuses on comments directly relating to the proposed tariffs, in response to question 1, and does not cover wider comments made by respondents

2. Responses showed that there was support in principle for reducing the tariffs for solar PV, indeed most respondents agreed that the current level is too high and has led to commercial investors exploiting the tariffs. However, there was widespread concern that the Government's proposals would reduce the tariffs by too much, too quickly.

3. For example, one local authority while agreeing with the principle felt the proposals were disproportionate:

   'We agree the tariff should be set at such a rate that creates demand for renewable energy technologies so that they become established and with early knowledge of a phased reduction the market and price can reduce over time through competition and economies of scale. We accept that as the process develops FITs will need to be adjusted to ensure it represents VFM [value for money] from both energy companies' perspective as well as the individuals investing in renewable energy.'

4. A number of respondents argued that the proposed reduction in tariffs did not reflect the reduction in installation costs (i.e. the installation costs have fallen by 30% but the proposal was to reduce tariffs by around 50%). Others argued that the Government has not taken into account the peripheral and maintenance costs involved. Several respondents questioned the level of reduced installation costs with a few arguing this was due to the influx of cheap (inferior) products. For example, one supplier wrote:

'The only major reductions in prices that have been experienced are the costs of PV panels. Ancillary products such as inverters and framing have remained relatively unchanged, as have installation costs. The Government appears to be of the opinion that the price of PV products will continue to fall indefinitely at this rate. What does not seem to be recognised at this stage is that the price cuts experienced thus far are in fact artificial and cannot be sustained.'

5. While a minority view, there were other respondents who did agree with the proposed reduction in tariffs. For example, one respondent said:

   'Costs of fully installed systems have fallen from around £5,000/kW in 2009 to around £3,400/kW today – a fall of around 30%. Domestic customers have seen returns over 15%. We agree that returns at this level are unsustainable and unfair. We have modelled the proposed tariff levels against the current delivered prices that customers are paying today and agree that for installations below 4KW, the tariffs deliver the stated returns of about 4.5%.'

6. A number argued that the proposed reductions in tariffs were not in line with other technologies, such as wind power. Some respondents argued that the proposed tariff rates had been set using the most generous calculations (i.e. based on properties in the south with south facing roofs).

7. Many respondents disagreed with the rate of return that the proposed tariffs were intended to provide, arguing that the return on investment was unattractive, quoting EST figures which suggested a payback of 20 years. However, a few respondents said that the revised rates would remain economic and attractive for investors and businesses in particular, though there was concern that they could cause householders to withdraw from the market. Some argued that the payback period should be pegged to 10 years, with the rate tapering off after that while others argued the tariff should not be paid after the installation costs have been paid off.

8. Many respondents (particularly in the charity sector) argued for a preferential higher rate for charities and social projects where the finances raised could be used either to pay for further energy efficiency measures or continuing and extending community projects. Some respondents felt there should be a distinction between householders with small systems and commercial organisations with large systems (e.g. over 4kW).

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