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UK Renewables Obligation 2013-17 banding review decisions finally announced

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Authors: Richard A. Ceeney, Nicholas Rock, Stefan Schmitz

Introduction

On 25 July 2012, the UK Government (through the DECC – the Department of Energy and Climate Change) published its long awaited response to its October 2011 to January 2012 consultation on future levels of banded support under the UK Renewables Obligation (RO).

The RO is currently the main UK mechanism aimed at giving developers of more expensive renewable generation technologies grid parity with fossil-fired generation. Under the RO, renewables developers receive a subsidy per megawatt hour of electricity generated. This comes in the form of certificates (ROCs) that can be sold to electricity suppliers, who are obligated by law to supply a certain minimum level of green power in the UK market. ROCs are currently traded at about £45 each. Although current plans are for the RO system to be closed for new entrants in 2017, with a Feed In Tariff Contract for Difference approach to apply subsequently, projects already subject to the RO system are to be "grandfathered"; therefore, the levels of RO support will remain critical for the lifetime of those projects accredited to the scheme before it closes.

The report contains much that was expected based on last year's consultation proposals, but also contains some surprises, particularly in respect of future levels of support for onshore wind projects after April 2014 and for all projects under 5MW after April 2013.

This client briefing outlines and comments upon some of the key elements of the Government's proposals (which remain subject to State Aid clearance and Parliamentary approval). The full report can be found here.

The proposals in outline

As expected, the response confirms:

- Onshore wind subsidies are to be reduced by 10% to 0.9ROC/MWh for new accreditations and additional capacity added in the period 2013-17, as has been proposed in the consultation process (but subject to important caveats discussed further below).

- Offshore wind subsidies are to reduce in line with the consultation proposals – 2ROC/MWh for new accreditations and additions accredited in 2013/14 and 2014/15, then degressing to 1.9ROC/MWh in 2015/16 and 1.8ROC/MWh in 2016/17 reflecting expectations of reducing costs over time.

- There will be no additional band for floating generation technologies.
- Wave and tidal stream projects up to a maximum size of 30MW are to receive 5ROC/MWh as in the consultation proposals. Projects over 30MW will get 2ROC/MWh for their capacity in excess of 30MW.
- There will be a range of different support levels for biomass fired plant, including a new ROC band to support existing coal plant converting to sustainable biomass fuels.
- Levels of solar support remain, for the time being, at 2ROC/MWh, but are to be reviewed yet again.

Among the most controversial announcements are the following:

- There is no guarantee that the cuts to onshore wind ROCs will be limited to 10% for the whole of the period to 2017. On the contrary, the 0.9% level is in fact only guaranteed until April 2014.
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- A call for evidence on onshore wind industry costs will be launched September 2012 and report in early 2013. Should the evidence gathered indicate a “significant change” to generating costs or other statutory ground for review, this will trigger an immediate further review of onshore wind ROC levels, the results of which would be implemented from April 2014.
- However, on the plus side, the Government has also promised that “given the importance of maintaining investor confidence” in the event of such a further review there will be grandfathering of projects already accredited by the time of the review and grace periods for projects “already committed” by the time any further cuts take effect. It appears that this may apply not just to projects that have already been accredited under the RO before the April 2014 implementation date, but also for example to consented projects with a pre-existing grid connection and turbine order in place or potentially those that have by then otherwise invested a “significant proportion of total development costs”.
- Government says it will consult on the detail of such grace period provisions in the event that an April 2014 cut is triggered.
- There is a surprise proposal to consult on closing the RO to new wind, hydro, anaerobic digestion and solar projects under 5MW from 1 April 2013.
- For these projects, the developers can currently choose between two parallel regimes: the RO system, and a Feed In Tariff (FIT) direct subsidy.
- The proposal would remove the option, and force such plant into the small-scale FIT regime where they would expect to receive significantly lower levels of support due to the low FITs budget. This is a particularly stark issue for the Anaerobic Digestion industry,

given that DECC also announced last week that it was placing caps on the number of AD plants that can claim FITs.

Comment

The 10% cut to subsidies for onshore wind farms is the best result the sector could have expected, following weeks of speculation that the current subsidy level would be cut by 25% due to pressure from the Treasury.

It should not be assumed that a 10% cut in the number of ROCs awarded to a MWh automatically leads to a 10% reduction of income or revenue for a UK onshore wind project, and on that subject some of the current press consideration of the announcement is a little misleading. The revenues of UK renewable energy projects depend entirely on the underlying power purchase agreement (PPA). While it is true that the price in essentially all UK PPAs depends to some degree on the current ROC value, that is only one of several elements which make up the price per kWh. Of these, the most important one is, of course, the wholesale price for electricity, which is unlikely to come down. Therefore a reduction of the number of ROCs by 10% will not lead to a 10% reduction of income; the reduction should be significantly less, the degree depending on the terms of the PPA.

That said, the cut will still hurt.

The market is already suffering, with finance difficult to raise and the German offshore wind market competing for capital investment; the result in the industry is that profit margins are already being squeezed and capital expenditure is being cut.

Add to this the uncertainty which the Government has injected into the sector by threatening a further review and potential cuts to subsidies in 2014, and the outlook for the UK onshore wind market could certainly be better.

The green energy sector desperately needs stability and a pipeline of major wind projects. A review into subsidy arrangements every two years damages confidence, as most wind projects take far in excess of 18 months from conception to completion.

It is therefore of little comfort to onshore wind energy companies and investors to know that the goal posts could move again in April 2014, when subsidies are likely to be further reduced, even accounting for the Government’s olive branch of certain “grace periods”.

The offshore wind market may pick up the slack (reinforced by the positive news that the Government's support for offshore wind holds firm), but it is not yet clear whether, or when, it will be able to do so.

The energy from waste combined heat and power sector will welcome the reversal of the Government’s original proposal to reduce support for EfW CHP to 0.5 ROCs/MWh and keep the level at 1 ROC until 2017 and the new hydro sector’s position also improved (from 0.5 to 0.7 ROCs) compared to the consultation proposals.

The proposals include a complex range of support levels for different types of biomass-fired plant. The most interesting proposals surround coal plants that convert to run on biomass. Any plant that uses biomass for at least 85% of its fuel will get 0.7ROCs/MWh in 2013/14, rising to 0.9ROCs/MWh in 2014/15. Plants burning a lower percentage of biomass will receive fewer ROCs. Dedicated biomass plants will receive a declining level of support from 2016, as proposed last year. However, DECC intends to introduce a cap on how many can be built so that there is not a sudden rush. To address concerns about the environmental impacts of biomass, DECC intends to revise existing sustainability criteria, including setting a new minimum greenhouse gas saving requirement.

It is at first blush surprising that the Government has chosen, in an announcement on renewables, to make a statement on the importance of gas power. The Energy White Paper outlined a concept for long-term gas power as a means of counteracting the inflexibility of nuclear and renewable energy provision. Now it is a major part of the Government's energy policy in its own right. This move could make the green energy sector further question this Government's long-term green credentials – undermining confidence even more - and put the chance of the UK meeting its future carbon budgets at significant risk. However, this decision appears to have been driven by the Treasury's insistence that the cost of de-carbonising the UK's electricity system must be lowered and seems to have been the price of keeping onshore wind support levels higher than originally proposed.

It is proposed that a revised Renewables Obligation Order implementing the decisions will be laid before Parliament in the autumn. In the meantime, the Government intends to consult further on various aspects of the proposals including the biomass proposals, support levels for solar PV and the plan to close the RO to plant under 5MW from April 2013.